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Glittering prize

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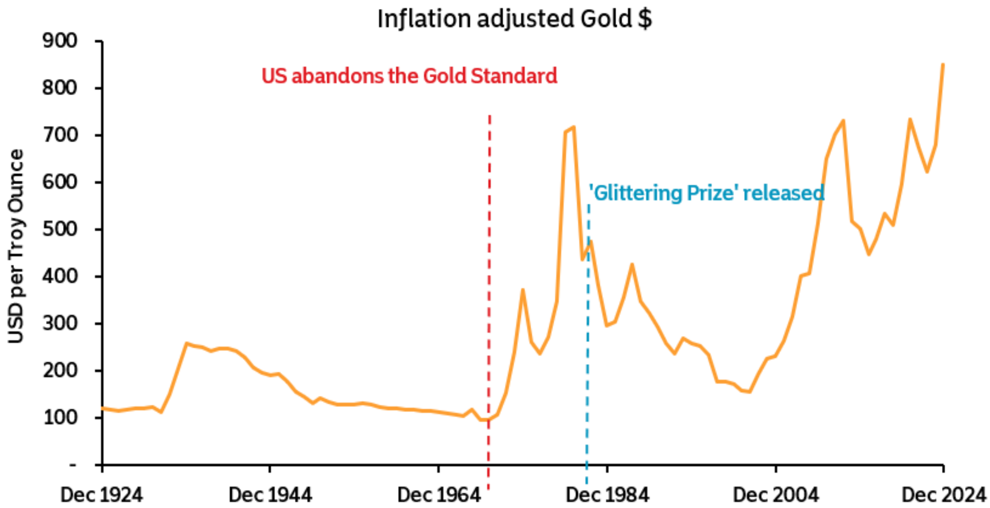
Chart of the Week



Sources: Bloomberg Finance L.P., Federal Reserve of Minneapolis.

What this chart shows

The chart shows the 100-year history of the gold price adjusted for inflation. If the price of gold were to rise at the same rate as the US Consumer Price Index (CPI) over a specified period, then the line would be flat. When the line goes up it shows that the gold price in US dollars is increasing by more than the rate of US consumer prices, or that the gold price is constant whilst consumer prices are falling (deflation). If the line is falling it shows the opposite; that the gold price is falling faster than US consumer prices, or that the gold price is constant while consumer prices are rising. In the 20 years following the release of 'Glittering Prize' by Simple Minds in August 1982, the spot gold price barely changed, whilst US consumer prices more than doubled, leading the inflation adjusted gold price to more than halve. Today, it is showing us that the inflation adjusted gold price has risen to century highs when measured using annual or monthly data. The dotted red vertical line indicates 15 August 1971 when the US abandoned the 'gold standard', a monetary system whereby a fiat currency (a government issued currency like the US dollar or British pound) was linked and exchangeable into gold.

Why this is important

Gold is a non-yielding commodity which makes it difficult to value compared to other assets like bonds or equities. It often polarises opinion and at any time a case can be made for why one should own it, not least its status as the ultimate safe haven asset, which is perhaps one reason why it is up 30% year to date. Wars, elections and the lingering threat of resurgent inflation will have helped lift the 'yellow metal' higher this year. Over the longer term it is seen as a store of value. Its 'real' worth – its inflation adjusted purchasing power – should at a minimum be maintained through time. In the last two decades its purchasing power has more than tripled. As it stands today, gold is either pricing in a lot of future inflation (over 10% per annum for the next 10 years to get back to its 100-year average), or it looks relatively expensive after being bid up by central banks looking to diversify their reserves. At these levels there are probably cheaper ways to protect against future inflation, but in an increasingly unstable world the insurance gold brings is unparalleled, and whilst there are more buyers than sellers, the price might yet find new highs before its real worth is rediscovered.

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