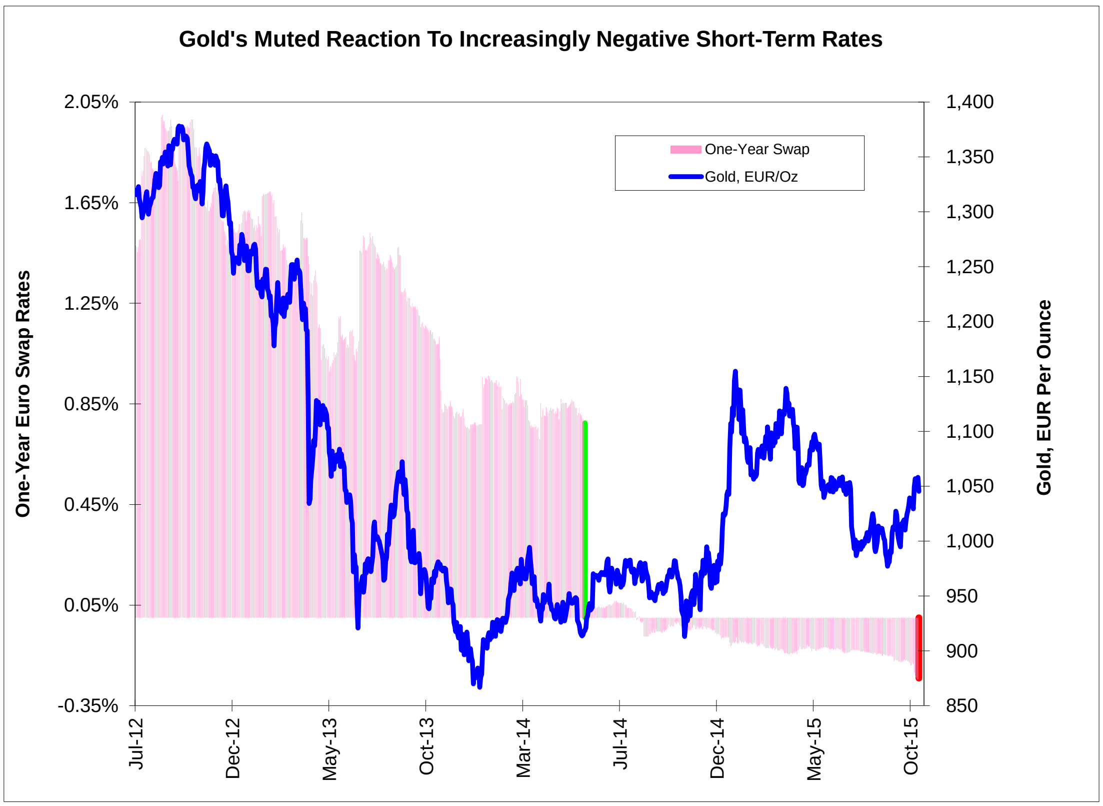
Gold And Negative Short-Term Euro Rates

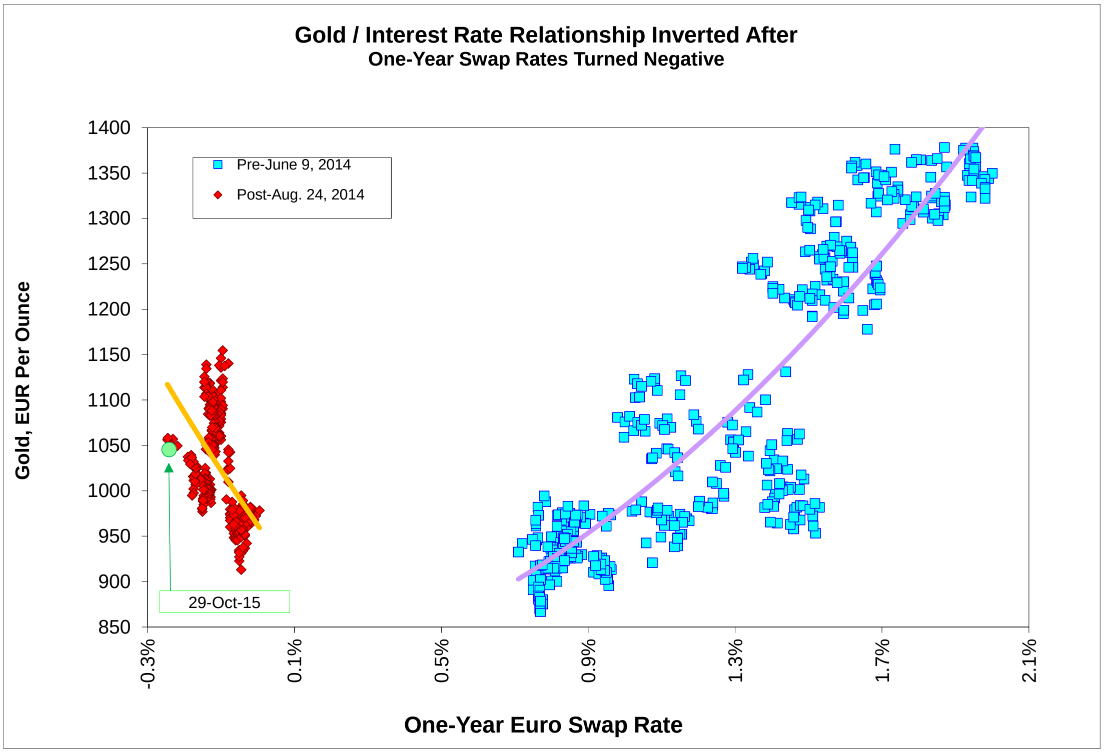
The relationship between gold priced in EUR and one-year EUR inflation swaps has remained broken throughout the era of negative interest rates in the Eurozone. If we map one-year EUR swap rates from the July 2012 “whatever it takes” pronouncement by Mario Draghi onwards against gold, we see gold stabilized in June 2014 when one-year swap rates fell sharply, highlighted with a green column. Once these swap rates turned negative on August 25, 2014 in premature anticipation of direct quantitative easing by the European Central Bank, gold turned higher into late January 2015. Even though one-year inflation swap rates bottomed have declined steadily from -0.095% on January 23, 2015 to -0.241%, gold retreated from €1,154.70 to €1,045.23.

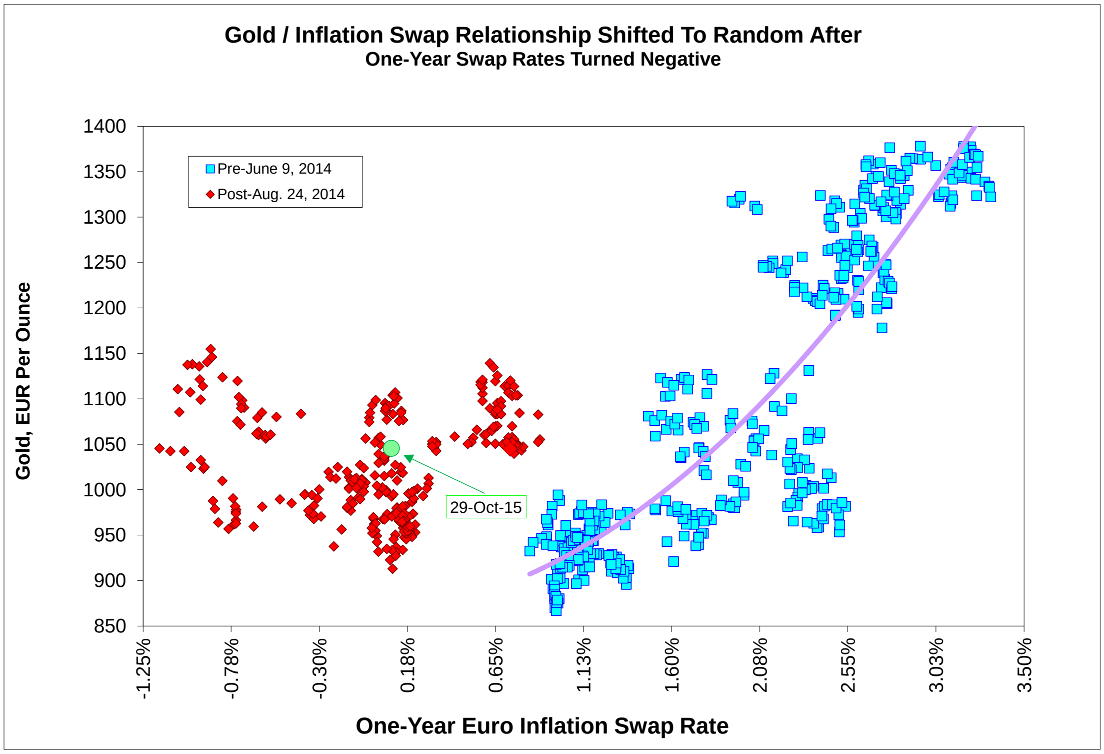


If we map gold against one-year swap rates pre-June 9th and post-August 25, 2014, omitting the intervening segment for visual clarity, we see an inverted relationship between gold and both one-year swap and one-year inflation swap rates after short-term rates turned negative.

However, the relationship between gold and one-year inflation swap rates shifted from a defined inverse one to a random one as one-year inflation swap rates rebounded to 0.09% from their January 15, 2015 low of -1.162%.

While gold in EUR terms benefits from lower short-term interest rates, it does not benefit from declining inflation expectations in the Eurozone. As the two measures have had a negative correlation of -0.57 since August 2014, it does not follow that declining short-term interest rates will produce negative short-term inflation swap rates, but the conditions that might lead to higher one-year inflation swaps very well might lead to higher one-year swap rates and to lower euro prices for gold.


Gold / Interest Rate Relationship Inverted After
One-Year Swap Rates Turned Negative
Pre-June 9, 2014
Post-Aug. 24, 2014
29-Oct-15
Gold, EUR Per Ounce
1400
1350
1300
1250
1200
1150
1100
1050
1000
950
900
850
-0.3%
0.1%
0.5%
0.9%
1.3%
1.7%
2.1%
One-Year Euro Swap Rate


Gold / Inflation Swap Relationship Shifted To Random After
One-Year Swap Rates Turned Negative
Pre-June 9, 2014
Post-Aug. 24, 2014
29-Oct-15
Gold, EUR Per Ounce
1400
1350
1300
1250
1200
1150
1100
1050
1000
950
900
850
-1.25%
-0.78%
-0.30%
0.18%
0.65%
1.13%
1.60%
2.08%
2.55%
3.03%
3.50%
One-Year Euro Inflation Swap Rate