Gold Is More Risk-Off Than Negative-Rate Driven

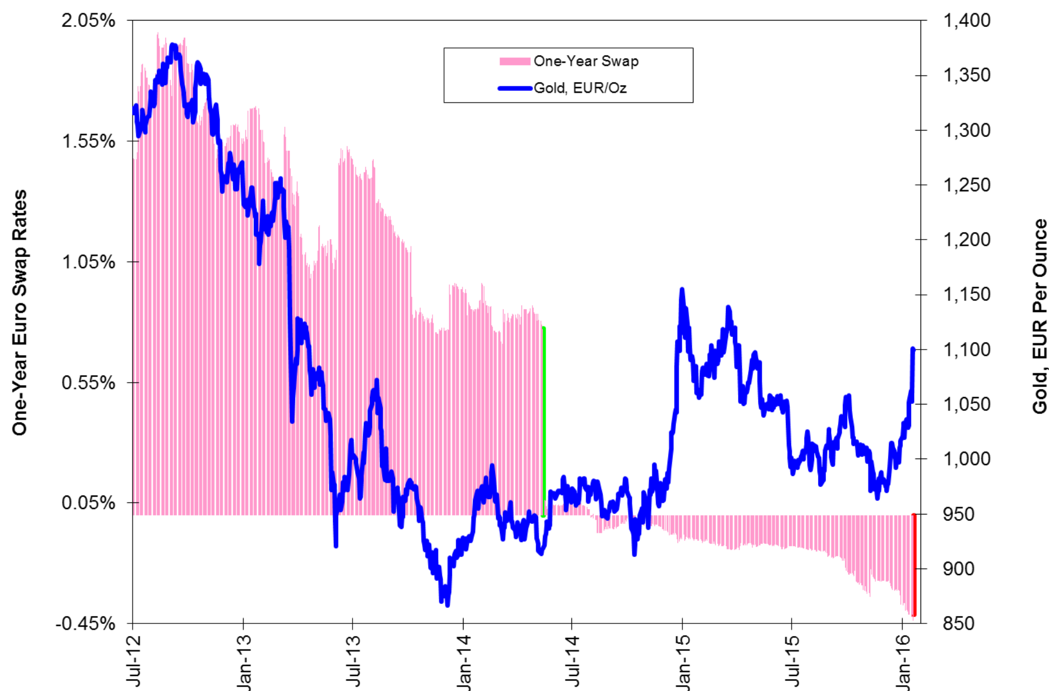
Life used to be so simple. You bought at $1, sold at $2 and took your 1% profit. But those were before the days when central banks razzle-dazzled themselves and everyone else with their as-yet unproven notion that ever-lower short-term interest rates would lead to a debt-fueled economic boom. We now have to deal with the spread of negative interest rates as a result.

At first blush gold seems to be a very logical beneficiary of these negative nominal and implied real rates as the implied carrying cost of gold, a pet rock or a handful of dirt turns negative. I noted this in February 2015 in the case of Eurozone interest rates and inflation swaps. Let's update some of that analysis and add a risk-off component to it.

Eurozone Rates

Let's map one-year EUR swap rates from the July 2012 "whatever it takes" pronouncement by Mario Draghi onwards against gold. First, 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, the period discussed in the earlier column. Gold then fell from €1,154.70 on January 23, 2015 to €964.11 on December 14, 2015 even though one-year inflation swaps declined from -0.095% to -0.272% over this period.

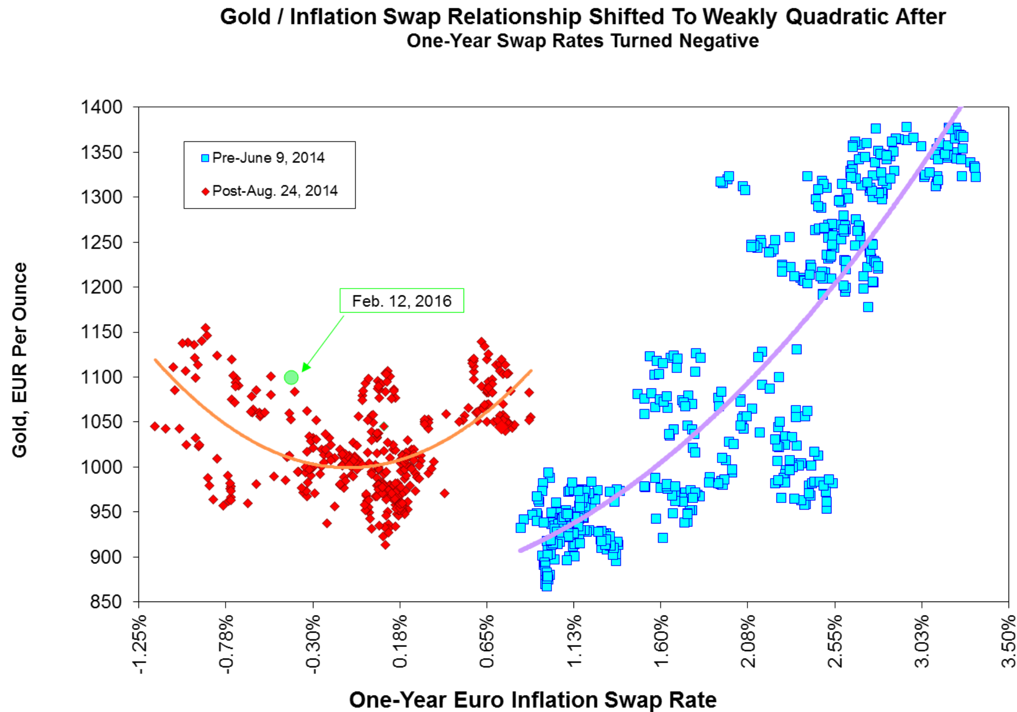
This presents a causation problem. If increasingly negative interest rates were bullish for gold in euro terms in early 2015, then why did gold continue to sink terms between January and December 2015?



Inflation Expectations

Let's split the post-July 2012 period into two segments, one ending with the collapse of one-year nominal swap rates in the Eurozone in June 2014 and one beginning with the advent of negative one-year swap rates in August 2014. The relationship between gold and one-year inflation swap rates shifted from a defined inverse one to a weakly quadratic one over these two periods. We would need to see a much stronger relationship, one wherein gold prices

accelerate as a function of negative inflation swap rates and vice-versa, to impute causality between these two markets.



Risk-Off

Further complicating the causation problem was gold's rise in EUR terms began when the European Central Bank decided against a more aggressive monetary accommodation in early December 2015. One-year nominal swap rates declined from -0.223% to -0.411% and one-year inflation swaps declined from 0.42% to -0.42%.

What did gold do in EUR terms since then? It has returned 16.67%. So here we have an environment where already-negative nominal rates, which had not been driving gold higher for more than ten months, intersected with a massive decline in inflation expectations, which should reduce the real return for holding gold even in a negative-rate environment.

What else changed significantly over this period? A strong burst of risk-off in financial markets, most of which is familiar to you as a trader and investor. Gold effectively became a beneficiary of the TINA (there is no alternative) argument that had been working for equities. This suggests once the present risk-off irruption stops, a statement and not a forecast, an alternative to gold will be presented and it will come under renewed pressure.