

# Gold should benefit in a NIRP environment

James Butterfill

Executive Director – Head of Research & Investment Strategy

research@etfsecurities.com

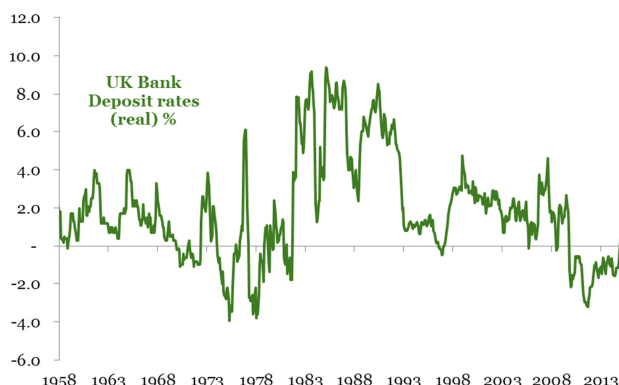
## Summary

- Historically, in negative real interest rate environments gold has performed better than in non-negative rate periods
- Gold is likely to be used by corporates as a way of avoiding the negative interest rate burden
- NIRP (Negative Interest Rate Policy) isn't the final experiment by central bankers
- NIRP could push gold into backwardation and therefore could be used as a carry trade

## There is little difference between NIRP and negative real rates

There has historically never been a period where a major bank's deposit rates have turned negative until now, with the European Central Bank (ECB) cutting the bank deposit facility to -0.4%. Looking at UK data, which has the longest time bank interest rate deposit series data available of any country, can give us some clues as to what might happen to gold during periods of negative rates. We see there being no substantial difference between negative deposit rates today and negative real deposit rates back in the 1970's and the post credit crisis period. Periods of negative real yields typically lead to capital flight from depositors into real or yielding assets and both are a form of "soft-default" as they are designed to generate inflation by encouraging spending and thus reduce the real value of debts.

UK Bank Deposit rates (real)



## Central banks engineering negative real rates

Central banks are complicit in generating the inflation so

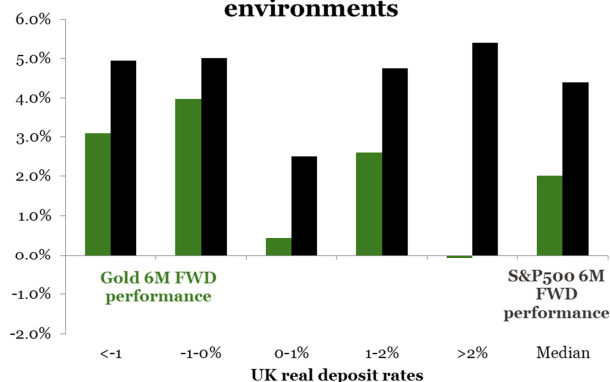
desired by the central government. In a recent FRBSF Economic letter titled "Is There a Case for Inflation Overshooting?" written by senior San Francisco Federal Reserve economist Vasco Cúrdia, argues that the US Federal Reserve (Fed) is happy to allow inflation to overshoot by keeping interest rates low. Given that core inflation is rising faster than nominal interest rates, a negative real rate policy is clearly being pursued in the US. It cannot persist forever though, as it would constitute a breach of the Federal Reserve Act, and expose the central bank to all sorts of political interference. However, as policy undertaken today is to target inflation and employment outcomes in over a years' time, the central bank can argue that it is keeping policy loose due to looming risks it sees in the future.

Whether negative in real terms (Fed) or in nominal terms (ECB, Swedish Riksbank, Danish National Bank, Swiss National Bank, Bank of Japan), negative rates appear to be the policy choice of modern developed world central banks.

## Gold outperforms in negative real interest rate environments

There have been two distinct periods where bank deposit rates were negative in real terms: in the 1970's and post credit crisis period. There were mild negative real rates in the late 1950's but the gold price was fixed, and so we look at data from 1968, when the gold price started to move. 1968 marked the end of both the unified fixed exchange rate regime and the beginning of the end of Bretton Woods.

Gold & Equities in real deposit rate environments



Historical data suggests that there is a relationship between negative real interest rates and the gold price. The chart above highlights the 6 month forward median price performance of

gold in different real rate environments. The data highlights a distinct outperformance of gold in negative real interest rate environments relative to more normal periods. We have included the S&P500 index performance as a benchmark, highlighting that real interest rates have little impact on equity market performance.

### Gold vs. US Real Interest Rate

Daily data, From Mar 06, 2006 to Mar 06, 2016



## The unintended consequences of NIRP

Negative interest rates set by the ECB are having some unintended consequences. According to Bloomberg, institutional investors, savings banks and pension funds are debating whether it is worth bearing the insurance and logistics costs of holding physical cash as overnight deposits fall deeper below zero, negatively impacting returns. Consequently they are looking for ways to avoid paying negative interest rates. Munich Re's approach has been to boost its gold holdings.

Banks are likely to suffer from the negative rates on the ECB deposit facility too, although the proposed TLTRO II auctions have more favourable funding conditions than the original

TLTRO initiative. In TLTRO II banks lending above a certain benchmark will receive a discount, which will help compensate for the "tax" on their deposit rates. Encouragingly, the introduction of TLTRO II and the purchase of non-financial corporate bonds by the ECB highlights that central banks are looking for alternative methods of stimulus, and that NIRP is not necessarily the final experiment by central bankers. The ECB is acutely aware of the negative impact that negative interest rates could have on the already meagre European lending environment.

## NIRP could push Gold into backwardation

Interest rates are a key input in the pricing of a commodity futures contract and accordingly play a role in total return futures investment in the asset class.

Futures contracts for commodities are priced on the concept of the 'cost of carry'. The cost of carry incorporates storage and insurance costs, and the funding cost of the cash needed to purchase the underlying commodity. With lower, and potentially negative rates expected to prevail, prices along the commodity futures curve will be forced lower as funding costs are cheaper. The lower interest rates go, the greater the potential for the commodity curve to move into backwardation.

In addition, because there is a cost to holding cash in a NIRP environment, rising demand for defensive or 'monetary assets' like gold should lift prices at the front end of the curve as the opportunity of holding cash balances rises.

In summary, we find that in a negative real interest or NIRP environment gold is likely to outperform relative to more normal periods.

## Important Information

### General

This communication has been issued and approved for the purpose of section 21 of the Financial Services and Markets Act 2000 by ETF Securities (UK) Limited (“**ETFS UK**”) which is authorised and regulated by the United Kingdom Financial Conduct Authority (the “**FCA**”).

The information contained in this communication is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities. This communication should not be used as the basis for any investment decision. Historical performance is not an indication of future performance and any investments may go down in value.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

This communication may contain independent market commentary prepared by ETFS UK based on publicly available information. Although ETFS UK endeavours to ensure the accuracy of the content in this communication, ETFS UK does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this communication make no warranties or representation of any kind relating to such data. Where ETFS UK has expressed its own opinions related to product or market activity, these views may change. Neither ETFS UK, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this publication or its contents.

ETFS UK is required by the FCA to clarify that it is not acting for you in any way in relation to the investment or investment activity to which this communication relates. In particular, ETFS UK will not provide any investment services to you and or advise you on the merits of, or make any recommendation to you in relation to, the terms of any transaction. No representative of ETFS UK is authorised to behave in any way which would lead you to believe otherwise. ETFS UK is not, therefore, responsible for providing you with the protections afforded to its clients and you should seek your own independent legal, investment and tax or other advice as you see fit.



The  
intelligent  
alternative

ETF Securities (UK) Limited  
3 Lombard Street  
London  
EC3V 9AA  
United Kingdom

t +44 (0)207 448 4330  
f +44 (0)207 448 4366  
e [info@etfsecurities.com](mailto:info@etfsecurities.com)  
w [etfsecurities.com](http://etfsecurities.com)