

A Little Further Down the Road

The most overused expression that has come about since governments in Europe and the US have been unable to compromise on budget negotiations is “kicking-the-can down the road.” Unfortunately, it remains appropriate following Thursday’s last minute deal to avert the Treasury imposed (or perhaps supposed) budget ceiling deadline. The implication of revisiting these political issues in another 90 days in the future creates uncertainties for investors. By chance, Washington could put together that fantasized grand bargain budget deal, but if history can provide any indication and considering there have been eight budget commissions since 2010, chances seem slim.

This prompted Chinese rating agency Dagong to once again downgrade US credit. The firm revised their A status down one notch to A- as concerns with an increasing US debt burden seem to outpace potential growth in fiscal income and economic growth. Following the selloff in the gold market last week, this news alone gave the metal enough support to re-enter the trading range we’ve seemed to be stuck in since mid-September. And while failing to advance fiscally has not been supportive of gold, the fact that gold did not selloff following a finalized budget deal and actually held its rally through the end of the week seems to have eliminated the bearish undertone of the market for the time being.

The other big factor driving demand in the gold market has been the increased demand for the physical metal, particularly from the usual suspects India and China. Reports of increasing premiums on the Shanghai Gold Exchange over the London market support the notion that Asian buyers are again willing to pay a premium for the

physical metal. This was also the case in July as inventories replenished following the precious metals breakdown in April and June.

It’s important to differentiate the outlook for the gold price in the sense of a short term and medium term perspective. The biggest distraction to all asset classes since the beginning of September has been fiscal negotiations in Washington. As Robert Schiller was one of three recipients awarded the Nobel Prize in Economics this week, his contribution can remind us that the irrationality of investors may avert asset prices away from their fundamental values in the short term. I am not attempting to imply that gold is overvalued or undervalued; moreover, gold (and all asset markets) have been over consumed by a budget process with an easily predictable outcome.

Tuesday (October 22) of next week the Bureau of Labour Statistics will report the September payrolls report. Jobs data is the single greatest factor that influences the US Federal Reserve’s decision to taper their asset purchases, and that’s where gold’s focus will return. Regardless of Tuesday’s payroll report, however, the inevitable taper will not come anytime soon.

Despite the independence and the operational structure of the US Federal Reserve, Bernanke will not begin the taper. He is now a lame duck. Part of the legacy Bernanke leaves at the US Federal Reserve is the transparency he has created in terms of the role the Fed plays in financial markets. As his credibility has been questioned by some market participants, current economic conditions aside, the reigns have been handed over to Janet Yellen, and anticipation of the inevitable Fed Taper goes with the upcoming budget deal, just a little bit further down the road.

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