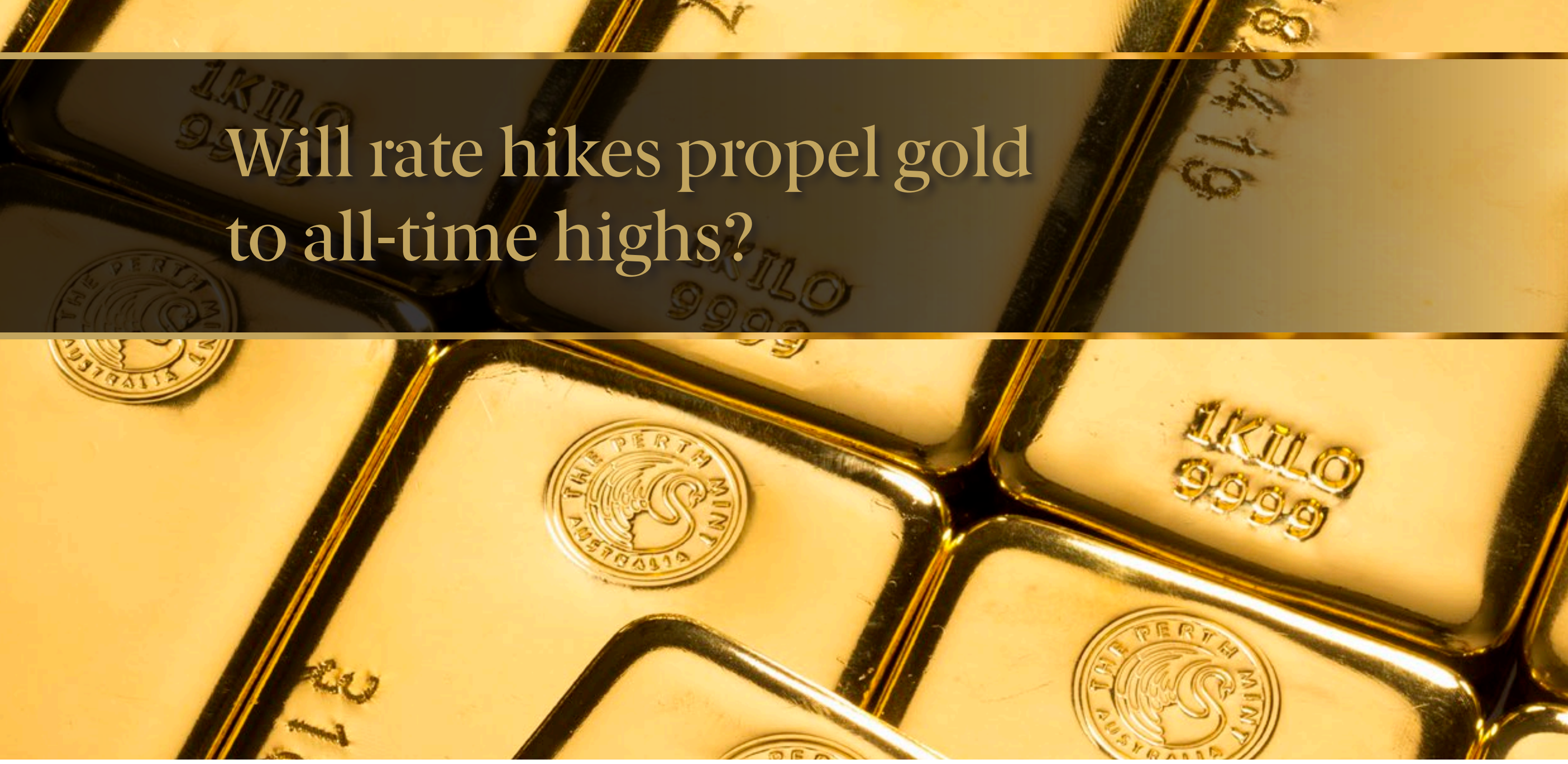



# Will rate hikes propel gold to all-time highs?

Gold prices have soared in recent weeks, with the conflict between Russia and the Ukraine at one point pushing prices back above USD 2,000 and AUD 2,800 per troy ounce (oz).

The rally comes after a roughly 15 month period in which gold prices were in a corrective pattern, having fallen by about 15% between August 2020 and January of this year.

Several factors drove this correction, including:

- A rising US dollar, which was up 6% in 2021.
- Stronger than expected economic growth.
- An incredibly strong rally in equities, with the S&P 500 up more than 25% in 2021.
- Cryptocurrency price strength for most of 2021, with Bitcoin at one point pushing up toward USD 70,000 per coin.

On top of these non-precious metal specific factors, gold itself was also overdue for a correction, having rallied by approximately 70% from below USD 1,200 to more than USD 2,050 oz between late 2018 and late 2020.

And while for now all eyes are on the Ukraine, there is another catalyst for higher gold prices that may soon come to the fore. Higher interest rates.

## Won't higher rates sink gold?

In theory, gold prices should be on the back foot in 2022, with higher interest rates and the conclusion of the various quantitative easing programs undertaken by global central banks to support economies through the pandemic representing potential headwinds for the precious metal.

The logic is simple enough - gold doesn't pay an income. Therefore, if the interest rates one can earn in a bank account or term deposit are on the rise, then the opportunity cost of owning gold is going up, which should be bearish for the gold price.

In reality, history demonstrates that gold prices have typically tended to rise alongside increases in interest rates. This can be seen in the table, which looks at rate hike cycles and movements in the US dollar gold price over the last 50 years.

Rate hike cycles and US gold price moves

| Time period | Interest rate move (%) | Gold move (%) |
|---|---|---|
| 1972 to 1974 | +9.6 | +224 |
| 1977 to 1980 | +13.0 | +294 |
| 1986 to 1989 | +4.0 | -7 |
| 2004 to 2007 | +4.3 | +69 |
| 2015 to 2019 | +2.3 | +33 |

*Source: The Perth Mint, St Louis Federal Reserve, LBMA*

## Keep an eye on inflation

One factor to keep a close eye on in 2022 is inflation.

While gold doesn't always go up when inflation is running hot, it does have one of the best track records of any asset class as a hedge against rising consumer prices.

As an example, analysis conducted by The Perth Mint shows that the gold price in Australian dollars has on average risen by just over 20% in nominal terms in years local inflation was 3% or higher.

| Infalation environment | Number of years inflation in this bracket | Avergae nominal gold return (%) |
|---|---|---|
| Less than 3% p.a. | 27 | 3.6% |
| More than 3% p.a. | 23 | 20.4% |

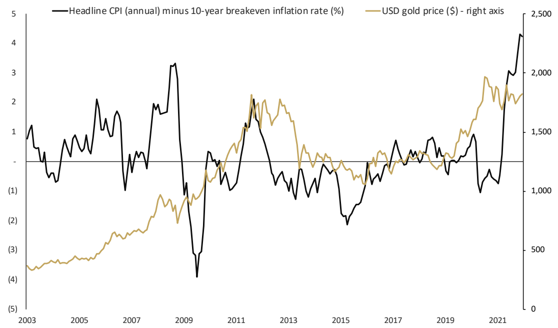
*Source: The Perth Mint, Australian Bureau of Statistics, World Gold Council*

What makes the inflation outlook so interesting for gold going forward is that, at present, the market is expecting inflation rates to rapidly decelerate, and to stay low in the decade ahead.

This can best be visualised when considering the fact that while headline CPI rates hit 7% in the United States by the end of December 2021, the 10-year breakeven inflation rate, which measures what the market expects inflation to average in the next 10 years, was just 2.56%.

That is the largest gap in 20 years between the current CPI rates and 10-year breakeven inflation rates. This can be seen in the chart below, which also highlights the US dollar gold price during this time.

Gap between current CPI rates and 10-year breakeven inflation rates 2003 - 2021




*Source: The Perth Mint, St Louis Fed, Bureau of Labor Statistics*

The only other time we've seen anything like this kind of gap was back in 2008, when there was more than a 3% difference between the headline CPI rate and the 10-year breakeven inflation rate.

Back then, like now, gold went through a corrective period, at one point falling by approximately 20%. That corrective cycle was short-lived and ended with an explosive move to the upside, with gold rallying by more than 150% in the three years that followed.

Given this history, and the fact there is plenty of room for CPI growth to fall yet still overshoot market expectations, there are multiple reasons to think current inflation dynamics will ultimately lead to higher gold prices in the years ahead, irrespective of what happens with interest rates.

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The Perth Mint

## This report has been compiled by The Perth Mint.

The Perth Mint is Australia's largest and most highly accredited precious metals enterprise. It offers a comprehensive suite of investment options including ASX listed gold product Perth Mint Gold (ASX:PMGOLD), storage solutions, and physical bars and coins for purchase. With assets under management valued at more than AUD 6 billion, The Perth Mint is trusted by some 70,000 clients across 130 countries to safeguard their wealth.

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