



MAIN TOPICS

- US stocks decline after FOMC policy statement
- US dollar rebounds sharply
- Gold remains firm despite volatile currencies
- China's new laws are bullish for gold

Rand Refinery Weekly Gold Commentary

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During last week the US dollar staged a strong rebound following the FOMC monetary policy meeting statement in which it did say the U.S. economy's growth track will be more modest than the Fed had expected in recent months. The sell off in US equities intensified following a string of disappointing data and the DJI fell 3.3% by the end of the week. After hitting a major support level of 80, the US Dollar Index rallied strongly, possibly due to short covering initiated at this level. Even though the US dollar rose almost 3% on the week, gold prices remained firm and continued to consolidate above the \$1200/oz level.

In spite of exceptionally strong GDP data from Germany, the euro lost ground against the US dollar and was weakest currency last week. German Q2 GDP showed spectacular 2.2% growth, way above expectation of 1.3%. This was the strongest number since the reunification two decades ago. However, overall Eurozone Q2 GDP growth was much lower at 1.0%. Greece is still in recession with a -1.5% contraction while the 0.2% growth in Spain and 0.4% in Italy were only modest. The gap between the fastest and slowest economies' performance was much larger in the second quarter than in the previous periods. Germany, France, Italy and Spain were all within 0.4% of growth in the first quarter. There were fresh concerns that these imbalances will only intensify on austerity measures in peripheral Eurozone countries.

The Japanese yen hit a 15 year high against dollar, following the sharp dive in treasury yields. However, the yen then weakened sharply on intervention talk which triggered yen long positions squaring.

According to a report by Lloyds Bank, precious metals such as gold were the best performing asset class of the first half of the year. Of the nine asset classes analysed, five – precious metals, UK commercial property, UK bonds, international bonds and cash – delivered a positive return for investors. They rose in value by an average of 9.7%, with gold turning in the best performance thanks to a rise of 13.5%. Four lost money: UK residential property, commodities, UK equities and international equities. International equities were the worst assets to hold over the period, falling by 6.8%.

The declining value of the major currencies is the main driving force behind the rising price of gold

As I have often alluded to in the past, one of the major driving forces behind this bull market has been the declining value of the major currencies in particular the US dollar. Gold is bought and sold in U.S. dollars, so any decline in the value of the dollar causes the price of gold to rise. The U.S. dollar is the world's reserve currency - the primary medium for international transactions, the currency in which the worth of commodities are calculated, and the currency primarily held as reserves by the world's central banks. However, now that it has been stripped of its gold backing, the dollar is nothing more than a fancy piece of paper. The dollar has been in an overall downtrend since 2001, and this longer-term down trending pattern seems well established and likely to continue. The Dollar Index which is a widely used index that measures the US dollar relative to a basket of foreign currencies has already dropped more than 30% since 2001 while gold has risen more than 400%. (The currencies in the

Index include the Euro, Yen, Sterling, Canadian Dollar, Swedish Kroner and Swiss Franc).

Gold is a monetary metal whose price is determined by inflation, by fluctuations in the dollar and global equities, by currency-related crises, interest rate volatility and international tensions, and by increases or decreases in the prices of other commodities. The price of gold reacts to supply and demand changes and can be influenced by consumer spending and overall levels of affluence.

Gold has maintained its value in terms of real purchasing power in the long run and is thus particularly suited to form part of central banks' reserves. In contrast, paper currencies always lose value in the long run and often in the short term as well. It is therefore not surprising that most of the central banks are now reluctant to sell any of their gold and that is also the reason Russia, India and China are hoarding gold.

China's new laws will eventually give hundreds of million of individuals access to gold

Recently, the Chinese government announced that it will allow more of its domestic commercial banks to import and export gold. The new law will eventually give hundreds of millions of Chinese citizens access to gold-linked investment products.

The demand for gold in China has already increased during the first half of this year as concerns over the global economic recovery spurred investment. China National Gold Group Corp., the country's largest state-owned gold producer, even reported a 40% increase of gold bar and coin sales over the past six months. The total volume of gold traded on the Shanghai Gold Exchange jumped 59% in the first half of 2010 to 102.1 million ounces (3,175 tons).

TECHNICAL ANALYSIS



The price of gold has been consolidating between \$1200/oz and \$1215/oz (black circle). It has now rebounded \$60 since its recent lows made in July and looks set to breach the 50 day MA blue line.



About the author: David Levenstein is an independent precious metals market commentator with more than 30 years experience.

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