World demand for gold is strong, despite a price drop to the lowest level in four years

The market rallied, leaving gold behind. The strong US Dollar and an apparently positive economic outlook for the United States have caused the price of gold to reach its lowest level in over four years last Friday, touching USD$ 1,174.18/oz. – the lowest since the end of July 2010. Analysts have placed the blame for this drop on “surprisingly strong growth” in the United States, prompting a greater prospect of a prompt tightening of monetary policy. There was some surprisingly good economic data from the US: gross domestic product (GDP) grew at an annualized rate of 3.5% in the third quarter, which is far better than expected, confirming the Fed’s optimistic outlook in the days preceding the announcement. The apparent accuracy of that prediction muted the demand for gold as a safe haven. Moreover, the strong economic performance has reduced the market’s fears that Fed is unable to manage inflation as the former Fed Chairman, Alan Greenspan, had warned just days before the big market rally. It appears the market is very happy to ignore gloomy inflation predictions and this has not been good news for gold investors, as Greenspan urged Americans to buy gold.

The higher chance of a GOP win in the congressional elections on November 4, moreover, have fueled predictions of a very bullish reaction from Wall Street, marked by a rise of industrial and energy stocks, which will likely continue to keep gold in the doldrums. The rise of the US Dollar in response to the sharp increase in bond purchases by the Bank of Japan have also been a burden for the price of gold. Yet the price of gold is actually enduring the effects of very ‘messy’ markets and uneven economic growth. There are, in fact, few assurances that the Fed will raise interest rates to control inflation because economic growth has been lackluster overall and there is still a long way to go before it will be strong enough to prompt a sharp turn in current monetary policy. A lower price of oil has also deflated inflationary tendencies. Geopolitical tensions are also very pronounced and precedent suggests that such conditions tend to buoy, rather than sink, the price of gold. Those geopolitical tensions are not exclusively related to the rise of the Islamic State in Iraq, Syria and beyond or to Russia and Ukraine.

The geopolitical situation has been made all the more uncertain because of the ever worsening economic conditions in the European Union. Even Germany is starting to feel a hit of recession and Washington, Republican or Democrat, will not feel sufficiently optimistic to lift the economic stimulus measures just yet, which should eventually generate some lift for the price of gold. More significantly, gold can also benefit from sustained, and even rising, demand from key markets such as China and India, where the recent September wedding season coincided – perhaps prompted – imports of gold rising by a remarkable annualized rate of 449%. Moscow has also continued to demand physical as the Russian central bank has raised its reserves to a record level. As mentioned in InvestorIntel last week, a referendum in Switzerland to be held at the end of this month, could greatly affect greatly the outlook for gold prices. Swiss citizens are called upon to decide on the extent to which their country’s central bank will have to replenish its reserves.

One of the measures that will have to be adopted in case of a ‘yes’ victory – which the polls predict to be likely for the time being – will see the Swiss National Bank (SNB) having to maintain at least 20% of its assets in gold bullion, meaning it (SNB) would be forced to buy about 1,500 tons of gold within 5 years, which, in practice, means that 10% of global production would be absorbed by Bern. Not to mention that such an initiative could be adopted by other countries – including the United States – setting off a chain reaction. Meanwhile, China, based on the weekly statistics of the Shanghai Gold Exchange, continues to experience good demand for gold, which was very strong early in 2014 only to wane from March to August and now seemingly set to rise again. The latest figures show that China has purchased 68 tons in a period of just two weeks, a sign that suggests that Chinese demand is soaring and there can be no doubt that, at present, India and China are buying gold at a rate sufficient to absorb most of the available supply of physical gold in the market. Considering that they are not the only countries buying, the real puzzle remains why gold prices are dropping in the international market. Surely, the time has come for gold to resume an upwards path