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BUSINESS

Central banks and major investors join gold rush

Private and institutional investors have long used gold as a safeguard against financial crises. Now, more and more central banks are buying the precious metal to hedge against the euro and dollar debt crises.

Gold bars are considered immune against inflation

"Each burns for gold, all turns on gold --alas for us! poor creatures!" - wrote German poet Johann Wolfgang von Goethe in his tragic play "Faust" in the early 19th century. The dictum still holds true today. Despite the fact that gold doesn't pay dividends or earn any interest, it is coveted like never before.

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Goethe's dictum that 'all turns on gold' still holds true

At first it was private and institutional investors who sought refuge in the precious metal's crisis-proof qualities - now central banks are joining them in an attempt to safeguard their monetary systems against the impact of the European and United States debt crises and subsequent currency fluctuations.

"Gold is always attractive to people when they assume there is a crisis," says Friedrich von Metzler, who heads the Metzler private bank based in Frankfurt. "People do have to assume there is a crisis when they look at the financial situation many countries are in."

Fearful, gold-hungry investors have caused the metal's price to double over the past two years to reach record levels above $1,600 (1,100 euros).

Times change

"The trend with regard to gold will continue upwards while the debt problems in Europe and the US remain unsolved," predicts Eugen Weinberg, a commodities analyst with Commerzbank.

Things used to be quite different. In the late 1990s, the price for one fine ounce of gold stood at $300 - barely enough to cover the cost of mining and refining the metal. Back then problematic inflation seemed to be a thing of the past and central banks saw little reason to hold large metal reserves to back the paper money they issued. The Reserve Bank of Australia, for instance, sold 167 tons of gold - two thirds of its holdings - within six months in 1997, thus driving the price down even further.

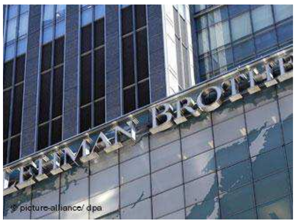
Across the world, gold production sank and mines closed down, causing roughly 200,000 miners in South Africa alone to lose their jobs. In the year 2000, according to the US-based business information service Bloomberg, the price of gold fell to an average of $272 per fine ounce- $20 less than what extraction cost.

The South African Krugerrand is one of the most popular gold bullion coins

But after the terrorist attacks of September 11, 2001, the trend reversed: In order to prevent a recession from occurring, the markets were flooded with money. Nominal and real interest rates sank to around zero, the shadow of inflation returned, commodity and food prices went up, and a housing bubble developed in the US.

Insecure times make for higher demand

Ever since then, investment brokers have noted three periods in which gold, because of its alleged insusceptibility to inflation, was in particularly great demand: in 2008, when the Lehman Brothers bank went bankrupt; in 2010, when scale of the Greek debt crisis became apparent; and in 2011, when it became obvious that the European Union was having a hard time tackling debt problems in Ireland, Portugal and Spain.



The bankruptcy of Lehman Brothers is one recent event that prompted a gold rush

Since then, there has been no stopping the gold rush. Analysts with Commerzbank say gold is more than a commodity. Rather, current developments prove that "gold serves not only as a safeguard against inflation, not only as an indicator of economic fears, and not only as an anti-dollar" but as a currency in its own right that is profiting from the weakness of the world's two major currencies: the euro and the dollar.

Investment consultant Wilhelm Peinemann agrees. He bought a disused savings bank fitted with a vault in Göttingen and has been in business buying up gold bars on behalf of clients since 2005. "My clients are convinced the price for gold compared to paper money will climb even higher," Peinemann told the Handelsblatt newspaper recently.

But others sound a note of caution. "I consider putting all your money in gold a risk that many people underestimate," says Susanne Steinmann of the Berlin-based Quirin Bank.

Emerging economies serve as price booster

Still, the Landesbank Baden-Württemberg (LBBW) predicts that the price for one fine ounce of gold will continue to climb to $1,750 by mid-2012 as hedge funds and institutional investors buy gold to safeguard their assets against the faltering dollar.

Central banks in industrialized countries are holding onto their gold bars

The central banks of emerging economies are expected to be the biggest price boosters. Mexico's central bank, for example, bought 93 tons of gold in a three-month period. China, Russia, India and Thailand have also been stocking up on the precious metal, while industrial countries have, to a large extent, stopped selling their gold.

According to the World Gold Council, an independent association of gold producers, the US was hoarding 8,133 tons of gold in June, followed by Germany with 3,401 tons. All the world's central banks together have stockpiles weighing some 27,300 tons.

If you add those to the International Monetary Fund's holdings and those of the Bank for International Settlements, the total amount of gold being kept in reserve is at 30,800 tons - about one fifth of the 165,000 tons that have been mined since record-keeping began.

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