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# The Political Economy of Gold in Geo-Economic Evolving Conditions

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## Abstract

Since the 18th century, the western world has gone through political and economic alterations. Gold has been of economic importance over thousands of years in several civilisations. It gained international economic significance during the 19th century, when several countries officially adopted the Gold Standard. With the world becoming more intertwined, gold has found new importance for economies and investors alike. It has been a safe haven during a time of economic crisis which has been reflected on its price. This paper examines the development of gold in a changing global, political and economic environment. For investors it has become a safe haven during the crisis, but how reliable is gold? How far can investors predict gold's worth in times of crisis and what kind of crises drives gold? The interplay of global players, governments, their policies, currency strategies and large private investors have complicated the predictability of the gold price. Hence, the present study is aimed to analyze the reliability of gold when countries are headed into crises as well as economic and political impacts on the gold price, using content and data analysis method based on library resources**.**

**Keywords:** Bretton Woods, Gold Standard, Emerging Markets, Bullion, Inflation.

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## 1.Introduction

Gold’s property as metal and medium for storage of wealth has made it so valuable over centuries. Gold has a long and complex history. From gold’s first discovery, it has embodied wealth and assured authority. Archaeological digs propose the use of gold began in the Middle East where the first known civilizations began. By the third century AD, the citizens of Rome wore necklaces that contained coins with the image of the emperor. In the Americas, the skill of Pre-Columbian cultures in the use of gold was highly progressive long before the coming of the Spanish. (OnlyGold.com, 2015). The 19th century was the golden age. The gold rush started in the Ural Mountains in Russia in the 1820s. Later gold was also in discovered Siberia. In January 1848 Gold was found in the Sacramento Valley California which led to a gold rush in that region. This continued into 1851 with the discovery of masses of gold in Australia. In March 1886 the richest gold deposits of the world were discovered in South African Transvaal at the so-called Witwatersrand. The last gold rush of the l19th century was in Alaska; wherein August 1896 on the estuary of the Klondike River in the Yukon River Gold was found. The rich deposits that triggered the gold rush were significant for the economic strength of the respective country that capitalized on acquiring the gold. (Doll,2015)

Gold has always had significance to humans, even before it was money. This is established by the unusual efforts made to obtain it. Searching for gold was a worldwide effort going back thousands of years, even before the first money in the form of gold coins appeared about 700 B.C. (bullion.nwtmint.com,2012). In the present day, somewhat over half of the entire world's gold is used in ornaments, at 84,200 tonnes, or 50.5%. Another 31,000 tonnes, or 18.7%, is set aside for private investment purposes, with another 29,000 tonnes, or 17.4%, held by the world's governments (Howe,2013).

## 2.Methodology

This study has been carried out in the descriptive-analytical manner, and the method of collecting data has been library form. Then, the questions are analyzed by giving reasons and describing the history and current causes related to the issue.

## 3.Geo-economics Concept and Political Economy

The term geo-economics emerged in the early 1990s when the Soviet Union was about to collapse (Scholvin, Wigell,2017:3). Although the concept of geo-economics appeared at the end of the cold war, thanks mainly to the works of Edward Luttwak, the interrelations between state power, economy and international trade have been taken into consideration throughout history. Controlling trade routes, gaining access to natural resources and conquering markets have been important factors in international economic relations. In fact, geo-economics illustrates the strategic interactions between state agencies and various economic sectors to enhance the power position of states in the contemporary international system (Csurgai,2017: 4). Hence, it seems that a three-part definition of Geo-economics can be very comprehensive. Geo-economics uses economic tools to defend national interests and produce useful Geopolitical results; "and the impact of other nations' economic actions on the country's geopolitical goals." The first section is the use of economic tools to maximize and defend national interests; the second part is understanding how (at least from a theoretical point of view) domestic economic power can enhance the power of a country in the international system; and the third part is the effect of economic measures of other nations and countries on the geopolitical goals of the country (Mokhtari Hashi,59:2018).

According to Luttwak, post-Cold War international relations would remain driven by rivalry amongst states but the preferred means for pursuing adversarial goals would be economic rather than military. Using Luttwak's own words, National power in the era of geo-economics derives from disposable capital in lieu of garrisons and bases (Scholvin, Wigell,2017:6). Therefore, various geo-economic changes have an impact on other economic variations such as gold and its value. For instance, rising powers such as China have become geo-economic players. Their state- capitalist economies endow them with geo-economic means that most Western powers lack such as state-owned banks and state-owned enterprises. China has used these means to create asymmetric investment and trade relations with several neighbouring countries that it can now use as political leverage (Scholvin, Wigell,2017:5). In the following, other political and economic alterations by which the gold price can change will be discussed.

## 4.Discussion and Findings

### 4-1. The Gold Standard

In the 19th century the states where the main economic actors and in accordance with a Mercantilist approach it was the state's role to provide security as regarding relations to other states but also to acquire wealth. (Smith, El-Anis, & Farrands,2010). Great Britain was the first to adopt the gold standard in 1821, followed, in the 1870s, by the rest of Europe. The rise of a gold standard was meant to stabilize the global economy, dictating that a nation must limit its issued currency to the amount of gold it held in reserve (Howe,2013). By 1900 all major countries other than China had switched to the gold standard, linking their currencies to gold. Before World War I, the UK departed from the Gold Standard but returned to it in 1925. In 1933 President Roosevelt suspends US dollar convertibility to gold. The export of all transactions in and the holding of gold by private individuals were forbidden. In 1934 the dollar was once again convertible, but at a new price. In 1939 World War II closed the gold market.

The gold standard was introduced as it gave uniformity to the monetary unit, not only in time but in space too. Under the gold standard, currency units were defined in terms of a given quantity of gold and were typically convertible into gold. The central banks were the prime holders of gold and needed to hold sufficient reserves to convert all of the representative money, it had issued, into gold at a promised exchange rate. The significant point of the system was the credibility of the official commitment to gold and such commitment was international. The gold standard ensured long-term price stability; high levels of inflation seldom existed and "hyperinflation impossible" as the money supply could only grow at the rate of gold supply. For instance, the monetary expansion from 1897 to 1914, which was experienced worldwide, was a reflection of increased gold output. High level of inflation under a gold standard was seen exceptional such as during and post-war periods due to large scale devastation on the economies. However, with the outbreak of war, the gold standard was abandoned by almost every country. (Karunagaran,2011).

### 4-2. Why the Gold Standard was Abandoned

The gold standard was a critical source of the relative prosperity of the late nineteenth and early twentieth century and was deferred at the outbreak of World War I. The return to gold at pre-war parities as soon as possible should be considered part of the gold standard's normal operation. Returning to gold at the pre-war parity, and thus at something close to the pre-war price level, making it easier for a government to sell nominal bonds and increase attainable seignorage (Bordo & Kydland,1990). Possibly for these reputational reasons, and certainly because of widespread unhappiness with the chaotic monetary and financial conditions that followed the war (there were hyperinflations in central Europe and more moderate but still serious inflations elsewhere), the desire to return to gold in the early 1920s was strong.

1922 the adoption of a gold exchange standard, in which convertible foreign exchange reserves (principally dollars and pounds) as well as gold used to back national money supplies, thus "economizing" on gold was recommended. During the 1920s the vast majority of the major countries succeeded in returning to gold. The classical gold standard of the pre-war period functioned reasonably smoothly and without a major convertibility crisis for more than thirty years. In contrast, the interwar gold standard, established between 1925 and 1928, had substantially broken down by 1931 and disappeared by 1936. In contrast, in the interwar period, the relative decline of Britain, the inexperience and insularity of the new potential hegemon (the United States), and ineffective cooperation among central banks left no one able to take responsibility for the system as a whole. The technical problems of the interwar gold standard included the following three:

1.The asymmetry between surplus and deficit countries in the required monetary response to gold flows. In theory, under the "rules of the game," central banks of countries experiencing gold inflows were supposed to assist the price-specie flow mechanism by expanding domestic money supplies and inflating, while deficit countries were supposed to reduce money supplies and deflate. Thus, the Bank managed the gold standard (with the assistance of other central banks) so as to avoid both sustained inflows and sustained outflows of gold. In contrast, the two major gold surplus countries of the interwar period, the United States and France had central banks with little or no incentive to avoid the accumulation of gold. While Britain, Norway, Finland, and Sweden had a fiduciary issue a fixed note supply backed only by domestic government securities, above which 100% gold backing was required most countries required instead that minimum gold holdings equal a fixed fraction (usually close to the Federal Reserve's 40%) of central bank liabilities. First, just as required "reserves" for modern commercial banks are not available for use as true reserves; a large portion of central bank gold holdings was immobilized by the reserve requirements and could not be used to settle temporary payments imbalances. For example, in 1929, according to the League of Nations, for 41 countries with a total gold reserve of $9,378 million, only $2,178 million were "surplus" reserves, with the rest required as cover (League of Nations,1944:12).

2.Under the interwar gold exchange standard, countries other than those with reserve currencies were encouraged to hold convertible foreign exchange reserves as a partial (or in some cases, as a nearly complete) substitute for gold. Thus, just as a shift by the public from fractionally backed deposits to currency would lower the total domestic money supply, the gold-exchange system opened up the possibility that a shift of central banks from foreign exchange reserves to gold might lower the world money supply, adding another deflationary bias to the system.

3.Insufficient powers of central banks. This forced the central banks to rely on discount policy (the terms at which they would make loans to commercial banks) as the principal means of affecting the domestic money supply. However, in a number of countries, the major commercial banks borrowed very infrequently from the central banks, implying that except in crisis periods the central bank's control over the money supply might be quite weak. The loosening of the link between the domestic money supply and central bank reserves may have been beneficial in some cases during the 1930s if it moderated the monetary effect of reserve outflows. For example, the Bank of France, which was the recipient of massive gold inflows until 1932, was one of the banks that were, prohibited from conducting open market operations.

Given both the fundamental economic problems of the international economy and the structural flaws of the gold standard system, even a relatively minor deflationary impulse might have had significant consequences. For several reasons including a successful stabilization with attendant high real interest rates, a possibly undervalued franc, the lifting of exchange controls, and the perception that France was a "safe haven" for capital beginning in early 1928 gold flooded into that country, an inflow that was to last until 1932. Since the U.S. share of monetary gold remained stable at something greater than 40% of the total, the inflow to France implied significant losses of gold by countries such as Germany, Japan, and the United Kingdom. The monetary tightening in the United States in 1928, a contraction motivated in part by the desire to avoid losing gold to the French but perhaps even more by the Federal Reserve's determination to slow down stock market speculation.

Once these destabilizing policy measures had been taken, little could be done to avert deflation and depression, given the commitment of central banks to the maintenance of the gold standard. Attempts by any individual central bank to reflate were met by immediate gold outflows, which forced the central bank to raise its discount rate and deflate once again. Instead, given the commitment to the gold standard (and, presumably, the absence of effective central bank cooperation), the Fed had little choice but to let the banks fail and the money supply fall. For the positive question of what caused the Depression, we need only note that a monetary contraction began in the United States and France, and was propagated throughout the world by the international monetary standard. If monetary contraction propagated by the gold standard was the source of the worldwide deflation and depression, then countries abandoning the gold standard (or never adopting it) avoided much of the deflationary pressure. Scandinavian countries, which left gold along with the United Kingdom in 1931, recovered from the Depression much more quickly than other small European countries that remained longer on the gold standard (Bernanke & James, 1990).

**4-3. After the Gold Standard**

The ‘gold standard’ encountered practical hardship to put into operation. At any point of time, the total demand for gold was much greater than its limited supply, and hence the quantity of gold available in the world was smaller to sustain the ever-growing modern-day economic activities among the countries. Although in the contemporary world it is impossible to maintain the gold standard, this system had the advantage of more stable ‘inflation management’ than discretionary paper money regimes. (Smith, El-Anis, & Farrands,2010)

In 1944, the Bretton Woods conference sets the basis of the post-war monetary system. Bretton Woods system is an attempt to strike a balance between a liberal world market and the domestic responsibilities of states (Cox,2005). The system was based on Keynes social economic theory.

Keynes differed from many liberal thinkers as he argued that markets are not perfect and needed state intervention to complement the working market. (Smith, El-Anis, & Farrands,2010). Each country that joined the Bretton Woods system had the right to acquire US dollars' reserves at a fixed price of $35 per ounce in gold exchange. The main objective of the Bretton Woods system was the re-establishment of European economic power and the revival and simplification of world trade. For this purpose, the exchange rates between the currencies needed to be stabilized. Despite the economic successes that occurred thereafter there was increasing evidence of lack of monetary order. The lack of a balance of payments mechanisms and the supremacy of the US dollar led to the eventual crumble of the system. US President Richard Nixon terminated this era in August 1971 and the US Dollar subsequently no longer bound to gold. In March 1973 the exchanges markets closed in many European countries as the Bretton Woods system threatened to collapse. As a result, the majority of the large industrialized nations moved to a system of flexible exchange rates. (Doll,2015).

**4-4. World Gold Reserves and Sovereign Wealth**

In the late 90s, the Central Bank for the first time declared that gold will remain an important element of their reserves. In 2009 central banks collectively become net purchasers of gold for the first time in two decades with growing purchases by emerging market countries (Bor90). Yet many countries had still chosen to intervene in the foreign exchange market and with the increase in exchange rate volatility, countries felt it is inevitable to hold more foreign exchange reserves including a sizable part of it in gold. On the contrary, it was widely perceived that a higher level of reserves will enhance the credibility of the central bank's exchange rate policy, at least among emerging market economies (EMEs). Experiences across countries also revealed that flexible exchange rates based on discretionary paper money standards showed high short-term variability and also medium-term swings around purchasing power parities with diversions of up to 30 per cent and lasting from five to twelve years. As a result, foreign exchange reserves with the central banks, irrespective of fixed or flexible exchange rate regime is considered as necessary.

Gold is an essential part of foreign reserves, partly because of historical reasons and partly due to its ‘universal acceptance’ and ‘international liquidity character'. Gold, therefore, remains important as central bank reserve, as a hedge against risks, and as a barometer of geopolitical uncertainty.

Central banks hold reserves for the following key reasons which are interlinked.

•The most important reason being it facilitates to intervene in the forex market to ensure orderliness. It helps in meeting transaction purposes, such as to finance foreseeable foreign-exchange demands of the economy.

•However, the more important aspect, in the case of emerging economies, has been that it acts as bedrock of investors' confidence in the country's ability to meet its foreign exchange commitments.

•A quick survey of the literature reveals that the major reserve management objectives of central banks, in general, are put in the order of their importance, viz., safety, liquidity and return. The blend and ordering of these interrelated objectives will, however, depend on country-specific factors, such as the country's exchange rate regime, its creditworthiness and its degree of vulnerability to external shocks as well as the range of domestic instruments available for monetary operations.

The above objectives can be seen as a safety net against financial shocks and sudden stops in access to international capital markets. Previous international financial crises have shown that holding and managing sufficient reserves of foreign currency, and disclosing adequate information on them to markets, helps a country prevent and weather external crises.

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It is clear from the above that one of the key objectives of reserve management stresses the precautionary/ insurance function of holding of the foreign exchange reserves, at times of emergency. The role of forex reserves as ‘defence’ against potential financial crisis has been considered an ‘overwhelming function’. The forex reserves can be more effective in providing such ‘insurance’ if their value is highest precisely when the probability of an occurring crisis environment is highest (Claudio et al., 2008). Experience reveals holding adequate forex reserves reduce the chances of occurring external crisis and certainly help to reduce the cost of managing such an event if it occurs. From EMEs’ perspective such as India, official reserves have to reflect the potential market infirmities in the private sector that are needed as a cushion when markets get suddenly risk-averse and hence, safety and liquidity should normally have higher orders of priority in the management of reserves. Also, greater liquidity that reserves provide presumably reduces the likelihood of financial crises, and may also reduce the cost of foreign borrowing in normal times. It is in these contexts, gold is an asset of “safe haven”, and its value tends to appreciate at times of stress and hence becomes critical to be part of reserves. Gold occupies a special position in the foreign reserves of central banks as it is widely stated to be held for reasons of diversification. Unlike any currency, its value is not greatly affected by particular country’s economic policies including one of those having huge official reserves of gold. Interestingly, gold still remains the most generally acceptable means of international settlement, and therefore it is still a convenient, useful, and necessary part of the reserves of central banks and monetary authorities. Gold still represents the ultimate form of payment in the world...’ Besides the above, literature also points out that people, generally, like their country hold sizeable gold reserves. (Karunagaran,2011).

**4-5. Demand for Gold**

According to the US Investor Report, there are two key drivers for the demand of gold; fear and love trade. Of the two demand drivers, fear sees gold as a store of value. Love trade takes place when gold is bought as a gift for dear ones during festivals and special occasions. For the sake of relevance, I will focus on fear trade as in this case demand is driven by the purpose to provide a safe haven for accumulated wealth to store for future use. Fear trade buys out of fear of war or anxiety over government policies; mainly by negative real interest rates where inflation is greater than the nominal interest rate—and deficit spending. (U.S. Global Investors,2010).

An example is the Federal Open Market Committee's announcement on 19th March 2015, that interest rates would not be raised until inflation gains more steam. With inflation rates negative for the first time since 2009, and with the U.S. dollar index at an 11-year high, it was most probable to expect near record low interest rates for some time longer. Along with major stock indices, Gold prices immediately spiked at the news, rising nearly 2 percent, from $1,151 to $1,172.

One of gold's main drivers is the strength of the U.S. dollar. Gold and the U.S. Dollar has a historical inverse relationship. In September 2011, when gold hit its all-time high of $1,921, the dollar index was at a low, low 73. As the dollar broke above 100 on 20th March 2015, gold was under a lot of pressure. However, it was nothing compared to the early 1980s, when gold plunged 65 percent from its peak of $850 per ounce as the U.S. currency began to strengthen. There is opposite effect in the Eurozone as well as other regions around the world. In March 2015 the euro slipped 24 percent and many analysts expected the euro to fall below the dollar for the first time. When priced in this weakening currency, gold climbed to a two-year high.

As already mentioned, one of the strongest drivers of the fear trade in gold is real interest rates. Whenever a country has negative-to-low real rates of return, which means the inflationary rate (CPI) is greater than the current interest rate, gold tends to rise in that country's currency. To illustrate this point, it is worth looking at the U.S. 5-Year Treasury yield and subtracts the consumer price index (CPI) or the inflationary number from it. The result is either a positive or negative real interest rate. When that number is negative, gold tends to be strong. And when it is positive, gold has been weak in the past. In March 2015, real interest rates in the U.S. turned immensely positive, putting additional downward pressure on gold.

| How Real Interest Rates Drive Gold | | | | | |
|---|---|---|---|---|---|
| **5 yr Treasury Yield** | − | Inflation | = | Real Interest Rate | Price of Gold |
| **March 2013** | | | | | |
| **0.88%** | - | 1.50% | = | ↓ -62% | ↑ $1614 |
| **December 2013** | | | | | |
| **1.74%** | - | 1.20% | = | ↑ +0.54 | ↓ $1187 |
| **March 2014** | | | | | |
| **1.53%** | - | 1.60% | = | ↓ -0.07% | ↑ $1350 |
| **March 2015** | | | | | |
| **1.58%** | - | -0.10% | = | ↑ +1.68% | ↓ $1146 |
| **June 2018** | | | | | |
| 1.23 % | - | 1.30% | = | ↑ -0.98% | ↓ $1331 |
| **November 2019** | | | | | |
| 1.05 % | | -1.71 % | = | ↓ -0.81% | ↓ $1511 |

(**Source:** Data from Bloomberg, U.S. Global Investors,2015 )[1]

The yield on a 5-year Treasury bond in March 2013 was 0.88 percent. Take away 1.5 percent inflation, and investors were getting a negative real return of 0.6 percent. This made gold a much more attractive and competitive asset to invest in. March 2013, was the last time we saw gold above $1,600 per ounce. Because inflation has been in the negative territory, returns on the 5-year Treasury are higher than they have been in several quarters. Compared to many other government bonds worldwide, the U.S. 5-year Treasury is actually one of the very few whose yields are positive, which tarnishes gold's appeal somewhat like an investment.

The following oscillator for the 5-year period shows a strong inverse relationship between the 5-year Treasury bond and gold. Each asset class swings when the other one sways, and vice versa. (Holmes,2015).

1.Holmes

## 5.Analysis

### 5-1. Gold in a Changing Economic and Political Environment

Gold has been used as a store of value and form of currency since ancient times. Since the seventeenth century it has been formally traded over the counter in London and by the nineteenth century, it underpinned the largest fixed exchange rate system the world has ever known (the Gold Standard). In contrast to other commodities, gold does not perish or degrade over time, giving it unique properties as a very long-term store of value. Gold mined today is interchangeable with gold mined many hundreds of years ago. The supply of gold has also been relatively fixed for the last century, with annual mine production a small share of the total stock of gold outstanding and with a limited ability for annual production to rise in response to changes in the gold price. As a result, gold prices lack the strong link to the economic cycle that other commodities have and gold has thus often exhibited low or even negative correlations with these and other financial assets.

Gold is also unusual among financial assets in not delivering a yield, e.g. these factors give gold an unusual set of behavioural characteristics compared to other financial assets. Despite many different institutional settings (such as the Gold Standard, the Bretton Woods system and from 1971 a free-floating price for gold) and the migration of gold from use as an everyday currency to an investment vehicle, the long run purchasing power of gold has remained remarkably stable over time. In the 1830s, the price of gold in 2010 dollars was around US$450 per troy ounce, with the real terms price much the same in 2005, more than a century and a half later. The tendency for gold to hold its real terms value over long periods has often led to gold being described as an „inflation hedge". However, the reality is more complex as the gold price does not simply move in line with the general price level but rather exhibits long periods where it moves without any apparent link to inflation trends. At the beginning of 1980 the price of gold rises to 850 U.S. dollars (2,100 US dollars adjusted for inflation) for the first time. Rising oil prices and the associated high inflation, the Soviet invasion of Afghanistan and the revolution in Iran are driving investors worldwide to the "safe harbour" Gold. As a result, the U.S, greatly reduce inflation. In a long-term phase of economic growth, the gold price dropped. Speculation about a reduction of the gold reserves of the Central Banks reduces the gold price to 251.70 US dollars in August 1999. Only two months later 15 European central banks agree to limit the purchase of gold. The result: the gold price rises to a two-year high of 338 US-dollars. (Doll,2015) In the early 1980s the real price of gold leapt to over three times its very long-run average, while the 1990s saw a lengthy bear market which saw the gold price fall well below its long-term average.

The weak dollar, rising oil prices and the nuclear conflict with Iran drove the gold price to 730 US-dollars in 2006. This is the highest level for 26 years. In June the same year, market profits pushed the gold price down to 543 US Dollars. In September 2008, the collapse of the US investment bank Lehman Brothers changed global finance - and gives the gold highest price jump within a day in history. On the 17th September 2008, the gold rose by to $90 within 24 hours.

In the wake of the global financial crisis in February 2009, the price of gold reached unprecedented levels. In February 2009 the gold price reached over 1,000 U.S. dollars. This was the result of drastic losses on the international stock markets and the risk of a global recession. Gold loses some ground at the end of 2009 further ground. However, speculation about an extension of the gold reserves by central banks ensures that the gold price escalates to levels to and above 1,200 US-dollar. By 2010 the gold price escalates from record to another. In particular, the fear of an expansion of the European debt crisis drives the precious metal. Investor demand in that year brought a massive plus of almost 30 percent for gold. At the end of the year, the price of gold soars to over 1,400 dollars due to the federal bonds purchasing program. The gold price accelerated in August 2011. Global collapsing stock prices strengthen investors' flight to safety. Within a few weeks, the gold price rose strongly and rose to 1912 dollars. An increase to $2,000 was seen as axiomatic by most experts, instead, a slump followed.

In June 2013, the speculation on a declining influx of cheap money from the Federal Reserve System negatively affects the precious metals. The price of gold heads to 1200 dollars per troy ounce and threatens the largest quarterly loss since the collapse of the Bretton Woods monetary system in the early 1970s. In December 2013, gold suffers its first yearly loss in 13 years. The price of the precious metal drops by 28 per cent and falls on to 1201 dollar. Analysts remain sceptical and predict further losses. Goldman Sachs calculates the gold price to drop to 1050 dollar at the end of 2014. According to Morgan Stanley, the gold price would average to 1313 dollar per ounce price in the year 2014 on average - and thus lower than the 2013 price forecast of 1420 dollar an ounce. Reason for this adjustment is Federal Reserve's monetary policy; investors fear that cancelling the bond purchases is just a temporary act and not waived. This would, therefore, hinder any price progression for gold. The gold price can gain some momentum in the first two months of 2014. It rises from the beginning of January to the end of February by ten per cent to 1330 dollar. Especially the rising demand for the stock exchange-acted index in gold funds, which acquire the precious metal physically, leads to the price rise. The gold price once again notes a 200-day line. To technically oriented investors this is considered as an important signal to a change of trend.

As the conflict between Russia and Ukraine threatens to escalate in March, investors once again looked the safe haven gold. In March 2014, the gold price rose up to 1383 dollars. From then onwards it however permanently went downward. At the end of May, the price for an ounce gold was 1294 dollar, slightly under the price at the end of February.

At the beginning of 2015, the gold price rose to 1,300 dollars. But the US economy is thriving and investors anticipate an imminent increase in interest rates. That would strengthen the dollar and the gold price would be hampered. Accordingly, the gold price made a dive downhill since January and ended 1,190 dollars in March.

The gold price is very much considered a crisis barometer. This barometer surprisingly signalled no dramatic crises in July 2005, neither a threatening decay of the euro-zone nor the increasing risk of a hard impact of the Chinese national economy. This was rather disappointing for speculative investors, who bought gold, in order to sell it rapidly with profit. Substantial sales of by Chinese investors caused a slide to the gold price. The price for the precious metal fell over up to four per cent to 1088.05 dollars. There was also fear that the Greek central bank would sell their gold reserves. This is however very unlikely as Greek gold reserve would cover about one percent of their debt. Besides the gold would be irreparably lost after a sale and would be needed for a new currency after a Grexit. (Doll,2015)

The plunging gold price in July 2015 has slashed margins for miners around the world, making 10 per cent of production now uneconomical. Overnight gold dropped to its lowest point in five years, marking the tenth straight day of losses and the worst period of depreciation since 1996. The fall of the gold price despite crisis at various fronts has prompted many analysts to state that the metal has lost its lustre (Doll, 2015). Even though the gold price stands above post-1971 real terms average, these developments caution investors against assuming a rapid reversal in the price. Moreover, gold prices were above their post-1971 real terms average for almost all the 1978-1990 period, while in the current bull market prices have only been clearly above this level since 2007. It is also possible that while gold's real price eventually falls back this takes place not by a fall in the nominal gold price but by a substantial rise in the general price level, that is that the current price proves an accurate warning of high inflation down the road. The strong performance of gold during the inflationary 1970s and early 1980s confirms its potential value in periods of rapid price rises. Moreover, the gold price was fixed for the majority of both periods due to the operation of the Gold Standard.

**5-2. Gold and Exchange Rates**

Demand for gold is likely to rise as the world heads towards a multi-currency reserve system under the impact of uncertainty about the stability of the dollar and the euro, the main official assets held by central banks and sovereign funds. This is the conclusion of a wide-ranging analysis of the world monetary system by Official Monetary and Financial Institutions Forum, (OMFIF), in a report commissioned by the World Gold Council, the gold industry's market development body. Investors in emerging market assets can use gold to reduce the risks associated with exchange-rate volatility and benefit from significant cost efficiencies, according to a new report from the World Gold Council. Exchange-rate risk is a serious and increasingly relevant issue as investors in the US and other developed economies look beyond their domestic markets to diversify their portfolios and pursue opportunities for greater returns.

Given the significant changes in the global economic landscape over the past decade, the conventional wisdom about exchange-rate hedging has evolved. The robust growth in emerging markets and aggressive monetary policies in developed markets have resulted in expanded interest-rate differentials and, consequently, increased traditional exchange-rate hedging costs. Given the current trade-off between the costs of hedging and its benefits, many investors opt to leave their allocations un-hedged, exposing their portfolios to significant downside risks. (World Gold Council,2013)

**5-3. Gold and Inflation**

The link between gold and inflation has to some extent obscured structural changes in the gold market. For much of the 19th century, the gold standard kept the nominal price of gold fixed for extended periods. After World War II, the Bretton Woods exchange rate system also retained a gold link to the value of the US dollar, which again meant that gold prices were not free to react to the interplay of supply and demand. Notably, the average real price of gold since 1971 is much higher than it was in the preceding 150 years (around US$650 in 2010 prices versus US$475) which strongly indicates a major structural change in the market over the last forty years. The gold price increased steadily since the beginning of the 2000s. Experts were of the opinion that the increased consumption was linked to the growing debt burden of the United States and the weakening of the US dollar against other currencies. The invasion of the US troops in Iraq in February 2003 and the associated fear of a conflagration in that region drove gold to the highest level since four-and-a-half years: 388.50 Dollars. In the following two years, the gold price marked up between 400 and 500 US-Dollars.

When inflation is greater than the nominal interest rate gold tends to rise in that country’s currency. In the U.S., with the second round of quantitative easing in 2010, or QE2, in full force, an extended period of negative real interest rates was predicted to last through 2011. The Federal Reserve was acutely aware increasing interest rates would hinder America’s economic recovery. Given the elevated number of home foreclosures and high unemployment in 2010, the Federal Reserve did not want to risk a relapse by raising interest rates too soon (U.S. Global Investors,2010). It was of no surprise that gold reached a record of 2000 USD in August 2011.

Factors that cause inflation and how this affects the gold price is listed below:

- Money printing has caused inflation;
- Inflation has increased the cost of mining;
- Price of gold will rise considerably once people realise how money printing has increased inflation;
- The dollar will increasingly lose value;

- Fiscal policy will not take place as taxing the middle class is out of the question and raised tax on the rich would make them take money out of the country and or employ fewer people. All these would mean less tax and make fiscal policy fruitless.
- However, inflation can be seen as a tax on the money as the value of wages decreases.
- In the long run, people would opt more for hard assets such as gold as a safe way to store wealth.

It is clear from the above that one of the key objectives of reserve management stresses the precautionary/ insurance function of holding of the foreign exchange reserves, at times of emergency. The role of forex reserves as 'defence' against potential financial crisis has been considered an 'overwhelming function' among the EMEs, especially in the post-Asian currency crisis scenario. The forex reserves can be more effective in providing such 'insurance' if their value is highest precisely when the probability of occurring a crisis environment is highest. From EMEs' perspective such as India, official reserves have to reflect the potential market infirmities in the private sector that are needed as a cushion when markets get suddenly risk- averse and hence, safety and liquidity should normally have higher orders of priority in the management of reserves. It is in these contexts, gold is an asset of "safe haven", and its value tends to appreciate at times of stress and hence becomes critical to be part of reserves. Gold occupies a special position in the foreign reserves of central banks as it is widely stated to be held for reasons of diversification. Unlike any currency, its value is not greatly affected by particular country's economic policies including one of those having huge official reserves of gold. Interestingly, gold still remains the most generally acceptable means of international settlement, and therefore it is still a convenient, useful, and necessary part of the reserves of central banks and monetary authorities. Besides the above, literature also points out that people, generally, like their country hold sizeable gold reserves (Karunagaran,2011).

Uncertainty of the major reserve currencies, (*viz.*, the dollar and euro) spurred central banks, including India and China, to buy gold. The Reserve Bank had stated that gold was bought with the intent to diversify its foreign exchange reserve, which is not uncommon among the central banks (Karunagaran,2011).

Another factor that can influence gold prices, and to some extent is related to inflation, is the level of real interest rates. As gold lacks a yield of its own, the opportunity cost of holding gold increases with a real interest rate increase and decreases with a fall in real interest rates. Periods of negative real interest rates ought to be especially positive for gold, and this contention is supported by studying the 1970s when real interest rates were substantially negative for lengthy periods. More recently, short-term rates near zero combined with modest inflation (and inflation expectations) have also implied mildly negative real rates and may have supported the demand for gold. It is probably no coincidence that in the wake of radical rate hikes by central banks in this period, gold declined from its 1980 peak level with some funds diverted into other assets like cash and government bonds.
However, a falling dollar increases the purchasing power of non-dollar area countries (and a rising dollar reduces it) driving up prices of commodities including gold (or driving them down in case of a stronger dollar. In periods of dollar weakness, investors look for an alternative store of value, driving up gold prices. The weakness of the dollar in the late 1970s was associated with rising gold prices, as was substantial dollar weakening that began in 2002 (Karunagaran,2011).

**5-4. China Factor**

China has grown vastly since the beginning of the reform of 1970s. Economists generally attribute China’s economic growth to two major sources, large scale capital investment and rapid productivity. Historically, China has maintained a high rate of savings which has made China the largest lender of the global network. On the other hand, more production was due to the allocation of resources for more productive sections (Asgarkani, Ghahramani, Ghaderi Hajat,2019:213) and this all happened after economic alterations in the country and adopting economic- oriented strategies (Pournajafi, Shariati,2015:159). This was then followed by the coordination and combination of nationalism, Chinese Marxism and Chinese production method which eventually led to the growth of the country (Ghaffari, Shariati,2011:89). Accordingly, Farid Zakaria describes China as the largest country with the fastest economic growth, the world’s biggest industrial producer, the world’s second-biggest consumer, the world’s biggest-saver, the world’s second-biggest military spender and the world’s second- biggest spender (Rasooli Saniabadi,2019:196). In fact, there has been much consternation (particularly in the United States) about China’s use of geoeconomic strategies, meaning the “use of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results.” Commentators have accused of China employing “debt-trap diplomacy” to gain control over strategic infrastructure abroad as part of its Belt and Road Initiative; using informal sanctions to coerce its neighbours; and establishing parallel international institutions, like the Asian Infrastructure Investment Bank, to undermine existing alternatives. Whether or not these concerns about China are justified or overstated, it is important to note that geo-economic strategies are not new, nor is their use one-sided. The United States has long used geo-economic strategies, such as international institution-building and employing positive and negative economic sanctions, to achieve its national interests (Roberts, Moraes, Ferguson,2018). Hence, China’s geo-economics strategies in the world’s economy are another key contributing factor to the gold price. Since the importance of China’s economy has been rising, the country’s role in gold price is undeniable. Accordingly, the tensions between China and the U.S. and the likelihood of deals have had impacts on the gold prices. According to Reuters, gold prices increased due to the fear of escalating U.S. - China tensions. “There seems to be some risk-off sentiment in the market... We’ve now seen prices move up on the back of concerns around (U.S.-China) trade and we think that will continue to underpin a strong performance in gold,” said Capital Economics analyst Ross Strachan (Soreng,2019).

Additionally, the rivalry between Yuan and dollar can have impacts on gold prices too. China’s leaders talk of the Yuan’s internationalisation in peaceful terms. A more diverse monetary system will breed financial stability for the world, they say. But China’s rise poses a bigger threat to America. In fact, China is a possible adversary, governed by an autocratic regime with a statist approach to the economy (The Economist,2015). In this way, many analysts believe that China’s rise is worrisome and hold that China’s economic, and consequently political, moves threaten the United States interests, but they disagree on how to manage or control the threat. Some analysts analyze the issue from the perspective of the Chinese authorities or from their own perspective. From the perspective of this group, the Chinese officials and leaders see the world Government- centred and competitive, in which power plays a fundamental role. Accordingly, they are determined to use every tool for the development of power and degrade the position of the United States (Pashapoor,2018:197). Thus, America has good reason to worry about the Yuan. Its emergence as a credible alternative to the dollar would undermine a cornerstone of American power. Some in China even take a darker view of how competition between the Yuan and the dollar will play out. Song Hongbing, the author of “Currency Wars”, a conspiracy-laced series of books, foresees America fighting the Yuan every step of the way (The Economist,2015). Hence, it can be said that currency rivalries can influence the value of gold. In fact, the weaker the dollar is, the more expensive the gold get. Thus, these unstable currencies might increase the price of gold, since investors easily become uncertain about the value of currencies and try to invest in gold.

## 6.Conclusion

The importance of gold in the international economy is undeniable. Gold prepares wealth and assures authority. Historically, Great Britain was the first to adopt the gold standard to stabilize the global economy. In fact, the gold standard system ensured price stability and reduced the level of hyperinflation. However, the system was not constantly used by countries due to wars, conflicts, the system itself and the economic problems. Afterwards, in 1944, the Bretton Woods conference set the basis of the post-war monetary system which was an attempt to strike a balance between a liberal world market and the domestic responsibilities of states. Nonetheless, the lack of a balance of payments mechanisms and the dominance of the U.S. dollar led to falling apart. Afterwards, the Central Bank for the first time declared that gold will remain an important element of their reserves to use in case of shocks or crises. Accordingly, various economic and political turbulences can influence the gold price and as mentioned previously, the gold price has experienced a period of volatility since 1830 due to these causes. Considering the economic reasons, consumer demand for both, investment or trade can be a critical reason. In fact, people tend to purchase gold to protect them from uncertainty. Secondly, inflation is another key cause of price change of gold. As a matter of fact, when inflation rises, the value of the currency goes down and therefore investors tend to hold money in the form of gold. Thus, in inflationary conditions, when inflation remains high, gold becomes an inflation hedge. This increases the price of gold in the inflationary period. Another cause is the weak dollar factor. To be precise, any weakness in the dollar pushes up gold prices and increases the value of gold given that investors seek other currencies to invest.

Apart from economic factors, political turbulence can have impacts on the price of gold. For instance, nuclear conflict with Iran, rising oil prices, Russia and Ukraine conflicts as well as China's role can alter the economic and political relationships among countries, leading to changes in gold prices. Thus, it is safe to say that all factors influence the value of gold, and these factors are not only international actors such as investors, governments but also their policies and currency strategies. This eventually makes it difficult to predict the value of gold and make us believe that the price of gold is dependent on the strategies of policymakers and investors along with political and economic conditions.

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