Money and Gold

MAY 16, 2022

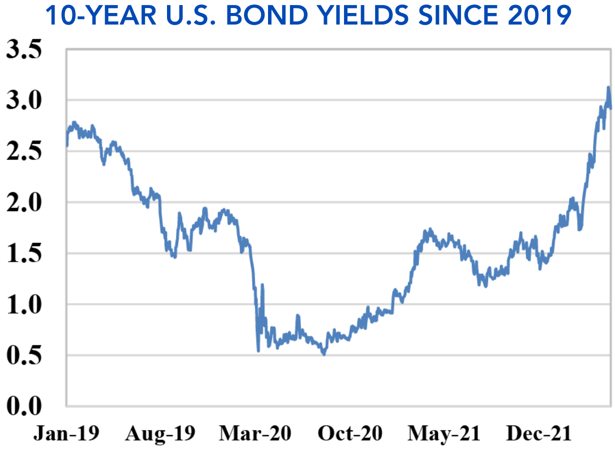
Gold prices have fallen sharply over the past four weeks from around $2,002 on an intraday spike on April 18th, to as low as $1,785 on May 16th. Gold fell further and sooner than CPM had expected. Of course, gold was in good company as U.S. equities have also dropped back to levels they have not visited since the first quarter of 2021, while bond prices across the board have sunk. Silver was in with this broad mix of financial assets that dropped sharply in the first two weeks of May. Let's take a look at what's causing these declines and what to expect.

WHY GOLD AND SILVER PRICES HAVE DECLINED

INTEREST RATE HIKES BY THE FEDERAL RESERVE BANK

These declines have all had the same origin. The independent variable driving asset prices sharply lower has been the much more forceful anti-inflation stance and actions by the U.S. Federal Reserve Board. The Fed's Open Market Committee raised the fed fund's rate 0.50% on May 3rd, the largest increase since 2002. It also signaled further large increases if inflation rates do not show signs of moderating and announced the imminent start of its long-promised and anticipated unwinding of the massive bond portfolio on its balance sheet.

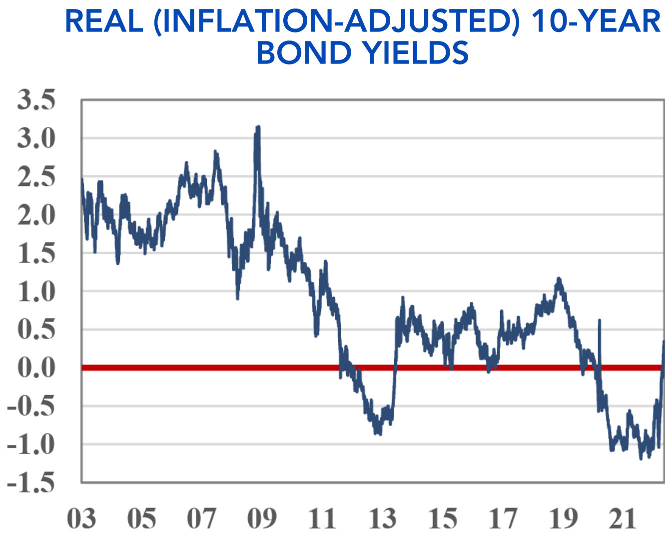
INCREASE IN U.S. TREASURY INTEREST RATES



While the course of the Russian invasion of Ukraine has been a factor, the main drivers have been the increase in U.S. Treasury interest rates, market expectations of further increases to fight inflation, and market concerns that the Fed's aggressive tightening could push the U.S., if not the world, into a recession.

The -1.4% contraction in U.S. real gross domestic product in the first quarter accentuated these concerns. The chart above showing 10-Year Treasuries since January 2019 drives home the market concerns about rising interest rates: In just a few months interest rates have risen past where they stood in January 2019, pre-pandemic. However, contrasting that to the longer term view of 10-year Treasuries, one sees that even in the face of May's increase in 10-Year Treasury interest rates, they remain far below rates prior to 2012, and far below levels likely to throw the U.S. economy into a recession.

Other factors could trigger a recession, including the effects of the Russian invasion of Ukraine, but it does not seem likely that the Fed would be the culprit should a recession arrive in 2022 or 2023. Adding to this view is the fact that inflation-adjusted interest rates have only now crossed into positive territory for the 10-Year rates and remain deep in negative territory for shorter-term interest rates.

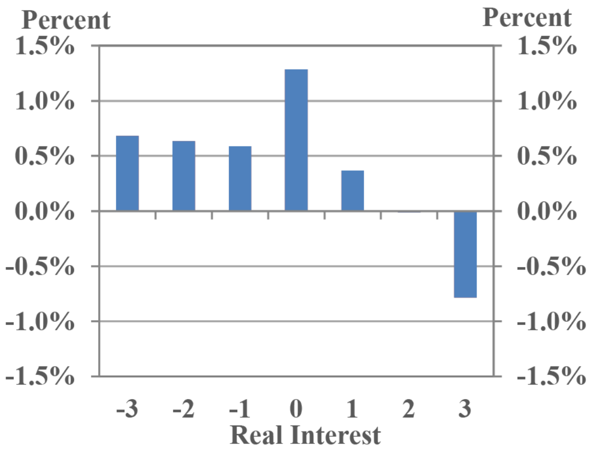


A RECESSION IN THE HORIZON?

For these and other reasons, CPM feels that the concerns in financial markets, that a recession is imminent, are misplaced, although we do believe that a recession could occur down the road in 2024-2025.

Our expectation is that market confidence in the Fed's ability to manage an anti-inflation campaign that does not derail economic growth will increase over the coming months. Meanwhile inflation already is showing signs of peaking, which previous reports explained as primarily arithmetic based on the fact that 2022 inflation rates will be measured off of already high 2021 price levels. Price levels may not fall, but the rate of increase in prices is likely to decline over the next several months.

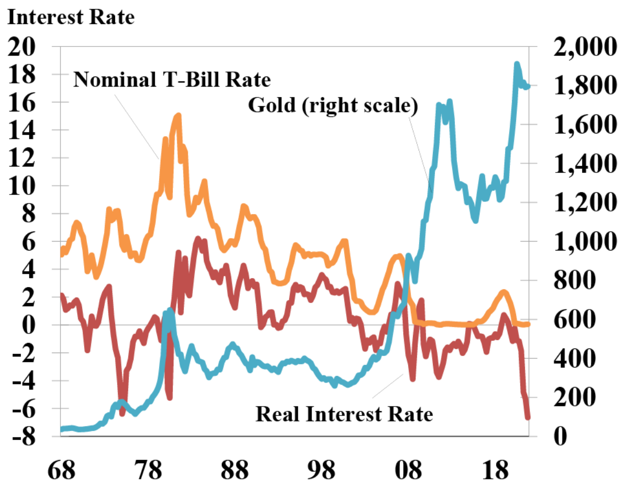
GOLD RETURNS IN DIFFERENT REAL INTEREST RATE ENVIRONMENTS



While CPM expects the Federal Reserve Bank to manage not throwing the United States into a recession later this year or in the near future, we do see signs of a recession on the horizon. There remains a great deal of slack in the U.S. economy and world economies. With that said, our expectation is that a recession may be held off until 2024 or 2025.

Capacity utilization, labor market trends, housing and non-residential construction, room for business inventory expansion, easing of supply/delivery delays and obstructions, continuing construction. and other expansionary effects of the fiscal largess of the past several years all suggests to CPM that a recession may not be imminent, though something that could happen in 2 or 3 years.

REAL AND NOMINAL T-BILL RATES AND GOLD PRICES



In this environment, gold and silver may not rise, but they may not fall significantly further as they move into the seasonally weak summer months.