

14th June 2005

Gold–Euro Correlation: The End of a Beautiful Friendship?

Global Commodities

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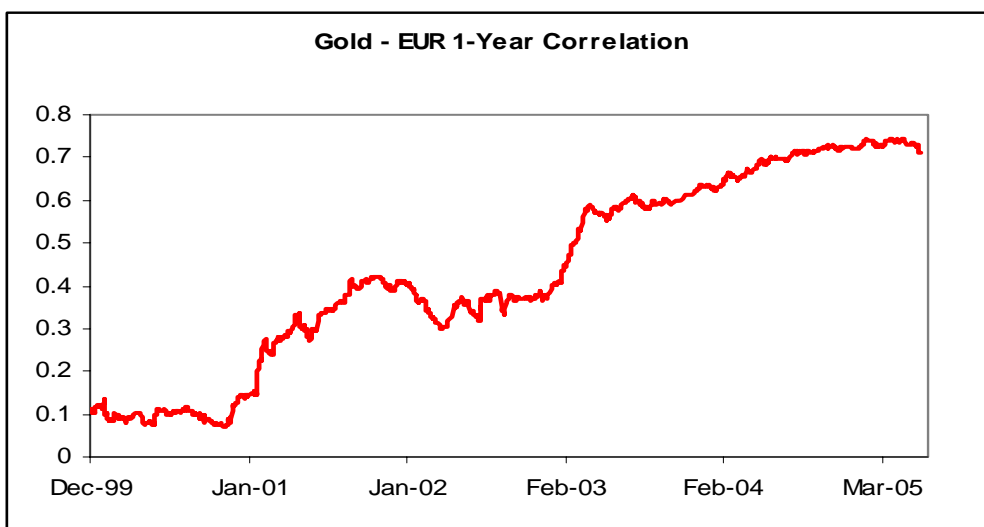
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For the past five years, the correlation between movements in the gold price and the Euro has been increasing. As can be seen from the graph below, the relationship between the two has been particularly strong since 2003, when gold rose to \$400 and fully regained the monetised status it had enjoyed until the mid-1990s.

The main reason for the high correlation has been the shared perception of gold and the Euro as alternative investments to US\$. During this period the major currencies, including gold, have tended to react in concert to economic news from the USA. Gold, with neither an underlying economy, nor price-sensitive supply and demand issues, is the purest of the “currencies” and its fortunes have been a mirror image of the dollar’s. Similarly, the Euro has been seen by many as the natural first choice alternative currency to US\$, and has benefited from recent US\$ weakness caused primarily by the USA’s dual deficits growing to record levels.

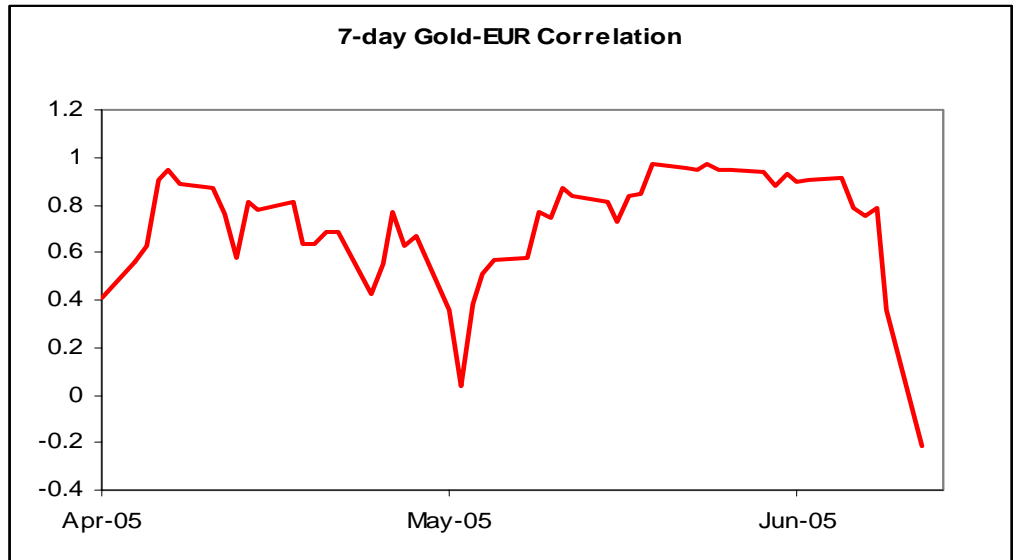


However, in the past few days, the close relationship between gold and the Euro has begun to break down. Both on Friday and Monday, they moved in opposite directions as political turmoil, a sluggish economy and long-term structural problems took their toll on the European currency at the same time as positive trade data from the USA boosted the dollar.

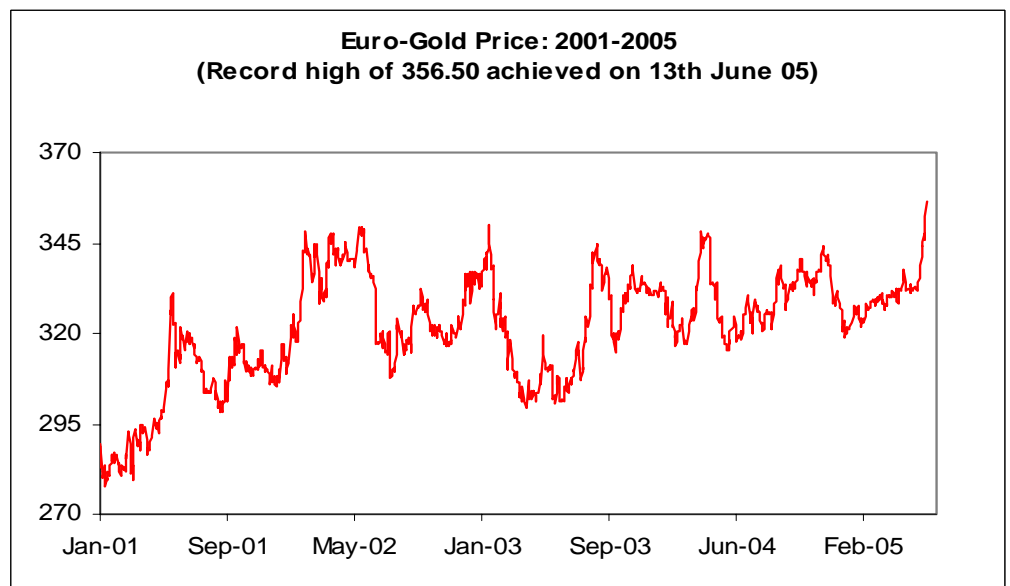
The surprising aspect of market behaviour over this period has been that the US\$ gold price has **risen**, despite the general dollar strength. On Friday morning, gold was trading at around \$423 and on Monday it posted a 5-week high price above \$430. Historically, gold and the US\$ are highly negatively correlated and so in these circumstances gold would have been expected to weaken.

That it did **not** weaken indicates that gold is benefiting from the Euro’s fall from favour. The choice of an alternative currency to the US dollar has been described as a beauty contest of ugly sisters. The major currencies, primarily the Yen and the Euro, have had their problems in

recent years. With the French and Dutch rejections of the EU Constitution, confusion over the future direction of the Union and deep dissatisfaction amongst a number of key member states, gold has suddenly started to look a lot more beautiful.



It is too early to say whether the decoupling of gold from the Euro will be a long-term phenomenon. However, the fact that in recent days gold has avoided being tarred with the Euro brush bodes well for its longer-term outlook.



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