

Smart money is on gold as inflation threat increases

ECONOMIC policies are raising the chances of rapid inflation. The annual production of gold, the traditional hedge, is far below the world's rate of monetary growth. An inflationary panic could thus bring an explosive gold price rise.

Gold has little intrinsic value. However, it is regarded as an inflation hedge and store of value, and that psychological association becomes tighter as inflation worsens and the gold price rises. Arguments about the irrationality of gold investment are wrong: in an inflation-prone environment, the belief in gold becomes self-reinforcing.

Meanwhile, alternative safe-haven stores of value, such as foreign currencies and US Treasuries, are falling away.

In the stagflationary

conditions of 1980, gold peaked at \$875, or the equivalent of \$2,300 today. However, the rise to inflation levels then was gradual. Current monetary and fiscal policies increase the threat that if inflation returns, it will do so violently.

Smart investors are hedging against this possibility through gold. Hedge fund tycoon John Paulson paid \$1.3bn for 11pc of AngloGold Ashanti. The company is unprofitable at present but would hugely benefit from a gold price rise. Should other hedge funds turn to gold, its price could soar.

The ongoing US Treasury bond bubble is driven by desire for a safe haven. When it collapses, a gold bubble fuelled by inflationary concerns may be inevitable.

Martin Hutchinson