Gold Prices

The price of gold has declined through most of 1997, dipping below $300 per ounce in early December. While industrial and jewelry demand remains high, central bank sales more than offset it. The strength of the dollar is increasing fears that still more gold will leave central bank vaults as foreign countries demand more U.S. currency. Strong stock markets, by providing a very attractive alternative asset, have also reduced the private demand for gold. Financial turmoil in Asia may eventually enhance gold’s attraction, but the effects are not yet apparent.

In a related market, the option on gold futures with a strike price of 310 and an expiration date of November 14, 1997, plummeted to only $10 just before expiration. As the option moved from in the money (spot price of gold above $310) to out of the money (spot price below $310), it became worth less. The chances of gold rebounding decreased as the expiration date approached, and the option lost even more value.

Gold prices have no discernible relationship to the Consumer Price Index (CPI), which has climbed steadily throughout a decade of gold price gyrations. A somewhat closer relationship exists between gold prices and the inflation rate (the rate of change in the CPI). There is a lot of noise in this relationship, but it does seem to capture big moves; both measures decreased sharply in the early 1980s. A scatter plot shows this positive relationship more clearly. Statistically, gold prices can explain about 30% of the variation in CPI inflation since 1980.