Gold

For those who think it is the “only real money” as well as those who, with Lord Keynes, consider it a “barbarous relic,” gold retains its fascination. Over the past decade, however, it has been a poor investment because its dollar price has generally declined. Much of this decline can be traced to concerns over gold’s future role in the world monetary system. Central banks hold over one-fourth of the total gold supply, so their actions—and rumors about their actions—have a significant effect on gold prices.

One way to gauge expectations about price movements is to look at the futures market, but this is less true for gold than for most other commodities. Gold, with a large supply and low storage costs, is often a “full-carry market,” with the futures price tied to the spot price by the cost of borrowing money and carrying the gold forward. Thus, with a few exceptions, the basis (the difference between the spot and futures price) responds more to interest rates than to gold conditions.

The options market, which is particularly sensitive to changes in risk, may provide more information. The option to buy a December 2000 gold futures contract became more valuable in late September 1999 when European central banks announced they would limit gold sales. This not only increased the price of gold but also resolved uncertainty, pushing the call price higher.