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WORLD GOLD COUNCIL

GEOPOLITICAL UPHEAVAL EMPHASISES GOLD'S VITAL ROLE

Gold's deep and liquid market makes it important for institutional investors during periods of increased risk, writes Shaokai Fan, global head of central banks, World Gold Council.

"THE PRICE OF GOLD CAN RISE IN THE LEAD UP TO EVENTS AT A TIME WHEN OTHER ASSET CLASSES HAVE YET TO REFLECT GEOPOLITICAL CONCERNS.

AS Russian troops entered Ukraine on 24 February 2022, the gold price surged to an intraday high of $1,974 per ounce. In the weeks that followed, as global risk assets retreated in the face of heightened geopolitical risks, gold went on to gain a further 8.75% to trade within a whisker of its record high at $2,075.

Geopolitical events in isolation are neither the only nor the main reason why investors should own gold. But, given gold's broad contribution to returns, diversification, liquidity and its positive portfolio impact, these events represent a clear example of why gold can be such an effective and well-established hedge against market risks.

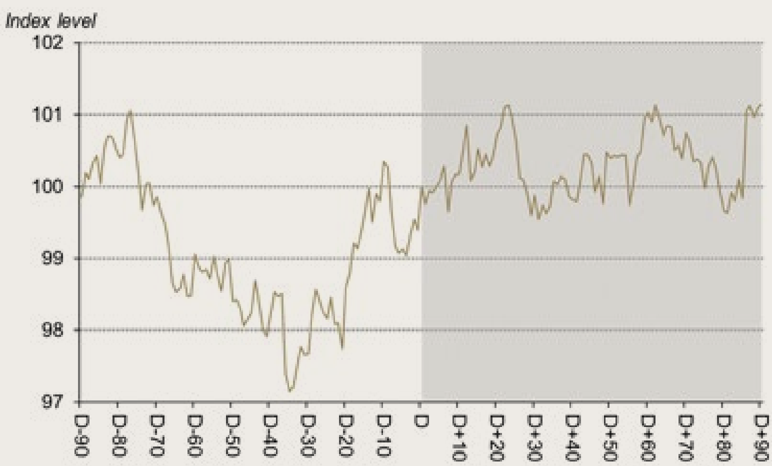
Analysis suggests that gold has reacted positively to tail events linked to geopolitics and, despite price volatility, tended to keep those gains in the following months. In addition, as gold is particularly sensitive to geopolitical risks, the price of gold can rise in the lead up to events at a time when other asset classes have yet to reflect geopolitical concerns (Figure 1). This was the case in early February when tensions between Nato and Russia were rising but not yet at the forefront of the market's attention.

Our gold return attribution model offers some insights. While there is evidence that safe haven flows contributed to gold's rise in February, the full extent of its impact could not be captured. Instead, the unexplained component of our model captured geopolitical concerns that weren't fully reflected in other variables such as the dollar, volatility or oil, which normally react strongly in times of geopolitical instability. This suggests that gold prices are much more sensitive to geopolitical risks than other asset classes and can offer portfolio protection ahead of potential risk events.

Gold also trades in a deep and highly liquid market, with collective volumes surpassing $120bn a day and tight bid-ask spreads. The market's scale and depth mean that it can comfortably accommodate large, buy-and-hold institutional investors. In stark contrast to many financial markets, gold's liquidity does not dry up, even at times of financial stress, making it a much less volatile asset. Combined with the fact that bullion carries no credit risk, these factors make gold a sought after safe haven asset.

Amid today's increasingly precarious market environment, gold's portfolio role has never been clearer. This sentiment is evident among central banks. According to the 2022 Central Bank Gold Reserve Survey, 25% of central bank respondents now intend to increase their gold reserves over the next 12 months, the highest proportion since the start of the survey in 2019. In the face of rising inflation and geopolitical instability, central bank gold demand is likely to remain robust and a pillar of support for overall gold demand.•

1. AVERAGE GOLD PERFORMANCE BEFORE AND AFTER VARIOUS GEOPOLITICAL EVENTS*



The gold price is indexed at 100 at the start of the event, denoted by 'D'. Geopolitical events include: Start of Yom Kippur War (6 Oct 1973), Iranian Revolution: Commencement of Shah's Exile (16 Jan 1979), Iran-Iraq War (22 Sept 1980), Chernobyl nucelar disaster (26 Apr 1986), Iraqi invasion of Kuwait (2 Aug 1990), Operation Desert Storm (17 Jan 1991), World Trade Center bombing (26 Feb 1993), Oklahoma City bombing (19 Apr 1995), September 11 attacks (11 Sept 2001), US Iraq invasion (20 Mar 2003), Fukushima nuclear disaster (11 Mar 2011).

Source: Bloomberg, ICE Benchmark Administration, World Gold Council