

## **Double Dip Recession – a boon for Gold**

By Chris Gan, Sept 15, 2010

The view that the global economy is heading for a double dip recession is fast gathering momentum. Nouriel Roubini, the professional economist credited with predicting the subprime crisis in 2008 is one of the main proponents of this view. He says that we are in for a rough ride, as the impact of massive fiscal and monetary stimulus by governments especially in developed countries, since the 2008/09 recession wanes. Recent developments in the US suggest that there are hints of this happening. And, this will likely be a boon for gold, which is not only regarded as a hedge against inflation, but more so as a hedge against uncertainties and volatility.

### **Threat of double dip recession hangs over investors**

Despite the equity markets rallying this week on the back of renewed optimism of a global economic recovery as seven out of 91 European banks passed their “stress test”, the threat of a double dip recession still hangs over most investors, like Domicile’s sword.

Gold is up 8.6 percent this year and set a record \$1,265.30 an ounce on 21 June 2010 as investors sought to protect their wealth against the European debt crisis and on concern that the global economy may slow. However, demand remains strong as physical demand came in strongly as gold hovered around the \$1200 per ounce levels.

### **U.S and advanced economies may experience subpar growth**

It is argued that developed countries such as U.S and U.K which have been artificially propped up by government stimulus since 2008 / 2009 will face some strong headwinds as the positive impact wanes. And it could well fall back into a deep recession or what is known as a double dip sooner rather than later. This is analogous to like having a heavy dosage of painkillers when your body was under attack as a result of illness, suddenly wears off.

The huge budget deficits and public debt which economies like the U.S have chalked up from its stimulus plans, will lead to a massive deleveraging in the public sector. The Obama administration rolled out close to \$1.6 trillion of different sorts of fiscal initiatives, adding to the country’s public debt which has ballooned to a staggering \$13 trillion. The private sector which is also highly geared especially in the housing and credit sectors has not even started to be weaned off its high dose of easy debt. All this will likely to lead to households having little left for consumption and investments. Hence, growth in the advanced countries will be anaemic and below its long-term trend.

Countries which have spent too much and “lived beyond their means” like U.S, U.K and Greece with the urgent need to deliver will spend less, consume less, and import less moving forward. This will have a massive negative impact on Asia, as its exports will not rebound as strongly as expected as a result. As such emerging economies will also suffer lower growth rates, as its exports will remain weak.

### **Emerging countries like China may not be able to compensate**

Other the other hand, countries with high savings (and high statutory reserves) like: China, Germany and Japan will not be able to compensate for the deleveraging in developed countries by spending more. These countries are already constrained by their own domestic economic and social issues, and have spent massively in their first round of stimulus post the 2008 crisis.

Hence, the recovery of global economies in terms of aggregate demand will remain weak, and overall, lower growth can be expected.

Already 2Q 2010 data is showing signs of a slow down. This will only accelerate in second half of 2010 as the effects of fiscal and monetary stimulus subsides. Incentives like ‘clunkers- -for-cash’ and others would have been used up, while the labour market will continue to be weak as unemployment in the U.S remains high at 0.9%.

Developed countries could be looking at a U-shaped recovery or at worst, prolonged L-shaped recession.

**Summary of Outlook**

US	Eurozone	China	Japan
<ul style="list-style-type: none"> <li>• Below trend 1H2010 growth at 2.7%,</li> <li>• 2H could also be weak with growth dropping to 2.2%. 2011 growth could well be subpar.</li> </ul>	<ul style="list-style-type: none"> <li>• Zero growth due to fiscal austerity measures instituted as a result of sovereign debt crisis,</li> <li>• Weak Euro could help external balance but the benefits could cause damage to export and growth in US, China and emerging Asia</li> </ul>	<ul style="list-style-type: none"> <li>• Signs of slowdown, with overheating in property sector likely,</li> <li>• Slowdown in advanced countries and weaker euro could dent China's growth as exports slow</li> <li>• GDP growth of 11% last year to slow to 7% by year end</li> <li>• Bad news for the rest of Asia and commodity dependant economies like Australia and Canada as China's imports slow.</li> </ul>	<ul style="list-style-type: none"> <li>• Anaemic real income growth.</li> <li>• Domestic demand continue to be weak</li> <li>• Exports to China could slow.</li> <li>• Growth will likely to continue to disappoint.</li> </ul>

Although slower growth in U.S, China, Japan and Eurozone may not necessary lead to a massive global contraction, but it does puts it in a vulnerable position to being tipped back into a full-fledged recession.

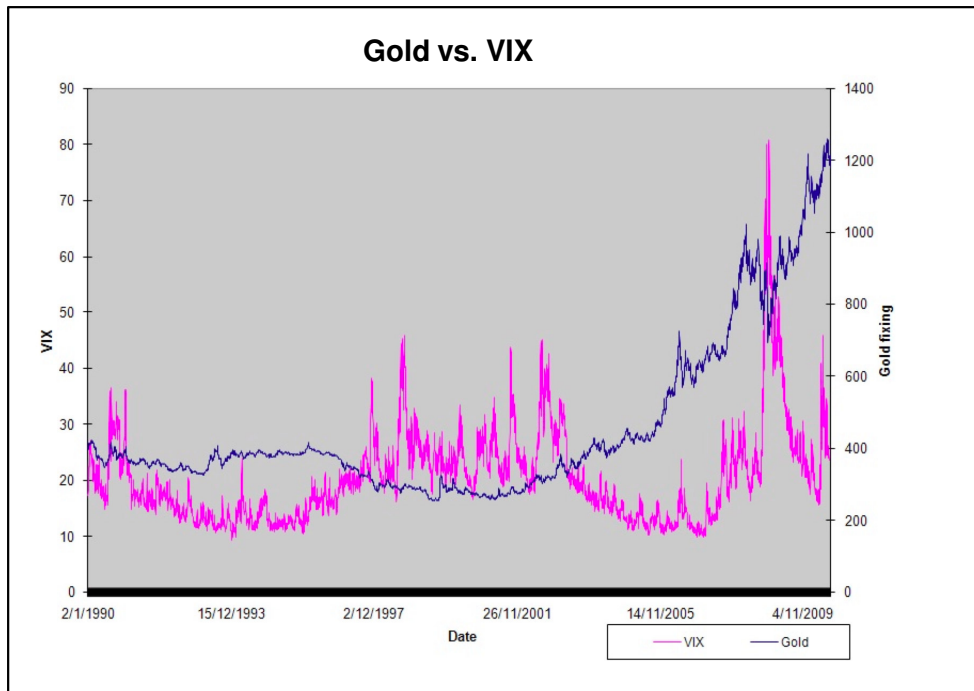
**Potential shocks which could lead to double dip recession**

Eurozone sovereign debt could worsen; a severe asset price correction could lead to increased global risk aversion, volatility and financial contagion. Roubini argues that this vicious cycle of asset price correction, weaker growth could lead to further price declines, and as a result, the global economies could fall into further recession. So, those proponents of a V-shaped recovery would appear to have been misguided. Asia especially China which is seen as the saviour to the rest of the developed world may not be able to "pull the rabbit out of the hat" this time. We could well be running out of options: for the countries already massively indebted and pump-primed their economies with stimulus, additional quantitative easing or printing more money may make no difference. The sick man is already so pumped with painkillers, antibiotics, and other medication, that giving him a stronger dose may not help but may instead make him even worse.

**A Boon for Gold**

By year end, gold will post its eleventh year of straight gain, adding 8.6% year-to date. With the global economy facing the prospect of falling back into a prolonged recession, investors are likely to seek refuge in this precious metal, and hence this could create potential upside for the metal.

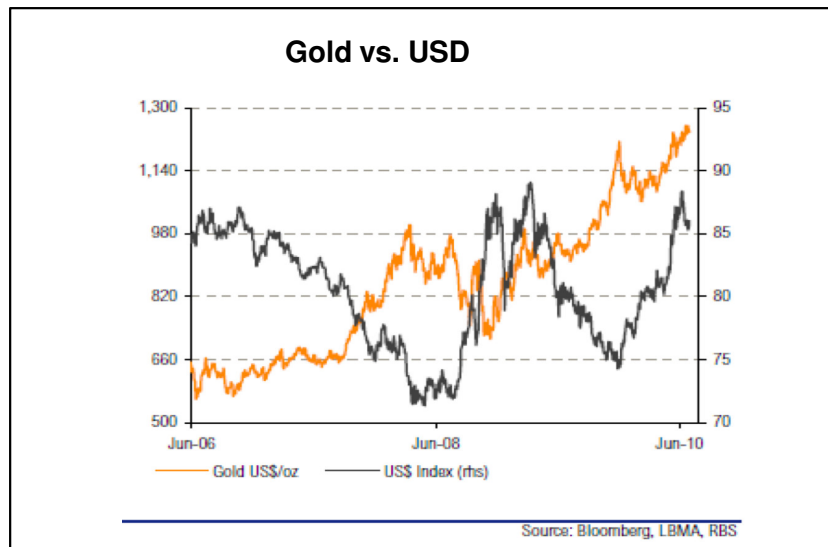
Volatility as measured by the VIX is increasing, and gold, which continues to be preferred as a refuge for economic uncertainty, is also riding the uptrend (see chart below).



A poll of analysts and traders by Reuters showed that they expect gold price to rise next year by another 7% to a median of \$1228 per ounce. This was up from \$1150 per ounce when polled in January 2010. Gold hit a high of \$1264.90 per ounce during the height of the European debt crisis.

The resurfacing concerns over recessionary conditions should keep investment demand strong for gold which is a good hedge against market volatility and vulnerability for investors. ETFs like SPDR Gold which have seen hefty inflows in April and May 2010, stabilised in June 2010. The gold market will continue to derive its strength from investment demand as investors seek to protect their capital against further economic pitfalls, and near zero interest rates in U.S (as Feds keep rates steady).

Although the US dollar has recovered somewhat from its bottom (vs. other major currencies), gold prices have also bucked the trend. Gold prices are also higher now despite the US dollar's appreciation. the decoupling effect suggest that investors are still concerned about the overall health of the economy, and seeking safe-heaven in gold.



Over the longer term as long as global growth remains uncertain, with the possibility of countries like U.S slipping back into a prolonged recession, the demand for gold should remain strong.

*"More gold has been mined from the thoughts of men than has been taken from the earth."*

*Napoleon Hill, (American author, 1883-1970)*

#### **About the Author**

*Chris Gan has many years of experience in investments, having worked as an investment analyst early on in his career, and also as a corporate consultant. He has spent the last few years specializing in the area of wealth management with two local banks. In addition, he has lectured on investments and finance at two established universities - his alma mater, Lincoln University, New Zealand and Monash University (Australia) , Sunway campus).*

*He regularly contributes to educating the investing public on investment techniques in professional and business journals in Malaysia. Chris is the author of three books: 'How to Sell Unit Trust and Why People Buy', 'What You Need to Know About Structured Products' and 'Getting Started in Investment: A Smart Guide'. He is also a regular speaker and trainer for professional bodies like the Federation of Investment Managers Malaysia (FIMM).*

The information, opinions and financial data presented are for educational purposes only and are not intended as investment advice. No guarantees are made as to the accuracy of the information provided herein. Any links provided to other server sites are offered as a matter of convenience and in no way are meant to imply that Auruma International endorses, sponsors, promotes or is affiliated with the owners of or participants in those sites, or endorses any information contained on those sites, unless expressly stated.

AURUMA International

Did you know?

All copyrights reserved.

*... that most gold - 78 percent of the yearly gold supply is made into jewelry. Other industries, mostly electronics, medical, and dental, require about 12 percent. The remaining 10 percent of the yearly gold supply is used in financial transactions.*

*...the "Welcome Stranger," the largest gold nugget ever recorded, was found in Victoria, Australia, in 1869. It weighed 78 kilograms (about 172 pounds). When it was melted down, it produced 71 kilograms (156 pounds) of pure gold.*