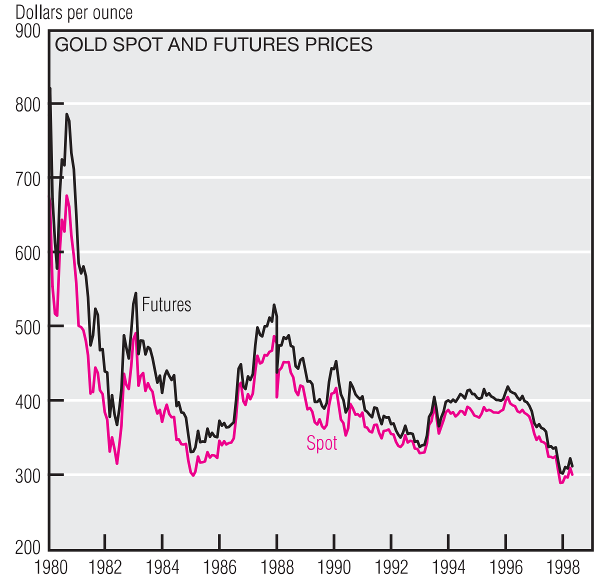
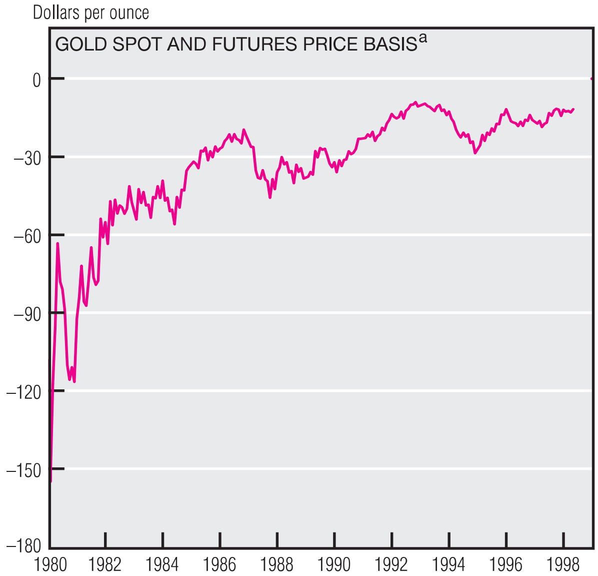
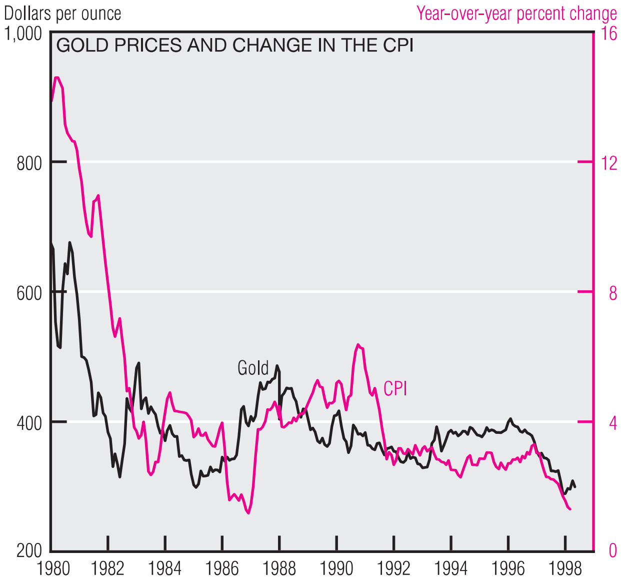
Gold Prices







a. The price basis is the difference between the gold spot price and the gold futures price.
NOTE: All gold prices are in dollars per troy ounce.
SOURCE: DRI/McGraw–Hill.

Gold prices have begun to rebound in 1998, reversing the downward trend that began nearly two years ago. Analysts have attributed this recent strength to reduced fears that central banks will sell off their gold, good U.S. economic news, and less selling pressure by speculators. Some have gone further, suggesting the possibility of an upward trend. These analysts argue that, by increasing the extraction price, environmental regulations are reducing the supply of gold. Furthermore, some mines are not making a profit at current prices and may be expected to cut output or shut down, further reducing supply.

Futures prices continue to track spot prices closely. The basis (the spot price minus the futures price) remains negative, as is usual for an easily storable commodity whose supply is large relative to annual consumption. This is predicted by the cost-of-carry model, which argues that the futures price will be the spot price plus the cost of storing the commodity.

Some people use gold prices to predict inflation, since gold has often signaled inflation rate changes over the past two decades. As the scatterplot makes clear, however, the relationship is closest for the high-inflation years of the early 1980s. In periods of low inflation, the relationship shows more uncertainty. Thus, the recent increase should be taken as suggestive, but not indicative, of higher inflation in the months ahead.