Gold Is Soaring - Is Big Inflation Next?

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Overview

Friends and colleagues increasingly ask me what I think about gold's rise to new record highs this summer. And the follow-up question almost always is: Does gold's surge mean inflation is about to spike? I will address both of those questions today.

There are numerous factors which can cause the price of gold to rise significantly, but I don't believe inflation fears are the main driver behind gold's recent surge. I believe it has much more to do with uncertainty and fears surrounding the COVID-19 pandemic. But I'm getting ahead of myself.

Following that discussion, we'll look into the rampant increase in fraud and abuse within the government's unemployment insurance program – which among other things, offered unemployed workers $600 per week in bonus payments. As I've discussed previously, these weekly payments meant that over two-thirds of the unemployed were making more to stay at home than to go back to work.

While the $600/wk. payments stopped at the end of July, the House of Representatives has already passed a massive new stimulus bill which extends those payments through next January. It remains to be seen what the Senate counters with, but I think it's safe to assume weekly bonus payments of at least $400-$500 (if not $600) will resume very shortly. This is not good for the economy long-term.

Gold Prices Soar to Record High – The Question is Why?

Probably the most common question I've been asked this year, aside from questions about the COVID-19 pandemic, is: *What is causing gold prices to soar?* Gold prices have spiked from around $1,200 per ounce in late 2018 to a new all-time record of $2,059 on August 6.

Gold is up nearly 30% this year – making it one of the best performing asset classes. Investors worldwide have been flocking to gold this year largely because of fears over the coronavirus crisis and the unprecedented actions of governments and central banks around the world in an effort to head-off an economic depression.

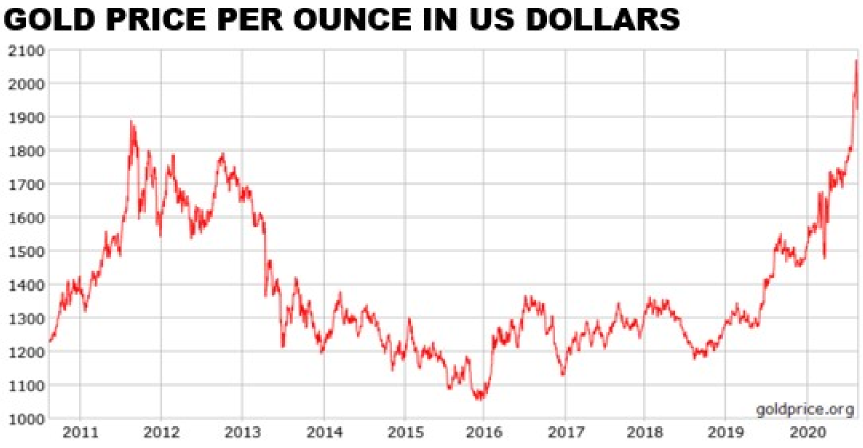
The US government, for example, will run a record-large federal budget of at least $3.7 trillion in fiscal year 2020, which ends on September 30, according to the Congressional Budget Office. That almost doubles our previous highest annual budget deficit of $1.9 trillion in FY2009 during the Great Recession

Meanwhile, the Federal Reserve has added more than $3 trillion to its balance sheet this year, sending it to an unheard of $7.2 trillion, and there's no sign the Fed is done yet. And of course, the Fed slashed short-term interest rates to near zero earlier this year and has suggested it could keep rates at *"zero-bound"* until 2022 if necessary.

The combination of unprecedented money printing and near zero interest rates has pushed the US dollar sharply lower this year, and this, too, is driving gold prices higher. Geopolitics has also been a factor buoying gold this year, highlighted by renewed tensions between the US and China.

There are also other factors contributing to gold's rise to new record highs, but those mentioned above are the main drivers. More and more forecasters are now predicting gold will go even higher still. Goldman

Sachs recently upped its forecast to $2,300 while Bank of America says it could go to $3,000 in the next year. No one knows, of course.



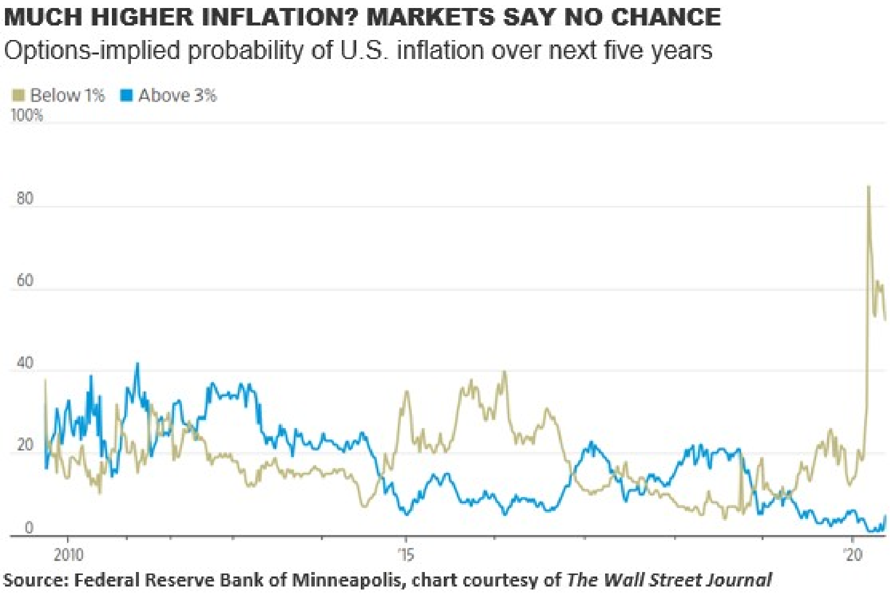
Is Bull Market in Gold Signaling Much Higher Inflation?

There is no doubt many investors who have piled into gold this year have done so because they are convinced the yellow metal's spike to record highs is a sign that rising inflation is finally about to pay us a visit. And that could prove to be true.

However, the markets which usually warn us about rising inflation are signaling just the opposite this year. Without getting too far in the weeds, the bond market's expectation of inflation – calculated as the ordinary Treasury yield minus the TIPS (Treasury Inflation-Protected Securities) yield – shows inflation below 1% for the next five years, and below 1.5% for more than a decade.

The inflation options markets (usually referred to as "swaps") also allow us to look at the odds of inflation rising just ahead. The latest data from the Minneapolis Fed show only a 5% chance of inflation averaging more than 3% over the next five years – meaning a 95% chance it won't rise to near that level.

The probability priced into options of inflation averaging less than 1% over the period was 52%. While down from the peak of 85% in March, that's still quite high.



Source: Federal Reserve Bank of Minneapolis, chart courtesy of *The Wall Street Journal*

So, what conclusions can we draw? While the recent spike in gold prices *could be* a sign that higher inflation is on the way, it could also be because of numerous other factors, as discussed earlier. At this point, the surge in gold demand is primarily the result of the COVID-19 pandemic, in my opinion and that of others.

A close second is the fact that traditional inflation indicators such as the Treasury/TIPS yield spread suggests inflation will remain below 1% for at least the next five years. Plus, the inflation options markets which are priced for a similar low inflation scenario for at least the same period.

The bottom line is: If we are headed for a sharp increase in inflation just ahead, as many gold enthusiasts

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seem to believe, it will be one of the greatest market misses in history.

My advice: I would not be chasing gold at today's record levels. It may indeed go higher as Goldman Sachs and Bank of America seem to believe, but I think that train has left the station.

If gold is a permanent part of your portfolio – as it is in mine – then hold onto it. But I would not be a first-time gold buyer after this massive run.

Unemployment Fraud Rampant Due to $600/Wk. Bonus

Since mid-March, unemployment systems nationwide have seen a record-breaking 51 million people file for unemployment. While many of these people need the benefits, plenty of others are taking advantage of a lucrative situation provided by the recently passed *CARES Act (Coronavirus Aid, Relief & Economic Security Act)*. Specifically, the *CARES Act* provided bonus payments of $600 per week to those who qualified – in addition to the usual jobless benefits provided by their states.

Before the weekly $600 benefit expired at the end of July, at least 68% of people receiving unemployment insurance benefits were being paid more to remain unemployed than to return to work. Not surprisingly, most of these people elected to stay at home. Business owners across the country are complaining they can't get their former employees to return to work as they reopen.

It remains to be seen what will happen now that the $600/wk. payments have ended; however, the House has already passed a giant new relief bill which would extend the $600 payments through the end of January. Now it's up to the Senate to offer its version of a new relief bill, which is expected this week, and for the two sides to compromise.

Between the growing number of scammers filing false claims and former workers who are staying at home and refusing suitable work, the Department of Labor's Inspector General now estimates that waste, fraud and abuse in the unemployment insurance program will explode to more than $26 billion for the *CARES Act* payments alone.

To put that into perspective, the entire unemployment system paid just over $26 billion in benefits during all of 2019. This means taxpayers will likely pay more in unemployment fraud costs from the *CARES Act* alone in 2020 than they paid for the entire unemployment system last year.

The federal government's approach to unemployment relief is not working. If we want to stop fraud and abuse in the unemployment system, we have to stop making it so easy and lucrative. I warned about this when the *CARES Act* was first signed into law in March. In any event, paying people not to work is definitely bad for the economy long-term.

It's time for Congress and states to tighten their eligibility requirements, improve accountability measures and let the weekly $600 unemployment insurance bonus expire – to make sure that unemployment funds remain available for the people who need them the most.

All the best,
Gary D. Halbert

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