

Commodities  
 Global

## All that glitters is gold

Fiscal failures in and outside the US take gold to new highs

- ▶ **Gold hits record intraday high of USD1,719/oz as S&P's downgrade of US sovereign long-term debt triggers heavy safe-haven buying**
- ▶ **Longer term, gold will be supported by global sovereign debt concerns, accommodative US monetary policies and the gradual erosion of the USD's reserve currency status**
- ▶ **We are raising our 2011, 2012, 2013 and long-term gold price forecasts to USD1,590/oz, USD1,625/oz, USD1,550/oz, and USD1,375/oz, respectively, from USD1,525/oz, USD1,500/oz, USD1,450/oz, and USD1,250/oz, respectively**

### An ill wind blows good for gold

Gold prices surged to a record intraday high of USD1,719/oz in reaction to the S&P decision to downgrade US long-term sovereign debt to AA+ from AAA. Sovereign risk has emerged as the principal driver of bullion prices in the last year and a half. Historically, heightened sovereign risk has boosted investor demand for gold. The logic of this is relatively straightforward: as gold is a widely traded hard asset and proven safe-haven instrument, investors have traditionally turned to it when faith in government policies, which can be reflected in a government's credit rating, deteriorates. Historically, gold moves positively with sovereign risk due to gold's traditional characteristics as a safe haven, rising when risks increase and falling when risks contract.

When Greek sovereign risk first emerged as a major issue earlier in 2010, the gold market rallied, after initial weakness. As the situation worsened, gold price rose significantly. At the height of the Greek crisis in May 2010, German banks sold a record number of gold coins, and gold prices surged above USD1,200/oz. The deepening and spreading of sovereign risk, as the Greek contagion impacted other peripheral EU nations including Ireland, Portugal, and Spain and, more recently, Italy, was bullish for gold and as the Greek crisis mutated, gold remained generally well bid throughout the balance of 2010 and 2011.

The downgrade of US sovereign debt shows that the locus of sovereign risk has shifted to the US. This unprecedented historical event has buoyed gold above USD1,700/oz. The recent debt ceiling debacle focused attention on the unsustainability of the US fiscal situation. According to Stephen King HSBC's chief economist in [US debt downgrade: Another fine mess](#) (7 August 2011), the US fiscal situation was unsustainable even before the financial crisis, due to the costs associated with an ageing population and extravagant

8 August 2011

**James Steel**  
 Analyst  
 HSBC Securities (USD) Inc.  
 +1 212 525 6515  
 james.steel@us.hsbc.com

View HSBC Global Research at:  
<http://www.research.hsbc.com>

Issuer of report: HSBC Securities  
 (USA) Inc.

### Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

social security commitments. The US credit downgrade, coming so close on the heels of the debt ceiling crisis has left investors searching for a safe haven and choosing gold. The debt ceiling agreement also closes off further fiscal stimulus as an option for policymakers. This leaves monetary policy as the only weapon left to battle slow growth and high unemployment. Expectations that the Fed will keep monetary policy highly accommodative, is further boosting gold. There may also be an element of concern among investors that the Fed may monetize the debt. The inflationary consequences of such action are supportive of gold. Even if this is not policy, the fear among some investors that this might occur, should keep gold well bid.

## A golden port in a storm

Gold has a lot to recommend it during times of elevated sovereign risk and financial stress. Gold has rallied since the beginning of the financial crisis in 2007, in large part because as a hard asset it has no counter party or credit risk. Unlike other hard assets, however, it is highly liquid with an active global market. Gold is also viewed as a surrogate currency. Proof of its currency-like status is evidenced by its role as an important component of central bank foreign exchange reserves. This unique combination of lack of counterparty and credit risk, ample liquidity and surrogate currency status typically makes gold attractive to investors during periods of uncertainty.

The gold rally remains intact after years of price appreciation because the global crisis, which started in 2007, has mutated but has not been resolved. Massive official intervention has only shifted liabilities, actual and contingent, from the private to the public sector. This has exposed a negative debt sustainability trend in the developed world – including the United States – that started well before the financial crisis.

Unlike other safe-haven currencies, central banks cannot effectively intervene against gold to prevent its appreciation. The “safe haven” currencies, the CHF, NOK and JPY have appreciated noticeably in recent weeks, much to the chagrin of domestic policymakers. Last week, the Bank of Japan intervened strenuously to stem the rally in the JPY and the Swiss National Bank cut interest rates to weaken the CHF. These currencies may be subject to further intervention. Gold, however, does not face the threat of intervention and may move higher unimpeded by any government. Central banks with gold reserves could sell their bullion but the countries with the largest reserves, the US, Japan, Germany as well as others give no indication of doing so. Central bankers and other policymakers make little reference to higher gold prices and they do not appear to be contrary to any sovereign country’s interests. More importantly perhaps the supply of gold is not dictated by government monetary policy. While central banks can prime the printing presses at will, the supply of gold is fixed in the near term and increases only as a function of mine output.

## The US dollar is key

Historically, gold trades inversely to the USD. This is logical considering that gold is the world’s supreme hard asset and the USD the world’s supreme paper asset. Also as gold is priced in USDs, the value of the dollar impacts the demand for gold outside the dollar bloc and is an important factor governing mining costs. The relationship however is not lock step. Periodically since the beginning of the crisis in 2007 gold and the USD have moved together as investors have rushed into the USD, or more specifically US Treasuries and other USD assets during times of uncertainty, as well as gold. Thus gold and the dollar

have tended to move in sync during periods elevated risk. Over the long run, however, the inverse USD/gold relationship has also been re-established.

To the degree that the credit downgrade has damaged the USD, it has strengthened gold. HSBC's chief currency strategist David Bloom in [US debt downgrade: Another fine mess](#) (7 August 2011) stated the US downgrade is a watershed moment for the USD even though it was already seen as a very likely development after the recent debt ceiling wrangle. Given gold's relationship with the USD, the downgrade can also be viewed as a watershed moment for gold. The USD will remain the world's reserve currency according to Mr. Bloom but its status is being chipped away. This is almost tailor-made for gold to rally. The currency most able to replace the USD is the EUR – but many would not accept it as an alternative, according to Mr. Bloom. Meanwhile the other important currencies of rapidly emerging economies, such as India, Russia, China and Brazil have less liquidity combined than the Canadian dollar. So although this downgrade has damaged the USD and will chisel away at its position at the center of the financial system, there is nothing to replace it as the world's reserve currency of the world anytime soon, according to Mr. Bloom. In this atmosphere of uncertain change, investors may turn increasingly to gold.

## Conclusion

We are raising our 2011, 2012, 2013 and long-term average gold price forecasts to USD1,590/oz USD1,625/oz USD1,550/oz, and USD1,375/oz, from USD1,525/oz, USD1,500/oz, USD1,450/oz and USD1,250/oz respectively. Given the positive correlation between gold and silver, we are also raising our silver price forecasts. We are raising our 2011, 2012, 2013 and long-term silver forecasts to USD38/oz, USD32/oz, USD30/oz and USD25/oz. We believe gold prices could be volatile for the rest of the year with a trading range of between USD1,850/oz and USD1,550/oz. Silver will lag gold due to its industrial metal status and we anticipate a trading of between USD42/oz and USD36/oz for the remainder of 2012.

If history is any judge, the decade-long gold rally will not end until sovereign risks – in and outside of the US – recede. This is unlikely to occur until the US fiscal situation is on a sustainable path, the US budget deficit reduced and progress is made on reducing the growth in the debt-to-GDP ratio. Any further decline in investor confidence regarding monetary and fiscal policies is likely to translate into even higher gold prices. How confident investors will be in government to remedy fiscal and global economic challenges, and the direction of the foreign exchange markets, will be important factors in determining gold prices. Among these, the long-term decline in the USD is an important element in our expectations of historically high gold prices. In this atmosphere, traditional supply/demand factors, including mine supply, producer hedging policies, and jewelry and industrial demand may take a second place to macroeconomic and geopolitical influences and investment demand on gold. We believe that on balance, these macroeconomic factors will keep the demand for gold elevated for the rest of the year and into 2012 and keep gold prices historically high – although possibly not at current levels – for years to come.

# Disclosure appendix

## Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: James Steel

## Important Disclosures

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other investment products mentioned in it and/or to participate in any trading strategy. Advice in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document and take into account their specific investment objectives, financial situation or particular needs before making a commitment to purchase investment products.

The value of and the income produced by the investment products mentioned in this document may fluctuate, so that an investor may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Value and income from investment products may be adversely affected by exchange rates, interest rates, or other factors. Past performance of a particular investment product is not indicative of future results.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at [www.hsbcnet.com/research](http://www.hsbcnet.com/research).

\* *HSBC Legal Entities are listed in the Disclaimer below.*

## Additional disclosures

- 1 This report is dated as at 08 August 2011.
- 2 All market data included in this report are dated as at close 08 August 2011, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

# Disclaimer

\* *Legal entities as at 04 March 2011*

*'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris Branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Düsseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt SAE, Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Securities SA, Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv; 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler AS, Istanbul; HSBC México, SA, Institución de Banca Múltiple, Grupo Financiero HSBC; HSBC Bank Brasil SA – Banco Múltiplo; HSBC Bank Australia Limited; HSBC Bank Argentina SA; HSBC Saudi Arabia Limited; The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch*

**Issuer of report**

**HSBC Securities (USA) Inc.**

452 Fifth Avenue

HSBC Tower

New York, NY 10018, USA

Telephone: +1 212 525 5000

Fax: +1 212 525 0356

Website: [www.research.hsbc.com](http://www.research.hsbc.com)

This material was prepared and is being distributed by HSBC Securities (USA) Inc., ("HSI") a member of the HSBC Group, the NYSE and FINRA. This material is for the information of clients of HSI and is not for publication to other persons, whether through the press or by other means. It is based on information from sources, which HSI believes to be reliable but it is not guaranteed as to the accuracy or completeness. Expressions of opinion herein are subject to change without notice. This material is not, and should not be construed as, an offer or the solicitation of an offer to buy or sell any securities. HSI and its associated companies may make a market in, or may have been a manager or a co-manager of the most recent public offering of, any securities of the recommended issuer herein. HSI, its associated companies and/or their directors and employees may own the securities, options or other financial instruments of any of the issuers discussed herein and may sell them to or buy them from customers on a principal basis. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. In Hong Kong, this document has been distributed by The Hongkong and Shanghai Banking Corporation Limited in the conduct of its Hong Kong regulated business for the information of its institutional and professional customers; it is not intended for and should not be distributed to retail customers in Hong Kong. The Hongkong and Shanghai Banking Corporation Limited makes no representations that the products or services mentioned in this document are available to persons in Hong Kong or are necessarily suitable for any particular person or appropriate in accordance with local law. All inquiries by such recipients must be directed to The Hongkong and Shanghai Banking Corporation Limited. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. In the UK this report may only be distributed to persons of a kind described in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001. The protections afforded by the UK regulatory regime are available only to those dealing with a representative of HSBC Bank plc in the UK. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF).

In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch.

© Copyright. HSBC Securities (USA) Inc 2011, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Securities (USA) Inc. MICA (P) 208/04/2011 and MICA (P) 040/04/2011