Gold - is its perch the shutdown effect… or ?

Gold prices were able to nimbly seize on the large equity rout and volatility in December 2018, rallying $60 toward $1300, over a time period when most of the market was out. That in of itself was a welcomed feat—the fact that it exhibited some safe haven tendencies and thwarted some $ strength has been noted as an important "win". However, of more importance is Golds ultra calm and contained range its held around $1275-1300 throughout 2019, despite macro risk being reapplied and risk assets from EM (+7%*) to SPX (+5%) to oil (+17%) soaring since the Christmas eve hole.

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Essentially, Gold has had every opportunity to unwind some of those gains, alongside other unwinds in safehavens YTD (US 10 yr yields have rallied from 2.55% to 2.8%; CHF depreciated from 1.03 toward 1) and the partial resurgence in the $ (DXY bouncing from 95 to 96.50). Currently, macro is struggling through a US political stalemate, a trade war stalemate, and a Brexit stalemate, helping the VIX to retreat below 20 again; that 'boringness' is usually never good for Gold and abnormal price action—in an asset class that isn't driven by true S&DS—should always be respected and its worth a deeper look in an attempt to decipher who or what is behind the resilient Gold bid…

Gold has rallied 2.2% since the sneaky (pre-Christmas) Trump-induced shut-down. The below outlines just how much past sustained US shutdowns impact Gold, the $ and risk assets (SPX) and provides some thoughts.

Findings:

- US risk assets have *never* reacted negatively to political dysfunction — on average, over the past 6 US Government shutdowns, SPX has rallied >3%.
- Gold on the contrary posts a mix of returns when theres a US government shutdown, on average putting in only mild returns (+1%). It is however positively correlated to the length of the Government shutdown. At the current pace, Gold would only reach $1295 if the shutdown extends for another month, all else equal.
- However, in light of the $ and risk assets move YTD, its fair to conclude that the now 34-day US shutdown has assisted in bringing to the forefront our key "short politics" / long gold" structural theme which could reinvigorate both investor and sovereign-related interest as they search for alternatives to de-dollarize, or "de-Trump"
- The $ on average posts very mild declines (-0.3%) during previous US government shutdown periods, but rallies relatively better - around 1% - in the initial 10days following a reopened government. That would take DXY back up to the 2018 double top highs < 98 and would provide some buying opportunity in Gold.

The 'process of elimination' thinking in determining Golds bid is as follows:

- Indian and/or Chinese jewelry / physical demand—a core crutch, not necessarily a driver of bullish price action—has been lackluster given high gold prices in local currency terms and subdued local premiums.
- Investor inflows have been steady (COT/paper data has been halted due to the Government shutdown) with the only viable and confirmed participant being strong ETF inflows (YTD of 1.3m oz taking ETF holdings to >72m oz, 5year highs)
- One needs to wait for data confirmation in a few months to confirm any potential official sector buying (which was notable in 2018), and one that is tough to gauge

In the end shut-downs are not linear—the longer it lasts, the increasingly more costly it becomes as the hardship faced by workers eats into spending and ultimately growth. And if historical polling data is any indication, the shut-down knock to whomever (or whatever party) is usually short-lived; Trumps own ratings have even remained surprisingly steady (40% approve which is well above the Dec 2017 levels when he signed off the on the tax cut). Overall, this is not a fight about policy (Congress could find a solution) - its about authority and power and emblematically highlights a core theme and risk—extreme/polarizing US politics becoming increasingly entrenched. This has piqued the interest of larger equity-type (ETF), *potential* strategic (OTC) investors or sovereign-related demand.

Overview of Federal US shutdowns involving furloughs*
price reaction across some assets if shutdown is longer than 1day

Shutdown year		No of Days	Employees furloughed	Cost to Gov, mn	DXY	SPX	Gold	Comment
1980	Carter	1	1,600	$1				
1981	Reagan	1	241,000	$90				
1984		1	500,000	$65				
1986		1	500,000	$62				
Oct-90	H.W. Bush	3	2,800	$2.60	-0.8%	0.6%	-1.2%	Occurred over a weekend, so effects are weaker
Nov-95	Clinton	5	800,000	$400	-0.5%	1.3%	0.0%	2 shutdowns within 2 months over 1996 federal budget
1995–96		21	284,000		1.3%	4.7%	2.7%	
Oct-13	Obama	16	800,000	$2,100	-0.6%	2.9%	2.2%	Deadlock over Obamacare
Jan-18	Trump	3	692,900	?	-0.5%	1.0%	0.7%	Deadlock over upcoming budget and the funding of DACA
*2018–19***		*33*	*380,000*	*?*	*-0.9%*	*8.8%*	*2.2%*	Deadlock over funding for a border wall
				Average	**-0.3%**	**3.2%**	**1.1%**	

*list only includes funding gaps that have led to actual employee furloughs
** Price reaction up until Jan 23 2019
SOURCE: Scotiabank Commodities Strategy;

US Government shutdown:

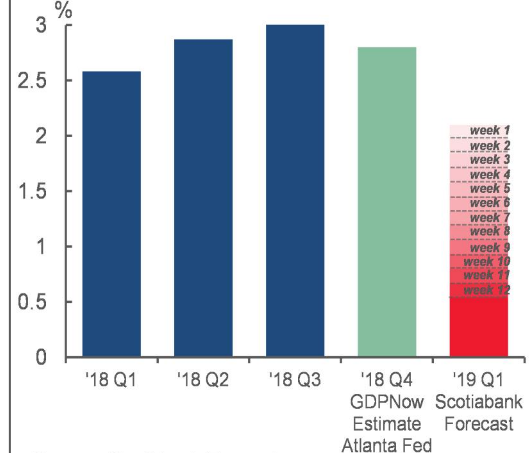
Americas shutdown is now the longest on record at 34 days, almost 1m federal workers are not being paid, the costs are rising and the list of casualties and potential impact on growth is growing.

Other specific social or economic casualties include jammed airports due to unscheduled TSA absentees (costing passengers and airlines time and money), the chance of food-stamp programs running out funds & delays in tax refunds and unstaffed national parks and monuments (harming tourism). IN markets, theres a lack of some important economic & flow reports by agencies not funded including new home sales figures, construction spending, housing starts, factory orders, trade, retail sales, durable goods orders & CFTC/positioning data, and the SEC has stopped reviewing IPO filings.

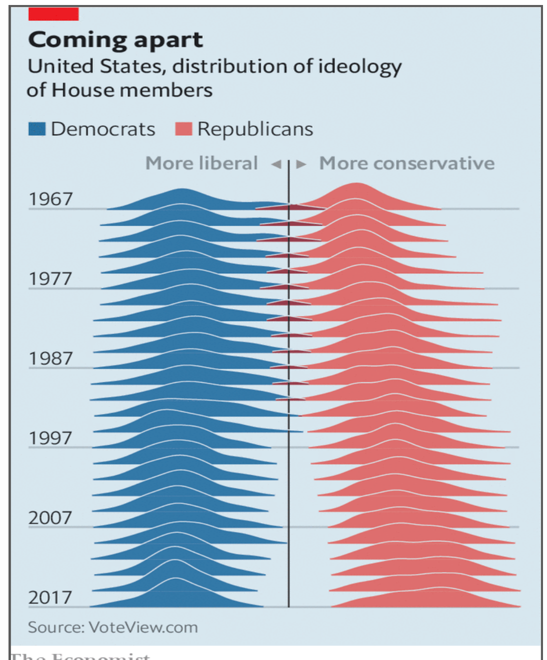
Impact on growth & risk assets:
Yesterday the White House (well Kevin Hasset, chairman of Trumps Council of Economic Advisers) said if the partial government shutdown extended through March, there's a chance of zero economic expansion in Q1 (although "humongous" growth would follow once federal agencies reopen). These comments suggest a larger impact to growth than estimates from Moodys (they estimated for each week the shutdown continues, the growth dent is only 0.04 percentage points/week)

Currently, SPX is up a mega 8.8% since Dec 22nd, which is counterintuitive. Its aligned directionally with past reactions to shutdowns—on average, over the past 6 US Government shutdowns, SPX has rallied >3% - but has overreached drastically. The January effect*, an historically muted effect on growth (the 16day shutdown in 2013 lowered GDP growth in that quarter by only 0.3%) and/or the fact that investors believe the shutdown will be resolved by Congress (as it always is) perhaps helps explain away this outperformance. **That, or risk markets are pricing in the fact that since its pre-election year, fiscal stimulus (especially with this government) could replace the "Powell put" on any sharp downturn; not to mention a divided Congress is pro-growth, in theory, on the thinking that hamstrung governments dont wield *all* the power and generally 'step aside' for the private sector to get on…**

** the idea / theory that the stock markets performance in the first 5days of the year is a decent predictor how it will perform over the entire year. Its predicated on the idea that tax-loss selling in December unfairly knocks stocks to undervalued levels at which point investors reload into these laggards in January.*

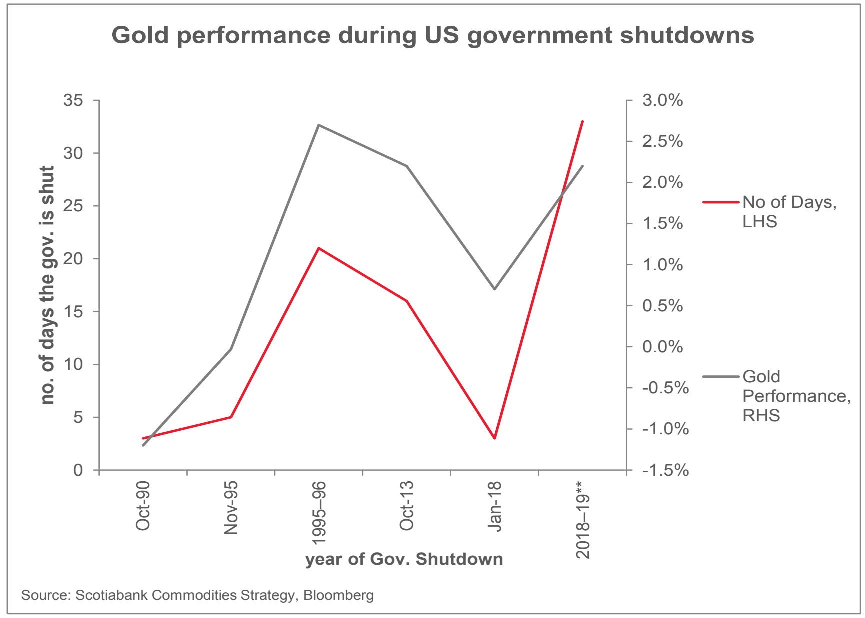


Sources: Scotiabank Economics, Bureau of Economic Analysis, Federal Reserve Bank of Atlanta.* Estimates based on comments made by Kevin Hassett, Council of Economic Advisers



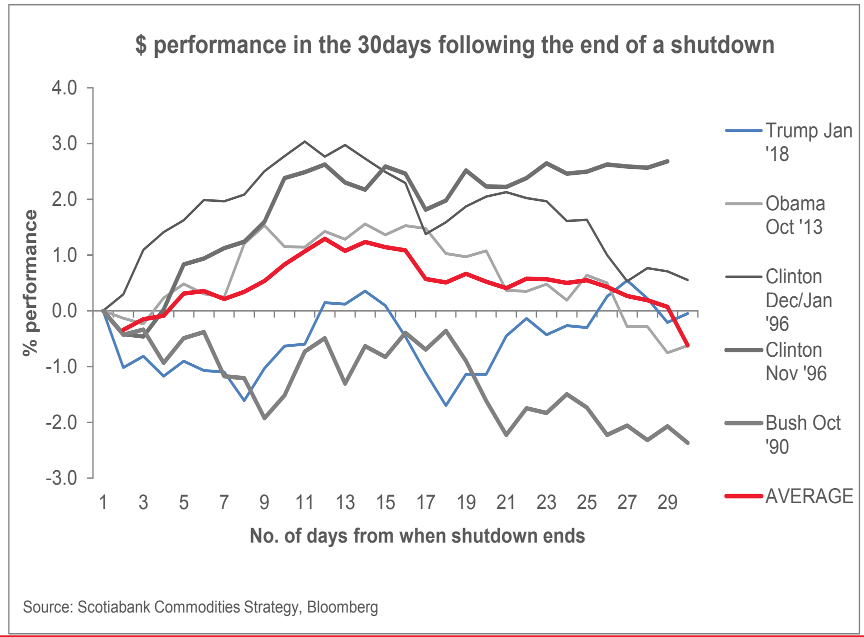
Impact on Gold and the $:

Gold on the contrary posts a mix of returns when theres a US government shutdown, on average putting in only mild returns (+1%). It is however positively correlated to the length of the Government shutdown (as the graph depicts). The 2.2% returns since the Dec 22nd shutdown, implies Gold would only just reach $1295 if the shutdown extends for another month, all else equal. **However, in light of the $ and risk assets move YTD, its fair to conclude that the now 34-day US shutdown has assisted in bringing to the forefront our key "short politics" / long gold" structural theme which could reinvigorate both structural investor and sovereign/ central bank interest as they search for alternatives to "de-dollarize" or "de-Trump"**



Source: Scotiabank Commodities Strategy, Bloomberg

The $ on average posts very mild declines (-0.3%) during previous US gov shutdown periods. The markets assumption is that when (not if?) the gov re-opens, the $ should appreciate further. The historical data confirms this—on average over previous shutdowns, the $ has appreciated around 1% in the initial 10days following a reopened government. **That would take DXY back up to the 2018 double top highs < 98 and would provide some buying opportunity in Gold.**



Source: Scotiabank Commodities Strategy, Bloomberg

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