As investor sentiment oscillated between risk-off and risk on, so did gold prices. Everything from positive trial results of an experimental Covid-19 treatment to crashing oil prices roiled markets. But if you look at the big picture, with prices in INR terms up 19% this year, you would agree that gold loves a crisis. It's not really the crisis but how policy makers tend to react to a crisis, makes gold attractive.

Opening up the economy won't save the economy

Politicians hoping to kickstart the economic engine back to life might be in for some disappointment when they discover that they can let businesses reopen but they can't force people to shop, eat or visit. With sharp contraction in economic activity and surge in unemployment, consumers will be less optimistic about their financial prospects and this will have repercussions for spending and GDP growth in the months ahead.

Moreover, with health experts warning of more outbreaks if the lockdown is lifted too soon, the global economy could very well get trapped in a vicious cycle of outbreaks and shutdowns until a vaccine is eventually found. This could fundamentally change the way people consume, socialize, or invest. This will continue to take its toll on the economy and increase the need for government support. And for as long as we are in that transition, safe havens like gold will be in demand as investors decide what to invest in for the future.

There is no "normal" to return to

Even before the pandemic hit the world, geopolitical and economic issues such as the US-China Trade war plagued the global economy.

Global growth was slowing. US national debt was already lingering above $23 trillion. The Federal Reserve pivoted to loose monetary policy in 2019 to pump up the economy. Central banks were buying gold in the low-interest-rate environment, the dollar index was weakening and global debt was surging. Why else was gold already on an upward trajectory before Covid-19?

Now, with the outbreak exacerbating the existing macroeconomic weaknesses, we expect interest rates in the US, as well as the rest of the developed world, to be low for a longer time as central banks try to boost GDP growth. This makes holding gold a more viable option than holding US treasuries as it successfully preserves purchasing power in the upcoming negative real rate environment.

Also, central banks seem to be increasing the size of their balance sheets by monetizing ballooning government deficits to counter the economic slump. As of now, major economies of Germany, Japan, and the US have announced stimulus packages worth 35%, 20%, and 10% of GDP respectively. More stimulus measures are in the works as the pandemic furthers its toll on the economy. This will lead to a permanent debasement of fiat currencies in a way because once the central bank prints more money, it generally never gets unwounded. With such high liquidity sloshing around and also seeping in the real economy, unlike 2008 where liquidity remained bound to financial markets, the probability of inflationary prospects looms large. This is incredibly bullish for gold - the currency of last resort and the ultimate store of value.

Calls for dethroning of the dollar

The dollar has weakened more than 3% after scaling to highs of 103 levels in late March as global central banks launched massive stimulus measures to limit the economic fallout from the coronavirus pandemic. With rising deficits and debt in the US making holders of US treasuries nervous, calls to

replace the dollar with a super-sovereign monetary system could gain strength, and gold could potentially fit into that role.

The pandemic has heightened US-China tensions

Covid-19 has further soured US-China relations amid the unfinished business of the trade war. A war of words and a blame game between the two countries have ensued. Trump has criticized China's response to the virus outbreak and referred to Covid-19 as the 'Wuhan' or 'Chinese' virus.

This points to a further flare-up in geopolitical tensions in the post-pandemic world which will have consequences for global order and governance. This will push up demand for gold.

Moreover, the USA's international response to the pandemic has raised serious questions about US capacity to lead. The pandemic has exposed the worst of US President Donald Trump's 'America First' agenda, and Beijing's intention to take advantage of the crisis, to boost its claim to global leadership.

Things are likely to get worse before they get better

The world is currently staring at the worst economic downturn since the Great Depression, with the IMF estimating that the global economy will shrink by 3% in 2020. Thus right now, everything is about the current crisis and what we can do to avoid a deeper economic recession. But ultimately, this monetary impulse will become the primary driver of investment demand for gold. As expected, investment demand for gold was strong in the first quarter,with ETF inflows in the first quarter up more than 300% compared to inflows last year

It will take a long time to gauge the full cost of the coronavirus pandemic and some analysts fear the current forecasts do not paint the full picture of the economic damage. If that is the case then the deteriorating macroeconomic backdrop is expected to encourage the further rotation of money from risk assets like stocks and bonds to defensive assets like gold.

From Greenspan to Powell – The great "Put" continues

"People are undertaking sacrifices for the common good," Fed Chair Powell recently remarked. "We should make them whole. They did not cause this." With more than 26 million people filing for unemployment benefits, Powell led Fed will thus continue to print money to make good on the business and wage losses that people face. The government doesn't feel constrained by their ability to tax or borrow, given they can tap the central bank which is ready to provide access to a bottomless pool of money. The long term consequences of such policies are disastrous.

However, in the short term it may ignite animal spirits at least in the financial markets and result in some possible correction in gold prices. Although, we expect any downsides to be limited given the macroeconomic backdrop remains extremely bullish for gold.

Looking ahead, a coronavirus vaccine would ease the pandemic, but it wouldn't do anything to address the deficits and debt that were already rampant in the economy, accelerated by the coronavirus downturn. We thus recommend a 10-15% portfolio allocation to gold to capitalize on its risk-reducing, return-enhancing characteristics in these times of crisis and financial repression.