Gold as a Strategic Prophecy against Inflation and Exchange Rate

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Abstract

The study investigates the role of gold as a strategic prophecy against inflation and exchange rate. The main research question of the present study is whether gold has acted as a hedge against inflation and exchange rate for India. Study has evaluated monthly data of gold price, inflation and exchange rate over the period January 1991 to September 2012. By applying Augmented Dickey Fuller unit root test, Johansen Cointegration test and Granger Causality test in Error Correction Model framework, study concludes that Gold Price and Exchange rate are I (1) and Inflation is I (2). It also concludes that there exists long run equilibrium relation among all three variables. However, study provides evidence of no Granger Causality among these variables. By applying ARCH-LM test, heteroskedasticity was detected and Gold price can be modeled as GARCH (1, 1). A negative relationship was found between gold and inflation which suggests that gold acts as an internal hedge against inflation for India. Major implication of this study is that Indian investor should prefer gold investment in the time of inflation boom.

Keywords

Exchange Rate, Gold, GARCH, Hedge, Inflation