Why You Should Avoid Barrick Gold Corp. as Oil Declines

Description

As energy stocks are getting beaten up, many investors may be tempted to switch into gold stocks. After all, gold is often what people switch into when they're most scared. But is gold really a safe place to hide?

Well, not really. Below we'll take a look at why the oil price slide may be really bad for gold companies, using **Barrick Gold Corp.** (TSX: ABX)(NYSE: ABX) as an example.

Why cheap oil is bad for the gold price

Let's take a look at why gold prices have continued to languish in 2014.

First of all, investors have gotten scared by instability in emerging markets. Meanwhile, the U.S. economy has been performing well – GDP grew by 3.5% last quarter, and budget deficits are down — so investors have been buying U.S. dollars. And generally a stronger dollar causes the gold price to go down.

Secondly, inflation has come in much lower than many initially feared – over the past 12 months, core inflation in the U.S. was only 1.8%. And remember, gold tends to do well when people are fearful of inflation.

So let's take a look at what energy's fall means in this context. First of all, it will trigger even more instability in many emerging markets. Countries like Iran, Venezuela, and Russia are in particular trouble. Meanwhile, lower gas prices will put much-needed dollars in Americans' pockets. So low oil prices should help the American economy, and make the U.S. dollar even stronger.

Secondly, low energy prices will help lower manufacturing costs in the United States and around the world. So not only will gas prices be cheaper, but the price of other products will be held back too. In other words, inflation should be held in check.

To sum up, the low price of oil does no favours for the gold price.

Is Barrick ready for lower gold prices?

To give Barrick credit, it has done a lot of things right in the past year and a half. Costs have been cut, assets have been sold, and the company genuinely seems to have more discipline.

That being said, the company can't really afford to have the gold price decline much further. To illustrate, let's look at what happens if the shiny metal drops to US$1,000 per ounce.

Barrick plans to produce 6.2 million ounces of gold this year, at an average cost of $900. So if gold trades for US$1000, then that’s $100 of profit per ounce, or $600 million in total. Unfortunately, that doesn’t even cover finance costs of $800 million.

Given oil’s decline, Barrick is obviously an extremely risky investment. You’re better off avoiding the shares.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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bensinclair