Why Hasn't Gold Rocketed up to $1,500 by Now?

Description

Investors in **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX), **Goldcorp Inc.** (TSX:G)(NYSE:GG), and **Yamana Gold Corp.** (TSX:YRI)(NYSE:AUY) must be feeling a little frustrated by now.

After all, the Eurozone is a mess and the Chinese stock market is crashing. In theory, this could badly hurt economies around the world, leading to yet more money printing by central banks. But gold prices remain stuck well below US$1,200. So, what's going on? Why isn't gold rocketing back up?

It's all about the U.S. dollar

Let's start with the obvious. As the crisis in Greece worsens, investors have lost confidence in the euro. In response, they look for so-called safe haven currencies, which usually means the U.S. dollar.

This has caused the euro to depreciate against the U.S. dollar. To illustrate, one euro today can buy you about US$1.10. A year ago, one euro was worth more than US$1.35.

In fact over the past year the U.S. dollar has performed very well against practically every major currency. It's up about 20% versus the euro, the Japanese yen, the Canadian dollar, and the Australian dollar.

But here's the problem: gold is priced in U.S. dollars. So, as the greenback becomes more valuable, fewer dollars are required to buy an ounce of gold. Thus, the price of gold goes down.

How is this different from 2011?

In September 2011 the price of gold peaked at US$1,900 per ounce. At the time, Europe was still struggling, and there were plenty of issues in China. So, why was gold so strong then?

The answer should be obvious by now: there were serious concerns about the U.S. economy as well as its currency. At the time, the unemployment rate was still 9%. The housing recovery had yet to take form. GDP growth slowed to 1.6% that year.

These problems were being dealt head on by the Federal Reserve. A second round of so-called quantitative easing (QE) had just ended, and many pundits were (correctly) predicting a third round. Skeptics were referring to QE as “money printing,” and predicted that it would lead to high inflation. This made gold a very attractive-looking investment.

On top of all that, the U.S. dollar was very weak. For most of the year, it was worth less than one Canadian dollar. And from March to September, one euro could buy you more than US$1.40.

Where do we go from here?

A lot has changed in the last four years. The U.S. economy has recovered slowly, but steadily. Unemployment has fallen, and the housing recovery is in full swing. All the predictions of big inflation turned out to be false. The U.S. dollar has appreciated dramatically and is seen as a safe currency. All told, gold simply doesn’t have the appeal it once did.

In the future there’s little preventing gold prices from falling further. Interest rates could rise in the fall, which would be bearish for gold. Furthermore, most producers are still making a solid profit, so gold supply should hold up even if prices tick down.

Thus, if you’re holding any gold stocks, you should be careful.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:AUY (Yamana Gold)
2. NYSE:B (Barrick Mining)
3. TSX:ABX (Barrick Mining)
4. TSX:YRI (Yamana Gold)

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