Can Gold Fight Through the Interest Rate Headwinds?

Description

Gold is sliding back towards US$1,300 per ounce, and investors are wondering if more downside could be on the way.

Let’s take look at the current situation to see if the pullback is an opportunity to buy or a signal to stay on the sidelines.

Interest rate outlook

A number of factors can impact the price of gold, including interest rate moves in the United States.

The generally accepted theory is that rising interest rates can put pressure on gold prices, as they increase the opportunity cost of owning the non-yielding precious metal. When rates move higher, the return an investor can get from a fixed-income alternative increases, and that could trigger a shift of funds out of gold.

Higher rates in the United States can also drive demand for the American dollar and potentially push up the value of the greenback against other currencies. This would make gold more expensive for international buyers. In the past year, however, this hasn’t been the case, as the U.S. dollar lost value against a basket of foreign currencies, despite a number of rate hikes by the U.S. Federal Reserve.

Are rates headed higher?

The Federal Reserve raised rates three times in 2017 and bumped up the target rate again at the March 2018 meeting. Citing a strengthening economic outlook, Fed officials raised their GDP growth forecasts for 2018 and 2019, although the pace is expected to cool down in 2020. Based on the positive sentiment, most pundits expect the Fed to follow through on plans to raise rates two more times in 2018 and three times in 2019.

However, all eyes remain fixed on inflation.

Unemployment levels in the United States continue to fall, and that could trigger wage increases and lead to inflation. So far, inflation has remained below the Fed's 2% target rate during the recovery, and officials continue to see headline inflation at 1.9% for 2018, 2% for 2019, and 2.1% for 2020.

If inflation expectations increase in the coming months, the market could start to price in a fourth increase for both 2018 and 2019. Under that scenario, gold would likely take a hit.

Fear trade

Gold can also find support when investors are concerned about geopolitical risks to the financial markets. At the moment, the North Korea threat appears to be waning, and less attention is being paid to the risk of a China-U.S. trade war. As a result, safe-haven demand could be on the slide, which would add to downward pressure on gold prices.

Should you buy gold or the miners?

The interest rate headwinds are strong, and safe-haven support is starting to fade, so I wouldn't back up the truck for gold today, despite the pullback from US$1,360 to the current price of about US$1,315 per ounce.

For the miners, you have to be a long-term gold bull to own the stocks. If you fall in that camp, there might be a contrarian case to buy some of the top names on further weakness, as they remain out of favour, despite balance sheet and operational improvements in recent years.

For example, **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) has made good progress on its debt-reduction efforts and continues to focus on driving efficiency across its portfolio of mines. The stock currently trades at $17.50 per share compared to $22.50 a year ago when gold was US$60 per ounce below the current price.

If Barrick continues to move lower, it might be worthwhile to start nibbling, but you have to be convinced gold is headed higher over the long haul.

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