Why Is Gold Moving Higher After the Fed Rate Hike?

Description

Gold watchers might be scratching their heads a bit today, as bullion moves higher after the United States Federal Reserve raised interest rates.

What's going on?

Rising interest rates tend to be negative for gold, as they increase the opportunity cost of holding non-yielding assets, such as the yellow metal. The idea is that investors could dump their gold holdings and shift the funds into fixed-income alternatives.

Higher rates can also provide support for the U.S. dollar, in which gold is priced, making it more expensive for foreign buyers. This, however, wasn't the case last year. In fact, the American dollar lost ground to a basket of key international currencies, despite three rate hikes by the Federal Reserve in 2017.

The Federal Reserve just bumped up its target rate by a quarter point to 1.75-2%. It is the second rate hike this year. Coming into 2018, the market expected three increases, but it looks like the Fed is now leaning toward four moves, given the strong U.S. economy, falling unemployment, and an upward tick in inflation.

Tax cuts and a US$300 billion increase in government spending could be driving faster-than-expected economic growth, and the Fed wants to ensure inflation stays at its 2% target, where it has been for the past couple of months.

With all the bullish economic views and the increased pace of tightening, one would have expected gold to take a big hit in the wake of the decision, but that isn't how things have played out. In fact, gold is at a one-month high.

The U.S. is important, but the rest of the world also comes into play in the gold market. Part of the recent strength is likely tied to a decision by the European Central Bank (ECB) to hold current rates through mid-2019. Ongoing concerns over a global trade war are also providing some safe-haven support for bullion.

The trade fears might be overpowering rate-hike headwinds, and some pundits are concerned the U.S. economy could overheat and drive inflation higher than expected. Gold is often promoted as a hedge against inflation, and while analysts regularly debate gold's value as an inflation hedge, the view is widely held, so there could be support coming from that camp.

Should you buy gold stocks?

The miners remain largely out of favour, despite reasonable strength in gold prices over the past six months. If you have a bullish view on gold for the long run, it might be worthwhile to start a contrarian position in one of the producers, such as **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX).

Barrick has made good progress on its turnaround efforts, reducing debt from US$13 billion to US$6.4 billion at the end of 2017, and management intends to get the debt down to US$5 billion by the end of this year. All-in-sustaining costs are among the lowest in the industry, and Barrick remains the world's largest gold producer, with 2018 production guidance of 4.5-5 million ounces.

Barrick generates solid free cash flow and has received credit-rating upgrades in recent months, so things appear to be headed in the right direction.

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Date
2025/09/11
Date Created
2018/06/14

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