Two Reasons Why Gold Can Climb Above $1,500 This Year

Description

It seems that a dovish U.S. Fed has gotten every asset class rallying, from stocks, bonds and of course, gold. Currently your favourite precious metal is sitting at 6-year highs thanks to a confluence of macroeconomic data and stronger central bank buying. Here are two reasons that support gold breaking out above the long-awaited $1,500/oz level.

Weaker dollar outlook

The Federal Reserve's dovish switch in June has caused the trade-weighted U.S. dollar to register its first decline in five months. Furthermore, prior to this morning's jobs report, the market was pricing in a 100% certainty of a quarter point cut this year and a 30% probability of a 50-basis point cut.

One month later, risk appetites remain subdued as the global economic picture continues to be bleak and inflation elusive, as evidenced by the decline of inflation indexed bond yields, which move in the opposite direction to gold prices.

At the same time, while U.S.-China negotiations are currently taking a breather, concerns regarding further escalations between the two powers paint an uncertain outlook for U.S. businesses. Moreover, the inverted U.S. yield curve (as gauged by the spread between the three-month and 10-year treasuries) spells trouble for interest rate sensitive businesses on both the short and long ends of the curve, adding a further impetus for the Fed to cut rates and boost investment spending and confidence.

Higher central bank purchases and ETF inflows

The first quarter of this year saw net buying by central banks reach 145.5t, or +68% compared to last year, signalling the highest purchases since 2013. The contributing factors behind the central bank purchases were the usual suspects: geopolitical risk, trade tensions, sluggish economic growth and negative or low interest rates across the globe.

ETFs also saw a healthy start to the new year, with $1.9 billion, across the globe. Surprisingly, European ETFs continue to see inflows nearing all-time highs, mirroring demand for physical bullion, as issues such as Italy's growing budget deficit and Brexit continue to drive safe-haven demand in the region.

Caveat Emptor

Bear in mind that gold can give up its gains as quickly as it made them. For example, in the U.S. any de-escalation of tariffs with China will signal a return of risk appetites and central bank tightening policies, while in Europe, a positive end to the Brexit saga will also decrease gold demand.

That said, the biggest factor that will impact gold's forward outlook will be inflation and U.S. dollar strength. While traders are still pricing in a 25-basis point cut by the Fed before the end of this year, further positive data such as today's jobs report could spell trouble for gold.

However, if you're looking to go long here, a major name like **Agnico Eagle Mines Ltd** (TSX:AEM)(NYSE:AEM) would be a safe bet.

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