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Gold prices to benefit from heightened risk as investors hedge their bets

Gold prices have been forecast to remain strong into 2019 after recovering from a low point of US$1,160 in mid-August to US$1,307.89 today February 14.

The US Federal Reserve is expected to slow the pace of interest rate hikes this year, hindering US dollar increases and keeping upwards pressure on the gold price.

Geopolitical concerns, punitive sanctions on Russia and Iran and challenging global financial conditions have put myriad pressures on commodity prices, but the heightened risk carried into 2019 may be end up favourable for gold investors.

Typical drivers of the gold price can be grouped into four categories, according to the World Gold Council (WGC): wealth and economic expansion; market risk and uncertainty; opportunity cost; and momentum and positioning.

As a strategic asset, gold demand has historically been positively-correlated with economic growth as well as strongly responsive to periods of heightened risk.

Source: tradingeconomics.com

Strong price forecast for 2019

Early in January Goldman Sachs released a report raising its 12-month price forecast up from $1,350 an ounce to $1,425, a price last seen in August 2013.

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action@proactiveinvestors.com.au

The Goldman analysis maintains the gold price will be supported primarily by growing demand for defensive assets, with the slower pace of US Fed rate hikes boosting demand only marginally.

Bank of America Merrill Lynch predicts that with sustained global demand coupled with a weaker US dollar, the gold price could see highs of US$1,400 an ounce and an average of $1,296 across 2019.

Bullish on gold

In its "2018 Precious Metals Review" released in December, Refinitiv's GFMS metals research team said the US-China trade war this year had a negative impact on the gold price, pushing it below the $1,200 per ounce level after trading above $1,300 the first two quarters.

According to the report, any cooling off between the US and China might drive the dollar down and be beneficial to gold.

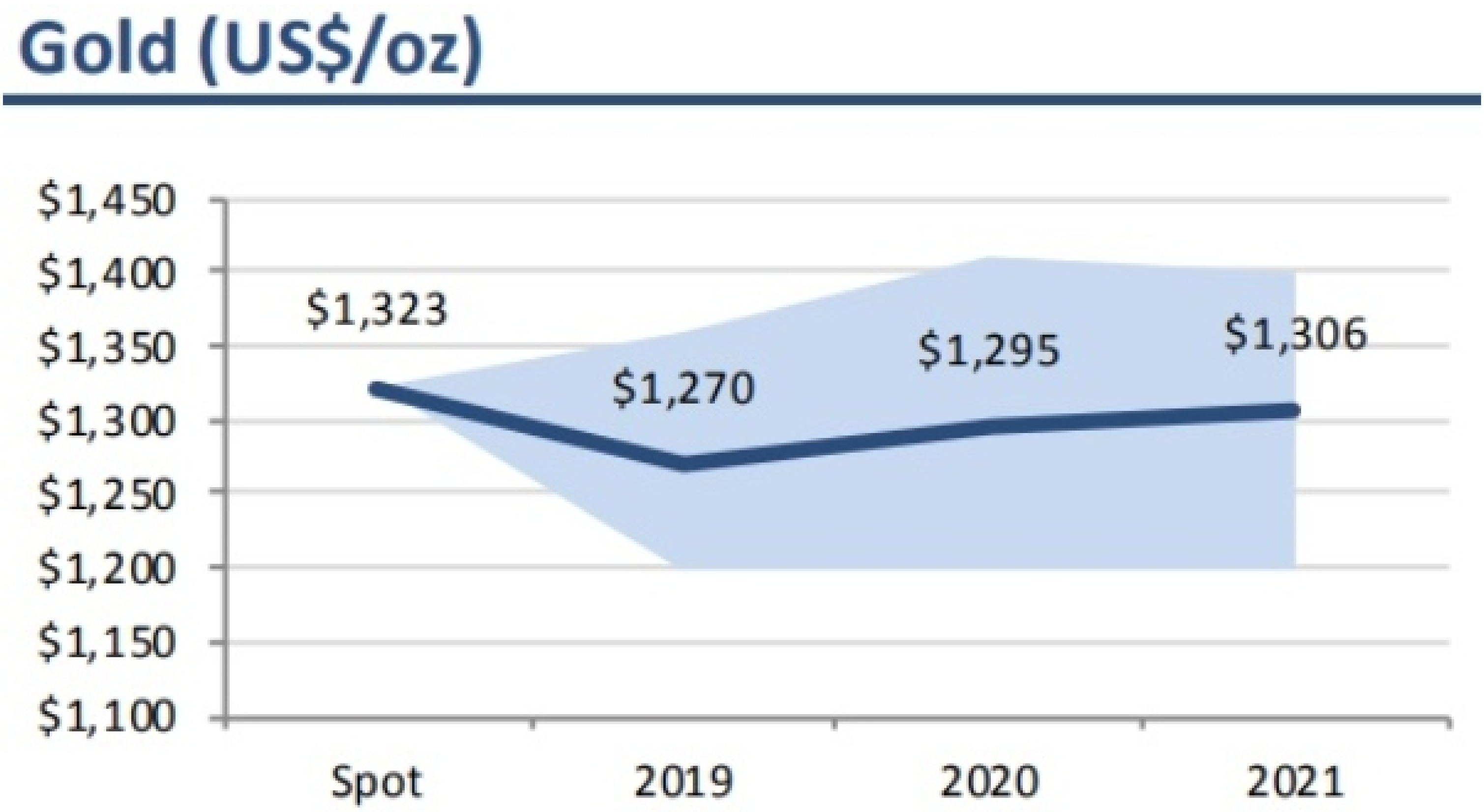
The WGC supported the bullish view on gold in its 2019 outlook, noting several trends that will be key in determining gold's demand.

These include:

Increased market uncertainty and the expansion of protectionist economic policies making gold increasingly attractive as a hedge;

Effects from higher interest rates and US dollar strength expected to be limited as US Fed has signalled a more neutral stance; and

Structural economic reforms in key markets will continue to support demand for gold.



Consensus gold price forecast. Source: PCF Capital Group

US Dollar losing pre-eminence

Geopolitical shifts emanating from Washington have caused countries around the world to rethink the US dollar as the primary global reserve currency.

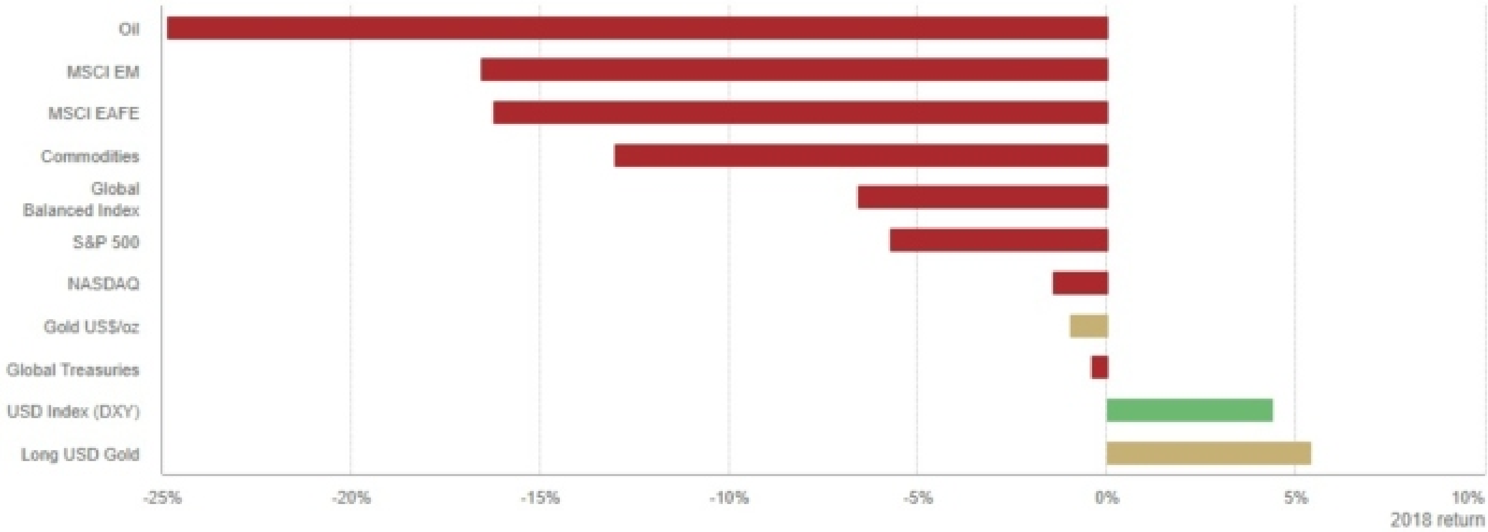
World Gold Council chief executive officer designate David Tait noted in the Council's 2019 outlook that geopolitical shifts, plus concerns about the US-China trade war, as the main cause of this drive.

The European Commission has proposed measures to make the Euro a reserve currency and decrease dependence on the dollar in international trade.

Europe's recovery from the debt crisis has not matched that of the US economy, leading to European banks and investors increasingly adding gold to their portfolios since early 2016.

Political challenges such as Brexit have created a level of unease among investors and other societal issues in Spain, France and Italy have ensured continued risk into 2019, potentially strengthening gold's position.

Tait also points out Russia's 'de-dollarisation' plans, under which Russian companies would use roubles, euros and the Chinese renminbi instead of the dollar.



Key global asset performance at December 31, 2018. Source: Bloomberg, ICE Benchmark Administration, World Gold Council

Increased gold mining activity

Gold mining activity has increased across the board, but Tait notes soaring demand for gold bars and coins in Iran as the country tries to counter US sanctions with increased gold mining to boost employment and growth.

Globally, the industry is going through a period of streamlining and M&A activity, looking to drive returns for shareholders.

The US$18.3 billion merger of Barrick Gold (TSE:ABX) and Randgold Resources (LON:RRS), which became effective on January 2, and Newmont Mining's announcement to acquire Canada's Goldcorp to create the world's largest gold mining group, is expected to trigger further consolidation across the industry.

According to PCF Capital Group, by the first week of December last year there had been 45 major gold asset transactions on the ASX for a total value of $2.3 billion, with 23 of these yet to be completed.

Research by S&P Global Market Intelligence shows global exploration budgets for minerals other than iron ore, coal and bauxite reached US$10.1 billion in calendar year 2018, up 19% year-on-year.

Gold exploration spending of US$54.3 billion in the past decade was 60% higher than the US$32.2 billion spent across the preceding 18 years.

READ: Gold sector sees M&A consolidation on ASX ahead of 2019 price uncertainty

Much of the Australian gold sector's consolidation in 2018 was focused on Western Australia's Goldfields region.

Producer Northern Star Ltd (ASX:NST) acquired Westgold Resources Ltd's (ASX:WGX) South Kalgoorlie operations and began a buy-out of Rand Resources Ltd (ASX:RND) and Tribune Mining NL (ASX:TBR).

Other sizeable acquisitions in the region were Hanking Gold's purchase of Coolgardie-based Primary Gold Limited (ASX:PGO) and Intrepid Mines Limited's (ASX:IAU) acquisition of AIC Resources Limited (ASX:A1C).

Mergers of note include: Silver Lake Resources Limited (ASX:SRL) and Doray Minerals Limited (ASX:DRM); MacPhersons Resources Ltd (ASX:MRP) and Intermin Resources Limited (ASX:IRC); and the three-way merger between Bardoc Gold Ltd (ASX:BDC), Excelsior Gold Limited (ASX:EXG) and developer Aphrodite Gold Limited (ASX:AQQ).

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Contact us +61 (0)2 9280 0700 action@proactiveinvestors.com.au

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