Dynamics of Gold 2015

By Jeffrey R. Paunicka

Several years ago in 2006 I wrote an article titled "Gold: The Target of Financial Hedging" At that time I predicted based on several economic factors that gold would move up 20-25%. As luck would have it, my projection was with in $20 for the 18 month period. In the world of Economics we use the term "Ceteris Paribus" which means all things equal. In the current world the dynamics of the precious metal prices can be challenging to lay out solid projections. Volatility in the stock market for the last 5 years has been more significant in trading equities and commodities. This is a far cry from all things being equal. However, I still believe there are some factors, we can consider without question to suggest where our trends will go.

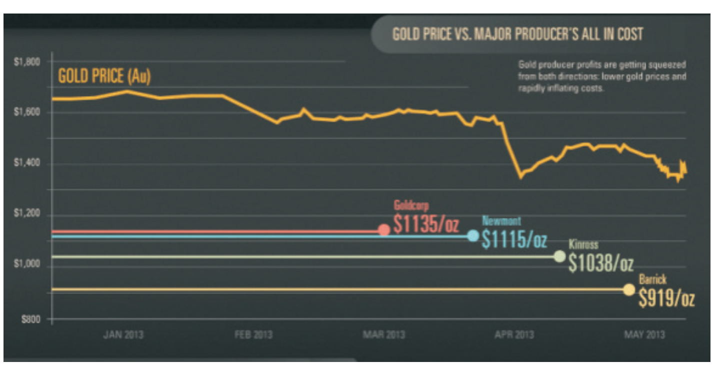
I must qualify by saying that whatever changes happen, the gold spot prices, either in a positive or negative movement, will be influenced by the actions of the Federal Reserve Bank in rolling out higher interest rates. And it is certain that higher rates will be introduced in 2015.

Mining Costs Resistance

Commodities analysts at investment bank Goldman Sachs said earlier this summer that a likely price drop to $1050 in world gold prices by end of 2014 will prove "generally short" lived. Because 90% of the world's current mine output would be unprofitable on an all-in costs basis at that price, Goldman's team peg $1200 per ounce as "a good estimate of the floor for gold". In reality, the price dipped to $1150, but the median price for the 3rd quarter was roughly $1200.

Reporting narrow margins with third-quarter earnings at the end of October 2014, the world's top three gold miners Barrick (NYSE:ABX), Newmont (NYSE:NEM) and Goldcorp (NYSE:GG) last reported all-in sustaining costs of $865 per ounce (down 5% from mid-2013), $1063 (down 17%) and $1060 (down 19%) respectively.[1]

The following graphic is an excellent depiction of the mining cost in contrast to actual spot prices.[2]



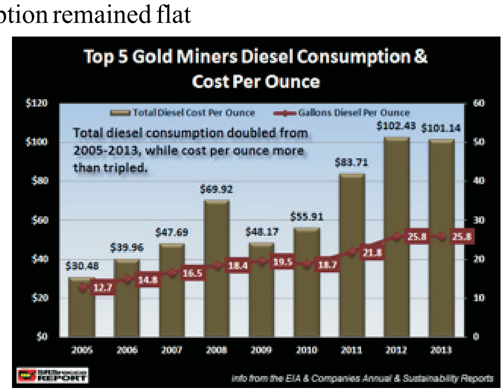
Supply/demand mechanics have told us that when margins are narrow, production, ergo supply drops off. This was the case of oil exploration and production back in 2007/8. Oil was at $140 per barrel and dropped to $40. On a first hand basis, I was traveling the country meeting with oil producers and their exploration/production efforts came to a rapid halt. It was not worth the effort to begin new well sites.

Production per Ton Influences

As gold is mined, existing mines are expending more efforts to increase the yields per ton of pay-dirt. Here is a fascinating cost factor that I found quite surprising. Consider the CAT 797F , it costs $5 million and uses six tires that cost $42,500 a piece. According to an article in the Engineering and Mining Journal. Studies show tire costs can exceed 25% of total haul-truck operating costs per ton; and total tire service and replacement costs over the useful service life of a haul truck can exceed the original purchase price of the truck.

Basically, tires cost just as much or more than the haul truck itself. That is an amazing statistic that just goes to show how expensive it is to mine gold.[3]

Diesel consumption per ounce of gold produced more than doubled from 12.7 gallons per ounce in 2005 to 25.8 gallons per ounce in 2013. You will notice that the diesel figures for 2012 and 2013 are the same. At first I thought we would see an increase in 2013, but as companies started cutting back on construction of new mines as well as high-grading (extracting higher grade ore), consumption remained flat



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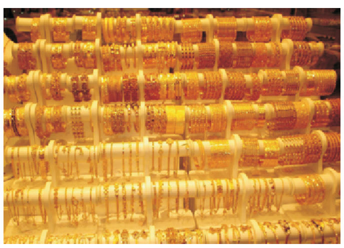
India Demand Surges

One factor we must consider is the demand for gold. As prices increase alternatives are sought out to fill the demand. We find jewelry produced that is silver based and plated with gold and a number of other combinations becoming more prevalent in the U.S. Market. But that is not the case in other countries around the world. In India, jewelry is viewed as a form of wealth that is worn much more than we see in the United States. These cultural differences are having different effects beyond our borders.

Bullion is bought during festivals in India and for weddings as part of the bridal trousseau. The festival season runs from late August to October and is followed by the wedding season. About 20,000 tons of gold are stashed in homes and temples, and Indians often inherit bullions in the form of ornaments or family treasure.



The World Gold Council said that gold imports by India, the world's biggest user after China, more than doubled in the third quarter of 2014 as a decline in prices spurred jewelry demand during festivals. Official purchases jumped to 204 metric tons in the three months through September from 91 tons a year earlier, council data showed today. Demand gained 39 percent to 225.1 tons, with jewelry purchases surging 60 percent to 182.9 tons, the highest for the third quarter since 2008, the council said. Coins and bar usage dropped 10 percent to 42.2 tons. [4]

Historical data for gold demand

Table 13: Historical data for gold demand

	Tonnes						US$bn					
	Jewellery	Total bar and coin invest	ETFs and similar*	Tech-nology	Central banks	Total	Jewellery	Total bar and coin invest	ETFs and similar	Tech-nology	Central banks	Total
2004	2,619	361	133	418	-479	3,052	34.4	4.7	1.7	5.5	-6.3	40.1
2005	2,721	418	208	440	-663	3,124	38.9	6.0	3.0	6.3	-9.5	44.6
2006	2,302	430	260	471	-365	3,097	44.7	8.3	5.1	9.1	-7.1	60.1
2007	2,425	438	253	477	-484	3,110	54.2	9.8	5.7	10.7	-10.8	69.5
2008	2,306	920	321	464	-235	3,775	64.6	25.8	9.0	13.0	-6.6	105.8
2009	1,817	835	623	414	-34	3,656	56.8	26.1	19.5	12.9	-1.0	114.3
2010	2,034	1,225	382	469	77	4,187	80.1	48.2	15.0	18.5	3.0	164.9
2011	2,029	1,573	185	458	457	4,702	102.5	79.5	9.4	23.1	23.1	237.6
2012	1,999	1,347	279	415	544	4,585	107.3	72.3	15.0	22.3	29.2	246.0
2013	2,361	1,766	-880	409	409	4,065	107.1	80.1	-39.9	18.6	18.6	184.5

Global demands for gold are combined with uses of bullion, jewelry and coins. Supply is controlled through the central banks and the World Council. Limits are established to how much can be bought by each country per year and in a 5 years aggregate period to avoid domination by any one particular country. However, gold can be purchased by them in the open market which will have a significant effect on spot prices.

Table 13 listed below shows the global changes in demand. Pay particular attention how the recession that hit in 2009 reduced the market demand for jewelry and increased the demand by central banks for reserves and hedging.[5]

The Prediction

As I have said before, Gold is the true global currency. Global demands are rebounding, economies are fragile in several European and South American Countries, adding to the attraction of an investment that will surpass what guarentees central banks can offer and the risks of volitity of the equities markets for the long run. The United States has a large overwhelming debt that must be managed without resulting severe inflation or explosion of interest rates. I see the price of gold to hover in the $1200 range with moderate increases to the $1350-1400 range in 2015. Beyond that remember. “Ceteris Paribus”.

1. Gold Mining Costs "Led by Prices", Not the Reverse, 10/07/2014, BullionVault
2. What is the Cost of Mining Gold?, 5/21/2013, Visual Capitalist, Jeff Desjardins
3. Gold Mining Industry: Fuel Costs Explode Over the Past Decade, 8/4/2014, SRSrocco
4. Gold Imports by India Double as Price Drop Fuels Demand, 11/12/2014, Swansy Alfonso
5. Gold Demand Trends, Second Quarter 2014, August 2014,World Gold Council