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Dryblower on the signals being sent by the rising gold price

Monday, 12 January 2015



AFTER three years in the wilderness gold has returned to centre-stage in the Australian mining industry, an event which is warmly welcomed but one which raises as many questions for Dryblower as it answers.

The first, and most disturbing, is that if gold is the star does that mean everything else is in trouble?

The reason for asking is that gold traditionally rises to the top during periods of economic recession. It is a metal which loves bad news.

Price moves over the past few weeks point to gold playing precisely that role. It has risen steadily since late last year as political tensions have shaken Europe and investors there have returned to a proven safe haven in times of trouble.

But Europe's problems with Ukraine, Greece, Italy and Islamic terrorism (to mention a few) do not explain why gold has done best in Australia where the gold index on the Australian stock exchange has risen by almost 20% in two weeks.

That remarkable rise, which qualifies for the description of "bull market" even if the index is rising off a low point, is doing more than reflect the gold price as we know it today.

What the gold index might be reflecting is a future gold price which, in Australian dollars, could be on its way to an all-time high of \$A2000 an ounce, or more.

Before getting into crystal-ball gazing territory and making the classic mistake of all gold watchers by predicting the future price, it's worth considering some of the events of the past 10 weeks, including:

- A 3.8% rise in the US dollar gold price which is up from \$US1178 an ounce in early November to Friday's closing price of \$1223/oz.
- An 8% fall in the value of the Australian dollar since early November from 88c to 81c.
- A 38% rise in the gold index on the ASX from 1678 points on the first trading day of November to 2315 on Friday.

Books could be written about those three facts though for Dryblower's purpose it's only necessary to point out that the reaction of Australian investors to gold is sending a simple story which is all about currency and a little about the underlying commodity.

The US dollar gold price, despite what some people have been saying, is really not up that far, especially given recent events in Europe where a break-up of the common currency, the euro, looks to be closer than ever thanks to the potential of Greece quitting – the so-called "Grexit".

Even the terrorist attacks in Paris did little for the US dollar gold price which rose by just \$7/oz in the aftermath of the attacks.

It has been a totally different story on the Australian stock exchange, where a gold rush appears to be developing as local investors place bets on a combination of gold continuing to creep higher in US

dollars, and for the Australian dollar to slide lower, a pincer move which is already doing wonders for the A-dollar gold price and which could do more soon.

The currency effect can best be seen by converting gold to Australian dollars with that early November price of \$1178/oz posted at a time when the Australian dollar was being exchanged at 88c – producing a local gold price of \$A1338/oz.

On Friday, when gold closed in London at \$US1217.75/oz, and the Reserve Bank was quoting an exchange rate of 81.38c, the Australian gold price was \$A1496.38, a fraction short of the \$1500/oz mark.

And that's the key point because gold, on conversion to Australian dollars, is looking very strong, and could get a lot stronger if the currency effect gets stronger and the Aussie dollar keeps falling – which it is likely to do given the country's poor terms of trade caused largely by falling prices for other commodities, especially iron ore, coal and oil.

How far will gold go? Heaven knows, but as a guide it seems that it might slip past the \$1500/oz mark today because the last price Dryblower saw (after London closed on Friday) was \$US1223.25/oz from the World Gold Council, and if you apply the official RBA exchange rate from Friday of 81.38c that produces a price of \$A1503.13/oz – so, we might already be there.

It's currency, not commodity, which has driven Australian gold company share prices up sharply in recent weeks with Newcrest Mining rising by 23% from \$9.90 in early November to a Friday close of \$12.18, and Northern Star Resources by an eye-catching 70% from \$1 to \$1.70.

What comes next is the really interesting bit and to save readers reaching for their own crystal balls here are a few gee-whiz calculations using the \$US1223.25 gold price and a few exchange rates.

At 80c the Australian gold price rises to \$A1529/oz. At US75c it reaches \$A1631/oz. At US70c it hits \$A1747.50/oz, and at US60c (which is what some analysts are tipping) the Australian dollar gold price soars to \$A2038.75/oz.

Will gold go that high? It could, and there certainly appear to be some investors placing bets that it's headed that way.



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