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GOLD PRICE SET A NEW RECORD: KEY DRIVERS OF THIS GROWTH

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Abstract. The article analyzes the growth in the price of gold due to the prevailing factors and circumstances in the global economy, widespread uncertainty and growing geopolitical tensions.

Keywords: increasing geopolitical tension, global crisis, inflation, economic recession, monetary policy, gold price, de-dollarization.

Just a year ago, we wrote, and it looks no less relevant today, and we said that nowadays, and this is no longer an irrefutable fact, the whole world is covered with uncertainty, and the growing geopolitical tension everywhere leads to problems in the global economy and the state of society. And sometimes it seems to all of us that globalization and cooperation are no longer relevant [1].

And this is indeed the case, as the world has faced dramatic changes and upheavals over the past few years that have changed society and economies dramatically: Brexid in 2016, US-China trade wars, the "black swan" in the form of COVID-19 in 2020 (in 2020, borders around the world closed, people and economies were isolated from each other: citizens were even banned from leaving their homes and the economy was disrupted, the service and entertainment sectors were very badly affected).

And because of geopolitical confrontation, military conflicts and economic isolation of countries have intensified in the world since 2022 [2].

All these events have changed the usual course of things and will have long-term consequences. And if during the COVID-19 pandemic the isolation of economies was a forced measure, in 2022 deglobalization is already political and will have a long-term effect. Sanctions due to the military operation in Ukraine have divided Russia from Europe and the United States: logistical routes have been destroyed, and multi-year agreements and contracts have been canceled. Relations between the US and China do not even think of improving. The Arab-Israeli conflict and the Iran-Israel confrontation are not separate and somehow isolated.

And the inability of the world's largest economies to agree on all these contradictions also has its price: rising inflation, which due to the closure of borders and violation of the balance of supply and demand is only getting worse, and due to the strengthening of monetary policy, and thus worsening conditions for lending and doing business, are pushing the world economy into recession [3].

And against this background, the gold price has repeatedly updated its highs. Thus, if the price of gold futures for June 2023 on the New York COMEX on April 13, 2023 rose to $2063 per troy ounce for the first time since March 2022 (quotes of the precious metal were approaching the historical record, which was set in August 2020 at the level of $2075 per ounce) [4],

then since mid-February 2024 the price of gold has been storming new heights: at the moment the metal exceeded its value of $2400 per ounce [5]. Thus, since the beginning of 2024, the asset has added more than 14% in price. And, in the opinion of most analysts - this is not the limit.

So what is it that is supporting the further growth of precious metal prices today, in addition to the factors noted at the beginning of this material?

Let's highlight a few more main reasons, and first, let's look at the dynamics of gold prices over the past 50 years.

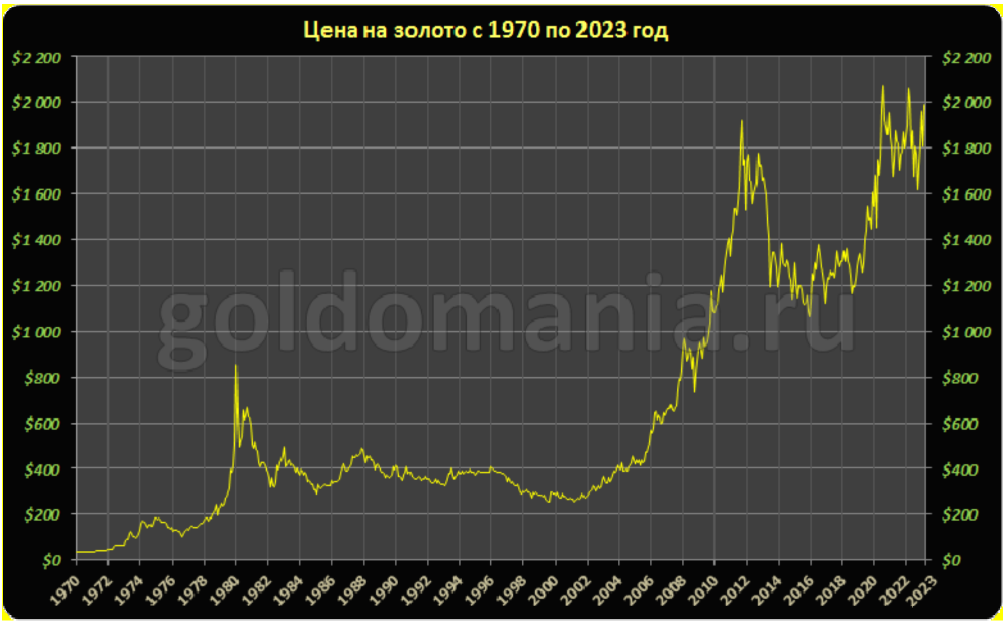

Figure 1. - Gold price dynamics over the past 50 years, in US dollars [6]

Next, let's note a few obvious changes in the gold price movement since the end of 2022, and this will be a new scenario.

So, before the geopolitical events of 2022, the price of gold over the last 90 years depended primarily on the volume of transactions between the Western and Eastern markets. Western countries determined supply and demand, while Eastern countries were the counterparty to the transaction. And according to the World Gold Council (World Gold Council), when the largest centers, in particular Great Britain or Switzerland, increased the volume of physical gold purchases, the price for it began to grow, and vice versa. As a result, gold moved from the West to the East and back again, synchronizing with the price: from decreasing to increasing.

The second factor that has historically and very seriously influenced the value is the relationship between the price of gold and the real yield of US government bonds. When real yields fall, bonds lose their attractiveness, which ensures that investors move into gold. But if the trend reversed and real yields began to rise, investors moved back into bonds.

However, since the end of 2022, both patterns have faltered. For example, according to Bloomberg, in August 2023, Treasury bond yields rose to a 15-year high (since the 2008 crisis). Thus, the yield on ten-year U.S. bonds rose to 4.33%, i.e. almost eight basis points above the 2022 highs. This should have significantly affected the gold price downward. But not only did it not decline, it rose by 16% from November 2022 to August 2023, from $1643 to $1954 per ounce.

It is also necessary to note here that in addition to the correlation of real profitability with the price of gold, the relationship between the volume of transactions with gold and its price has also ceased to work. Starting from the third quarter of 2022, both Great Britain and Switzerland are gold exporters, i.e. sellers.

According to the historically established paradigm, this should also have become a reason for the decline in the cost of gold. However, as we see, this is not happening. Thus, the West has ceased to significantly influence the pricing of the precious metal. Still, in order to understand what influences a significant change in gold pricing today, let's try to note the factors of its growth.

1. Escalation of geopolitical conflicts.

Due to geopolitical events in 2022, dollar assets have become more risky. Therefore, central banks in the Global South, the Middle East and Turkey have increased the importance of holding a neutral asset without additional risk. Thus, from the end of 2022, they started to actively pursue a policy of building foreign exchange reserves and covertly buying gold in Switzerland. This was done in order not to create frenzy around gold after the U.S. froze Russia's reserves, because otherwise the price of gold would rise significantly. And according to the report of the World Gold Council (WGC), in 2022 the central banks purchased 1136 tons of gold, which is the maximum for the last 55 years [7].

The WGC publishes such reports quarterly based on Metals Focus surveys that reflect how much gold they believe central banks have bought. But after the February 2022 events, these quarterly estimates are also higher than what central banks officially report to the WGC. Thus, it is safe to say that central bank interest is now playing a key role in driving the gold price.

We have also seen the reaction of the gold price since the beginning of the Palestinian-Israeli conflict: since October 2023 it has added more than 8%.

Hence we can conclude that any aggravation in geopolitics will have a positive effect on the gold price.

2. Inflation.

In 2022, global inflation reached its highest levels in decades. And despite the fact that the International Monetary Fund (IMF) predicts it should decline from its peak of 8.7% in 2022, to 6.9% in 2023, and 5.8% in 2024, sustained price increases will continue for an even longer period of time, in our view [8].

One major factor that points to this is the U.S. government budget deficit. Due to large social programs before the elections, investments in green energy, construction and support of dilapidated infrastructure, defense spending and assistance to its partners around the world, the U.S. needs to continue to increase its budget expenditures. And historically and repeatedly, it has been observed that excessive deficit budgets lead to inflationary consequences. In this scenario commodities become an attractive asset class.

And despite the fact that gold is not directly a pure inflation-protective asset, we can clearly see that this metal will continue to reduce risks in the event of various global turbulences and volatilities.

3. Phenomenal growth of the U.S. national debt.

Let's still not forget the growing U.S. national debt (See Figure 2 top left above).

Figure 2. – US government debt indicators [9]

In fact, this is the phenomenal growth of the national debt, which has long had and will continue to have a serious impact on many economic processes around the world. Obviously, the U.S. national debt has already grown to such an extent that the problem must be solved somehow, but no one knows how to do it at the moment. Of course, the process may be frozen for some time, but no one can say for how long.

As we can see, the figure (as of mid-April 2024) is really very large, moreover, it is simply unsustainable, because for each US taxpayer there is already more than $280 thousand, and to service such a debt in most cases is simply not possible.

4. Global economic outlook and possible recession in the US.

As we noted above, today we should not forget about the future outlook for the global economy and a possible recession in the United States, the likelihood of which cannot yet be written off.

Since the pandemic, the negative correlation between stocks and bonds has also been broken, different asset classes have ceased to serve as a hedge for the portfolio, while gold, on the contrary, can be used as diversification. At the moment, the share of investors in gold for hedging purposes is still insignificant. Therefore, if the recession scenario is realized, central banks of the global South will continue to form gold and foreign exchange reserves. And if geopolitical conflicts continue to escalate, the potential for gold price growth may be more significant.

5. Underinvestment in the industry.

The fundamental factors that also give us positive signals about the growth of the gold price include underinvestment in the industry, similar to the oil sector. Moreover, mining companies are more conservative in their financial policy and prefer, like oil companies, to distribute their cash flows in the form of dividends to investors. This may also indicate that cash is not being spent on new exploration and on increasing the existing capacities, as result which will not allow for a sharp increase in the existing production volumes.

The ESG agenda should also be taken into account: it encourages mining companies to emphasize mining not precious metals, but those metals that are involved and used in the green economy.

Against this background, let's speculate on the future outlook for the gold price?

And as we noted above, the standard market correlations that have been forming for a long time have been broken. And contrary to the belief that the price of gold should fall as real yields rise, this has not happened so far because of central banks' policy of building up foreign exchange reserves. And we will move towards the historical average value of 40% of the gold composition in reserves (against the backdrop of further geopolitical upheavals and problems in the economy), then this means that at least another $3.0 - $3.5 trillion could be added to this asset.

Thus, the growth of quotations may amount to at least 25% in the near future, which will correspond to a record level of more than $2700 per troy ounce.

In the meantime, we would like to say, as we said just a year ago, ”fasten your seat belts, this will be an unforgettable adventure - none of us, except maybe the deepest old people, has ever experienced such a thing”.

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