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How likely is $5,000 gold?

McEwen Mining chairman and prominent gold price bull Rob McEwen has laid out five reasons why gold will hit US$5,000 an ounce. When could it happen?

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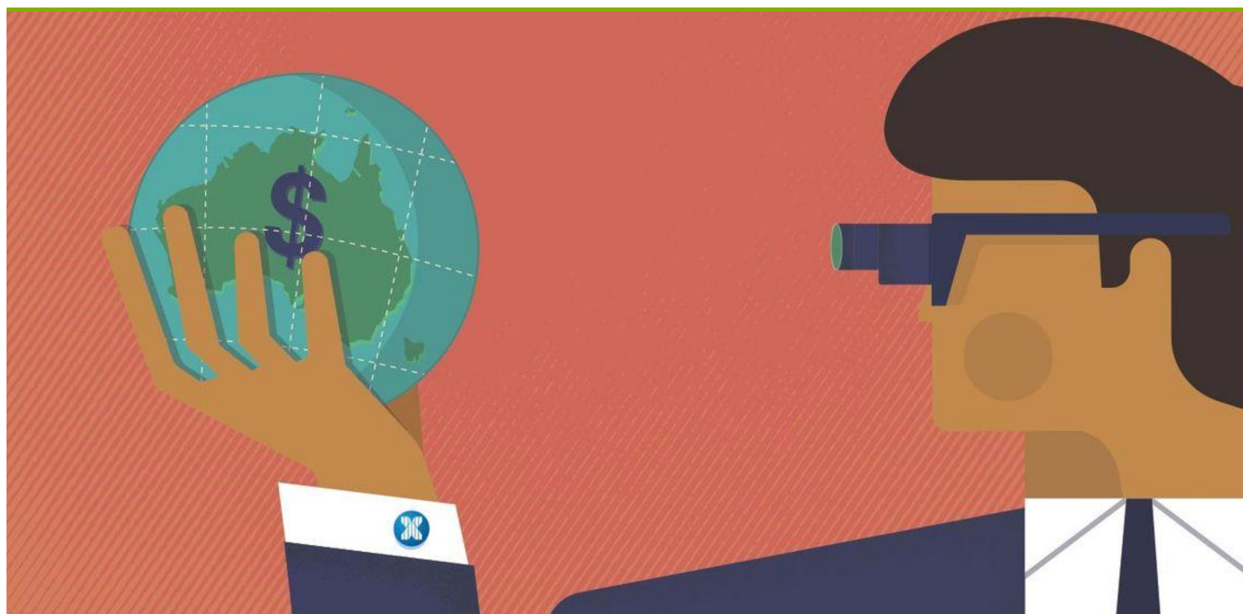

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Gold prices are potentially influenced by so many disparate economic forces that getting one's head around them all is beyond the intellectual reach of most humans. It would be folly to deny the possibility of McEwen's target being hit.

That said, gold has been one of the most disappointing investments over the past 40 years. In the early 1980s, forecasts of gold prices easily reaching several thousand dollars were commonplace. History shows the gold bulls of the 1980s hugely misinterpreted the macro factors they foresaw driving gold prices higher.

McEwen's number one reason for his bullish forecast, as he explained recently in an interview on Bloomberg TV, is a long established upward trend in the gold price. He pointed to successively higher low points following two earlier periods of strong price gains.

The historical uplift in the gold price has been the product of two steps. The first was a 600% jump starting in the mid-1970s followed by a 1982 low point near $295. The second was another 600% surge starting in the early 2000s followed by a 2015 low point close to $1,050.

McEwen is essentially telling us to connect and extrapolate the two points although he has pointedly eschewed putting his own name to when the price would get to $5,000.

Unfortunately, the 1982-2015 increase averaged less than $25 a year. At that rate, the $5,000 target would be hit in around 2065. Catastrophic climate change will be faster. Alternatively, replicating the 4.3% annualised rate of rise would get us to the

McEwen forecast by 2047.

The slow pace of appreciation reflects a frustratingly long wait between two periods of outstanding investment returns nearly three decades apart.

The gold price rises of the 1970s and early 2000s were accompanied by historically large shifts in the distribution of global wealth. The first was associated with OPEC flexing its muscles to divert a huge flow of funds from advanced oil importing economies to those of the Middle East. The second came with China pushing speedily into the ranks of the largest industrialised economies.

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McEwen's analysis omits any suggestion of what equivalently dramatic change in the structure of the world economy would precipitate the next similar shift in the gold price.

The second reason for higher gold prices, according to McEwen, is central bank buying "in a manner we have not seen in 40 years".

According to the International Monetary Fund (IMF), official gold holdings have risen from 29,964 tonnes in March 2009 to 34,408 tonnes at the end of June 2019.

Although such a rise has been unprecedented in the past 40 years, the size of today's official gold holdings are similar to those in early 1997 before the onset of the largest decline in 40 years.

Central bank buying may continue but, in a relatively closed system, headlines proclaiming unprecedented buying by one group could just as easily be replaced with stories of unprecedentedly large sales by others. At best, this is a glass half full argument.

The third reason cited by McEwen for a higher gold price is negative interest rates on some $16 trillion worth of government bonds worldwide and yields slipping lower on US government debt.

So far this year, the gold price rise has been similar to the increase in US government bond prices and the utilities component of the S&P 500. The gold price move has been consistent with shifts in the prices of a range of assets often referred to as "safe haven" investments.

These price movements can be characterised as cyclical, at least so far, and therefore reversible once global growth conditions improve, possibly with the help of fresh policy moves by German, Chinese and US governments and their central banks.

The fourth reason given by McEwen is the rise in the price of equities which has outpaced gold price movements. To make his point, he asked rhetorically which is likely to double from here, equities or gold.

A doubling of equity prices is not such an outlandish idea. If, for example, the earnings of S&P 500 companies rose by 6% a year for the next 15 years, even a more modest earnings multiple of 15 would imply a doubling in the S&P 500.

The propensity to consume, described by McEwen as being at a 60-year low, is the fifth reason to expect higher gold prices.

Weak consumption - or relatively high savings - suggests a need for more stores of wealth. With gold supplies limited by exploration and mining activity, prices would need to push higher to accommodate a stronger flow of savings.

Historically weak spending leading to an unusually strong build-up in savings could have been a compelling argument, if it were true. The US propensity to consume has fallen since 2005 when it hit a 50 year peak but has remained higher than between 1960 and 1990. Similarly, within the European Union, the propensity to consume did decline after 2009 but now sits near pre-2008 levels.

An IMF Working Paper (WP/18/277) published in December 2018 analysed the drivers and prospects of China's savings. The Fund's report concluded the global household savings rate had halved since 1980,

not grown. It found that, "since 2012, China's household savings have plateaued and gradually begun to decline".

Overall, McEwen's five reasons for gold prices to hit new heights fall disappointingly short of a compelling case.

Right now, investors are prepared to hand over their cash to governments for safe keeping without any compensation for inflation or risk. Rising demand for competing stores of wealth has warranted a gold price adjustment. That could prove wholly cyclical.

The ready embrace by investors of government-provided safety is the opposite of a failure of confidence which could propel gold prices to $5,000 in a step change reminiscent of the 1970s or early 2000s.

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