

# Outlook for Gold

Ninth International Gold Symposium

Lima, Peru

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DUNDEE WEALTH ECONOMICS



# Overview

## Gold down on recession – up on reflation!



## ***Outlook: Nine Bullish Arguments***

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1. ***Global fiscal and monetary reflation: PIIGS, US, etc.***
2. ***Global imbalances: the dollar must decline***
3. ***Global FX reserves are “excessive”: diversification***
4. ***Central bank attitudes to gold: now positive***
5. ***Gold is not in a bubble: room to rise***
6. ***Mine supply is flat: “peak” gold?***
7. ***Investment demand: long-run uptrend***
8. ***Commodity price cycle: many years to run***
9. ***Geopolitical environment: positive***

## ***Bullish: (1) Global Reflation***

### ***Antecedents of the Sovereign Debt Crisis:***

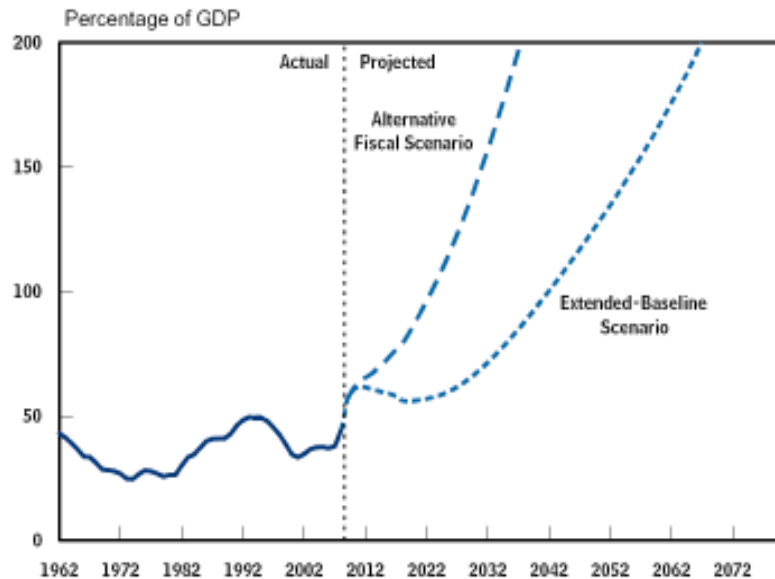
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- 1. Baby Boomer Retirement: The fiscal stresses this would cause was visible years ago***
- 2. The Great Recession: All governments around the world eased monetary policy and pushed their budgets deeply into deficit – and now the early boomers are starting to retire***
- 3. The Euro Common Currency: Membership in the Euro System caused interest rates to decline significantly even for “undisciplined” governments***

# Bullish: (1) Global Reflation

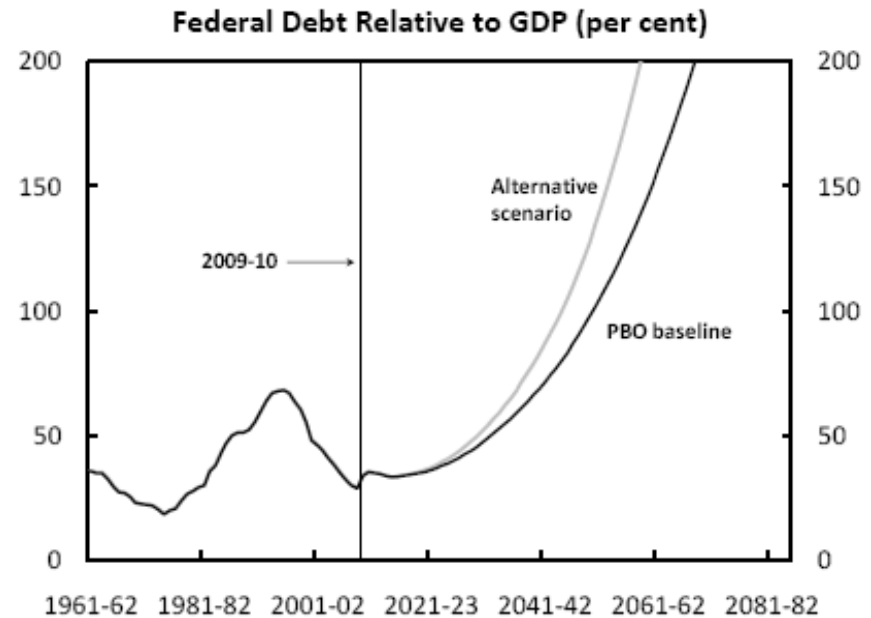
## Baby boomers are starting to retire ...

### US Scenarios



Source: Congressional Budget Office, November 6<sup>th</sup> presentation by Director Elmendorf  
Slide: Federal Debt Under CBO's Long-Term Budget Scenarios

### Canadian Scenarios



Source: Office of Parliamentary Budget Officer  
"Fiscal Sustainability Report", Feb 18, 2010

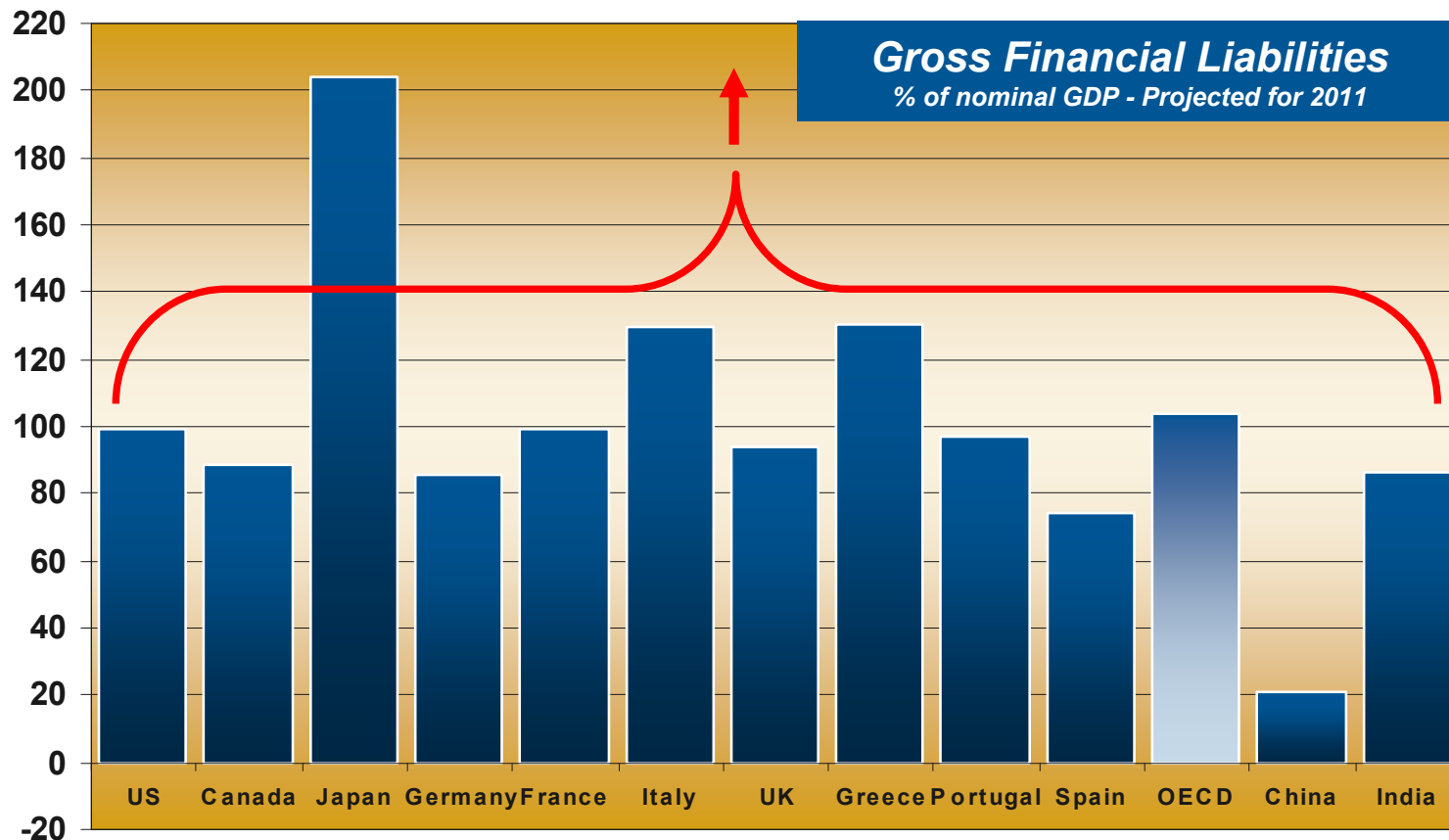
### Policy Options:

Increase retirement age  
Decrease payment per service  
Increase tax rates for services

Decrease benefits  
Decrease number of services  
Institute new taxes (VAT?)

## ***Bullish: (1) Global Reflation***

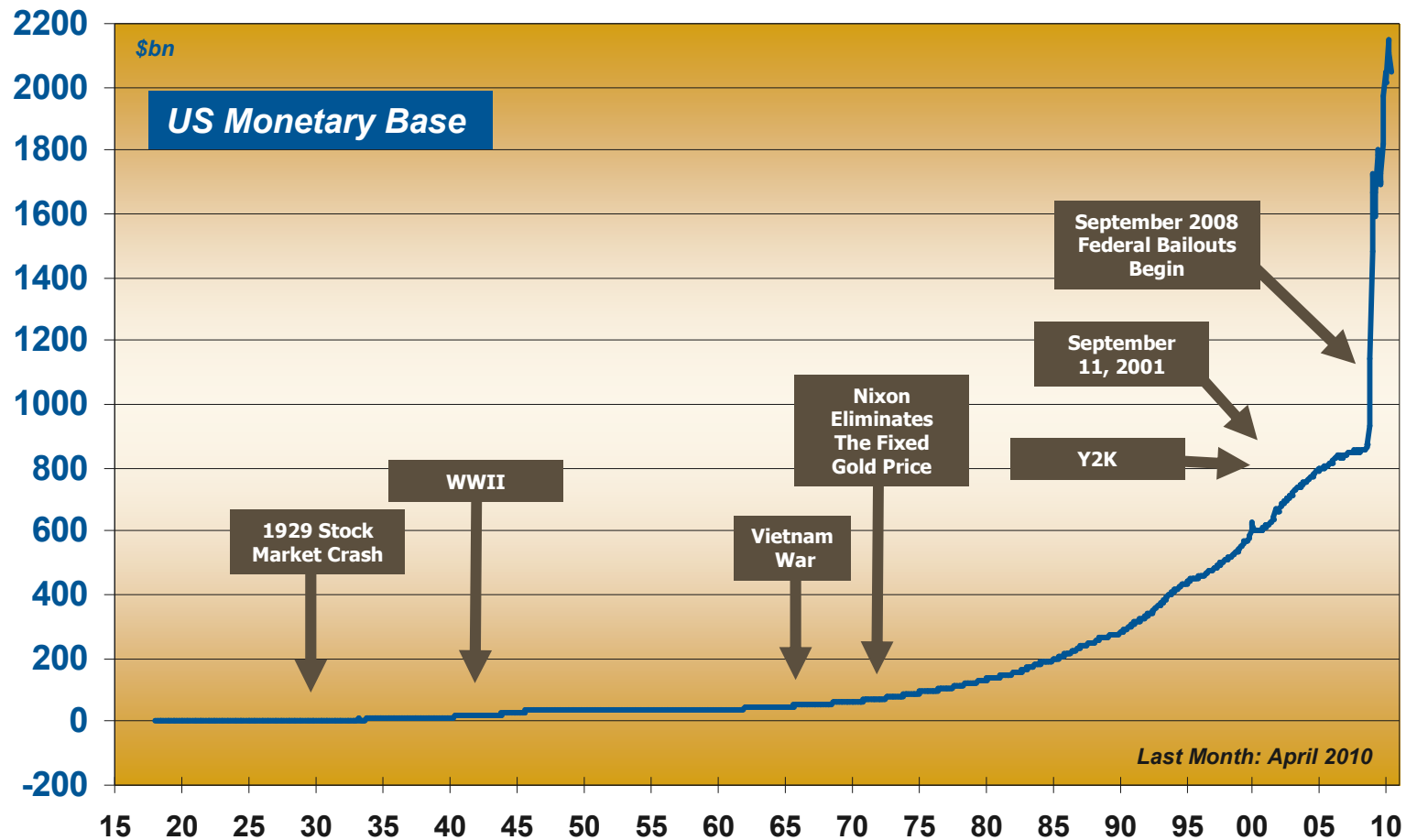
***Financial liabilities are set to ... explode ... !***



Source: OECD

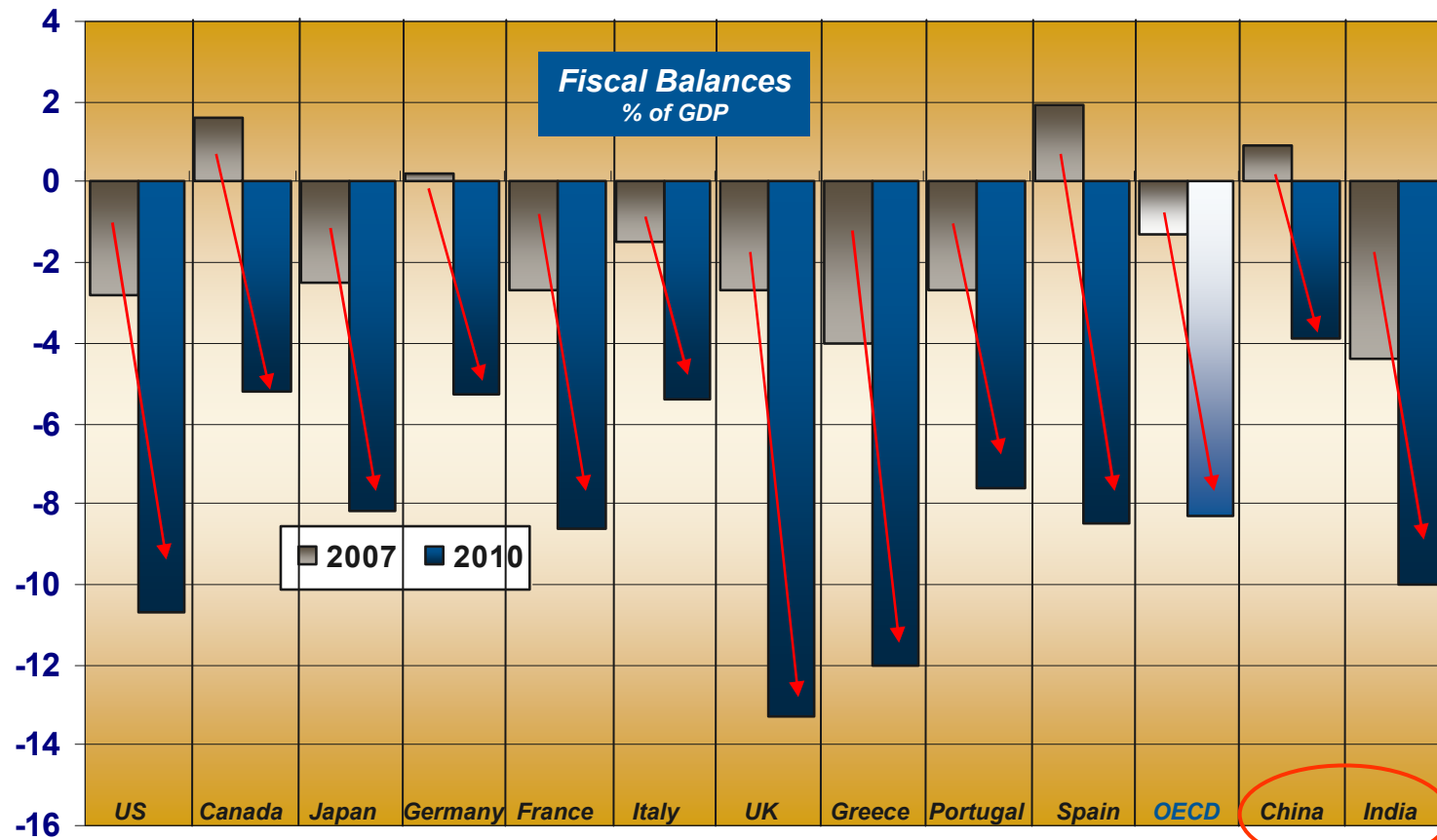
# Bullish: (1) Global Reflation

Monetary policy stressed by Great Recession



## *Bullish: (1) Global Reflation*

*Great Recession has blown up all budget deficits*



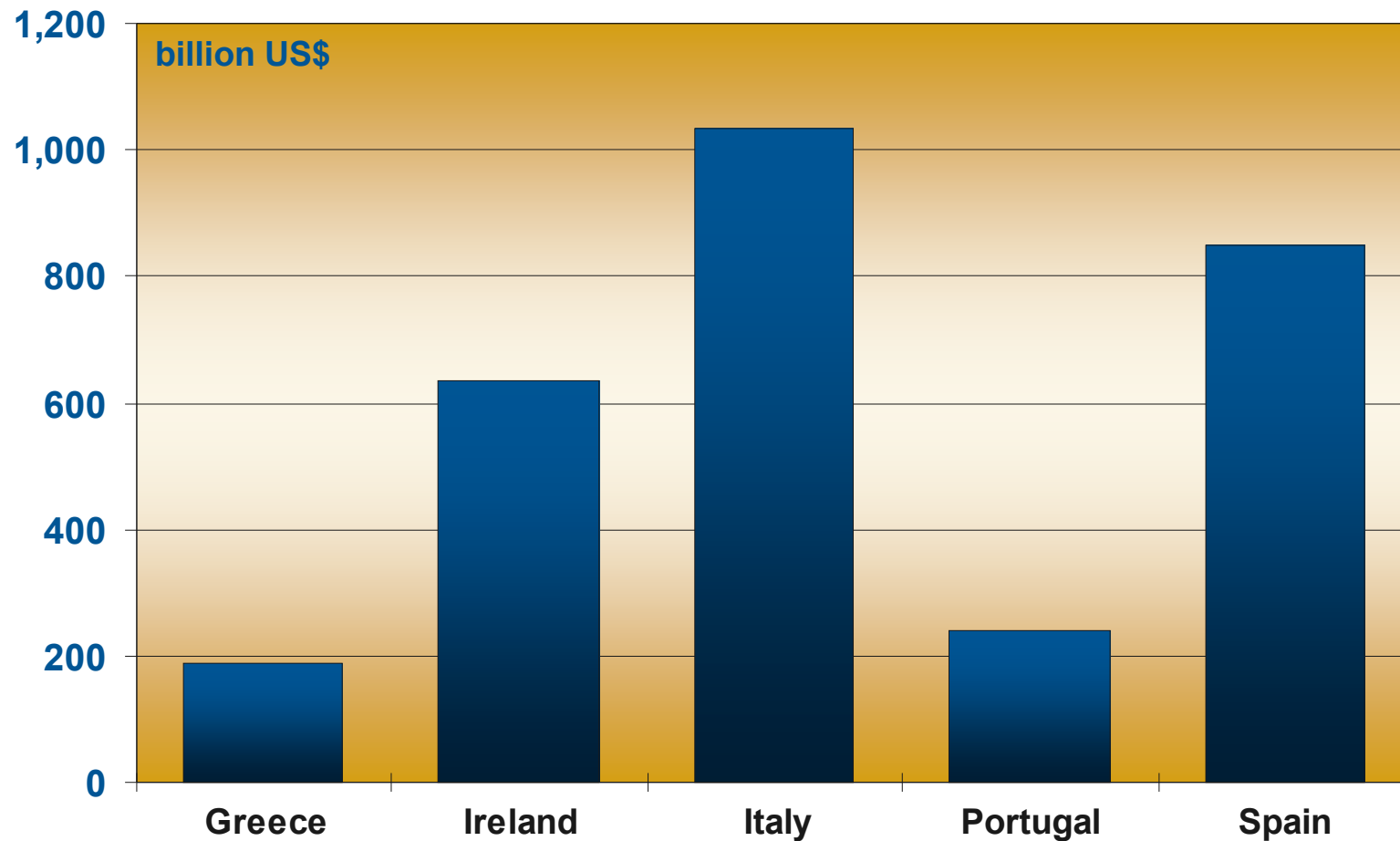
Source: OECD, IMF

**THEY ARE ALL PIGS!**



## ***Bullish: (1) Global Reflation***

***The Greek (PIIGS) crisis – European bank debt!***



# *Monetary and Fiscal Policy Stress*

## *How to reduce debt?*

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### ***Government Choices:***

***Renege on promises***

***Cut other services***

***Raise taxes***

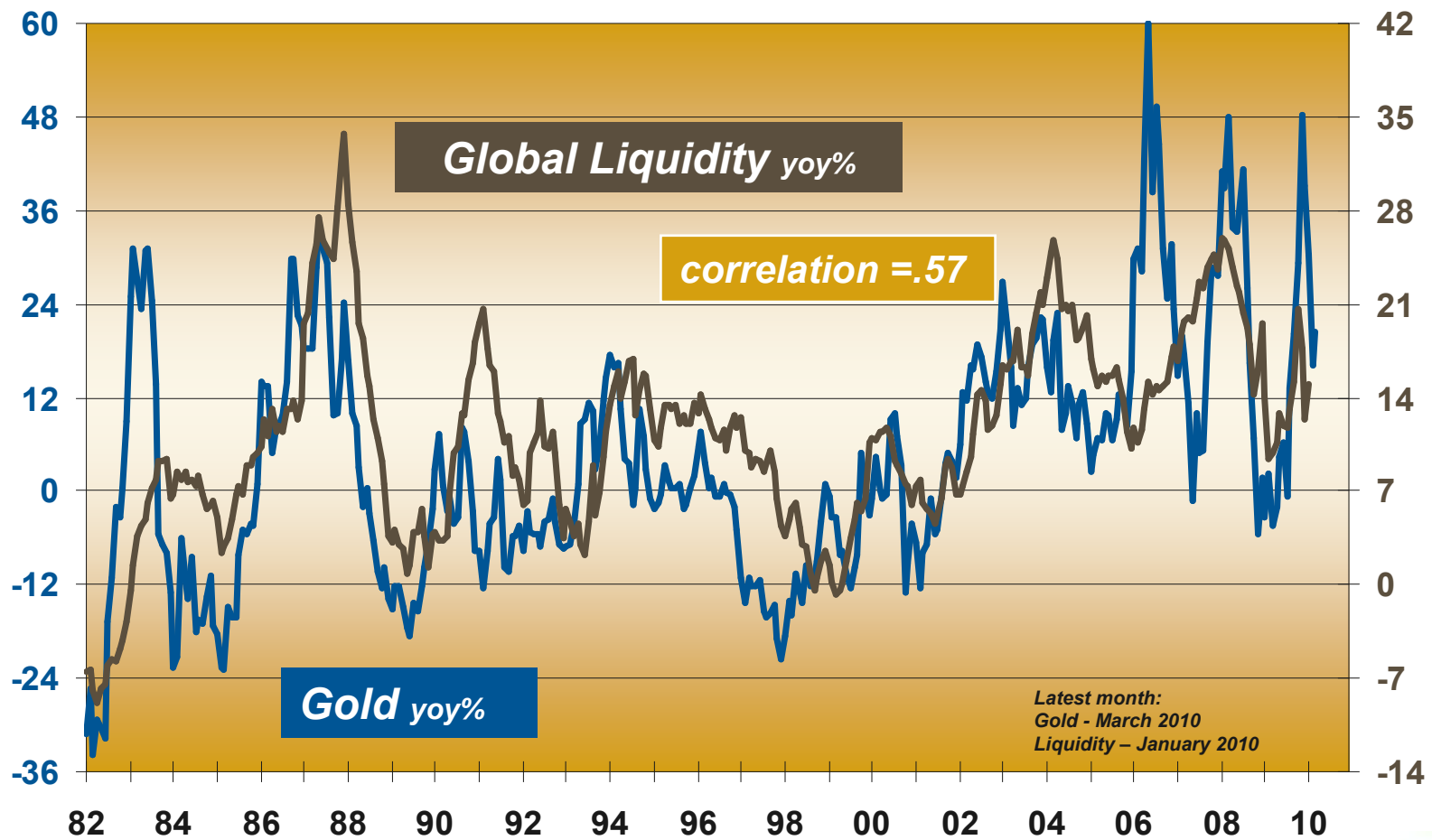
***Print more money***

***Where will the €750 billion from the May 9<sup>th</sup> European rescue package come from?***



# Bullish: (1) Global Reflation

“Money” drives gold ...

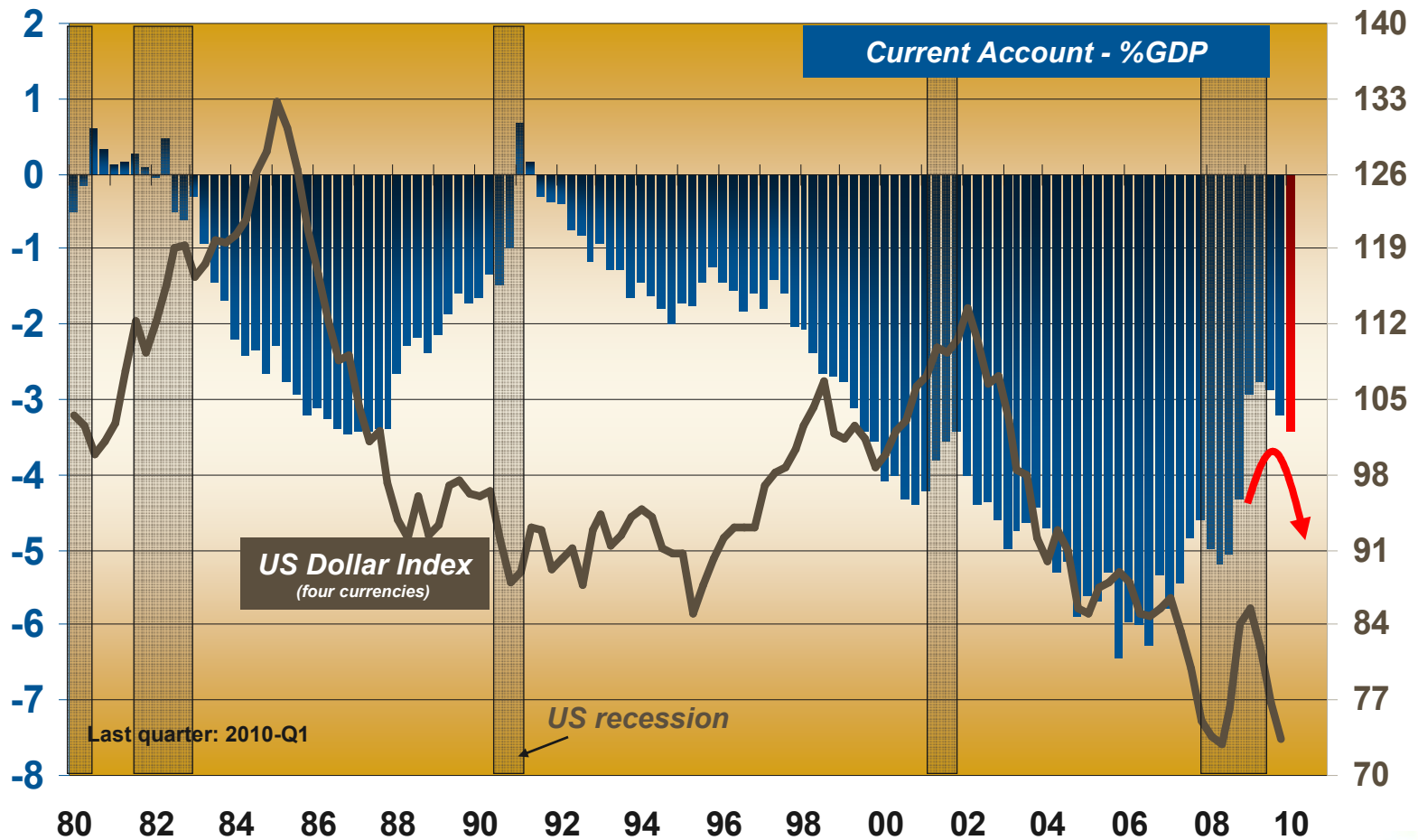


Global Liquidity: FX Reserves + US MBase  
Source: IMF, Federal Reserve



## ***Bullish: (2) Global Imbalances***

***The US current account deficit is rising again***



***\* So will continued recession!***



## ***Bullish: (2) Global Imbalances***

***The Obama Administration wants the dollar down***

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***“We can’t go back to the era where the Chinese or the Germans or other countries just are selling everything to us, we’re taking out a bunch of credit card debt or home equity loans, but we’re not selling anything to them”***

***President Obama on CNN in run-up to the G-20 Meeting in Pittsburgh, Sep 2009***

## ***Bullish: (3) Global Reserves***

*... which means FX diversification is likely*

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*The choices for a central bank are limited:*

### ***1. Other currencies***

- *These currencies must have deep international capital markets - some do: yen, euro, pound (**but euro now suspect**); some don't: renminbi, ruble*

### ***2. SDR's issued by the IMF***

- *The SDR is a basket currency that includes only the dollar, yen, pound, and euro - it has limited use outside of central bank markets*

### ***3. Gold and other "hard" assets***

- *But gold market is "narrow" and China likes commodity-producing assets*



## ***Bullish: (4) Central Bank Attitudes***

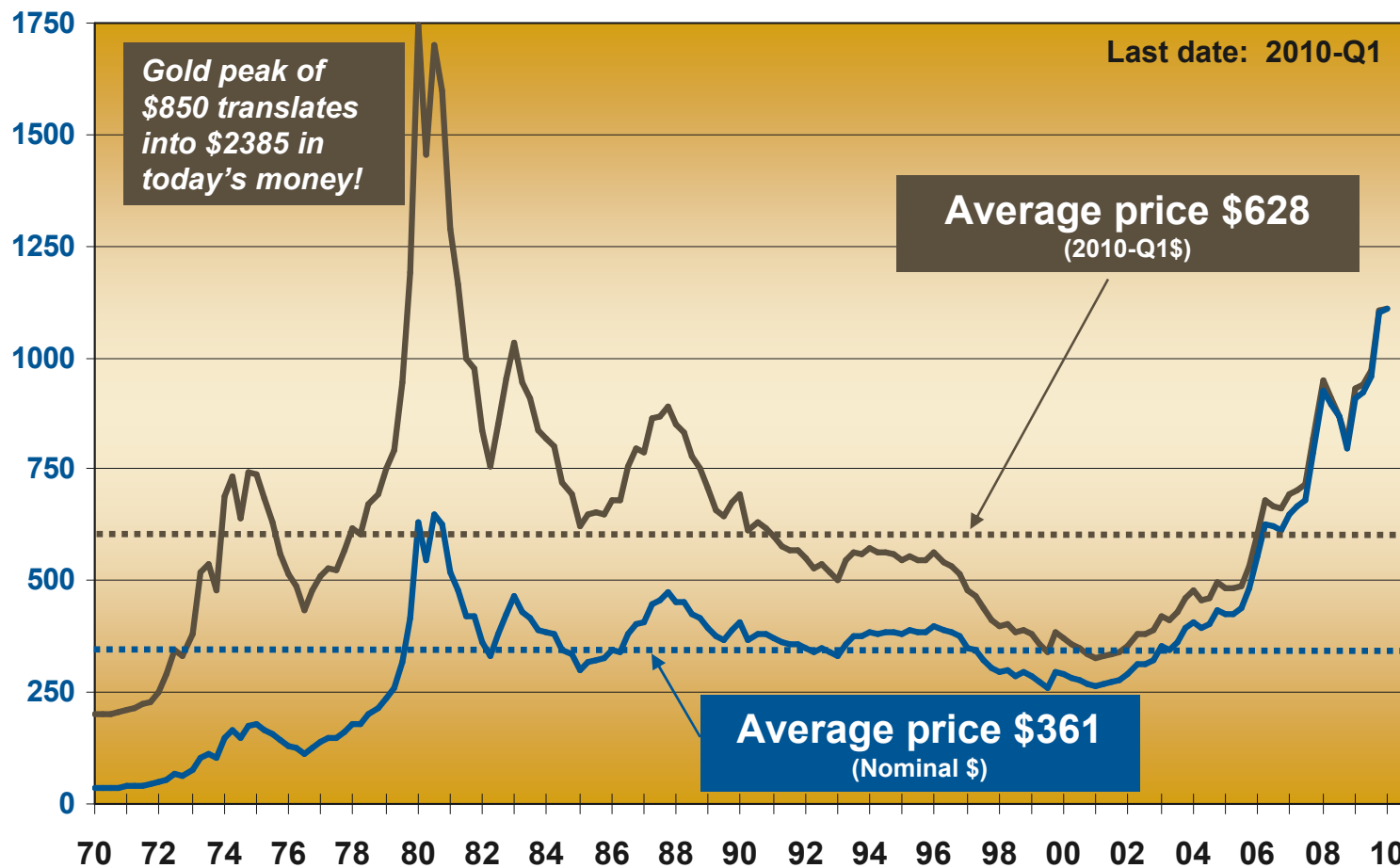
***Central bank attitudes towards gold have changed***

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- 1. CBGA signatories are selling less gold***
- 2. China raised its gold reserves from 600 to 1054 tonnes***
- 3. India bought 200 tonnes of IMF gold***
- 4. Russia and India have suggested a new SDR basket should include gold***

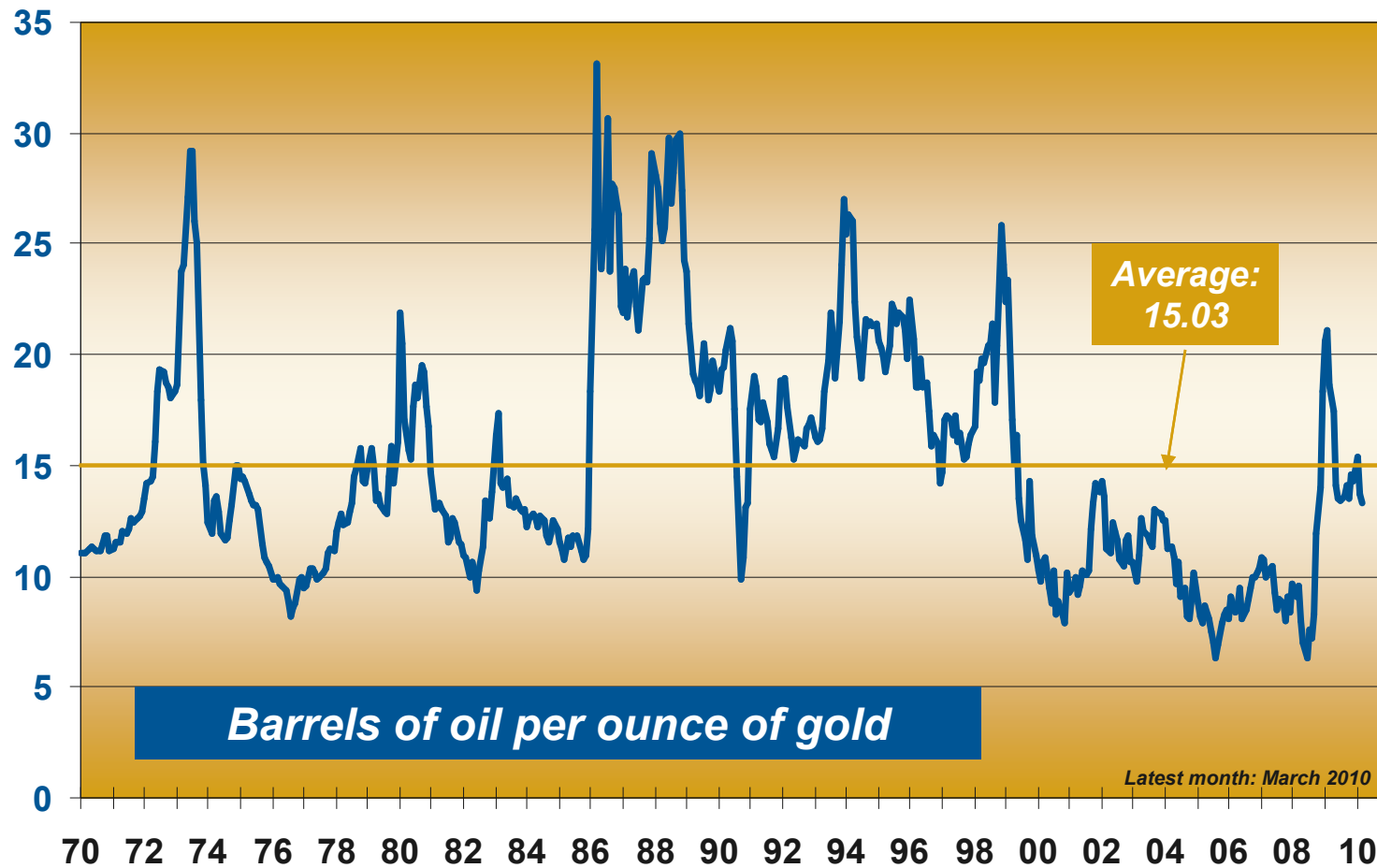


## ***Bullish: (5) Gold Not in a Bubble ... in constant Dollars***



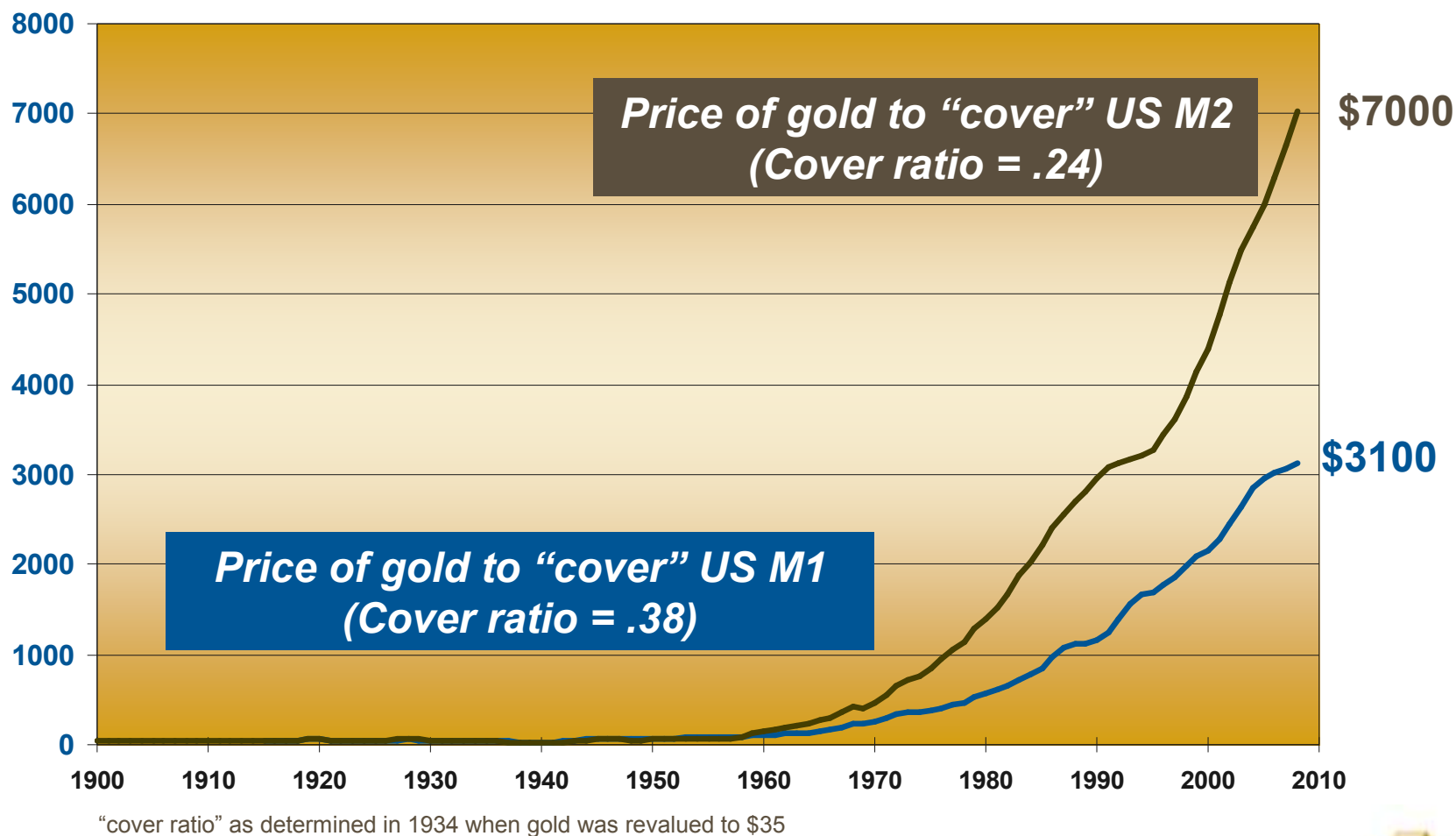


## ***Bullish: (5) Gold Not in a Bubble Not in terms of oil prices***



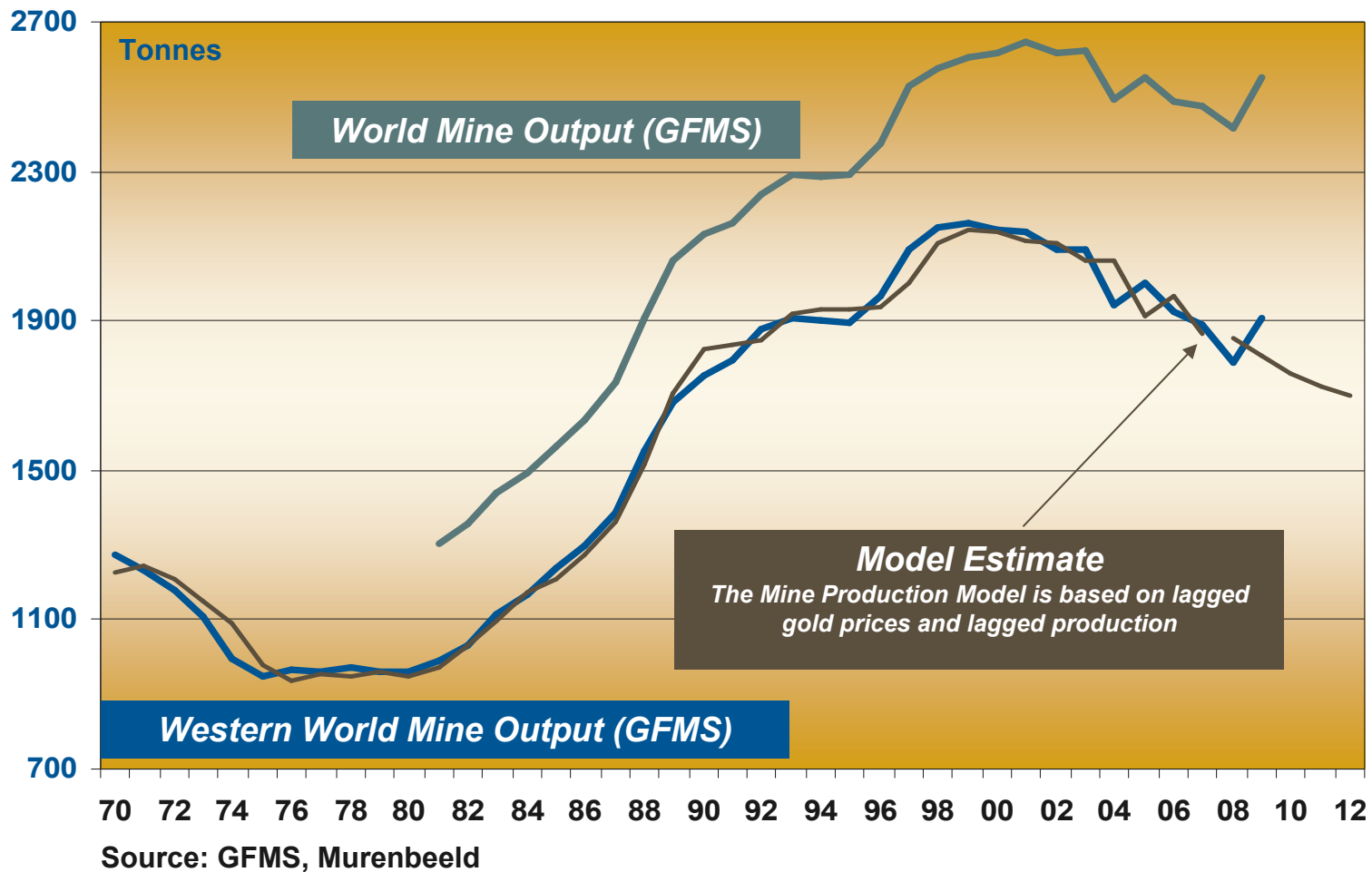
## ***Bullish: (5) Gold Not in a Bubble***

***Not if US gold had to “cover” US money supply***



# Bullish: (6) Gold Supply

## Model suggests WW mine output decline



## ***Bullish: (6) Gold Supply***

***The general commodity supply outlook is impaired***

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- 1. Difficult governments: i.e. Venezuela***
- 2. Governments are in debt: i.e. Australia has introduced a “resource super-profits tax” ...***
- 3. Environmental hurdles: i.e. The Gulf of Mexico disaster changes the future for off-shore drilling***
- 4. “Peak” gold, “peak” oil, peak ... : The low-hanging fruit has been picked ...***



## ***Bullish: (7) Investment Demand***

***Can we make a case for investment demand?***

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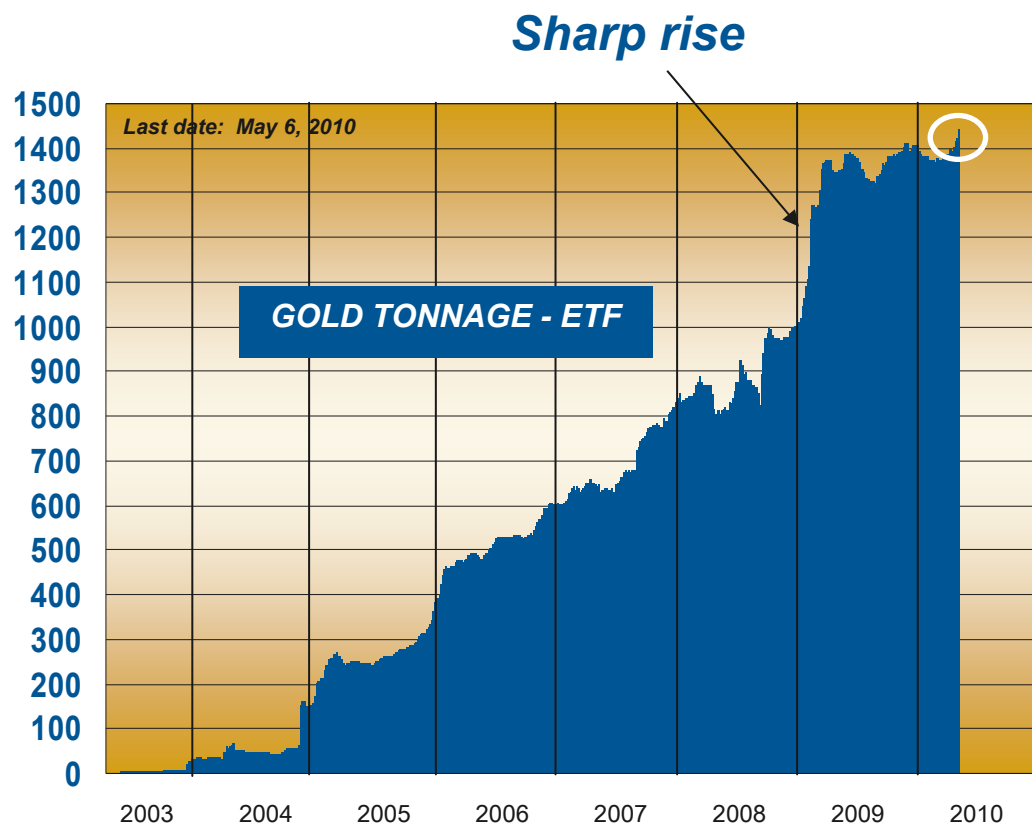
- 1. Central banks are rediscovering that gold is not another central bank's liability (i.e., China holds US Federal Reserve liabilities!)***
- 2. The private sector is beginning to worry about the nature of fiat currencies and the likelihood of currency debasement***
- 3. The private sector is also discovering that gold has attractive portfolio characteristics (gold improves the "efficient frontier")***
- 4. Commodities in general, and gold specifically, are morphing into an "investment asset class" (like real estate did once it became securitized)***
- 5. Jewelry demand wasn't always the dominant demand in the gold market; private and central bank demand was historically more dominant***
- 6. Major deregulation of Asian gold markets***



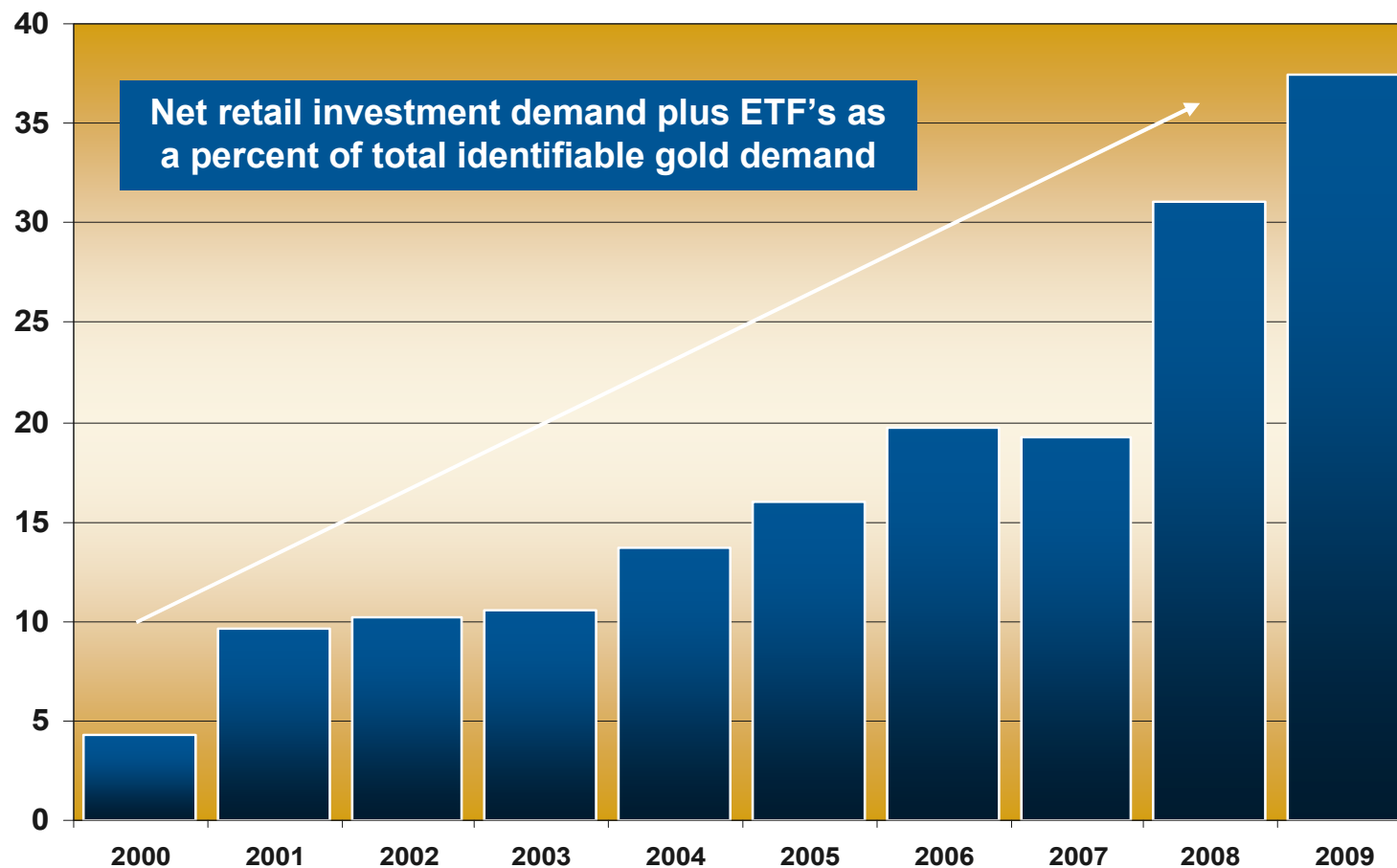
## ***Bullish: (7) Investment Demand***

***The gold ETF rising strongly since introduction***

- ***ETF demand was very strong during the financial crisis – notably so in 2009-Q1!***



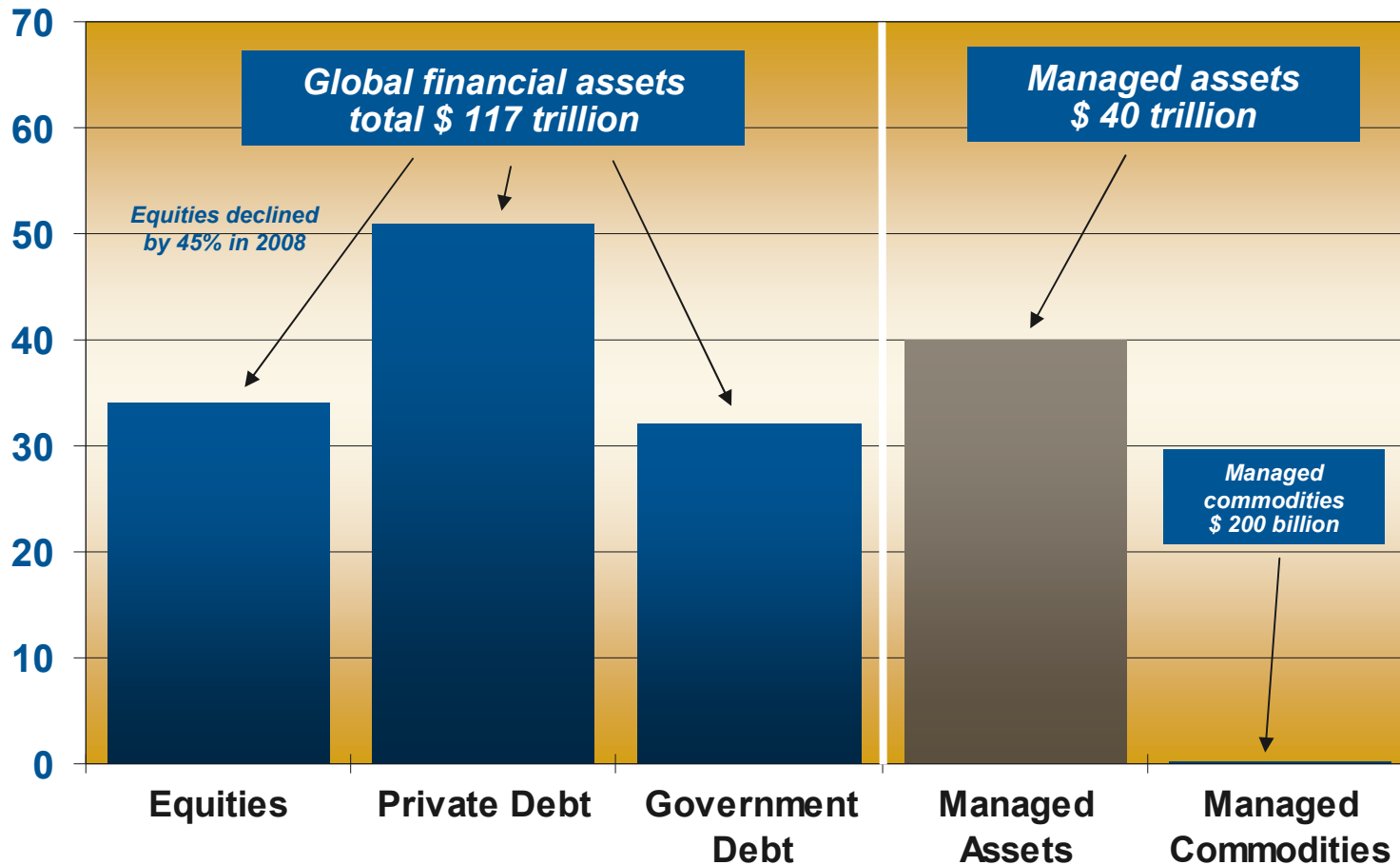
## ***Bullish: (7) Investment Demand*** ***Retail investment plus ETF demand rising***



Source: World Gold Council "Gold Demand Trends"  
Based on data tabulated by GFMS

## Bullish: (7) Investment Demand

Investment demand in gold/commodities will grow



Source: McKinsey & Company, IMF, Barclay's  
Estimates are for 2008

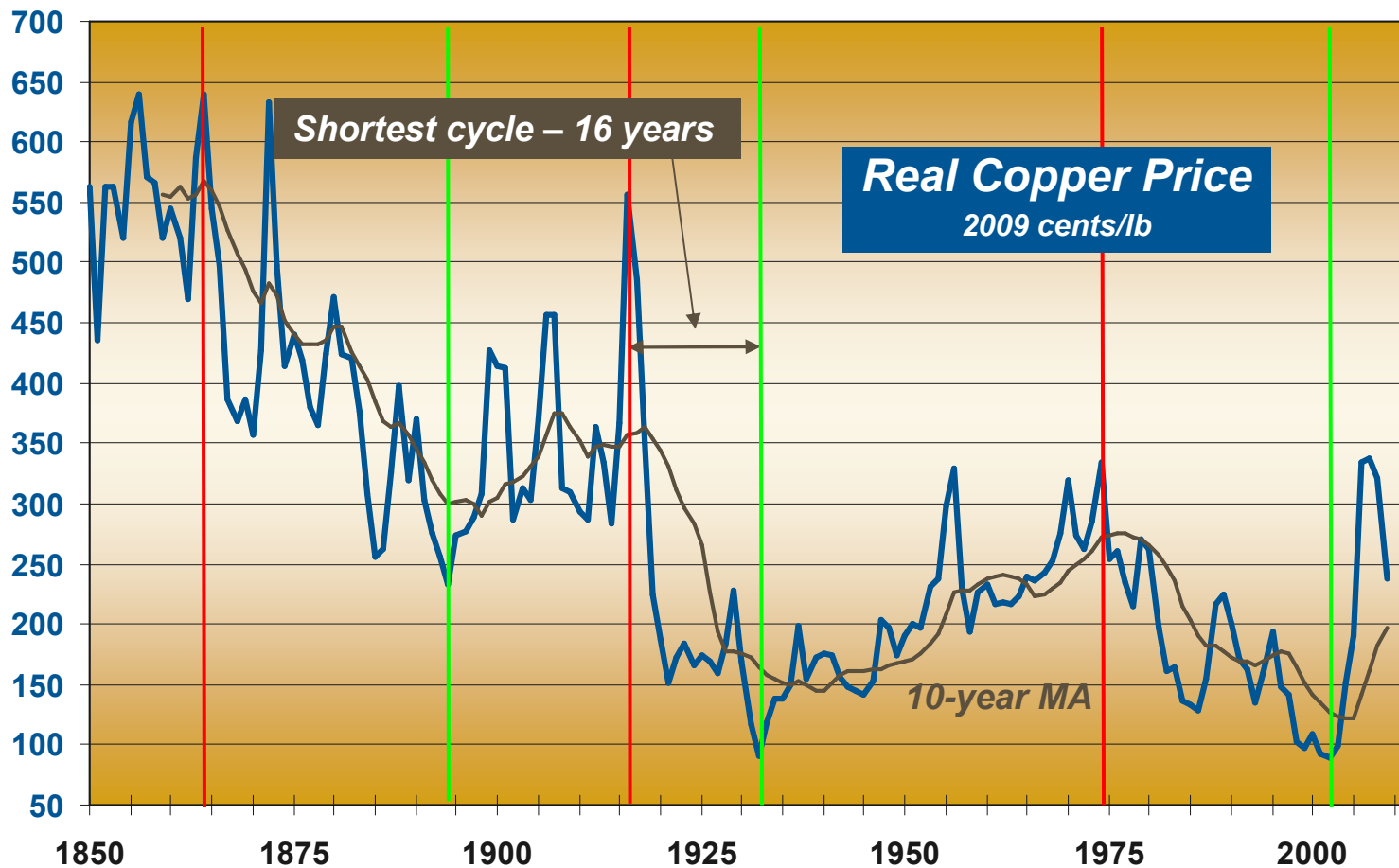


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## ***Bullish: (8) Commodity Cycle***

***The shortest copper cycle lasted 16 years***



## ***Bullish: (9) Geopolitical*** ***The biggest geopolitical crisis to date ...***



## ***Outlook: Five Bearish Arguments ... or Six?***

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- 1. Policy “exit strategies”:* in US, Asia, Europe**
- 2. Strong dollar/weak euro:* gold corr. with euro**
- 3. Absence of inflation:* deflation worries linger**
- 4. Liquidity of last resort:* for Greece, Italy, ...?**
- 5. Dehedging finished:* hedging to recommence?**
  
- 6. A “pop” in the Chinese bubble??***

## ***Bearish: (1) Exit Strategies*** ***fiscal policies must be tightened***

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### **Assuming central banks do not “print money”:**

- 1. Tighter fiscal policies will be a drag on economic growth***
- 2. Inflation pressures will remain subdued, and the threat of deflation will linger***
- 3. Confidence in monetary policy (and fiscal policy) will improve***
- 4. Which all will weigh heavily on the gold price***



## ***Bearish: (4) Liquidity of Last Resort***

***The PIIGS need cash!***

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- ***The PIIGS hold over 3000 tonnes of gold***
- ***We have been concerned about Italy for years***
- ***But Greece, Portugal, and Spain might be the first to sell – were it to come to that***

| <b>Gold Reserves</b> |               |
|----------------------|---------------|
|                      | <b>tonnes</b> |
| <b>Greece</b>        | <b>112</b>    |
| <b>Ireland</b>       | <b>6</b>      |
| <b>Iceland</b>       | <b>2</b>      |
| <b>Italy</b>         | <b>2452</b>   |
| <b>Portugal</b>      | <b>383</b>    |
| <b>Spain</b>         | <b>281</b>    |
| <b>Total</b>         | <b>3236</b>   |

## ***Bearish: (6) “Pop” in China’s Bubble??***

***What happens when the bubble bursts:***

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- 1. China’s growth rate will decline***
- 2. Money will leave China***
- 3. Demand for commodities will tumble***
- 4. Equity markets around the world will sell off – some very sharply***
- 5. “Safety” will be in vogue again – US Treasuries will rally***
- 6. Chinese gold demand will suffer***

### ***Will policy respond?***

- 1. The PBoC will likely “print money” ...***
- 2. ... as it, too, learns about non-performing loans***
- 3. Other central banks will want to insulate their economies***
- 4. Indeed, no one really wants to see China plunge into a sharp, albeit brief, recession***



## ***Our Latest (March-end) Forecast***

***We are bullish – Europe’s crisis game-changer??***

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# **Gold Price Scenarios**

(March-end forecasts)

|                            | <u>2010-avg</u> | <u>2010-end</u> | <u>2011-avg</u> |
|----------------------------|-----------------|-----------------|-----------------|
| <b>Scenario A:</b> p.=.10% | <b>\$1015</b>   | <b>\$915</b>    | <b>\$858</b>    |
| <b>Scenario B:</b> p.=.40% | <b>\$1140</b>   | <b>\$1170</b>   | <b>\$1230</b>   |
| <b>Scenario C:</b> p.=.50% | <b>\$1221</b>   | <b>\$1326</b>   | <b>\$1425</b>   |
| <b><i>Weighted:</i></b>    | <b>\$1170</b>   | <b>\$1226</b>   | <b>\$1293</b>   |



***Thank you for your attention!***

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