WHY GOLD WENT UP 30% THIS YEAR

The reasons behind the best gold market in a quarter-century.
(Written Dec 31, 2007)

What's behind the jump in gold prices? This fall, gold topped $800 per ounce. We haven't seen prices that high since 1980.[1] You may remember the drivers behind the 1970s bull market in gold: inflation around 15%, worries that OPEC would hold the global economy hostage, and the removal of artificial price controls during the Nixon administration. Today, the factors pushing gold higher are a bit different, but the main reason for gold's rise is basically the same now as it was then. Investors are anxious about the economy, and in times of high anxiety, some investors turn toward gold.

#1: The credit crisis. The uncertainty that gripped the housing, banking and investment markets this year was a boon for gold. Around the globe, investors watched and worried this year as the U.S. housing slump deepened, fearful that America would fall into a recession and drag other economies down with it. That fear triggered a "flight to quality," in the words of a World Gold Council official,[2] and sent demand for gold higher worldwide. As banking and real estate giants announced big losses on Wall Street, American investors also eyed hard assets, gold among them. Soaring crude oil and natural gas prices have also helped – rising oil and gas prices stir fears about inflation, and that is good for gold.

#2: A weak dollar. In addition to market demand, the soft dollar has also contributed to rising gold values. The dollar repeatedly fell to record lows against the euro and other core currencies this year. The Federal Reserve also cut interest rates three times in 2007. When the Fed cuts rates, it makes the dollar even less attractive to overseas investors, and the falling dollar helps to push up gold prices.

#3: Growing demand that is harder and harder to meet. Demand for gold is growing, especially in Asian investment markets. In fact, India is the world's top gold consumer.[3] It consumed about one-fifth of the world's gold in 2006, and in 2007, its gold purchasing is on pace to rise 50%.[4]

However, while demand in emerging-market countries may be high, environmental regulations on gold mining have tightened considerably since the 1970s and made it less convenient and cost-effective. This is yet another reason why commodities analysts are bullish about gold in the future.

If you are thinking about investing in gold, do it carefully. Make sure you talk with a qualified financial advisor who understands the commodities markets.

Citations.

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