A spotlight on precious metals

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As we approach the half year mark, the precious metals market continues to present exciting opportunities for investors. At the time of writing, gold and silver are up double digits.

Whether investors have been drawn to the enduring appeal of gold as a safe-haven asset or the industrial demand of silver for its extensive use in electronics, solar panels, and medical applications, staying informed has become increasingly key. The indexes which track the performance of gold and silver have outperformed the S&P 500, Russell 2000, the Bloomberg Aggregate Bond Index, US REITs, and treasury inflation-protected securities (TIPS) returns year to date.

Given the finite nature of the supply of precious metals, the conventional laws of supply and demand do not apply. Instead, gains in price tend to generate higher demand as price appreciation signals more value for use. According to a recent report by the United States Geological Survey, close to 187,000 metric tons of gold has been mined to date with remaining reserves estimated to be around 57,000 tonnes. The Silver Institute forecasts that a deficit (total supply less demand) will remain in 2024, marking the fourth consecutive year of a structural market deficit. Although this year's deficit is expected to ease by close to 10% to 176 million ounces (194 million ounces in 2023), it will still be exceptionally high by historical standards.

Given the breadth of the precious metals market, let's put the spotlight on the shiniest one; gold. Gold cannot be ignored, particularly given its greater use case as a store value and as global gold reverses are now larger than the reserves of the second-largest reserve currency, the Euro dollar. To understand why there has been such a positive price momentum, we have to consider both demand and supply dynamics.

Demand dynamics

Gold has been an important component of central bank reserves because of its safety, liquidity and return characteristics – the three key investment objectives for central banks. As such, central banks are significant holders of gold, accounting for around a fifth of all the gold that has been mined throughout history. Official world gold reserves have reached over 1,100 million troy ounces, the most since the 1970s. Over the last 13 years, world central banks' gold holdings are up over 20%. Global gold reserves are now even higher than just before President Nixon broke the US dollar's link to gold in 1971. In 2022 and 2023 alone, world central banks bought over two thousand tons of gold. Gold buying by central banks posted its strongest start to any year on record in 2024, helping drive overall demand for bullion higher in the first quarter. Despite its limited use in transactions, gold is generally viewed as a politically neutral safe asset which can be stored on home soil and can be insulated from sanctions or seizure.

According to Bloomberg, China has been selling record sums of US debt amid signs of diversification. During the first quarter of 2024, China sold a record amount of Treasury and US agency bonds, indicating its move to diversify away from American assets as trade tensions persist. Beijing offloaded over $50 billion of treasuries and agency bonds according calculations based on the latest data from the US Department of the Treasury. Meanwhile, the share of gold in China's reserves has more than doubled since 2015. Belgium, one of the top five US foreign-owned debt holding countries, also disposed over $20 billion of Treasuries during the first quarter of

2024 in exchange for gold and other foreign assets. In a separate report, the deputy managing director of the International Monetary Fund indicated that gold purchases by some central banks may have been driven by concerns about geopolitical and sanctions risk. China and countries with close ties to it have been increasing their holdings of gold in foreign-exchange reserves, while countries in the US bloc have kept them broadly stable.

Despite rising real rates, gold demand is likely to remain strong as emerging countries such as the BRICS have started trading oil and other commodities using non-US dollar currencies. These currencies may need to be exchanged into gold, a more stable store of value. China now settles half of its cross-border trade in renminbi, up from zero in 2010. The rise in renminbi use highlights efforts to circumvent using the US dollar. Gold has been revered in almost all human cultures for as long as civilizations have been able to admire and use it. Because of its unique properties, gold makes its ways into almost every sphere of modern life in some way, shape or form. The practical use applications of gold in jewellery, finance and investing, electronics and computers, dentistry and medicine, aerospace, medals and awards are expected to sustain robust demand. More recently, gold demand in India saw a significant rise, supported by a robust economic backdrop, while consumption in China increased in the first quarter, due to a surge in hedging needs.

Supply dynamics

According to the World Gold Council, the gold mining industry is struggling to sustain production growth as deposits of the yellow metal become harder to find. Even though there was a record first-quarter mine production in 2024, up 4% year on year, the bigger picture about mine production is that it effectively plateaued around 2016 and 2018 and we have not seen meaningful growth since then. Mine production inched up only 0.5% in 2023 compared to a year ago. In 2022, the growth was 1.4% year on year, and 2.7% the year before, while in 2020 global gold production logged the first decline in a decade, sliding 1%. It is apparent from these numbers that after 10 years of rapid growth from around 2008, the mining industry is now struggling to report sustained growth in production.

Large-scale gold mining is very capital-intensive, and requires significant exploration and development, taking an average of 10 to 20 years before a mine is ready for production. New gold deposits are becoming harder to find around the world as many prospective areas have already been explored. It is therefore getting harder to find gold, secure mining permits, finance, and operate the mine. Even during the exploration process, the likelihood of a discovery progressing into the development of a mine is low, with only about 10% of global gold discoveries containing sufficient metal to warrant mining.

Aside from the discovery process, government permits are getting harder to secure and requiring more time to come through. This is making mining more difficult. Securing licenses and permits needed before mining companies can start operations can take several years. Additionally, many mining projects are planned for remote areas that require infrastructure such as roads, power, and water, resulting in added costs in building these mines and financing operations.

Conclusion

As the global economy grapples with ongoing geopolitical tensions, gold often emerges as a stable investment, enhancing its allure for investors. On the other hand, any persistent inflationary pressures, driven by increased government spending and disrupted supply chains, may continue to draw investors toward gold.

As fiat currencies face devaluation risks, gold's intrinsic value becomes more attractive. Interest rates and quantitative easing programs could also significantly impact gold prices. Most recently, gold prices have been taking a breather after rallying to record highs, however, the overall outlook for this precious metal continues to appear positive and with more room to run.

Sources: World Gold Council & Bloomberg Economics
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