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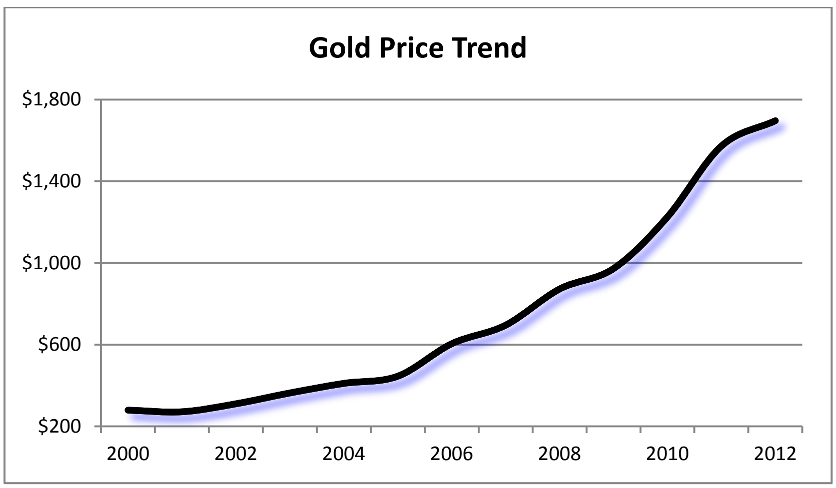
It's Gold You're Talking About!

In recent years, we have witnessed a steep rise in the price of gold. In light of on-going global financial crisis, investors have picked up gold in frenzy. So far, this frenzy has paid off as gold prices have reached unanticipated record highs.

Since 2001 the average price of gold has increased six fold. The price of an ounce of gold nearly doubled from $271 in 2001 to $445 in 2005 and climbed to $972 in 2009. The gold price skyrocketed to $1,225 in 2010, $1,572 in 2011, and $1,696 in the first three months of this year.[1]



To explore reasons for such an unprecedented price hike, we study the demand and supply of gold.

Demand for Gold

Gold has retained its grand status throughout history with a steady demand. Originally, traders used gold as a "medium of payment" and investors kept gold as a "store of value." Also, gold has been worn as jewelry, used in coinage, and applied in industry. Moreover, gold has been adopted as a "backing of currency" by various monetary systems around the world. Nowadays, the SPDR Gold Trust (GLD), the largest physically backed gold exchange traded fund in the world, has gained enormous popularity with

[1] goldprice.org

investors wanting to incorporate more gold into their portfolios. Recent estimates indicate that the quantity demanded for gold is approximately 920 tons per quarter. The world consumption of newly mined gold is about 50 percent in jewelry, 40 percent in investment, and 10 percent in industry.[2]

Supply of Gold

A total of 165,000 tons of gold had been mined in human history as of 2009. Leading suppliers of gold are China, Russia, the United States, Australia, and South Africa. The quantity supplied of *new* gold totals approximately 625 tons per quarter.[3] Official figures estimate that almost 25 percent of the world's gold produce is harvested from mines that are too small to be recorded.

Another valuable source of supply is *recycled* gold. It is obtained from old jewelry pieces and various retired industrial parts like electronic and spacecraft equipment. Overall, the supply of *recycled* gold has remained unchanged. The reason is that only ownership changes. Since gold is not a consumable, its inventory stays constant.

Factors Affecting Price of Gold

Investors use gold as a *hedge* against economic crisis and political turmoil. We have witnessed an unprecedented rise in gold prices due to recent financial crises in the United States and Europe. In particular, the downfall of the banking system in the United States and continued debt crisis in Europe drove investors toward gold. Gold prices began to rise as a result of such a big boost in the demand. The pressure on the gold demand escalated with a weakening dollar and a collapsing euro.

Anne-Laure Tremblay, an analyst at BNP Paribas, has appraised the status of the gold market:

> *Gold's fundamentals are strong and the recent rebound in risk appetite has encouraged investors to come back to the market or add to their existing positions. Anecdotal evidence suggests that bar and coin demand remains high in the U.S. and Europe, with physical gold being bought as a safe haven. We expect gold to reach new highs in 2012, although episodes of extreme risk aversion may trigger corrections along the way.*[4]

With improved economic growth in the United States and successful bailout of Greece and other troubling European economies, gold prices may find a tendency to fall.

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[2] 2 *Steadman, E., "*Understanding Gold: Demand and Supply Economics," equities.com, March 15, 2012, http://editorial.equities.com/commodities/understanding-gold-demand-and-supply-economics

[3] Ibid.

[4] Anderson, J., "Gold Prices: Bull Market or Fool's Gold?," equities.com, February 2, 2012, *http://editorial.equities.com/commodities/gold-prices-bull-market-fools/*

However, the gold "bubble" is unlikely to burst since there is much uncertainty in the market for crude oil. The price of imported oil would remain high because of threat of international terrorism; continued violence in Iraq, Afghanistan, and Syria; deteriorating relations between Iran and the West; unsettled polity in Egypt and Libya; and on-going crisis in Nigeria. As long as the international oil market remains unstable, oil prices will stay high and gold prices will follow.