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Standard Chartered says gold could hit US$5,000 per oz.

After a decade-long bull market "the gold mining industry has done little to bring on new supply," Standard Chartered concludes in a new report, arguing that the gold market will be in deficit until at least 2015.

In its base-case scenario the bank forecasts that the compound annual growth rate (CAGR) of gold production over the next five years will be 3.6%. Its bull case CAGR scenario is 5.6% and its bear case 2.2%.

"The limited new supply comes at a time when central banks have turned from being net sellers to significant net buyers of gold," the report states. "At the peak, central banks globally sold a total of 674 tonnes of gold in 2005, but in Q1 2011, they bought 129 tonnes of gold, an annualized figure of 517 tonnes."

The bank predicts a "gold market in deficit, even assuming flat growth in demand," and says it can "see the gold price potentially going to US$5,000 per oz."

Its analysis of gold projects under construction demonstrates that the "long-term gold price will need to be US$1,400 per oz. to justify capital cost," and for greenfield projects closer to US$2,000 per oz. in order to generate an internal rate of return of 20%. The bank also predicts that the rising cost of building gold mines "could result in delays at many projects."

The report was based on an analysis of 375 gold mines and projects around the world (the largest 345 gold mines and 30 copper and base metal mines with significant gold credits including operating mines and those under construction that are owned by 106 gold mining companies). In 2010, total production from the 375 mines in the Standard Chartered database was 1,764 tonnes, or about 67% of global gold production.

"The gold miners are running to stand still," the 68-page research report states. "A lack of funding from equity markets and a shortage of large gold mines makes it difficult for the industry to compensate for the depletion caused by aging mines and falling grades."

And if China were to raise its proportion of foreign exchange reserves in gold from the current 1.8% to be in line with the global average of 11%, the bank points out, "it would have to buy 6,000 more tonnes of gold, equivalent to more than two years of gold production."

The bank concludes that the best way to invest in the gold cycle is to buy physical gold or invest in junior gold miners that are one to two years away from production, adding that it is "cautious about the gold majors."

"Project plans of the big five gold producers by market cap suggest an average production CAGR of only 4% in the next five years," the report states. "They need to depend on expensive acquisitions in order to grow further. As a form of affirmation, the share price index we constructed for the gold majors underperformed the gold price by 149 percentage points over 1995-2011."

Citing figures from *Bloomberg*, Standard Chartered notes that all gold acquisitions over US$500 million since 1995 were done at "an average 40% premium to the market cap of the targets, 3.8x of book, or about 19x EBITDA."

Looking ahead, Standard Chartered argues that "there are very few large gold mines commencing operations in the next five years" and of the total five-year global volume growth in gold production over that period, about 29% will come from Asia, 23% from Africa, 17% from North America (mainly Canada), and 12% from South America.

Average grades will be 3.5 grams per tonne (gold reserves) and "the resource grade is typically lower than the reserve grade."

The report concludes that gold production growth "will be limited" and that demand will be driven by per capita gross domestic product growth in China and India, a weak U.S. dollar and high inflation.

Standard Chartered believes that only seven gold mines (Pueblo Viejo, Natalka, Tasiast, South Deep Mine, Pascua-Lama, Malartic and Detour Lake), and one copper-gold mine (Oyu Tolgoi) "have the potential to grow gold production by a total of more than 500,000 oz. in the next five years."

"The total incremental production these mines represent is about 28% of the total gold production growth in our database," the bank writes. "Thus any delay in these projects could affect the global gold production growth quite meaningfully."