World financing: EIU's quarterly gold outlook

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FROM THE ECONOMIST INTELLIGENCE UNIT

Demand

The outlook for global gold consumption is for a recovery in 2013-14 from a weak run in 2012, when consumption is estimated to have fallen by 7.4%. Annual declines in Indian and Chinese gold jewellery demand were an important restraint on overall consumption; both economies slowed in 2012, which led consumers to cut back on gold purchases. However, with loose monetary policy anticipated to continue in most markets during 2013, gold's attractiveness as a perceived inflation hedge is set to persist, and consumption is forecast to strengthen, growing by just over 3%. In 2014, while consumption in India should continue to recover, especially as prices weaken, overall demand growth is likely to remain fairly stable, as investors begin to factor in monetary tightening in the developed world (which is expected to begin in 2015, according to the Economist Intelligence Unit's global forecasts) and seek to lock in profits.

Indian demand affected by high prices in 2012

In the third quarter of 2012 Indian jewellery consumption ended its steady downward trend since 2011. The country's jewellery consumption grew by 7% year on year in the third quarter, marking a substantial change from the first half of the year, when high and volatile prevailing prices and the weakness of the rupee weighed on consumption. Consumers seemed to shrug off price strength during the third quarter, helped by the recovery of the rupee since mid-September and by the advent of wedding season. There may well have been a bounceback effect from sharp falls in the first half of the year too. Even so, gold jewellery consumption was down by 14% year on year in the first three quarters of 2012, according to the World Gold Council (WGC). For the year as a whole, we estimate that jewellery demand for gold fell by 6% in 2012.

The pick-up in consumption in the second half of the year is expected to extend into 2013. As a result, we forecast that a recovery in consumption growth is forecast to lead to growth of 7% in 2013 and 12% in 2014. This trend will be supported by lower domestic prices, as the rupee strengthens mildly in each year, and the return of more traditional buyers. To an extent, as well, Indian consumers will become more comfortable with the elevated gold price level, after an initial rise deterred some purchases in the first half of 2012. However, a

November 2012 decree by the central bank, banning loans for purchasing gold speculatively, will weigh on demand at the margin. A further risk to this outlook lies in the government's threat to reduce gold imports through new regulations in order to cut the country's current-account deficit.

Chinese demand in 2013-14 to be supported by a recovering economy

China looks to have narrowly missed out on overtaking India in 2012 to become the world's largest gold jewellery consumer. According to the WGC, it was the largest gold jewellery consumer in the first quarter of 2012, but since then it has underperformed its regional rival. Indeed, Chinese jewellery consumption fell by 5% year on year in the third quarter of 2012 as the economic slowdown made itself felt; this was still a slight improvement from a fall of 9% in the second quarter. We estimate a contraction in Chinese gold jewellery consumption of around 5% in 2012 as a whole.

Policymakers have counteracted the deceleration of the Chinese economy with monetary and fiscal stimulus, which has started to lift the economy since November-December 2012, and this should continue into 2013. Demand should bounce back in 2013 on the back of the economic pick-up, rising by around 10%. We then expect a renewed deceleration in 2014, as the prospects for gold jewellery as an investment item become more uncertain—gold is more commonly treated as an investment than a luxury item in China—and economic growth softens too.

Retail investment demand will return to positive growth in 2013-14

Global demand for bars and coins was stable in the third quarter of 2012 compared with the second quarter, with both at around 294 tonnes of net purchases. However, demand was down sharply from the record-high purchases in the year-earlier period, when investment in bars and coins was some 30% higher, reflecting fears at the time over the possible collapse of the euro zone. The WGC has noted that inflows of funds into retail gold investment channels were simply lower in July-September 2012, and did not necessarily represent profit-taking. Much of the year-on-year decline in bars and coin purchases stemmed from weaker demand from Europe, especially from German-speaking markets, according to the WGC. This reflected the base effects of high gold purchases in the second half of 2011, owing to high concerns about the currency union's durability.

Demand for bars and coins in India bucked the trend in the third quarter, rising by 12%. This marked a sharp turnaround from an extremely weak first half of the year, when consumption was down by around 50% year on year on the back of uncertainty over the tax changes and the high rupee price of gold (which prompted profit-taking). Chinese gold investment, which is coming from a low base, is expected to remain on a rising trend. This reflects the population's increasing purchasing power and the deregulation of the domestic gold market. The trend was, however, dented in mid-2012 by the softening economy. After a strong first quarter of 2012, year-on-year investment in bars and coins was negative. However, we expect emerging-market economies, led by China, to have picked up again around the turn of the year and that this trend will continue into 2013, suggesting inflation concerns could emerge as a supportive factor for gold investment.

We forecast single-digit annual growth rates for this component in 2013-14, averaging around 4% per year, following an estimated decline of 17% in 2012. The effect of renewed liquidity programmes by central banks and the prospects of a pick-up in inflation drove up the gold price from mid-August, but the rally faded, and the unclear path of gold prices will restrain gold bar investment. Overall, we now estimate that global net retail investment returned to closer to 2010 levels in 2012.

Inflows into exchange-traded funds (ETFs) are estimated at around 300 tonnes in 2012, a considerably higher level than previously expected, on the back of strong inflows in the third quarter. WGC data show net inflows into ETFs of 136 tonnes in the third quarter of 2012, a considerable rise from a total of 52.4 tonnes in the entire first half of the year. Investors are likely to have sought to take advantage of an anticipated price rise from the arrival of quantitative easing (QE) in mid-September. However, given that the effect of the third QE programme on commodity prices has been more modest than in previous rounds, we do not think that the inflows into ETF funds will have held up quite as well in the fourth quarter as in the third, despite being positive. We forecast inflows into ETFs to stay positive in 2013-14, although they will be slightly more subdued in the medium term as investors take profits and expectations of global interest rate increases grow.

Industrial use in 2012 set to contract by 3%, with a lacklustre outlook

Global consumption of gold for industrial purposes is estimated to have fallen by 3% in 2012, having been consistently slightly below corresponding 2011 levels in each of the first three quarters of the year. The elevated gold price is likely to have played a role in this trend, but the WGC also points to weaker consumer sentiment as a driver. Consumption of gold in electronic goods fell by 5% year on year in the third quarter, with the dental sector showing a larger contraction of 9%. High prices will tend to act as a drag on usage. Efforts will be made to switch away from gold in applications to cheaper alternatives, although anecdotal reports suggest that this is not always successful (outside of the dental sector). Industrial and dental demand is forecast to return to mild annual growth of 1% in 2014, supported by an expected lower gold price. In the medium term, gold is expected to retain its industrial role; it is being used in a number of new technologies, particularly as an active catalyst in controlling emissions and in solar cells.

Gold: consumption

(tonnes unless otherwise indicated)

	2010	2011	2012	2013	2014
Industrial & dental	466	453	438	436	440
Jewellery consumption	2,017	1,972	1,823	1,919	2,045
India	657	567	533	570	639
China	480	545	516	568	605
US	129	115	97	92	88
Turkey	71	64	82	78	81
Saudi Arabia	68	56	49	50	52
Russia	66	75	81	87	92
UAE	62	58	45	47	48
Indonesia	33	30	31	32	33
Italy	35	29	15	14	13
Japan	21	21	19	19	19
Net retail investment[a]	1,205	1,519	1,262	1,325	1,365
ETFs	382	185	298	268	255
Total	**4,070**	**4,129**	**3,822**	**3,949**	**4,106**
% change	12.5	1.4	-7.4	3.3	4.0

[a] Gold bars and coins; does not include exchange-traded funds (ETFs) or other investment flows.
Sources: World Gold Council (WGC); Gold Fields Mineral Services (GFMS); Economist Intelligence Unit.

Supply

In 2013 gold supply is forecast to expand by 4.2% as it recovers from the disruptions that affected production in some parts of the world in 2011-12. With prices remaining above historical levels, investment in expanding existing mines and developing new ones will help to offset the long-term decline in some traditional suppliers. Production growth is expected to remain stable at a similar pace of 4.7% in 2014, as some miners slow production to accommodate falling prices at a time of higher costs and declining ore yields. The official sector is forecast to remain a net buyer of gold throughout the forecast period, as central banks will continue to diversify their reserve holdings, although purchases are unlikely to match the levels seen in 2011.

Global mine output was down by just 0.3% year on year in the first three quarters of 2012, according to the WGC; by contrast, the World Bureau of Metal Statistics (WBMS) suggests that mine production was down by 1% year on year over the same period. Both sources cite expanded production from new projects and ongoing development at recently opened mines around the world. More recently, production prospects have suffered in South Africa and are only just getting back on track. As a result, we estimate 2012 supply growth to have been negligible.

Chinese expansion to confirm it as largest producer

China, the world's largest gold miner, increased mine output by 12.4% in the first ten months of 2012, according to data from the WBMS, a slightly higher rate than suggested by the Ministry of Industry and Information Technology. We estimate growth in 2012 of 9.8%, well above the rate of 5.9% recorded in 2011. The ministry has published estimates for an expansion of output to 450 tonnes by 2015, from an estimated 400 tonnes in 2012. This is broadly in line with our forecasts; even so, we expect mine output growth to ease in the remainder of the forecast period, to 3% by 2014, as the price incentive for production expansion begins to recede. Output will also be affected by the government's clampdown on safety and environmental regulations in the mining sector. China will easily remain the world's largest gold producer at that point. Moreover, Chinese mining firms have been making, and will continue to make, investment in promising foreign mines. They have been especially active on this front in Africa recently.

South Africa's operating environment will remain unfavourable

South Africa's gold production is expected to continue to fall during the forecast period, owing to industrial action and structural factors such as ageing mines and the diminishing profitability of operations. Production data for 2012 so far continue to paint a bleak picture, with both the WBMS and Statistics South Africa (SSA) indicating a fall of almost 5% year on year in January-October. The accelerated downturn in 2012 has certainly been accentuated by operational factors; all the same, South African output appears to be in long-term decline, having fallen by an annual average of 7% over the past ten years. Mining costs, particularly energy and labour, have risen. In September-October 2012 a serious labour dispute (originating in the platinum industry) halted large-scale production in the gold sector. Tens of thousands of miners went on strike amid tense standoffs between employers and workers and heavy lay-offs. Firms including AngloGold Ashanti, Gold Fields and Harmony Gold (all South Africa) were affected. The gold producers have since struck a deal with employee representatives that brought the miners back to work. Even so, the deal does not seem likely to mark the end of the current period of instability; the miners could be tempted to make new demands. Moreover, firms will shy away from new investments while industrial disputes remain a threat. Harmony Gold has already threatened to close a major mine at Kusasalethu if conditions do not improve. After falling by an estimated 8% in 2012, South African gold output is forecast to drift down further in 2013-14, declining by an annual average of 4.5%.

Canada's output is expected to recover in 2013-14

Canadian production fell by 0.4% in year-on-year terms in January-October 2012, according to the WBMS, after stellar growth of 10% in 2011. Production in 2012 should have been supported by the new Malartic mine (operated by Osisko Mining Corporation), but this does not seem to have been the case. Goldcorp, Canada's second-largest gold firm, struggled with operational delays at its main mine, Red Lake, in mid-2012, but problems at the mine were remedied in the third quarter; its output started to rise again in the fourth quarter and this should continue into 2013. Canada's output is expected to have contracted mildly in 2012, before picking up to an annual average growth rate of 3.5% in 2013-14. In the US, output will broadly stagnate over 2012-14; according to the WBMS, production achieved almost no growth year on year in the first ten months of this year.

Output growth in Australia will pick up owing to mine start-ups in 2012-13

A rebound in Australian gold production is forecast for 2013-14, with annual average growth of 4%, as new mines come on stream and assuming no further weather-related disruptions to supply. Output was down by 4.6% year on year in the first ten months of 2012, according to the WBMS, and is estimated to be down by a similar rate over the entire year. Yet, production will be boosted over the forecast period by the launch of production at Newcrest Mining's Cadia East Underground mine, among others. The latter will raise capacity by 8 tonnes annually, but the start date has been repeatedly delayed by legal disputes. It should nonetheless be able to ramp up to full capacity by 2016, in line with the company's plans.

We estimate that output of gold in Russia—the world's fifth-largest producer—slowed to almost no growth in 2012, expanding by just 0.4%. Data from different sources are not particularly conclusive, however, the WBMS suggests output fell by 3.3% year on year in January-October 2012, whereas domestic statistics show single-digit growth. The country's Gold Industrialists' Union expects output growth to have been mildly positive in 2012, even though production has declined at a number of mines, including the Kupol mine in the Arctic, which is owned by Kinross Gold (Canada). Russian gold output is expected to be supported from 2014 by the planned commissioning in December 2013 of an ore processing plant at the giant Natalka deposit, the world's third-largest deposit. Yet, there have also been industry warnings in recent months of a lack of investment for long-term production in the domestic gold industry.

Weak prospects for Indonesia's output

Gold output in Indonesia is in dire straits. Output was down by some 31% year on year in January-October 2012, according to the WBMS, extending the 41.3% year-on-year contraction recorded in 2011. The prospects for 2013 are not particularly good either, although we do think that the production freefall is coming to an end. Mining firms have been battling persistent labour unrest over wage levels and new and onerous government regulations. Among the major firms affected are Freeport-McMoRan Copper & Gold (US), G-Resources (Hong Kong) and Newmont Mining (US). Freeport-McMoRan Copper & Gold has managed to tame earlier tensions at its Grasberg mine, but could see industrial action return. G-Resources has been faced with environmental protests at its high-profile Martabe gold and silver project in North Sumatra; in September protests against the mine's waste treatment stopped production at the site. Eventual capacity of the mine could reach

250,000 oz of gold (around 8 tonnes), to make it one of the largest mines in Indonesia and Asia, but it is unclear how soon this can be achieved. Newmont Mining faces similar vulnerabilities.

There is also a layer of uncertainty attached to the Indonesia forecast, given government policies that include the introduction in May 2012 of a 20% export tax on a number of metal ores, including gold, and plans to introduce a ban on exports of raw materials from 2014. These policies are aimed at encouraging more domestic processing and the export of higher-value-added goods, but they are giving rise to concern across the entire industry. The authorities have also introduced new rules requiring foreign mining companies to reduce their stakes in Indonesian mines. In the light of these trends we now estimate that 2012 production will be 31% below 2011 levels, with output expected to recover in 2013-14 to an average annual growth rate of 4%, but with total output remaining a long way below 2010 levels.

Peru is balancing social concerns with much-needed investment

Production in Peru was essentially flat year on year in January-October 2012, according to the WBMS. Achieving stronger growth over the medium to long term will require the realisation of the more than US$30bn in mining investment that is in the pipeline. However, the sector is facing growing difficulties in obtaining and retaining what is known as the "social licence" (the local community's approval) needed to explore, start production or continue operations. Popular protests against mining projects that are considered environmentally dangerous have been intense, to the point that a state of emergency was introduced in a northern region of the country in July-September 2012, after protests against the plans of Newmont Mining to build a gold and copper mine resulted in several deaths. The dispute carried on into the fourth quarter of 2012 and the attendant uncertainty will constrain output in the future. The government is becoming more involved in mediating the disputes now, and this underpins our expectation that the country can raise its production levels slightly in 2013-14, with annual average growth of 3-3.5%.

Output is price-sensitive in some smaller African producers

Gold mine production is on the rise across Sub-Saharan Africa, particularly from smaller mines that have been made commercially viable by the recent strength in prices. Burkina Faso recorded a tougher year in 2012 than in the stand-out years of 2010 (with production up by 95.5%) and 2011 (40.3%). Production there is estimated to have fallen back by almost 10% in 2012, although this still leaves output well above levels recorded a few years ago.

In Ghana, Africa's second-largest producer after South Africa, production was up by 5.5% year on year in January-October, and this is in line with our estimate for 2012 as a whole. Ghana's gold industry has been a favoured destination for Chinese investment recently, and this has helped to lift output and improve mining technology. However, the transition has also brought some social and environmental strains to the fore and these present a risk to our expectation of steady expansion of gold output in the forecast period.

Production in Mali jumped in 2012. The WBMS suggests that gold output rose by 14.2% year on year in January-October 2012, and full-year growth is likely to have seen only slightly lower growth. Companies operating in the country have indicated that there has been no disruption to their operations despite the political uncertainty in Mali and the intervention of the French military in support of the embattled government.

Scrap sales to pick up as prices cool in 2014

We estimate that the volume of scrap supply increased moderately in 2012. Scrap supply was flat year on year in January-September, but we think that more sellers will have taken advantage of the higher gold prices in the fourth quarter to sell scrap gold. The general stagnation of the market masks differing trends globally. Recycling has been particularly strong in the US and in southern Europe (perhaps distressed selling), but weaker in the traditional markets of the Middle East, India and East Asia. For 2013 we project a slight acceleration of scrap selling, at 4% growth. There is then likely to be a surge in scrap gold selling during 2014, as holders of gold react to the expected price fall and anticipate further declines.

Central banks will continue their net buying streak

The official sector is set to remain a net buyer of gold in 2013-14, as it continues in its efforts to diversify its asset portfolios at a time of economic uncertainty. Central banks have been net buyers of gold since early 2009—the first time this has happened since 1988—indicating their desire to diversify their reserve asset portfolios away from foreign exchange (and the US dollar in particular). Central banks accelerated their purchases in 2011, encouraged by the exceptional levels of currency instability and economic uncertainty, with a surge in buying in the second half of the year to give an annual figure of 458 tonnes, up from 77 tonnes in 2010.

Purchases were up by one-third year on year in the first three quarters of 2012, at 374 tonnes, led by particularly large additions to official-sector reserves by the Philippines, Russia, Kazakhstan and Mexico. South Korea's central bank has been an especially active buyer; it announced that it had purchased 16 tonnes in July 2012 as part of its reserve diversification strategy, and added another 14 tonnes in November. The Russian central bank also added almost 18 tonnes to its reserves in July (although it later sold some). The central bank of Turkey has also been adding gold regularly to its reserves, as part of a policy initiative that allows commercial banks to hold a share of their reserves in gold. Late in the year Brazil's central bank also added 32 tonnes to its reserves. In light of this strong pace of buying, our estimate of full-year net purchases in 2012 is 454 tonnes, almost the same as the 2011 level. In 2013-14 we expect central bank purchases to continue at a substantial rate as they maintain their buying preference, but at a slightly lower level than in 2011-12.

Small-scale hedging is expected to continue in 2012-14

Net hedging remained small in the first three quarters of 2012, amounting to a net negative 12 tonnes. This followed the first positive net hedging figure for over a decade in 2011. We expect hedging of small amounts to continue in 2013-14, as producers start to fear a sharp downward correction in gold prices.

Gold: production

(tonnes unless otherwise indicated)

	2010	2011	2012	2013	2014
Mine supply	2,739	2,827	2,803	2,823	2,872
China	341	361	396	420	433
Australia	260	258	248	260	268
US	231	232	231	232	233
South Africa	191	187	172	162	157

Russia	200	210	216	223	231
Peru	164	164	166	171	177
Indonesia	127	74	53	55	58
Ghana	92	88	92	96	99
Canada	91	100	98	102	105
Uzbekistan	73	73	74	74	74
Mexico	70	87	92	96	99
Brazil	61	61	63	66	67
Official sector sales	-77	-458	-454	-400	-350
Old gold scrap	1,723	1,669	1,712	1,781	1,888
Net producer hedging	-108	10	-9	19	12
Total	**4,278**	**4,047**	**4,053**	**4,223**	**4,421**
% change	7.8	-5.4	0.1	4.2	4.7

Sources: WGC; World Bureau of Metal Statistics; Economist Intelligence Unit.

Stocks and prices

After a mild deficit in 2011 the global gold market is now estimated to have returned to a sizeable surplus in 2012. Our estimate is based on a recent significant upward revision of our top-line mine supply data, which are now sourced from the WGC, rather than from the WBMS as before. As a result, we estimate a global surplus of 231 tonnes in 2012, as demand was soft that year. In 2013-14 we forecast that the surplus will rise further, as mine supply is expanded but demand recovers only moderately. We expect a surplus in the global market of 316 tonnes by 2014.

Gold: supply and demand

(tonnes)

	2010	2011	2012	2013	2014
Supply	4,278	4,047	4,053	4,223	4,421
Demand	4,070	4,129	3,822	3,949	4,106
Balance	**207**	**-82**	**231**	**274**	**316**
Official sector gold holdings	29,770	30,228	30,682	31,082	31,432

Sources: WGC; GFMS; Economist Intelligence Unit.

Loose monetary policy will support the gold price into 2013

The gold price slipped below US$1,700/troy oz in December and early January 2013, after a sustained run-up to US$1,790/troy oz on the back of an expected resumption of quantitative easing by the US Federal Reserve in September. The Fed's looser policy stance certainly contributed to a stronger third-quarter price of US$1,652/troy oz, but the price gains have been much more modest than during the Fed's last round of quantitative easing. The gold price averaged US$1,722/troy oz in the final quarter of 2012 and US$1,668/troy oz for the year as a whole. In 2013 we forecast that the average annual price will drift up slightly to US$1,748/troy oz, but we no longer expect the price to average above US$1,800/troy oz in any quarter. The US debate around raising the debt ceiling may drive spikes in the gold price in early 2013, on the back of fears of a technical default if Congress will not agree to raise the ceiling. However, ultimately, we forecast that a stronger economic recovery later in the year, led by bullish equity markets, will draw some funds out of gold and into other asset classes. This will still see the gold price maintaining an average of around US$1,750/troy oz this year. We then forecast a decline to an average of around US$1,640/troy oz in 2014 (and below that by the final quarter of the year), as the economic recovery picks up and the prospect of monetary tightening leads further investors out of gold.

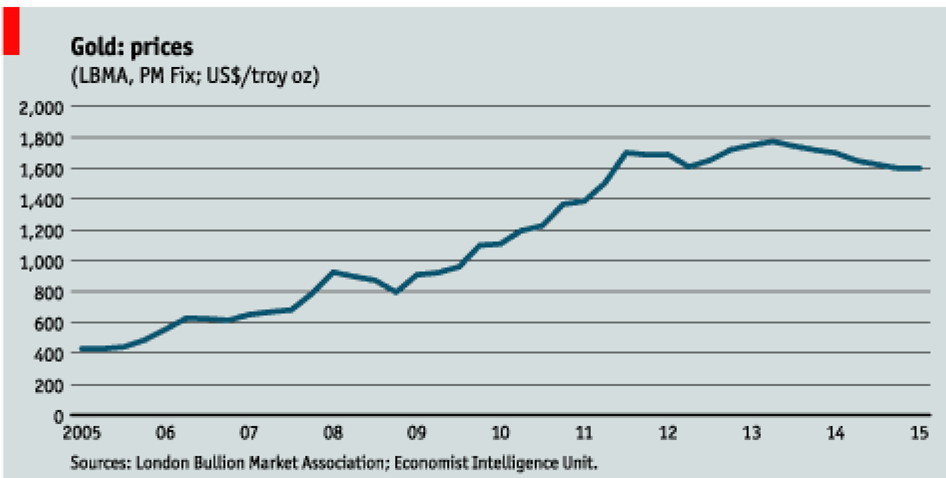
The pace of the global recovery, especially in developed countries, will influence gold prices.

In particular, if the economic recovery were to occur earlier than anticipated, then global central banks would be likely to raise interest rates sooner than expected as well. At present, the Fed has pledged not to do so until mid-2015, but if it moved earlier on interest rates, investors could decide that gold was no longer as important as a safe-haven investment and sell their assets. This move towards profit-taking could trigger a collapse in prices beyond the mild declines we are forecasting for 2014.

Gold: prices[a]

	2011	2012	2013	2014	2015
1 Qtr	1,386	1,691	1,750	1,700	1,600
2 Qtr	1,506	1,609	1,775	1,650	-
3 Qtr	1,702	1,652	1,745	1,625	-
4 Qtr	1,688	1,722	1,720	1,600	-
Year	**1,571**	**1,668**	**1,748**	**1,644**	**-**
% change	28.3	6.2	4.7	-5.9	-

[a] US$/troy oz, London Bullion Market Association (LBMA) PM Fix.
Sources: LBMA; Economist Intelligence Unit.



The Economist Intelligence Unit
Source: World Commodity Forecasts