Central banks and other institutions

As unconventional monetary policies – including the use of negative interest rates – expand, central banks continue to purchase gold as diversification remains a top priority.

Tonnes	Q1'15	Q1'16	Year-on -year change	Quarter-on -quarter change
Central banks and other institutions	112.3	109.4	↓ -3%	↓ -31%

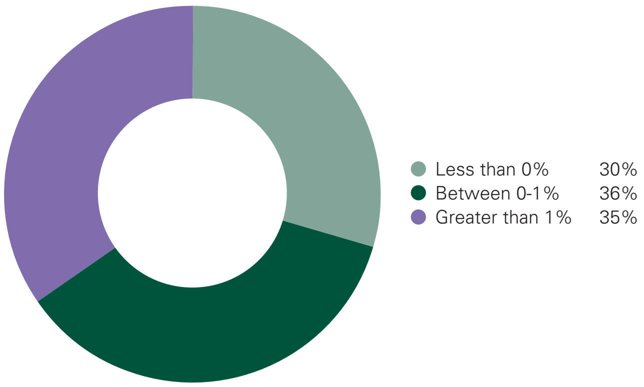
There is little doubt that central banks' enthusiasm for gold remains resolute. Having been particularly evident in the second half of 2015, when purchases amounted to the largest semi-annual total on record, 2016 has begun in similar fashion. In Q1, central banks purchased – on a net basis – 109.4t, slightly lower (-3%) than the 112.3t in the first quarter of 2015. This is now the 21st consecutive quarter of net purchases, dating back to 2011.

As discussed in *Key themes*, the first three months of 2016 were primarily defined by heightened levels of uncertainty amid growing investor concern about the effectiveness of negative interest rate policies, now prevalent throughout Europe and Japan. Aside from reducing the opportunity cost of holding gold, there are three other factors that arise from NIRP which support central bank investment in gold:

- Negative rates significantly reduce the pool of assets in which central banks are likely to invest, as many will be hesitant to commit to a loss-making investment strategy. Indeed, about 30% of advanced country sovereign debt currently trades with a negative yield (**Chart 6**).
- Negative rates were partially designed to counter currency appreciation pressures, but thus far the impacted currencies have actually strengthened, prompting concerns of potential intervention measures.
- Growing uncertainty about the effectiveness of negative rates has contributed to increased turbulence in financial markets.[12]

Chart 6: Around a third of global government debt has a negative yield

- Negative interest rate policies support central banks' continued investment in gold in a number of ways.
- Gold's diversification properties remain a top priority for central banks amid financial market turbulence.



Note: Totals may not equal 100% due to rounding.

Source: Bloomberg; World Gold Council

12 World Gold Council, *Market Update: Gold in a world of negative interest rates*, March 2016.

According to a recent HSBC survey,[13] reserve managers are finding it increasingly difficult to navigate the divergence in monetary policies around the globe. 80% of respondents agreed that negative rates had impacted reserve management, while negative rates we also described as "counterintuitive" to the "first priority of reserve management" – namely, security. The growing use of negative interest rates means reserve managers are having to consider alternative – and potentially less conservative – investments and currencies. The case for diversification of reserves using gold remains as irrefutable as ever.

Russia and China – the two largest purchasers last year – continue to accumulate significant quantities of gold. Russia increased its gold reserves by 45.8t in the first quarter, 52% higher than the same period in 2015 (30.1t). And China purchased 35.1t between January-March,[14] adding to the 103.9t bought in H2 2015. Kazakhstan's gold reserves increased in each of the first three months of 2016, extending the country's impressive buying streak to 42 consecutive months.

Conversely, selling activity remains contained. Although Canada sold 1.7t in Q1, notably reducing its gold reserves to a mere 68 ounces,[15] this was part of a longer term policy initiated almost four decades ago.[16] Malaysia (1.9t), Mozambique (1.9t) and Mongolia (1.3t) were the only other significant net sellers during the quarter.

Technology

Long-term decline in gold used in technology continues, although trend slows as China's smartphone segment offered some respite.

Tonnes	Q1'15	Q1'16	Year-on-year change	Quarter-on-quarter change
Technology	83.3	80.9	↓ -3%	↓ -4%
Electronics	66.3	63.9	↓ -3%	↓ -4%
Other Industrial	12.3	12.4	↑ 1%	↓ -2%
Dentistry	4.7	4.5	↓ -4%	↓ -3%

The volume of gold used in technological applications dropped to 80.9t (-3% year-on-year) in the first quarter. Improvements in smartphone shipments in China and an uptick in decorative demand countered declines elsewhere in electronics and buffered the secular downward trend in dentistry.

Widespread declines in electronics demand; outlook is bleak

Demand for gold in electronics weakened by a further 3%, to 63.9t, the lowest quarter since Q4 2013. Despite positive signs in some segments, global demand remained under pressure as uncertainty over global economic growth, and the rising gold price, drove continued thrifting and substitution.

These declines were geographically widespread. Double digit falls were witnessed in the main electronics hubs of Taiwan, Japan and South Korea. Taiwan was impacted by lower-than-expected demand for Apple products. In South Korea, the volume of gold used in LEDs was stagnant.

13 *HSBC Reserve Management Trends 2016,* April 2016.

14 Lack of data availability means no comparison can be made with Q1 2015.

15 Department of Finance, Official Reserves April 2016.

16 In 1980, Canada initiated a programme to sell its gold reserves "at a gradual and controlled pace," with the last gold bullion sold in December 2003. Since the end of 2003, Canada's gold reserves have been entirely in the form of gold coins.