Market commentary

Jewellery

The high price level has taken its toll on the jewellery sector; conversely recycling has sparked into life.

Tonnes	Q2'15	Q2'16	Year-on-year change	Year-to-date change
World total	513.7	444.1	↓ -14%	↓ -17%
India	122.1	97.9	↓ -20%	↓ -32%
China	169.0	143.5	↓ -15%	↓ -16%

As discussed in *Key themes*, the high and volatile price of gold – in a wide range of currencies – has hit jewellery consumers across the globe. Coming at a time when consumer confidence is at low levels in many markets has exacerbated its impact. India and China had the most influential impact on demand, although demand across many markets was subdued. Only a handful of countries have witnessed an improvement so far this year.

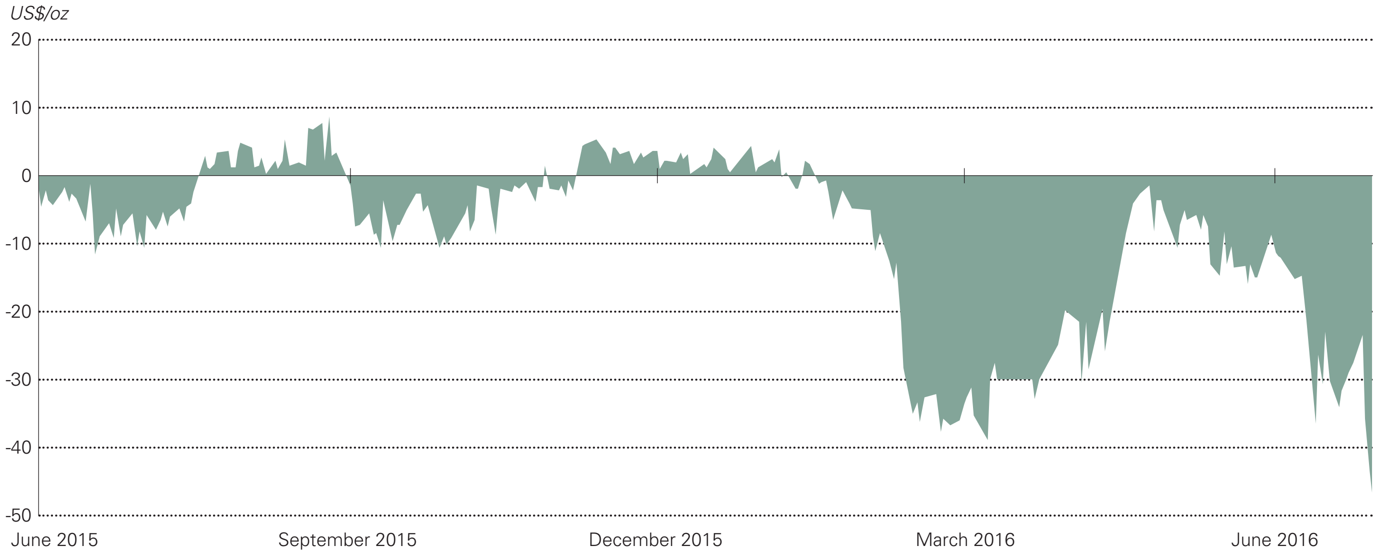
At just 444.1t, demand for jewellery in Q2 was the lowest quarterly total since Q2 2010. Jewellery demand in H1 2016 fell by 185.5t from the previous year – 149.4t of which was due to combined weakness in India and China.

Indian jewellery demand continues to struggle
India did not experience the expected bounce back in jewellery demand in the second quarter. Paltry import numbers and steep local discounts were omens of a disappointingly weak quarter. Official imports of gold halved to below 100t (the lowest quarterly imports since Q4 2013). And the local price was in discount for the whole of Q2 – moving out as wide as US$46/oz below the London benchmark price by the end of the quarter (**Chart 4**). Although Akshaya Tritiya sales provided a brief boost to demand in May, this was insufficient to prevent a severe Q2 contraction. The market faced three key issues:

- A sharp jump in the gold price
- Weaker rural incomes
- Government regulation

Chart 4: Indian gold price remains in discount due to subdued demand

- Jewellery demand for H1 was the lowest since 2009 at just 186.3t.
- After the national jewellers' strike ended in April, demand remained under pressure, not least due to gold prices hitting their highest levels since August 2013.
- Rural incomes have come under pressure, which further undermined gold jewellery consumption.



Source: GFMS, Thomson Reuters; Multi Commodity Exchange of India; World Gold Council

The national strike by jewellers which had effectively closed the market for six weeks, came to an end in mid-April. But there was no relief rally. Consumers were unprepared for the huge jump in the gold price when the market re-opened. Despite the discount, domestic prices pushed their way up to – and above – Rs30,000/10g, a significant psychological barrier for Indian consumers and the highest domestic price for more than two and a half years. Consumers were not only put off by the high cost, but also by the belief that such a price level would prove only temporary. Aside from essential purchasing and gifting around Akshaya Tritiya, demand was largely put on hold awaiting lower prices as a buying opportunity.

Lower spending by rural Indians was another blow to demand. The rural population accounts for more than half of India's jewellery demand, so any difficulty in this sector has a material impact on demand. Two consecutive years of deficient monsoon rainfalls have taken their toll on rural incomes. This is clear in other sectors, too. Poor rural spending has been cited as a reason for weak car sales and demand for consumer goods. Commenting on disappointing Q2 revenue figures for Hindustan Unilever Ltd, CEO Sanjiv Mehta said that *'The continued pressure on areas with deficient monsoon are manifest from the fact that …rural growth [has] lagged urban for another quarter…'*[8] While IHS Automotive analyst Anil Sharma noted that *'Cars …derive a lot of volumes from… rural markets. What we see… is a reflection of rural stress, stemming from rainfall deficit in the last two years.'*[9]

Lastly, the market continued to feel the reverberations from government regulation. The introduction of an additional 1% excise duty (which prompted the jewellers' strike in Q1) and the requirement that purchases above Rs200,000 need a Permanent Account Number (PAN) card have acted as headwinds to the industry, impacting demand in the organised sector most notably. An unintended side-effect has been to increase the flow of unofficial gold into India – in part as the trade attempts to find ways around the legislation. Despite demand remaining weak, an estimated 44t of smuggled gold entered the market during the quarter. This is in line with our 2016 full-year forecast range of 140–160t, up from around 120t last year.

Faced with these regulatory challenges and the increase in smuggling, India's bullion sector continues to make moves to formalise its business, with the intention that this will also encourage the jewellery sector to do the same. The large national and regional jewellery chains do not oppose the implementation of the excise duty. But smaller, independent and family-based retailers, who prefer to use cash-based transactions, are opposed to the duty and the additional administrative and financial burden it creates. The 'Bullion Federation of India', an industry body composed of 50 leading bullion dealers across 17 states, was created amid a groundswell of intention to conduct their business in a transparent way, avoiding any unaccounted money and fully complying with tax requirements and regulation.

High prices and low economic growth weigh on Chinese consumer sentiment

Gold jewellery demand in China was similarly weak, but – with the exception of the high gold price – the reasons were somewhat different. Q2 demand fell 15% to 143.5t. Following on from the disappointing first quarter, this resulted in the lowest first half total for Chinese jewellery since 2012 (322.5t). Weak consumer confidence was the backdrop to this picture.

In China, the relatively high volatility in the gold price proved to be off-putting for many who were concerned that the swift price rise may just as quickly be reversed. This also helps to explain the jump in recycling activity during Q2, which reached a 9-quarter high.

The broader background to the slow jewellery environment was China's continued general economic slowdown. GDP growth held steady at a relatively weak 6.7% in Q2 2016 and this continued to weigh on consumer sentiment.

Changing consumer tastes in China are also having a continued impact on demand volumes. A shifting preference for fashionable, unique, highly-designed 18k or gem-set pieces has come at the expense of traditional 24k jewellery. This trend may continue, given the younger profile of 18k gold jewellery customers as highlighted by our consumer research. Our survey showed that, of the more-than 1,000 respondents who had bought gold in 2015, 18–30 year olds were more likely to buy 18k jewellery than 24k (39% vs 25%).

8 Comment made during HUL Q2 2016 Earnings call, 18 July 2016; *https://www.hul.co.in/Images/jq-16-transcript_tcm1255-484738_en.pdf*

9 *http://asia.nikkei.com/Business/AC/India-car-sales-fall-in-May-on-weak-rural-demand*

That said, there is continued (albeit small) growth in the 99.99% (4-nines) purity bracket, but absolute volumes here remain small. The product mix appears to be shifting, with higher-designed 18k/gem-set jewellery and 4-nines jewellery seeing growth.

The jewellery industry continued to face disruption caused by the hallmarking legislation introduced in May. The requirements presented many retailers and manufacturers along the supply chain with a costly logistical and administrative burden, eating into already very thin margins and distracting attention from 'normal' business. The industry continues to consolidate, allowing those who best adapt to the changing consumer environment to benefit in the longer term.

Some of the smaller markets in the SE Asian region were, on the face of it, positive in Q2. But this was largely reflective of the weakness of demand in Q2 2015. For the most part, demand for gold jewellery was relatively muted due to the sharply higher gold price and consumers' attention turned instead to recycling existing jewellery holdings. First half demand across all regional markets was subdued compared with 2015, registering single-digit percentage changes.

Middle Eastern demand weak; Iran again the exception

Demand across the Middle East was, unsurprisingly, poor given the environment of high gold prices, relatively low oil prices and continued geopolitical unrest. Demand in Egypt hit a record low in our series of 5.3t. The domestic currency remains very weak, following the devaluation in March making local gold prices punitively high for many consumers.

In contrast to the surrounding markets, demand in Iran continued to improve on the wave of optimism sparked by the removal of sanctions last year. Demand grew 10% in Q2 (to 8t), taking half-yearly demand to 17.9t.

In Turkey, Q2 demand equalled the meagre 8.7t from the previous quarter (-25% year-on-year) with the result that H1 demand fell to a low of 17.4t. This is just ahead of the average quarterly volume over the last five years (16.3t). Ongoing political tensions, reduced tourism, rising unemployment, together with collapsing export revenues from Russia affected local sentiment towards gold.

Seven-year high in US H1 jewellery demand

Although the market was somewhat subdued ahead of the forthcoming Presidential elections, Mother's Day sales helped US jewellery demand to its 10th consecutive quarter of year-on-year growth (+1% to 25.9t). Demand for the first half year of 48.6t was the strongest since 2009. Growth in jewellery and watch sales comfortably outstripped that of general retail sales for much of the year-to-date, although the comparison was slightly flattered by weak gains in early 2015. Consistent, if moderate, economic growth and improving employment levels are supporting demand, although enthusiasm in the sector can be expected to wane over the coming months as the elections draw nearer.

Demand in Europe stabilises

European jewellery markets have also been relatively subdued so far this year. Despite the higher gold price, stabilisation or modest growth was the norm as economies continue to recover and the high-end of the market continues to grow. France was an exception; demand slipped marginally to 2.5t (-2%) as consumers continued to shift from gold to silver.

Demand in the UK grew marginally to reach 8.2t in the first half, the strongest H1 since 2010 as this market continues to build on the strong base established in the wake of the long-term secular downtrend from 2001 to 2012. The rolling 4-quarter average has hovered around 26t since the end of 2014, indicating the stability in the market.