Investment

Still-heightened levels of uncertainty boosted investment across Western markets; profit-taking in much of Asia and the Middle East tempered growth.

Total bar and coin demand				
Tonnes	Q2'15	Q2'16	Year-on-year change	Year-to-date change
World total	209.1	211.6	↑ 1%	↑ 4%
India	37.7	33.1	↓ -12%	↓ -22%
China	45.1	40.2	↓ -11%	↑ 11%

A 'perfect storm' of conditions in the gold market this year has pushed investment to historic levels. Demand of 448.4t was a near-record for second quarter investment, only lower than Q2 2010's stellar 606t. Consequently, demand for bars, coins and ETFs during the six months to end-June reached a first half record of 1,063.9t, worth a value of US$41.6bn.

But it was ETFs that really stole the show. Inflows into the sector have been exceptional: 579.2t in the space of six months, compared with cumulative outflows of 616.1t over the preceding 10 quarters. The value of gold-backed ETF AUM increased by +69% (US$38.1bn) in the first half of 2016 to reach US$93bn, their highest level since Q3 2013.

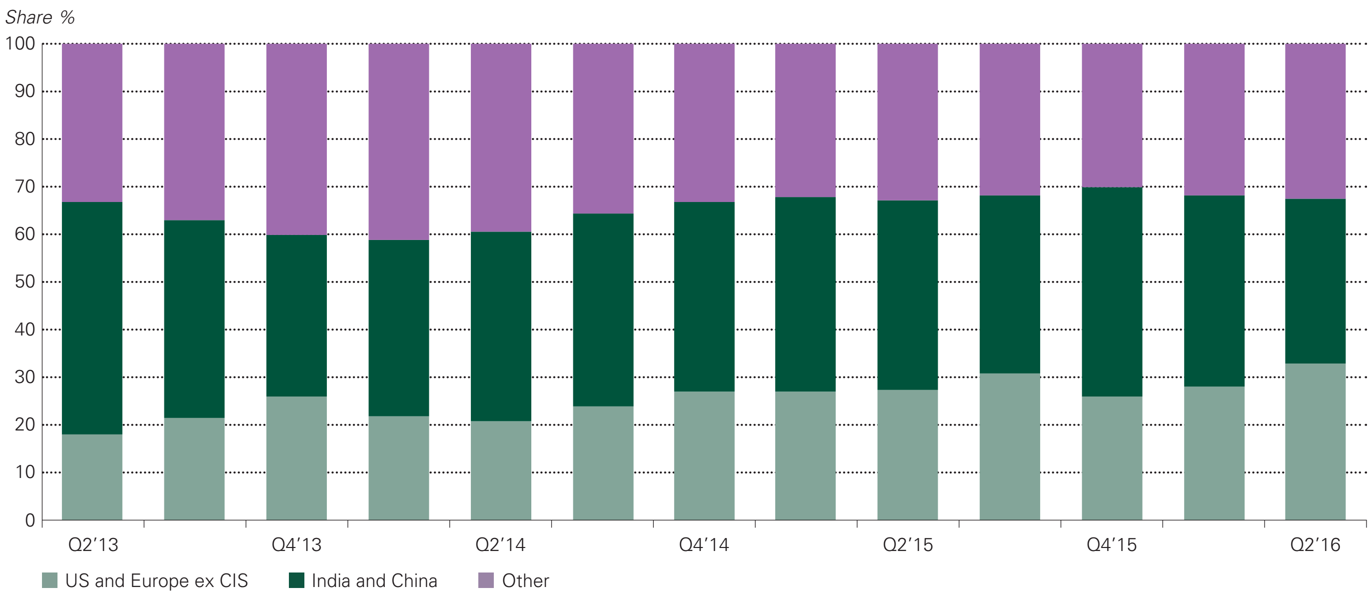
Key themes considers the main reasons behind this positive shift, but to recap: heightened uncertainty has triggered the release of substantial pent-up demand among western investors (**Chart 5**). And that uncertainty has been generated by:

- unparalleled loosening of global monetary policy (including widespread negative interest rates) to combat economic fragility;
- western political developments – namely, the UK voting to leave the EU and the looming US election;
- the slowing pace of US interest rate hikes (and consequent slowdown in US dollar strength).

The apparent end to the downtrend in the gold price has been a further cause (as well as an effect) of improved investor sentiment.

Chart 5: Western investors take a greater share of bar and coin demand in the second quarter

- Pent-up demand among US and European investors has fuelled much of the upsurge in investment in 2016 so far.
- Global uncertainty remains elevated, which should continue to underpin investment demand.



Source: Metals Focus; GFMS, Thomson Reuters; World Gold Council

Demand for gold bars and coins in Q2 (211.6t) was marginally firmer year-on-year. This took H1 investment to 484.7t, 17% down on the previous six-month period, but 4% higher than the first half of last year. Within this category, coin demand was the most robust while demand for medals and imitation coins deteriorated (the latter being almost a pure reflection of weak demand in India).

Positive sentiment in Western markets, combined with lacklustre demand in India and China, resulted in Europe being the largest market for gold bars and coins in Q2

After a solid start to 2016, European investment demand remained well supported in the second quarter – broadly stable at 44.7t (a figure that made it the largest gold retail investment market). For the first half-year, investment was fractionally ahead of 2015 at 104t. Intra-quarter trends reveal strong buying in April and May, which were largely cancelled out by a surge in profit-taking in June as the gold price jumped 9% in euro terms and 19% in pound sterling over the course of the month.

While the widely unexpected result of the referendum came too late in the quarter to materially impact European investment numbers for Q2, there was undoubtedly considerable interest in gold both in the run-up to, and aftermath of, the decision. This is supported by the Royal Mint, which stated that "one week on from the Brexit vote… [we] … continued to see strong activity from investors". Further evidence of this trend comes from online gold platform BullionVault's analysis, which in early July noted that although gold buying among private Western investors had "raced to the fastest pace in three years amid last month's Brexit referendum and financial shock," this was matched by profit-taking as gold "jumped in price like never before."

Within Europe, there were some slight differences across markets. The UK in particular showed heightened interest in gold investment products as the prospect of the referendum at the end of the quarter generated considerable caution among investors, although volumes remain small. Q2 demand jumped 65% to 3t. The H1 total reached a three-year high of 6.2t.

Contrastingly, in Germany, bar and coin demand for Q2 of 21.9t was 5% below Q2 last year. Two-way activity was healthy, but the heavy selling that kicked in after the sharp June price increase outweighed buying among retail investors.

US investors respond to sharp price moves

Investor behaviour in the US during the second quarter was a repeat of Q1: bar and coin investment closely mirrored the surge in demand for ETFs. First half demand for gold retail investment products was 75% higher than 2015, boosted by the sharp price increase. Sales of gold coins by the US Mint went through the roof. The number of 1oz Eagle coins sold in the first six months of 2015 more than doubled – to 405,000 from 198,500 in 2015 – and these coins were far more popular than smaller denomination (half- and quarter-oz) coins. Trade data also showed a huge influx in imports of gold coins from other countries.

Chinese investors see price rally as profit-taking opportunity

Chinese investment dropped off in the second quarter: demand halved from Q1 to 40.2t, an 11% year-on-year decline. Nonetheless, the H1 total of 121.4t was the strongest since 2013's exceptional surge.[10]

Profit-taking activity was boosted by price volatility: the spike in the price encouraged considerable liquidations, particularly as many expected a near-term correction to follow. A similar pattern was seen in activity in Gold Accumulation Plans (GAP), with a sharp increase in redemptions outweighing a healthy increase in gross inflows. A more detailed explanation of these products and the role they play in helping to meet investor needs is covered in the Focus Box *'China's commercial banks.'*

However, Chinese investors' appetite for gold products goes beyond just bars and coins. The sector has seen increasing competition from other products, as reflected in the sharp rise in gold-backed ETFs over H1 2016 from 6.3t to 24.4t.

Price volatility and weak rural incomes undermine Indian investment

India's gold market was very weak between January and June: imports plummeted as supply-led weakness was compounded by high and volatile gold prices. H1 bar and coin demand of 61.2t (-22%) was the lowest first half total since 2009. Notably, this is 9% lower than average *quarterly* demand over the last five years.

Demand in Q2 did not replicate the severe declines seen in Q1, but was weak nonetheless – down 12% year-on-year at 33.1t. Akshaya Tritiya offered some respite after the difficult start to the year, with the strike in the Indian jewellery sector (which restricted investment demand, due to the importance of the jewellery retail network as a distribution channel for gold investment products to the rural community in particular). But sharp, volatile gold price increases deterred investment-related purchases.

10 World Gold Council, *Gold market update Q2 2013* http://www.gold.org/search/research/market%20update

Incomes among the rural contingent are under pressure after two successive years of deficient monsoon rains. Additionally, rural inflation remains above urban inflation levels, further reducing the pool of funds available to rural investors. The weakness in the market was clearly reflected in the local price level, which remained at a sharp discount to the London benchmark price throughout the quarter.

Looking ahead, predictions are for an improved monsoon this year, which will boost rural incomes. And investment inflows are likely to resume as and when the gold price stabilises, even if that is at a higher level. But inventory levels throughout the supply chain remain elevated after such a subdued start to the year, so any uptick is not likely to be fully reflected in a rise in import levels until stock levels are at least partly run down.

Japan again the star performer among the smaller Asian markets

Investment across much of Asia remained very subdued in the second quarter; declines were widespread as the high gold price meant profit-taking weighed on net investment levels.

Vietnam extended the losses seen in the first quarter: Q2 demand fell 18% to 8.9t. First half demand of 20.3t was 19% below 2015's already weak H1 total. A combination of high gold prices, continued low inflation and a relatively stable exchange rate were the main factors keeping demand in check. However, inflation is starting to creep up and were it to break above the government's 5% p.a. cap that would act as an alert for domestic investors – particularly if the gold price stabilises.

A rise in Q2 bar and coin demand in Indonesia (+32% to 6t) was largely reflective of the low 2015 base period. Nevertheless, improvements in the domestic political climate and the surprise cut in domestic interest rates in June (in an attempt to spur economic growth against a benign inflation background) lifted demand.

Japanese investors have bucked the broad regional trend in 2016. Investment in bars and coins has swung from modest disinvestment to 9.3t of positive net new investment in H1 2016: the strongest first half for Japanese investment since 2005. Demand reached 5.8t in Q2 – marking the first time that Japan has had four consecutive quarters of positive net investment since the market switched to being a net seller in 2006.

A stronger yen made gold more affordable (the Yen price has increased by just 6% this year in comparison with US$ gold's 25% rise). Negative interest rates, Brexit, anxiety over global market conditions and distrust in Abenomics made it more appealing. The decision by Prime Minister Abe to postpone a planned sales tax hike in June (for a second time) raised further worries over the state of the Japanese economy and forced many to focus on gold for investment protection and wealth preservation. Tanaka (Japan's biggest bullion dealer) reported a strong surge in sales during June, particularly in the aftermath of the UK's 'out' decision.

And it was not just individual investors heading for gold. Reflecting the deterioration in the domestic macro environment and increasing global uncertainties, the number of pension funds invested in gold increased in the first half of 2016, and the gold investor base also expanded to include non-pension institutional investors.

The strength in the yen meant that the local price did not experience the rapid surges seen in other markets, thus existing holders did not have a strong incentive to take profits. The earthquakes that struck Japan in April, provided investors with a further motive for adding to their holdings.

Middle Eastern bar and coin demand slides to seven-year low

Iran was again the only bright spot in an otherwise very dismal picture for Middle Eastern investment demand. Demand in most markets across the region was affected by any or all of the following: the high and sharply rising gold price; ongoing political instability; continued pressure on revenue from relatively weak oil prices; and sliding tourist numbers. H1 bar and coin demand for the region as a whole – of 34.3t – was the lowest since 2009.

Iran managed to buck the trend, with a 2% increase in Q2 bar and coin demand to 7.2t. The market continued to benefit from the relief rally following last year's removal of international sanctions, and a cut in interest rates in response to slowing inflation further boosted demand.

First half-year investment in Turkey fell to an historic low of 8.8t – the lowest in our quarterly records back to 2000. High prices were the main reason, discouraging new purchases and instead resulting in some profit-taking.