# Supply

## Higher recycling levels and further hedging outweigh plateauing production, boosting total supply by 10%.

| Tonnes | Q2'15 | Q2'16 | Year-on-year change | Year-to-date change |
|---|---|---|---|---|
| **Total supply** | 1,041.7 | 1,144.6 | ↑ 10% | ↑ 8% |
| Mine production | 789.6 | 786.9 | ↓ 0% | ↑ 1% |
| Net producer hedging | -15.2 | 30.0 | - - | - - |
| Recycled gold | 267.4 | 327.7 | ↑ 23% | ↑ 10% |

In Q2, the total supply of gold increased by 10% year-on-year, amounting to 1,144.6t compared to 1,041.7t in Q2 2015. The primary driver of this increase was recycling (+23% year-on-year) which was boosted by the higher gold price in a number of price-sensitive markets. Mine supply rose 5% in the second quarter, but its two components saw contrasting fortunes: mine production was effectively flat year-on-year, while gold producers added 30t to the hedgebook.

**Gold production plateaus as margins grow**

The second quarter saw mine production reach 786.9t, virtually unchanged from the 789.6t seen in Q2 2015. Production levels continue to plateau, a consequence of cost management which has been the focus of the industry for the last couple of years. Higher production from existing and newer projects was more than offset by declines at larger projects.

Canadian mine output rose by 3t year-on-year in Q2, as continued ramp-up of the Eléanore and Cochenour projects added to increases at Canadian Malartic and Detour Lake. In Mexico, production from Fresnillo (+1.1t, +20%) again helped increase the country's year-on-year gold output, as did Torex Gold's El Limon-Guajes which entered commercial production at the end of Q1.[24] Increases from the newer Aurora and Karouni projects helped Guyana register a higher year-on-year output (+2t). Although recent mine start-ups have made a positive contribution to overall mine production, this will not have a significant effect. The project pipeline remains constrained, with 2016 output from new mines coming on stream expected to be around half of what it was in 2015.

Year-on-year output from Mongolia (-6t) and Indonesia (-12t) saw declines; production from both Oyu Tolgoi (-5.2t) and Grasberg (-4t) fell owing to mine sequencing.[25] In Peru, declines in production were once again led by Yanacocha, where production was 1.6t lower than in Q2 2015.

24 El Limon-Guajes is estimated to add a further 11t per year to overall mine production.

25 Mine sequencing is the process where ore and waste is mined in stages according to predetermined sections or blocks based on the geological model and mine plan.

Despite mine production being flat, gold producers have had a stellar six months. The focus on cost management in recent years has seen costs steadily fall since 2013. In Q2, year-on-year total cash costs and all-in sustaining costs fell 6% and 8% respectively. While further cuts will be increasingly difficult, costs are now at least under control. Coupled with the rise in gold prices during the first half, producer margins are now looking increasingly healthy. The all-in sustaining cost margin of US$479/oz in Q2 was at its highest since early 2013 (**Chart 10**). This breathing room has proved to be a boon for the industry, and gold mining equities continue to outperform the wider market.[26]

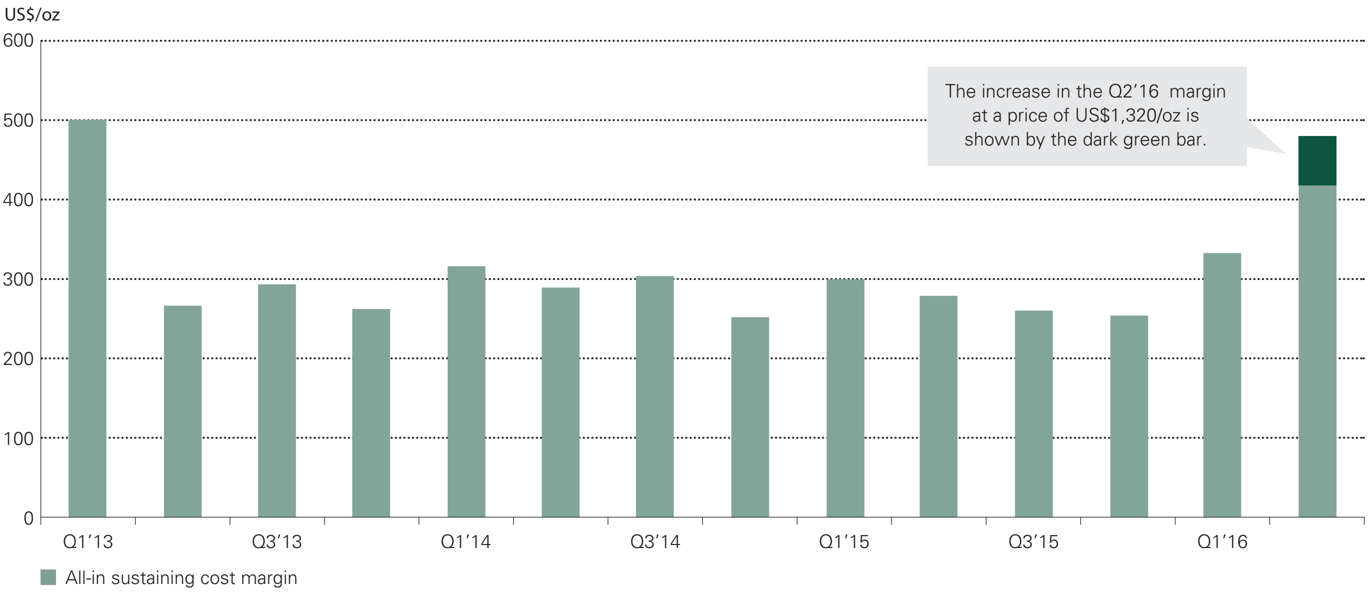
**Hedgebook continues to edge up**

Hedging – the selling forward of unmined gold – by gold producers has seen somewhat of a shift in the last year. We have now seen four consecutive quarters of modest hedging, totalling 113.8t. In the first half of 2016, net producer hedging reached 82.7t, up from the 17.7t of net de-hedging in the same period last year. The global hedgebook has risen to over 300t, its highest level since 2009. For perspective, this is still only a tenth of the level it was at 15 years ago.

The rationale behind recent hedging remains the desire to safeguard cash flow, whether that be to help manage or reduce debt levels, for investment in ongoing or future operations or to avoid volatility and exploit local currency advantages. This prudence is understandable given the upheaval in the industry in recent years. It should also be noted that those producers entering into, or expanding, hedging agreements have done so only partially – ensuring that they are still exposed to any further gains in the gold price.

**Chart 10: Gold producers have seen margins increase in the first half of 2016**

- The emphasis on cost reduction across the gold mining industry, combined with the recent price rise, has been a boon to producer profit margins.
- All-in sustaining costs were trimmed by 1% in Q2 from the previous quarter, signalling that further material reductions will be increasingly difficult.




Note: Margins are calculated using quarterly average gold prices; margin calculated for Q2’16 uses the most recently available (Q1’16) costs data. The dark green bar shows the increase in margin for Q2 when calculated using the end-June PM fix price of US$1,320.75/oz, compared with the margin calculated using the average Q2 quarterly price of US$.

Source: Metals Focus; World Gold Council

26 HUI Index increased 122% in H1 2016, exceeding returns from FTSE Gold Mines Index (+110%), S&P 500 Index (+3%) and MSCI ACWI Index (0%).

The price increase in 2016 has led to a number of producers to use this as an opportunity to lock in the price they will receive for their output. The gold price is 25% higher in US dollar terms, but at or above record levels in some other currencies such as the Australian dollar and South African rand (**Chart 11**). And it is in these regions where much of the recent hedging activity has been concentrated.

In Australia, Newcrest extended its hedge of Telfer production by a further 6.2t, while Oz Minerals (+5.3t) and Alkane Resources (+1.5t) were notable fresh positions. In Canada and the United States, the most notable hedges were 6.7t by Atlantic Gold and 5t by Alacer Gold respectively. Endeavour Mining – which operates in West Africa – hedged 12.4t (400,000oz) in Q2, 50% of its estimated gold production over the duration of the hedge. Shortly after the quarter had ended, South African producer Harmony Gold announced it hedged 20% of its FY17 and FY18 total production – 13.4t (432,000oz). This will help secure margins at some of the company's higher cost operations.

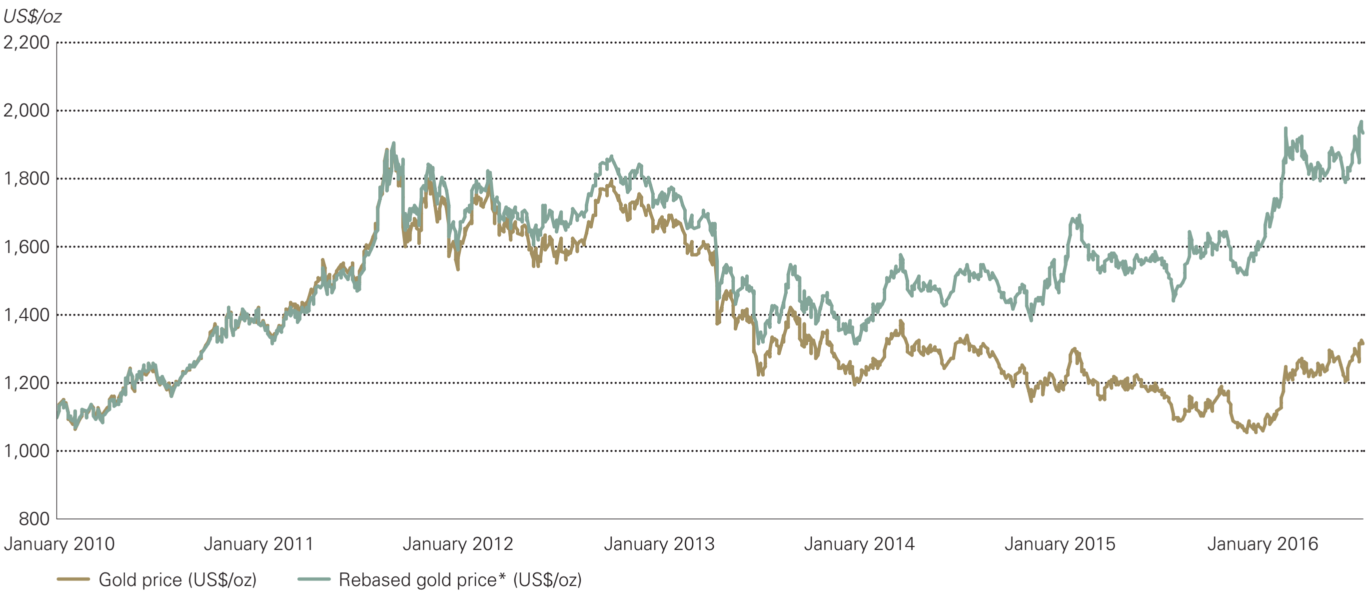
Our expectation remains that small-scale, sporadic hedging may occur should we see further price appreciation, but a sustained wave of large-scale hedging deals is unlikely.

### Recycled gold jumps in response to higher prices

The supply of recycled gold saw a 23% year-on-year jump in Q2, from 267.4t to 327.7t. This increase is primarily a function of the dramatic price increase that has been witnessed so far in 2016. While the gold price increased by 25% in US dollar terms by the end of June, many price-sensitive markets actually saw much larger increases owing to currency movements. In the first half of the year, recycled gold supply was 686.7t, 10% higher than the 625.9t of recycling seen in H1 2015.

**Chart 11: Gold producers "local" gold price is hitting new highs**

- The US$ price rise has been more than matched by the price in key producer currencies.
- Weakness in the Australian dollar and South African rand in particular have benefitted the industry.
- This has been a key reason for the uptick in hedging as producers make the most of the opportunity to lock in a higher gold price.




*The rebased gold price has been adjusted for local currency movements for the largest 20 gold producing countries. Local currencies are indexed from January 2010, and weighted based on 2015 gold production volumes.

Source: Bloomberg; World Gold Council

In India, an increase in recycling was attributed to selling among rural consumers, rather than outright selling by jewellery consumers more broadly. Weather-related events in the past couple of years have impacted rural incomes, making gold a useful source of funds with which to finance the purchase of farming products – such as seeds – for the sowing season ahead.

The one key exception was Turkey, where recycling was significantly down quarter-on-quarter and marginally down year-on-year. However, this is similar to what was seen in both 2014 and 2015. The price appreciation at the start of the year brought a wave of selling back by consumers, eager to capitalise on their gains. In the second quarter, recycling fell back to more normal levels, despite further increases in the price level. Political uncertainty continues to plague the country, with this sense of unease being exacerbated by a number of terrorist-related incidents. As a result, many consumers may also opt to leave their gold "under the pillow."[27]

27 World Gold Council, *Turkey: gold in action,* January 2015.