Market commentary

Jewellery

Soaring gold prices, market disruption in India and supply-constraints in China combine to impede gold jewellery demand.

Tonnes	Q1'15	Q1'16	Year-on-year change	Quarter-on-quarter change
World total	596.9	481.9	↓ -19%	↓ -27%
India	150.8	88.4	↓ -41%	↓ -51%
China	216.3	179.4	↓ -17%	↓ -4%

Global jewellery demand fell 19% year-on-year to 481.9t, 115t below last year's 596.9t Q1 total. The vast majority (99.3t) of the decline was generated by just two markets: India and China (**Chart 4**). These two jewellery powerhouses each faced their own particular set of challenging circumstances in the first quarter.

The sharp rise in the price of gold during the first quarter of the year was a deterrent to jewellery demand, particularly in the price-sensitive markets of Asia and the Middle East where consumers prefer to buy when prices are less volatile. But the unfolding predicament in India proved by far the greater obstacle.

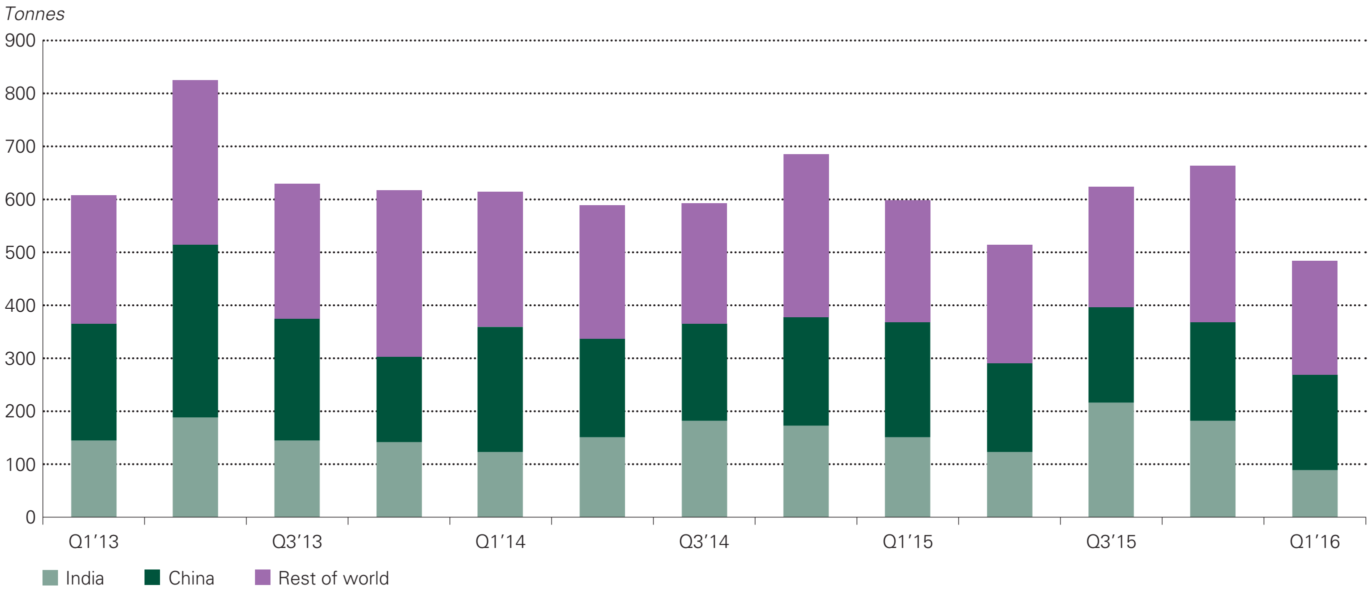
Strikes thwart India's jewellery market

Q1 2016 saw Indian jewellery demand hit a seven-year low of 88.4t, a 41% year-on-year decline. This is 44% below the five-year quarterly average for India of 156.7t and indicates the extent of the troubles faced by that market during the quarter.

The sharp rise in the local gold price through a number of key levels was discouraging in itself. The anticipation of a correction in prices and of a reduction in customs duty on gold kept jewellery demand tepid in February. But the final blow came in the budget released on 29 February. In it the government proposed not only an increase in both custom and excise duties on doré (from 8% to 8.75% and from 9% to 9.5% respectively), but also – crucially – a 1% tax to be levied on jewellery manufacturing. Widespread strikes across the jewellery industry ensued. Consumers were unwilling – and largely unable – to buy jewellery at a time of such uncertainty, a fact that is borne out in the demand numbers. This combination of headwinds faced by the industry resulted in swift, and deep, discounts in the local price. For more detail on Q1 Indian demand, see *Key themes*.

Chart 4: Jewellery demand down 19% to four-year low

- India – down 62t – accounted for over half of the 115t decline in global jewellery demand.
- China was also a major contributor, falling by 37t from Q1 2015.



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

But the outlook for India is more positive: consumers are waiting for their opportunity to re-enter the market. The steep local price discount has already been largely eradicated. The industry expects the pent-up demand that accumulated during Q1 to be released in the coming weeks as the market adjusts to the new tax structure and buying for the wedding season gathers momentum. In 2015, demand in H1 slumped in the face of numerous challenges before staging a strong recovery in the second half; 2016 is likely to play out in a similar way.

China: supply-side crunch

Demand for gold jewellery in China fell 17% in Q1, to 179.4t. Appetite for gold jewellery was curbed by the sharply rising gold price against a background of continued economic slowdown.

Despite receiving a lift in January and early February from the Chinese New Year effect, jewellery demand tailed off sharply in the second half of the quarter. The sector suffered marked losses as China's relatively anaemic economic performance weighed on consumer sentiment. Q1 GDP growth of 6.7%, while exceptional by Western standards and within the government's target range of 6.5%-7%, was the lowest Q1 rate since 2009. This took its toll on consumers: official data showed a drop of 3.9% in retail sales of gold and silver jewellery.[8]

Meanwhile, a supply-side crunch further hampered China's jewellery market. A new national standard for hallmarking of gold jewellery (the National Gold Standard Mark) came into force on May 4, which requires that all gold jewellery of 99% purity be hallmarked as Chuk Kam.[9] During March, retailers nationwide were busy adjusting their inventories in order to replace existing stocks with inventory that complies with the new requirements, in time for the early May deadline. This surge in stock replacement activity led to a temporary supply squeeze that intensified the slump in demand. But jewellers also took the opportunity to refresh their stocks with more interesting, higher-margin product offerings (e.g. 18k, gem-set, 3-D hard gold etc). These may entice consumers, and help support profits in the coming quarters, but may be detrimental to gold volumes, given that they have largely replaced plain 24k pieces.

The supply of gold jewellery in China came under further pressure as lines of available capital were constrained. During the quarter, domestic banks tightened the conditions under which they will lend to jewellery manufacturers and retailers. Retailers are gradually streamlining their operations in response to the tougher business climate and reducing overall inventories and order volumes, adding to the supply side-side pressure in the market.

Price rise takes toll in smaller Asian markets

Consumers across Asia were largely price-responsive in their behaviour: jewellery demand fell in most of the region's smaller markets. Of these, Malaysia (-23%) and Indonesia (-10%) were the weakest performers. In the former, the decline was again influenced by the introduction of the GST in April 2015 (consumers made their purchases in advance of the April tax increase, boosting the Q1 2015 number). Going forward, this effect should now begin to drop out of year-on-year comparisons. In Indonesia, despite seasonal factors being supportive of demand, the price rally quickly dampened it, while a continued focus on lower carat jewellery weighed on fine gold volumes.

Vietnam was, however, an exception to the depressed regional market, with jewellery demand 6% higher than Q1 2015. Although this can be partly explained by the relatively positive economic scenario (GDP growth in Q1 accelerated to 6.7% from 6.5% in 2015), the numbers are in fact more representative of investment demand. In Vietnam, a large portion of jewellery demand is accounted for by 'chi' rings. Although they are classified as jewellery, these crude products have very limited added value above the value of the gold they contain, being of very simple design and requiring limited labour input; the motive for buying them is therefore often investment-driven. As the premium on tael bars remains punitive in Vietnam, domestic consumers are forced to look elsewhere to satisfy their need for an asset that preserves wealth and protects against the ravages of inflation.[10]

All of the above notwithstanding, de facto jewellery demand was also lifted by the seasonal impact of Vietnamese New Year, as well as the Day of the God of Fortune (10th day of the 1st month of the Lunar Calendar).

8 National Bureau of Statistics of China, http://data.stats.gov.cn/english/easyquery.htm?cn=A01

9 'Pure gold' jewellery, known as Zu Jin in Putonhua and Chuk Kam in Cantonese is 24 carat jewellery, typically of 99.9% gold content (999 fineness). It is the mainstay of Chinese jewellery fabrication and consumption. Under previous hallmarking system, only 24k gold (of 99.9% purity) could be hallmarked as Chuk Kam.

10 State-owned Saigon Jewellery Corporation has the monopoly on the manufacture and sale of government-approved gold bars, of which the supply is limited.

Iran the only bright spot in a Middle Eastern region beset by difficulties
Gold jewellery demand in Iran rallied by 10% year-on-year (to 9.9t vs 9t in Q1 2015) as the market continued to feel the benefit of the lifting of Western sanctions. Nevertheless, this growth was tempered by the impact of 9% VAT.

The remaining Middle Eastern markets uniformly saw double-digit losses in Q1 jewellery demand, beset as they were by a mix of ongoing geo-political issues, low oil prices and weak tourism revenues. And that's before the gold price rally is added into the mix. Egypt was the worst casualty: demand fell to a fresh low of 7.7t (-18% year-on-year), slipping below the previous low of 7.9t from Q2 2011. The market was crippled by government restrictions on bank withdrawals. These were limited to no more than US$50k at a time – a relatively paltry sum for jewellery retailers and wholesalers.

It was a similar story for Turkey in Q1. Demand of 8.5t (-18% year-on-year) was the lowest quarterly total since Q4 2012 as the high gold price, piled on top of the struggling domestic economy, added to consumer woes. Terrorist atrocities further weighed on sentiment.

Startling import growth heralds strong quarter for US jewellery demand
In the US, demand for gold jewellery gained 2% year-on-year. This is the ninth consecutive quarter of year-on-year gains, impressive for a market where economic growth has remained relatively anaemic. The industry continues to benefit from retailers re-entering the gold segment, having previously slashed – if not completely eradicated – their gold product offerings.

The strength of gold jewellery imports in to the US in January and February was a clear indication of US consumers' continued desire for gold jewellery. Double digit gains were reported in imports (in fine gold volume terms) in both January and February, reflecting continued restocking among some larger retailers that continue to build up their gold allocation.

The positive consumer demand trend was echoed in upbeat official sales data, which showed stronger than expected growth in jewellery sales in January. The outlook for the remainder of the year is cautiously optimistic. While prospects for global personal luxury goods are positive – as highlighted by a report by Bain & Co which expects a resurgence in demand for these items over the course of 2016[11] – the Presidential elections in the second half of the year loom over the market and may increasingly temper consumer enthusiasm as they draw closer.

European jewellery demand has less than sterling start to the year
In Europe, jewellery demand continued in a similar fashion to the last 4-5 years: after a seasonal jump in Q4, demand subsided straight back to levels that are in line with the 13.3t Q1-Q3 average since 2012. Demand for the quarter amounted to 12.7t. The UK eked out a 1% increase in demand, to 4t. Data on the number of articles being hallmarked by the Birmingham Assay Office suggest that interest picked up in the latter half of the quarter, having been quiet in January after the usual Q4 seasonal rally.

11 Bain & Company, *Luxury Goods Worldwide Market Study, Fall-Winter 2015*.