Supply

Increased hedging coupled with a slight uptick in mine production outweighed a marginal decline in recycling. Overall, total gold supply grew 5%.

Tonnes	Q1'15	Q1'16	Year-on-year change	Quarter-on-quarter change
Total supply	1,081.0	1,134.9	↑ 5%	↑ 4%
Total mine supply	717.7	774.0	↑ 8%	↓ -10%
Recycled gold	363.2	360.9	↓ -1%	↑ 53%

Total supply in Q1 increased 5% year-on-year, the result of an 8% increase in total mine supply – the sum of mine production and net hedging – and a 1% decline in gold recycling. Total mine supply benefitted from a marginal increase in mine production – from both existing projects and recent start-ups – and a renewed interest in hedging from some producers. And while recycling dipped year-on-year, the rapid rise in gold prices at the start of 2016 fuelled strong quarter-on-quarter growth.

Mine output up slightly but pipeline remains constrained

During the first quarter of 2016, mine production totalled 734t, a modest 5t increase on the 729.4t of output in Q1 2015. Yet, over the long term, global production is plateauing: gold producers continue to trim costs and focus on maximising output from existing assets, while the impact of new mines coming on stream dwindles.

Production growth in the first quarter was driven by major operations in a handful of countries. In the United States, increases at Barrick's Goldstrike (+3.3t) and Cortez (+6.8t) projects led to a year-on-year increase in overall production levels. In Mexico, Fresnillo's Herradura (+1t) and Noche Buena (+0.6t) pushed production higher. The year-on-year increase in mine production in Indonesia was due to continued strong output from Newmont's Batu Hijau (+2.6t). Polyus Gold reported a 9% increase in output during the first three months of the year, boosting Russian production. The mild Russian winter was a key factor, as it prolonged the operating window for projects that would normally shut down during the most severe winter weather.

The rise in production should not be attributed to established operations alone. New mine starts have also played a part. Torex Gold's El Limon-Guajes mine in Mexico poured gold for the first time in December 2015, while Goldcorp's Éléonore and Cochenour mines in Canada are ramping up, having entered production in Q3 and Q4 2015 respectively. In Guyana, output was boosted by Guyana Gold Field's Aurara project and Troy Resource's Karouni project entering production in Q4 2015.

But the continued influence of new mines on mine production should not be overstated; the project pipeline is diminishing. In recent years, additional production from new mines brought on stream has declined (**Chart 7**). And continued cutbacks on sustaining capex by producers (all-in sustaining costs fell 11% year-on-year to US$832/oz in Q4 2015) and the focus on core assets means pressure on the project pipeline will persist.

Outright declines in production remain limited as producers are focused on maximising production from their existing portfolio of assets. One notable decline in production was at Yanaccocha in Peru, where output fell 2.1t year-on-year, mainly due to lower ore grades being leached and milled, as well as lower mill recovery.

Recycled gold

While Q1 recycling fell 1% year-on-year, the rally in the gold price in early 2016 boosted it 53% quarter-on-quarter, as price increases influenced consumers.

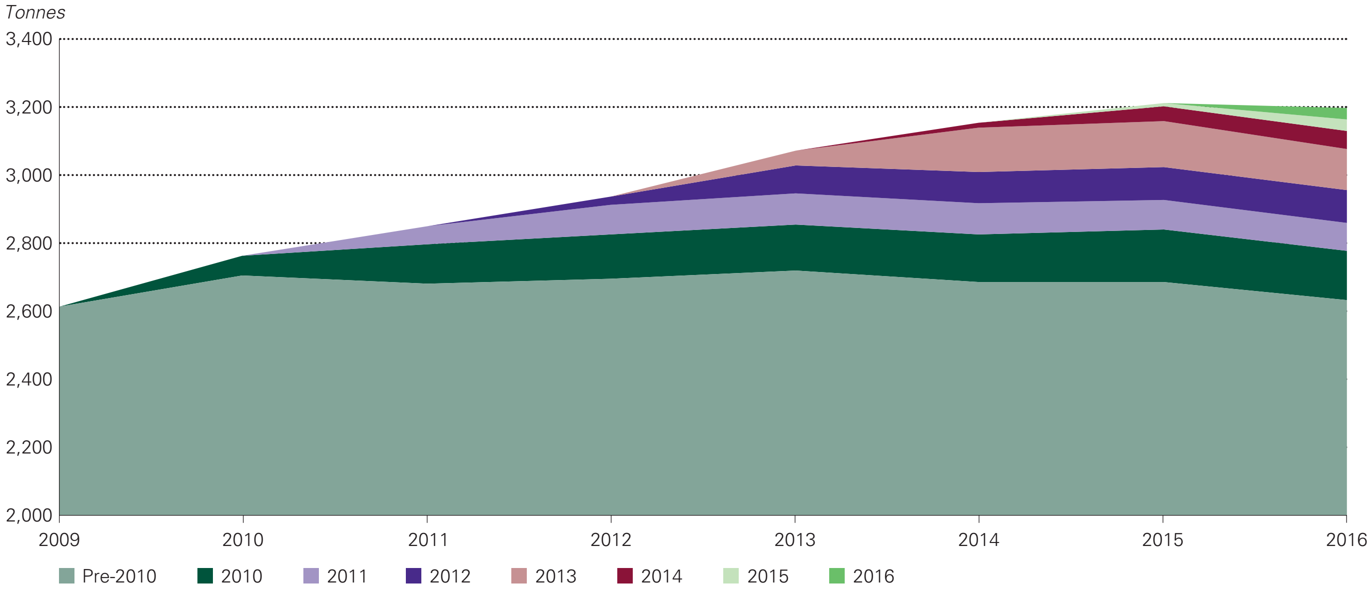
The strong start for gold in the first three months proved too tempting for some consumers, who took the opportunity to pocket a higher price for their old gold possessions. This behaviour was clearly evident in markets such as Thailand and Indonesia, where prices above US$1,200/oz acted as a strong sell signal.

In Turkey, the 13% appreciation in the local gold price during the quarter also encouraged recycling, although not to the same extent as in Q1 2015. The country's gold market is highly liquid, with an established infrastructure for recycling gold and consumers who are keenly aware of the gold price which means the market (both retailers and consumers) can quickly respond to escalating prices by selling gold back to be refined.

India's recycling market was more subdued. The well-publicised jewellers strike, in response to changes to taxation in February's budget, restricted recycling activity. With many consumers using jewellers to sell back old gold jewellery, the temporary suspension of trade meant that this recycling channel was significantly curtailed.

Chart 7: Sharp slowdown in new mine start-ups

- The number of new mines coming on-stream has slowed since 2013; these have made a small incremental contribution to global production.
- Global production is plateauing as producers continue to focus on minimising capital expenditure and maximising production from existing projects.



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

Hedging finds favour with some

Gold hedging totalled 40t in the first quarter of 2016, more than reversing the 11.6t of dehedging in Q1 2015. This increase brings the global hedge book to 253t (**Chart 8**). Gold's impressive rise in the first quarter of 2016 was viewed by a small number of mining companies as an opportunity to hedge for tactical purposes. While some entered into contracts to lock-in the price they will receive, others sought to secure the exchange rate.

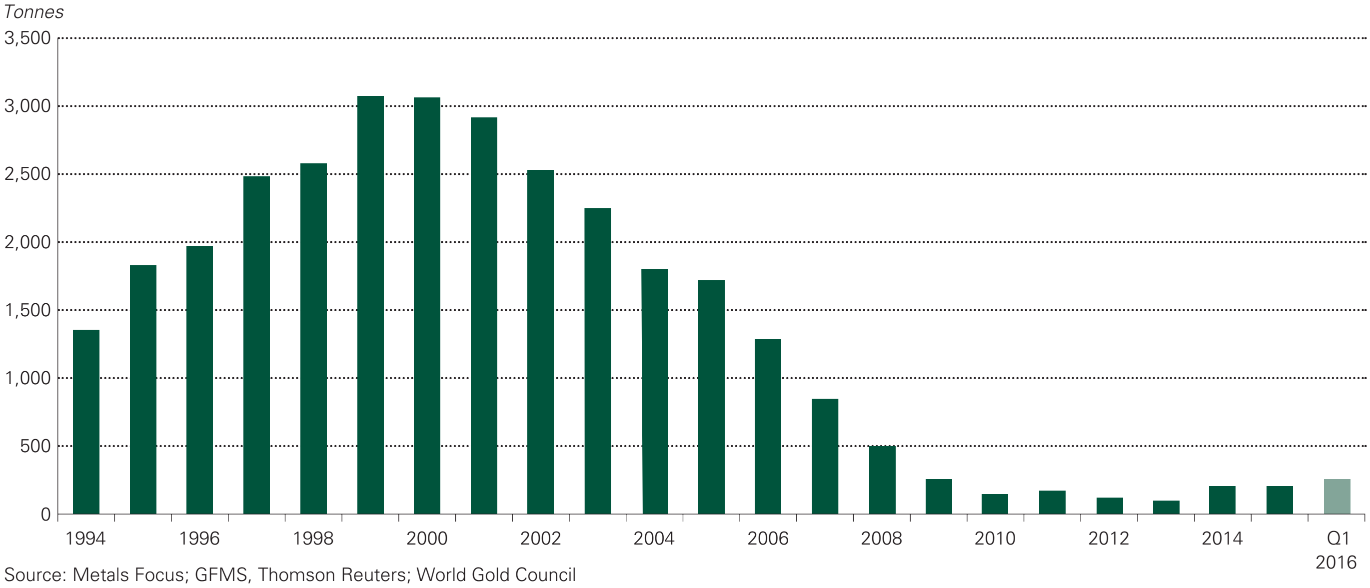
Polyus Gold – the largest producer in Russia – entered into the largest position, hedging 625,000 ounces (19.4t) over the next four years, while Evolution Mining hedged 4.7t out to mid-2020, bringing the company's total hedgebook to 26t. Both have been relatively active in the hedging space in recent quarters to make the most of the local price advantage. Newcrest also opted to hedge a portion of the future production from its Telfer mine (16.5t) in response to near-record high local gold prices.[20]

Acacia Mining hedged 4.2t of production from its Buzwagi mine in Tanzania, while New Gold opted to hedge 8.4t of its 2016 production. But both companies made clear they intend to remain unhedged in the long-term. New Gold stated: *"Our unique decision to enter into the option contracts is solely a function of 2016 being our most significant year of investment at our Rainy River project. We do not have any plans to enter into any similar contracts beyond this brief nine-month period."*[21]

While this increase in hedging is certainly notable – both given the companies involved and the size of some of the hedges – we don't expect to see a substantial shift back towards widespread long-term hedging. The focus in the industry remains on shorter-term hedges (over a time frame of months rather than years).[22] Many of the positions appear to be driven by the need to secure cash flow for project-related financing, or debt repayments. Further price appreciation may elicit sporadic hedging, although royalty, and in particular streaming, deals remain an alternative.

Chart 8: 40t of hedging in Q1 took the global hedgebook to 253t, up one third year-on-year

- New hedging activity is largely short-term and project financing-related.
- Although notable in recent terms, the uptick in hedging volumes is not significant in a historical context.



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

20 Newcrest's Telfer mine has relied largely on fly-in fly-out workers, which has resulted in it being sensitive to the local gold price. The company's other Australian assets remain unhedged.

21 *http://www.newgold.com/investors/NewGoldNews/PressReleaseDetail/2016/New-Gold-further-increases-cash-flow-certainty-with-gold-option-contracts/default.aspx*

22 *http://www.bloomberg.com/news/articles/2016-02-29/top-performing-gold-miner-adds-to-hedging-reboot-as-price-soars*