Gold Demand Trends
Second quarter 2016

August 2016

Key changes

Tonnes	Q2 2016 Year-on-year	Year-to-date
Gold demand	↑ **15%**	↑ **18%**
Jewellery	↓ -14%	↓ -17%
Technology	↓ -3%	↓ -3%
Investment	↑ 141%	↑ 127%
Central banks and other institutions	↓ -40%	↓ -23%
Supply	↑ **10%**	↑ **8%**

Source: Metals Focus; World Gold Council

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Second highest H1 for gold demand on record

Gold demand in Q2 followed the trends from the prior quarter: huge ETF inflows counterbalanced by anaemic jewellery demand amid rising prices. Investment was the largest component of gold demand for two consecutive quarters – the first time this has ever happened.

Key themes (more detail pages 2-7)

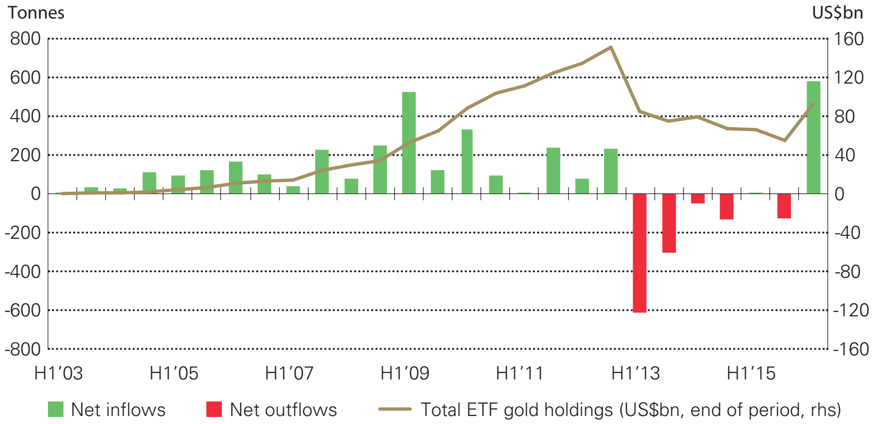
Record H1 investment – 16% higher than H1 2009: US and European investors clamoured for gold bars, coins and especially ETFs.

Gold price continued its climb: the US$ gold price rose 25% – the best H1 since 1980 – albeit with a few dips along the way.

Jewellery depressed: barring a few exceptions, conditions were unfavourable for consumers in most markets.

Featured chart

H1 2016 inflows into gold-backed ETFs were the strongest on record



Note: For monthly summary data and charts of gold-backed ETF holdings, please visit: http://www.gold.org/statistics

Source: Respective ETP providers; ICE Benchmarks Administration; World Gold Council

Key themes

Record H1 for gold investment

Investment demand of 1,064 tonnes (t) accounted for almost half of overall gold demand during the first six months of 2016. Western investors generated the bulk of this investment.

Investment has witnessed exceptional growth this year: record H1 demand of 1,063.9t is 16% higher than the previous H1 high from 2009, when the market was in the midst of the global financial crisis. Consequently, for the first time on record, investment has been the largest component of gold demand for two consecutive quarters. And this has been in no small part due to demand from Western investors across the spectrum, from retail to institutional and for bars, coins and ETFs.

Table 1: Data highlights for Q2 2016 demand (see *Gold demand statistics* for full details)

	Tonnes				US$mn			
	Q2'15	Q2'16	5-year average	Year-on-year change	Q2'15	Q2 '16	5-year average	Year-on-year change
Demand								
Gold demand	910.4	1,050.2	1,123.4	↑ 15%	34,899.4	42,530.6	51,076.4	↑ 22%
Jewellery	513.7	444.1	584.4	↓ -14%	19,691.7	17,983.1	26,194.8	↓ -9%
Technology	83.3	80.9	90.8	↓ -3%	3,194.1	3,276.1	4,146.2	↑ 3%
Investment	186.1	448.4	308.6	↑ 141%	7,134.5	18,157.5	14,437.6	↑ 155%
Total bar and coin	209.1	211.6	323.0	↑ 1%	8,017.4	8,569.4	14,867.4	↑ 7%
ETFs and similar products	-23.0	236.8	-14.4	- -	-883.0	9,588.1	-429.8	- -
Central banks and other institutions	127.3	76.9	139.5	↓ -40%	4,879.1	3,114.0	6,297.8	↓ -36%
Consumer demand in selected markets								
India	159.8	131.0	218.7	↓ -18%	6,127.2	5,304.7	9,942.1	↓ -13%
China	214.1	183.7	251.3	↓ -14%	8,208.7	7,439.5	11,282.1	↓ -9%
Middle East	72.2	57.4	79.1	↓ -20%	2,767.5	2,326.4	3,573.3	↓ -16%
United States	38.0	50.7	45.2	↑ 33%	1,455.5	2,052.1	2,043.2	↑ 41%
Europe ex CIS	59.8	59.3	81.4	↓ -1%	2,291.1	2,401.2	3,724.7	↑ 5%
Supply								
Total supply	1,041.7	1,144.6	1,115.6	↑ 10%	39,935.2	46,354.0	50,482.2	↑ 16%
Total mine supply	774.4	816.9	770.2	↑ 5%	29,685.8	33,083.7	34,481.1	↑ 11%
Recycled gold	267.4	327.7	345.5	↑ 23%	10,249.4	13,270.3	16,001.1	↑ 29%
Gold price								
LBMA Gold Price (US$/oz)	1,192.4	1,259.6	-	↑ 6%	-	-	-	-

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

The speed of the upswing in investment was in no small part due to the scale of pent-up demand that had built in Western markets. We noted this phenomenon in *Gold Demand Trends Q1 2016*, commenting that '*… inflows are from investors initiating or rebuilding strategic, long-term holdings after the wash-out of positions since early 2013. … latent demand among investors who have been looking for an opportunity to re-enter the market was a key factor* [driving ETF demand].' And the trend continued in the second quarter. Investors who had been awaiting a catalyst to enter (or re-enter) the market found they had reason enough to do so.

A number of factors turned the attention of the western investor community towards gold in the opening months of the year…and brought it even more sharply into focus in the second quarter. Global monetary policy remained front and centre. Negative interest rate policies (NIRP) in Japan and Europe, combined with expectations of a slowdown in the cycle of US rate hikes, underpinned investors' gold-positive sentiment, as did a growing optimism that gold's long term downtrend had come to an end. Heightened uncertainty has further focussed their minds.

2016 has unleashed a variety of events creating economic and political uncertainty, compounded by NIRP and further highlighting gold's role as a high-quality, liquid asset. The US election, the UK referendum on EU membership and possible implications of the 'Brexit' outcome, the increasingly parlous state of Italy's banking sector; these have proved a potent combination as far as gold investors are concerned. Add to that continued geopolitical unrest in the Middle East and the investment case for gold was cemented.

Smaller-scale investors have been very much in evidence in many Western markets: demand for US gold Eagle coins has jumped 84%[1] so far this year. And the UK's Royal Mint has registered a sharp rise in profits, which it attributes partly to the launch last year of 'Signature Gold', an online offering allowing investors to make fractional purchases of gold bars.[2] The Mint also revealed a huge spike in demand for this product after the result of the UK referendum. Similarly, smaller-scale investors came out in droves in other European markets, although this was countered by some substantial profit-taking in June as the euro-denominated gold price rallied to a two-year high.

1 Volume of Eagle gold coins in ounces to end-June 2016 (year-on-year): 501,000oz vs 273,000oz in H1 2015.

2 *http://www.royalmint.com/aboutus/news/a-golden-year-for-britains-oldest-manufacturer-as-annual-results-reveal-a-silver-lining*

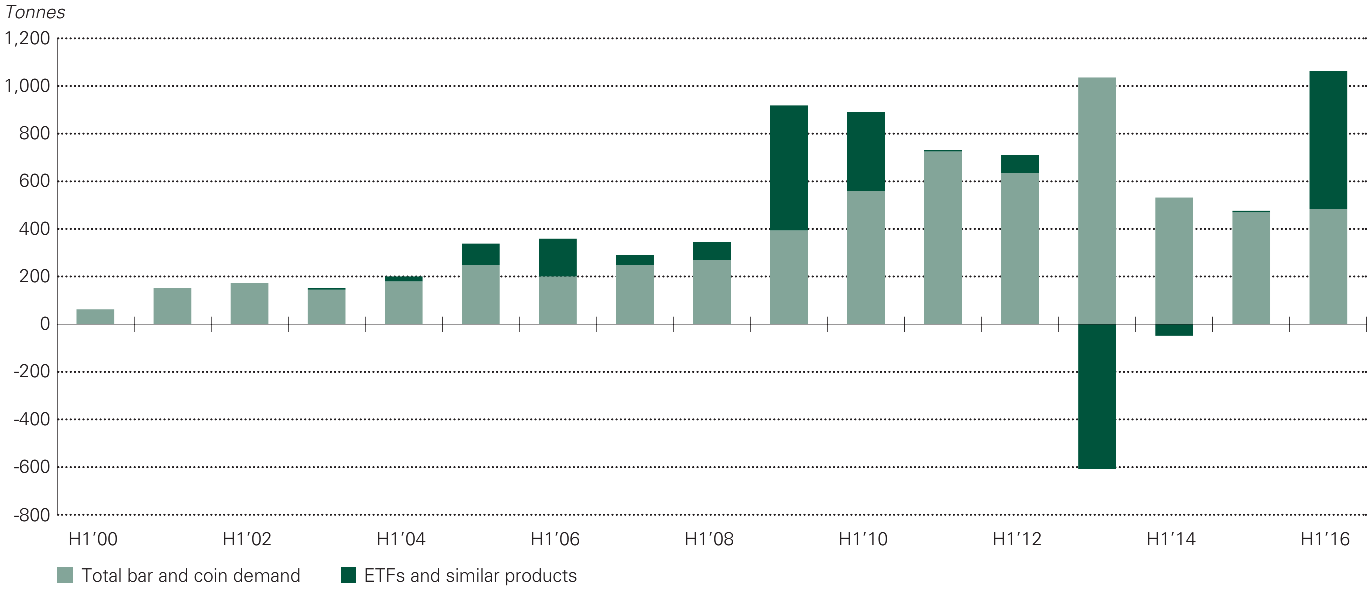
But it is the ETF space that has seen the most dramatic change (**Chart 1**). The growth in demand for gold-backed ETFs has eclipsed all other sectors in the first half. Demand for ETFs reached almost 580t, exceeding even H1 2009 when the sector saw inflows of over 458t in a single quarter. And ETFs have proved to have appeal beyond Western borders. Chinese investors continue to add to their investments in these products, taking holdings to 24.4t by the end of June – an almost four-fold increase since the end of last year. In value terms, Chinese gold-backed ETF holdings grew from US$215mn to over US$1bn in the first six months of 2016.

Although there is currently no indication that demand will come to a halt, there is evidence of profit-taking and it would be prudent to assume that recent momentum may be difficult to sustain. Nevertheless, the positive shift in attitudes among large-scale Western investors in particular, appears to have solid foundations. And we should see demand build on those during the quarter ahead.

In particular, the after-effects of the UK Brexit decision are likely to be reflected in Q3 data, given that the referendum itself came right at the end of the second quarter. Those effects are likely to be global. In the seven days after the vote, the search index for the keyword "Gold" compiled by China's search engine Baidu surged 44% year-on-year. And on the very day of the referendum, the index increase threefold. Similarly, Google Trends reported a more-than 500% spike in searches for the term 'buy gold' on the day of the referendum.

Chart 1: Record investment demand in H1 driven by geopolitical and economic concerns

- H1 investment broke previous levels, responding to rising levels of global uncertainty…
- …which in turn were driven by negative interest rates, the UK's referendum on EU membership and the prospect of a divisive US election campaign.
- Latent demand in Western markets further fuelled the rapid investment upswing.



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

Gold up 25%: strongest H1 price gain since 1980

Thanks to unbridled investment inflows, the gold price has surged since the end of 2015. But so has volatility, which has had mixed results for consumer demand.

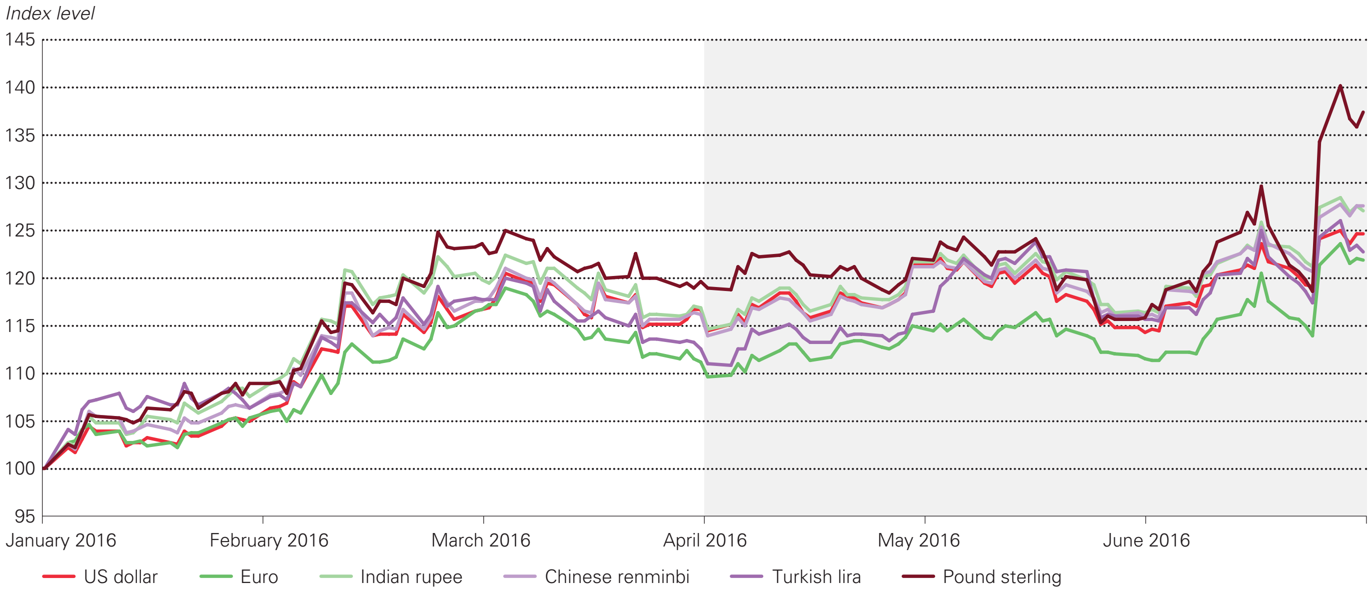
After starting the year with a stellar 17% Q1 gain, the gold price climbed further in the second quarter to set the seal on the strongest H1 performance for more than 35 years. In US$ terms, gold was one of the best performing investments in a basket of commodities that we monitor, behind only Brent crude (which burst higher on improving prospects for its supply dynamics)[3] and silver.

And given that the US dollar has strengthened against a number of currencies this year, gold's H1 performance when denominated in other currencies has been better still (**Chart 2**). Notable among these have been gains in the gold price expressed in pounds sterling (+37%), Indian rupees (+27%), Chinese renminbi (+27%) and Egyptian pounds (+41%).

But gold did not trace a smooth upward path: it had some pullbacks in May and June. Volatility ticked higher as a result, reaching 19.2%[4] for H1 compared with the long-term average of 18%.[5] While this played into the hands of some investors (notably in the US market, where the response has been to buy on price dips), it discouraged jewellery consumers in a number of markets. In fact, high, rising and fluctuating gold prices – at a time of fairly fragile consumer sentiment in many markets – resulted in a widespread dampening of jewellery demand.

Chart 2: Gold's impressive price rise in a range of key currencies in H1 2016 (index 100=01/01/2016)

- The 25% rise in the US dollar price of gold was exceeded by gains in local prices in some of the major gold consuming markets, including China, India and Europe.
- The sharp drop in the British pound following the Brexit vote caused a sharp spike in the sterling gold price in the closing week of June.



Source: ICE Benchmark Administration; Datastream; World Gold Council

3 Brent crude has since fallen back by around 20%.

4 6-month annualised daily return volatility in US$ for the period 31/12/2015 – 30/06/2016.

5 5-year annualised daily return volatility in US$ to 30/06/2016.

Jewellery demand lacks sparkle

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

Jewellery consumers have faced a tough environment in 2016 so far. Steep price rises have done little to attract demand in the more price sensitive markets. (Indian consumers in particular are notoriously wary of price instability and this year has proven to be no exception.) Challenging geopolitical and economic conditions continue to hamper the Middle Eastern markets. And China has battled with poor consumer sentiment, a sluggish economic environment and onerous hallmarking regulations. While there have been improvements in a few markets (most notably, the US and Iran), at the global level jewellery has suffered.

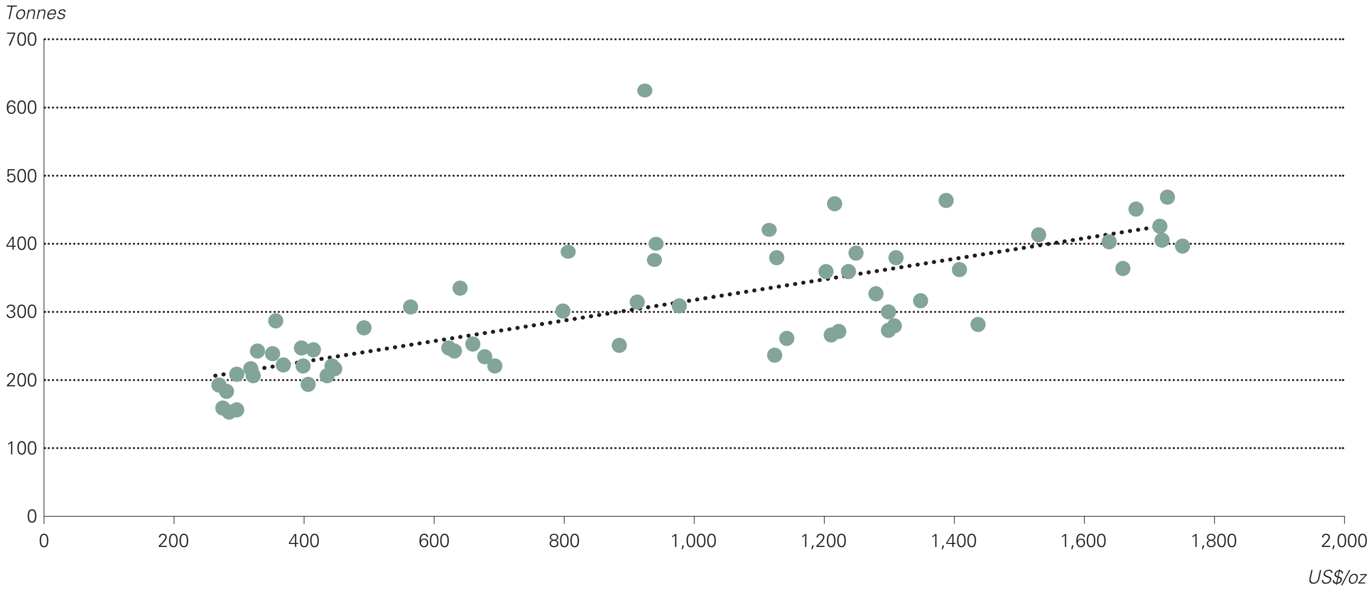
This is reflected in the data: the US dollar value of first half global jewellery demand (US$36.3bn) was the lowest since 2010. In volume terms, demand so far this year has lurked well below its five-year average – by around 20%.

The flip side to lower jewellery demand has been a rise in recycling activity. Recycling – selling gold jewellery for cash – is an important element of supply: in H1 it generated almost a third of the gold supplied to the market. It helps with the smooth functioning of the gold market and is responsive to a number of factors, one of the most important being the gold price.

Intuitively, higher prices boost recycling (**Chart 3**). While this is by no means the only factor affecting recycling, there is a strong correlation between the two: econometric analysis reveals that a 1% rise in the gold price will lead to a 0.6% increase in the annual supply of recycled gold.[6]

Chart 3: Higher price levels elicit higher recycled gold supply

- There is a strong correlation between the gold price and levels of recycling.
- Consumer research confirms this relationship – gold owners in India and China are more likely to sell their gold jewellery due to a high price than for any other reason.



Note: Tonnage levels are quarterly totals; price levels are quarterly averages based on the LBMA Gold Price PM (US$/oz).

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

6 'Price changes account for around 75% of annual changes in gold recycling once we account for major economic crises. For every 1% increase in price in a year, the supply of recycled gold will increase 0.6%.' Boston Consulting Group and World Gold Council, *The Ups and Downs of Gold Recycling*, March 2015.

Consumer research also backs up this finding. We recently conducted a large-scale survey,[7] in which high gold prices were cited as the most important factor influencing the decision to recycle gold jewellery. Among the respondents in India and China who had ever sold gold jewellery, a high gold price was the most common reason cited for doing so (27% and 43% respectively).

And price volatility can further magnify this effect. A sharp rise in prices can result in a jump in recycling in order to take advantage of unexpectedly higher prices. So it is not surprising to see that recycling grew in the first half of 2016, generating 686.7t of supply. This is the highest first half total since 2012, which was a time when distress-selling by Western consumers in the wake of the financial crisis was still high, and near-record gold prices were a strong incentive.

After a troubled first half of the year, the prospects are for jewellery demand to recover as we progress through the second half. India's key festivals of Dhanteras and Diwali, together with the Q4 holiday season in the west, should inject support. That being said, any optimism needs to be tempered by some of the headwinds that remain in place in a number of markets, such as economic slowdown in China, pressured rural incomes in India and a troubled geopolitical climate in the Middle East. Recycling will continue to respond to prices – as well as economic growth – and will remain a significant source of gold supply over the remainder of 2016.

7 On behalf of the World Gold Council, TNS interviewed jewellery consumers in China, India and the US and investors in China, India, the US and Germany. Total sample size: 14,000.