WORLD GOLD COUNCIL

Gold Demand Trends Q2 2017

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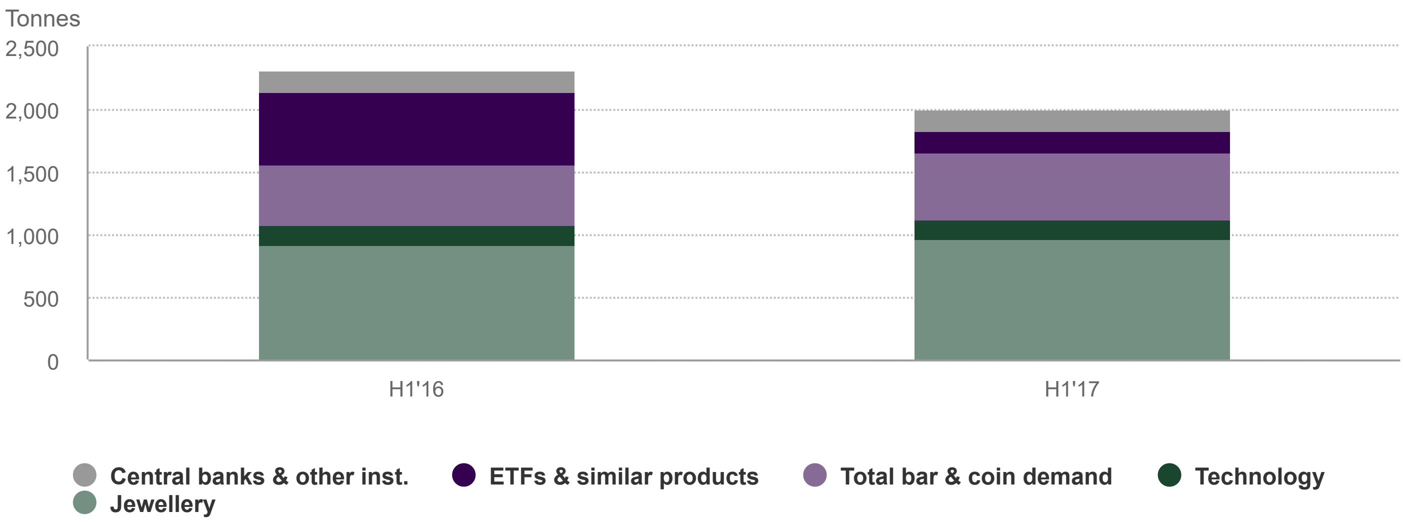
Q2 and H1 gold demand down on slower ETF inflows

Q2 gold demand of 953.4t was 10% lower than 2016, while H1 demand slowed 14% to 2,003.8t. Y-o-y comparisons are affected by record ETF inflows in 2016: demand from this sector slowed dramatically after last year's H1 surge. Central bank net purchases of 176.7t were also slightly lower in the first half (-3%). By contrast, bar and coin investment improved, as did jewellery demand, although the latter remains weak in a long-term context. Technology demand also made modest gains.

Slower ETF inflows drove H1 weakness



Source: Metals Focus; World Gold Council

Highlights

ETF inflows slowed dramatically from last year's record pace. But holdings continued to grow: after adding 56t in Q2, H1 inflows reached 167.9t. European ETFs saw the strongest H1 inflows: holdings in these funds reached a record 977.7t.

Bar and coin investment rebounded from very low levels. Q2 demand gained 13% from Q2 2016, while H1 demand rose 11%. A strong jump in Turkey was fuelled by economic recovery, double-digit inflation and relative currency stability.

Jewellery demand strengthened from a weak 2016, but fell short of the long-term average. India was the main contributor to the 8% gain in Q2, as it recovered from extremely low 2016 demand.

Central banks continued to buy, but at a more modest pace than in recent years. The most recent quarter saw Turkey's central bank add to its gold reserves – the first significant purchase since the 1980s.

Technology demand registered its third consecutive quarter of growth: up 2% to 81.3t. Growth in wireless charging and development of features that use LEDs boosted demand. New smartphone handsets supported chip production.

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Jewellery

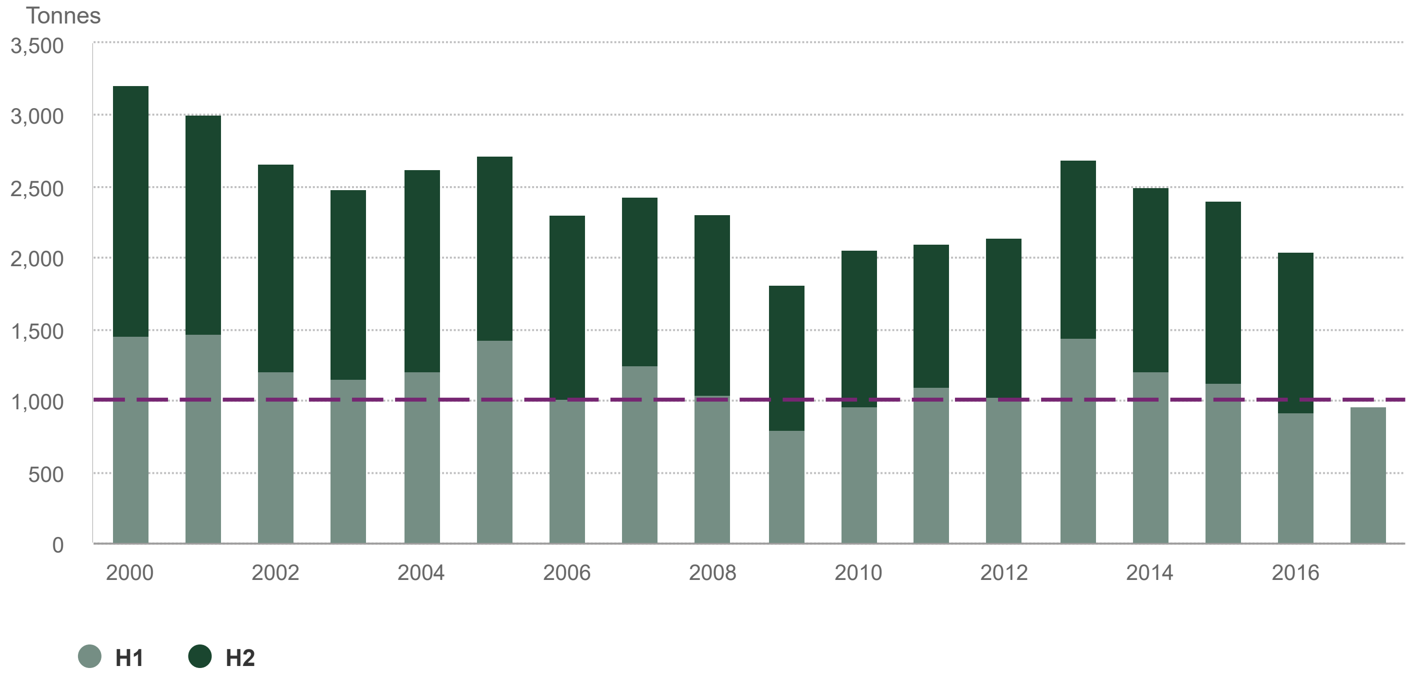
Global jewellery demand strengthened from 2016’s low base, but fell short of longer-term levels

- **Strong gains in India led the recovery, largely due to the weakness of 2016**
- **Fleet-footed Chinese jewellers continue to adapt in innovative ways to shifting consumer tastes**
- **Turkey saw a strong response to a sharp drop in the local gold price**

Tonnes	Q2'16	Q2'17		YoY
World total	446.8	480.8	▲	8%
India	89.8	126.7	▲	41%
China	145.6	137.7	▼	-5%

Global demand for gold jewellery of 480.8t was 8% higher y-o-y, but Q2 2016 was itself very weak; demand remained well below the five-year quarterly average of 586.2t. The H1 picture was similar: demand grew 5% from the very low levels of 2016, but at 967.4t, H1 jewellery demand was below 1,000t for only the fourth time in our data series.

H1 Jewellery demand recovered but remained below 1,000t



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

India

India drove global Q2 jewellery demand growth almost single-handedly. Demand shot up to 126.7t compared with just 89.8t in Q2 2016. The strong recovery had been widely expected after exceptional import figures were reported, hitting an all-time high of 104.6t in May as the market stockpiled gold ahead of the June GST rate announcement. Expecting a punitive GST rate, jewellers and consumers alike crammed their purchases into the first two months of the quarter, slowing down once the government confirmed that a 3% rate would be applied. Another brief flurry at the end of June, before the rollout of GST in July, pushed local prices to a premium of around US$3-4/oz above the international price, although some traders reported paying a premium as high as US$10/oz in some instances.

Indian prices rose to a small premium in June as GST rollout drew near

Source: National Commodity & Derivatives Exchange Ltd; World Gold Council

Demand was boosted by festivals, weddings and improved rural sentiment. Akshaya Tritiya – a key gold-buying festival in the Hindu calendar – boosted gold jewellery demand in the usual way. But the timing of the festival this year, falling as it did over a weekend and coinciding with a dip in the gold price, proved particularly encouraging. Estimates suggest that Akshaya Tritiya-related sales were up by around 30% y-o-y.

Rural sentiment improved further as the government continued to replace the currency that was plucked from the system by demonetisation in November. Although the pace of remonetisation has slowed (particularly as digital transactions have gained popularity) the value of currency in circulation has recovered to around Rs15.4trn – around 86% of the pre-demonetisation value. This greater liquidity has boosted rural purchases, along with expectations of a good monsoon rainfall and the positive impact of a higher number of auspicious wedding days in the Hindu calendar (26 auspicious days in Q2 this year, compared with just 8 in Q2 2016).

Outlook muted for H2. Although the 3% GST rate was lower than many in India had anticipated, we expect the new tax is likely to cause some short-term disruption as manufacturers, retailers, importers and consumers adapt to the new regime.[1] As consumers and importers brought forward their purchases to Q2, demand will likely be subdued for a few weeks. Stock is plentiful across the supply chain and consumers who have recently purchased are unlikely to do so again in the short term. As the market digests this gold, and adapts to GST, we feel the market environment should become more settled towards the end of the year. This, we believe, should be helpful for gold demand – particularly as the key October festival season approaches.

China

Chinese jewellery demand weakened again, but the pace of slowdown has moderated this year. Jewellery demand of 137.7t (down 5% y-o-y) was the lowest Q2 in China for five years. But the overall downward trend of the last three years has slowed so far in 2017: H1 demand was 4% below H1 2016.

A shift away from pure 24k gold to lower-carat, higher-designed and higher-margin gold jewellery remained the dominant trend. This continued move away from traditional plain 24k jewellery is in part driven by consumers expressing their individuality and differentiating themselves from older generations. But it is also an industry-driven trend. Retailers and manufacturers strive to prosper in a competitive industry by enticing consumers with new, innovative and – crucially – higher margin product. Chow Tai Fook, for example, launched a 22k collection in May. The range is high purity, with cutting edge designs, targeted at younger consumers and priced on a ‘per piece’ basis rather than by weight of fine gold.

Other companies have also launched innovative ventures to attract younger consumers. One noteworthy example is that of Luk Fook’s partnership with Tencent’s smartphone-based online game ‘Honour of Kings’ [2] to produce a championship ring for the game’s King Pro League. The game has 50 million active players [3], (most of whom are under 25) largely due to successful promotion on WeChat (Tencent’s ubiquitous social media platform). Despite the wide appeal of such products, their lower fine-gold content means they cannot prevent erosion in the volume of jewellery demand.

Headwinds buffeting Chinese jewellery demand may subside. Jewellery demand faces ongoing challenges: as younger consumers continue to pull away from the tradition of 24k gold, higher-margin, lower-gold-content products are being developed to fill the void. But so far this year, the pace of decline has moderated and, as the industry effectively targets key consumer segments, we feel the market may start to bottom out following the steady decline from its 2013 peak.

Other Asia

Smaller Asian markets were broadly firmer with a couple of minor exceptions: Vietnam led the way with a 10% y-o-y gain. Jewellery demand in Vietnam reached 3.9t in Q2, the highest second quarter for jewellery demand since 2008, as the market continues to recover from the lows reached in 2012. Accelerating economic growth provided a positive backdrop, although demand was boosted more specifically by fierce competition between leading jewellery manufacturers Phu Nhuan Jewelry and DOJI Jewelry Group, which saw both companies expanding their national network of retail outlets.

Middle East & Turkey

A dip in the local gold price triggered a strong response in Turkey: jewellery demand was up 20% y-o-y. The Turkish lira strengthened in value against the US$ throughout the quarter, causing quite a sharp dip in the local gold price in late-March/early-April. After lira prices had reached record levels in March, the drop sent a strong signal to consumers to buy, particularly as the wedding season approached. Demand has been underpinned by continued support from the Turkish government, albeit support that has focused on gold as an investment.

Regional jewellery demand was flat for the Middle East, disguising some sharp country-level divergences. Demand in Egypt dropped 20% y-o-y, hitting a new low of 4.7t. The Egyptian pound remains very weak, keeping local gold prices elevated. The central bank raised interest rates during the quarter in an effort to halt the currency’s decline, but this action served to undermine consumer appetite for gold jewellery. By contrast Iran’s jewellery market gained further strength: Q2 demand rose by 15% to 10.2t as consumer sentiment was buoyed by Hassan Rouhani’s landslide victory in the Presidential elections and expectations that interest rates may come down later in the year. H1 demand was 20% higher at 22.9t – the highest first half total for four years.

The West

The US market continues to creep up, building on the base established in 2012. Q2 tonnage was up 4% y-o-y at 26.9t, still a little shy of the five-year quarterly average of 28.9t. Demand in the first half of 2017 has been lifted by improving consumer sentiment, resulting in H1 demand growing 4% to reach 49.9t - the highest first half total since H1'09.

Q2 jewellery demand in Europe was weak: down 4% across the region. Demand was particularly anaemic in the UK, where prolonged uncertainty over Brexit deterred anxious consumers. Q2 demand fell 10% to a three-year low of 3.8t. Italian demand stabilised at 4t in Q2. Expectations are building for the long-term downtrend in the market to come to an end and – possibly – even for the market to manage some growth in the latter half of this year.

Investment

Investors added 56t to global ETF holdings in the second quarter. Q2 bar and coin demand was up 13% y-o-y

- **Europe dominates the ETF market in 2017, accounting for 76% of inflows in H1**
- **Q2 Chinese and Indian bar and coin demand were both up sharply on last year's relatively low levels**
- **US demand was exceptionally weak in Q2**

Tonnes	Q2'16	Q2'17	YoY
Investment	450.3	296.9	-34%
Total bar & coin demand	212.9	240.8	13%
India	32.3	40.7	26%
China	40.2	62.6	56%
Gold-backed ETFs	237.4	56.0	-76%

ETFs

Investors continued to buy gold-backed ETFs in Q2: global AUM grew by 56t. By the end of June, holdings of ETFs had reached 2,313t (worth US$92.4bn), [4] the highest month-end total since October last year. H1 holdings were up by 167.9t. And while this pales in comparison with last year's record growth, it nonetheless signals a continued interest in gold investment among institutional investors.

After 10 months of unhindered inflows in 2016, investment in gold-backed ETFs during the first half of 2017 have been rather more erratic. Of the main – sometimes conflicting – factors that influenced investor attitudes towards gold-backed ETFs, the three that seemed to dominate Q2 were:

- Monetary policy 'normalisation'
- Gold price
- Event risk

Monetary policy was again front of mind during the quarter as the Federal Reserve raised rates in June and ECB President Draghi signalled possible tightening in Europe as deflationary pressures start to reverse. The prospect of continued, if modest, monetary tightening dampened ETF demand. Rising interest rates are usually interpreted as being negative for gold. But the Federal Reserve continues to telegraph its plans for monetary policy clearly, and – since the end of Q2 – market expectations of a third US rate hike have subsequently been pushed out to Q1 2018. This gives investors ample time to adjust positioning, so we believe that gold should not come under undue pressure as the timing of a likely rate rise approaches.

The gold price rose by 8% during the first half of 2017, building on the 8% gains seen during 2016. This led to some investors taking a more cautious approach, reluctant to build positions after a strong price move. Others used it as an opportunity to take profits. Although lower prices may encourage fresh buying, anecdotal reports suggest that investment in Q2 was not generally driven by investors' expectations of strong near-term capital appreciation.

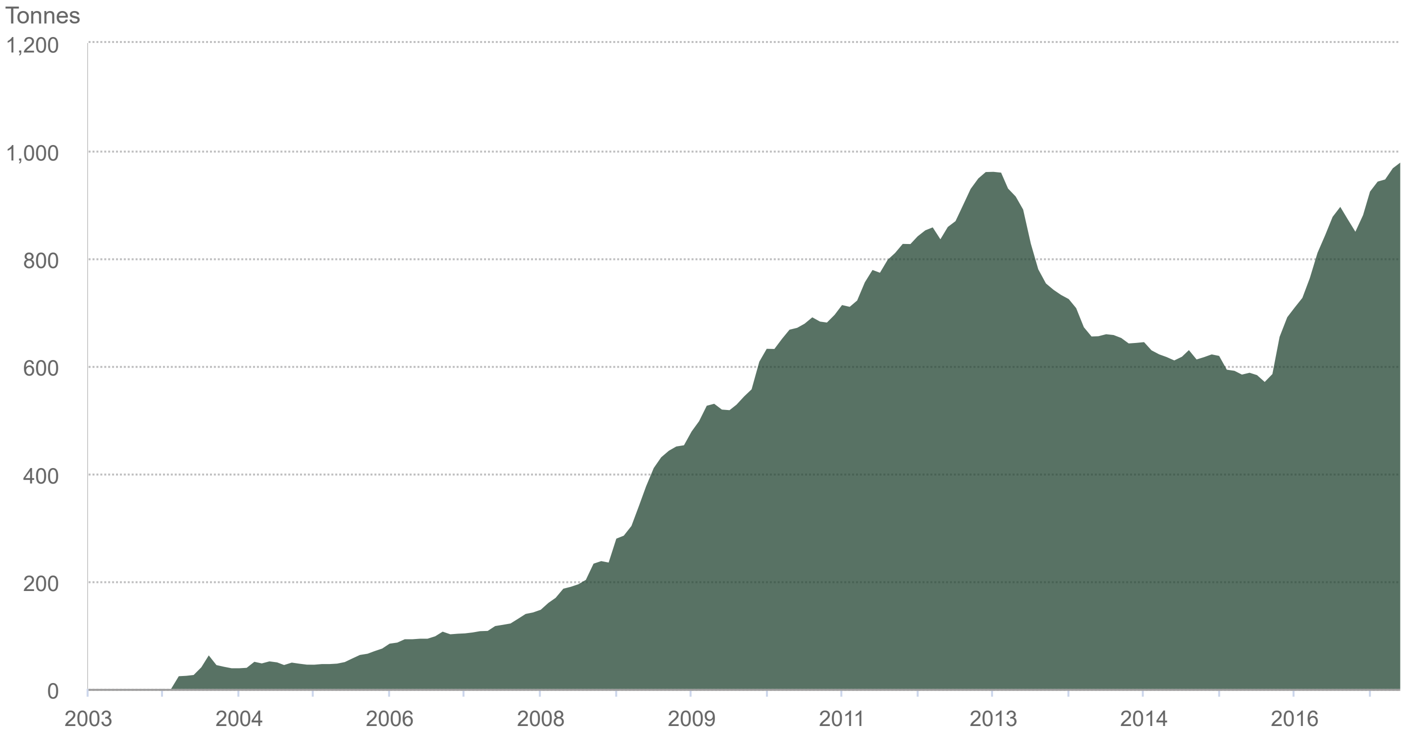
Event risk, particularly surrounding geopolitical tension, remained a key driver of demand for ETFs. Across Western markets investors were attracted by gold's properties as an insurance asset. The environment created by sporadic global terrorist incidents, tension between the US and North Korea, and the shock sacking of FBI Director Comey, left investors keenly aware of the risk of unexpected, destabilising events, and this underpinned an element of gold-backed ETF inflows.

Investment in the US and Europe was quite evenly matched in Q2, with inflows of 30.9t and 35.2t respectively. But it is European investors who dominate the H1 picture: ETFs listed in the region grew by 128t in the first half of 2017, absorbing 76% of net global inflows.

After a strong Q1, those inflows slowed markedly in Q2, although demand on the continent was firm, with little interest in outright selling. The region's geopolitical climate settled somewhat after the election of French President Macron. Negative bond yields in Germany – home to the largest European-based fund, Xetra-Gold – continued to drive investment into domestic funds, albeit to a lesser extent than in Q1, as they recovered from the record lows seen in March. [5] Anxiety caused by the UK election was largely confined to the domestic market, where Source Physical Gold ETF saw the biggest increase in holdings. The bulk of the 12.2t inflow was concentrated at the end of June, coinciding with the sharp drop in the Sterling gold price.

AUM in European-listed funds have grown sharply over the last 18 months. Tonnage grew from 570.2t at end-2015 to a new all-time high of 977.7t at the end of Q2, exceeding the previous peak of 960.1t from 2012.

Gold in European-listed ETFs hit an all-time high in Q2 2017



Source: Respective ETF providers; ICE Benchmark Administration; World Gold Council

Demand for US-based ETFs fluctuated throughout the quarter: inflows in April and June were partly offset by small mid-quarter outflows. Investors remained broadly – if inconsistently – positive in their approach to ETFs, as the factors outlined above vied for attention. Inflows of 30.9t were the strongest since Q2 last year.

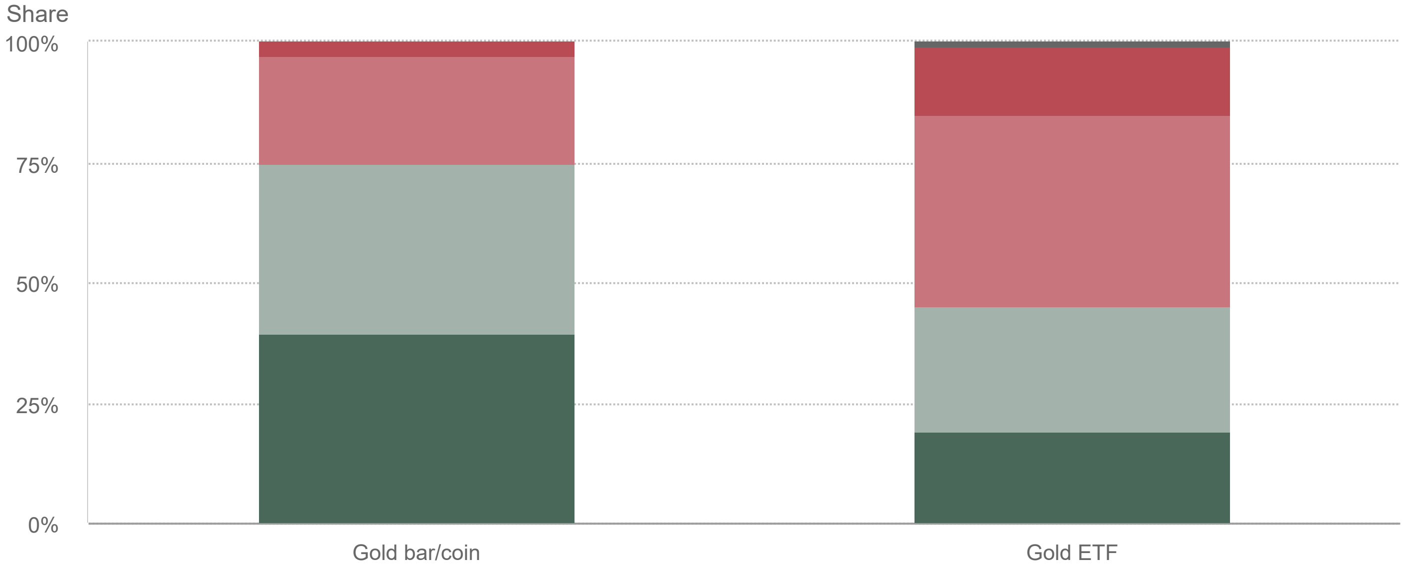
The path of inflation and interest rates continues to be subject to some uncertainty, with Federal Reserve messaging appearing to soften in recent weeks. Investors will continue to scrutinise the progress of the US economy, inflation and the US dollar, for signs that interest rate hikes may be pushed further out.

Away from the dominant Western markets, Chinese ETFs again saw outflows. Holdings of these funds dropped by almost 9t, more than half of which came from the Hua'an Yifu Gold Fund, which saw its first quarterly decline. Holdings dropped by 4.8t during the quarter, to 20t at the end of June – the lowest level for a year. But the outflows have reportedly had a positive consequence: strategic long-term investors now account for a greater share of the holdings in the fund.

Chinese gold-backed ETF holdings have shrunk this year, having risen more than six-fold during 2016. This volatility in part reflects the speculative investment behaviour that is more prominent in China than in many other markets. Our consumer research confirms this 'speculative' bias, which is more closely linked to gold-backed ETFs than gold bars and coins.

According to our research, 54% of Chinese investors described the role of their investment in gold-backed ETFs as being either speculative or for short term returns, compared with just 25% of investors in gold bars and coins.

China's ETF investors are more speculative than bar and coin investors



- **Don't know**
- **To make good returns in the long-term**
- **To protect my wealth**
- **To make good returns in the short-term**
- **Speculative/high-risk with potential for very high returns**

Note: Totals may not sum to 100% due to rounding.

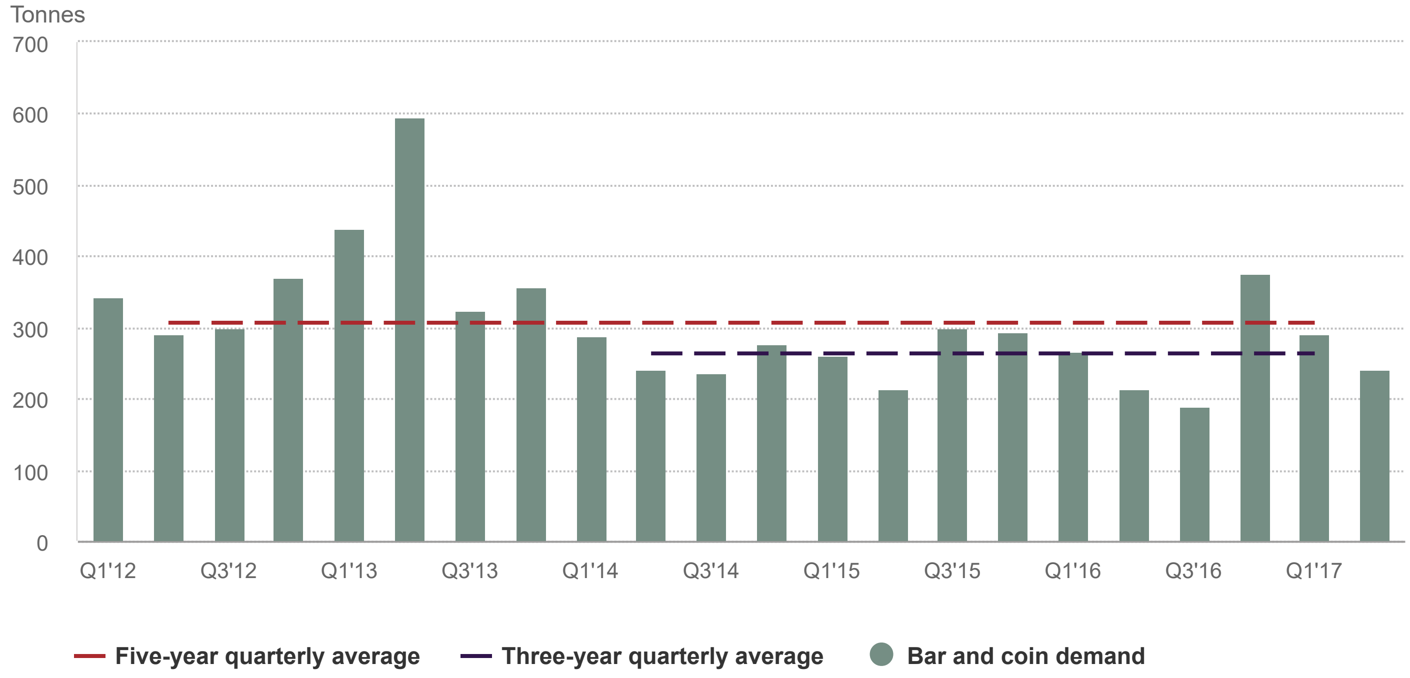
Source: Kantar TNS; World Gold Council

Bar and coin

Bar and coin demand in Q2 rose 13% compared to the same period last year. The H1 performance was strong too, with demand up 11%. Although encouraging to see demand bounce, the figures are flattered somewhat by exceptionally weak demand in H1 2016. When the longer-term trend is considered, Q2 demand of 240.8t was below both the five-year and three-year quarterly averages of 306.1t and 263t respectively.

In China, bar and coin demand increased 56% y-o-y, reaching 62.6t. This was a solid quarter, broadly in line with the three- and five-year average quarterly demand of 62.9t and 69.5t respectively. But when we look at recent trends it is clear that Chinese retail investment has slowed down a little. China saw exceptionally strong demand in the final quarter of 2016 and the first quarter of 2017, with over 100t bought in each. A depreciating currency and fears over State-imposed restrictions on the property markets in Tier 1 and 2 cities fuelled demand for gold as a high-quality liquid asset.[6] So far in 2017, however, the yuan has stabilised and the property market regulations have not had the impact many investors had feared.

Global bar and coin demand was up y-o-y, but remained relatively subdued



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

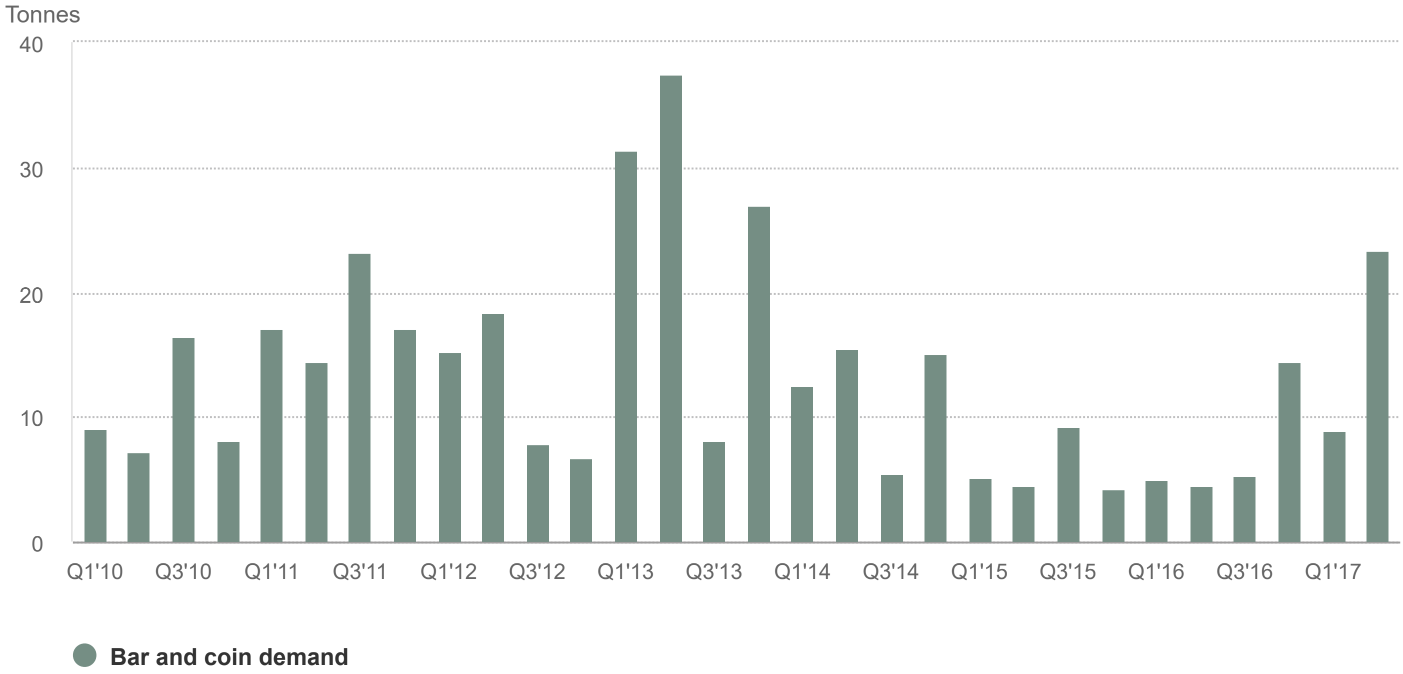
Purchases made directly from the SGE continued to gain traction, accounting for a significant proportion of Q2 bar and coin demand. Investors benefit from better pricing – bars from the SGE are usually 5-10 yuan per gram lower than those bought from commercial banks – and a sense of security from knowing they are buying gold from a trusted provider. With a minimum lot size of 100 grams, direct withdrawals from the SGE largely serve China's high net worth individuals.

Interesting things are afoot in Vietnam. Q2 2017 was flat y-o-y, with a modest 8.9t purchased. Real estate and equities proved far more interesting for many investors. But, as set out in its recently-distributed Circular No.03/2017, the Government is introducing measures to lift much of the red tape on gold bar trading activities.[7] From 22 July 2017, the Ho Chi Minh City and Hanoi branches of the State Bank of Vietnam (SBV) will be responsible for monitoring the raw material needs of the local gold industry. This will pave the way for these local SBV branches to grant import quotas to local businesses to import gold bullion. A small step, maybe, towards a more open gold market in Vietnam.

Indian demand was up 26% y-o-y, reaching 40.7t. This is the third consecutive quarter of y-o-y growth, as India's gold market continues to pick up from the low levels to which it fell at the start of 2016.[8] Sales during Akshaya Tritiya were especially strong. As noted in the jewellery section, [9] Akshaya Tritiya fortuitously fell on a weekend, and the extended sales period accounted for an estimated 15% of bar and coin demand for the quarter.

Demand in Turkey was particularly buoyant. Having been in the doldrums for some time, retail investment demand has perked up, hitting its highest levels since 2013. A few factors have underpinned this. Turkey's economy is recovering from the economic and political shocks it has suffered of late. In a recent paper, the Organisation for Economic Co-operation and Development (OECD) noted that "economic growth is projected to edge up to around 3.5% in 2017 and 2018…[and].. consumer price inflation is back in double digits" [10] Turkey's leading stock index – the BIST 100 – has enjoyed a stellar 2017, reaching all-time highs. And, after falling precipitously last year, the Turkish lira has stabilised. The improving economy, inflation edging higher, and a strengthening local currency coincided with a near 9% drop in the local gold price between April and May. Investors took advantage of this to increase their gold holdings.

An improving economic outlook boosted Turkey's bar and coin demand



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

European investment demand was flat y-o-y: 40.3t compared to 40.9t a year ago. Like China, investment activity has eased compared to recent quarters. Demand was especially buoyant at the tail-end of last year and the start of 2017 as investors took advantage of price dips and looked to gain exposure to an asset that could provide some security in the run-up to a spate of national elections. Some of these worries spilled over into Q2 2017: in France, there was strong investor interest in the run-up to the election, with Napoleon premiums hitting a high of 5% at one point.[11] But, in general, these worries have eased as the year has progressed. Rutte's and Macron's victories in the Netherlands and France respectively, and Angela Merkel's Christian Democratic Union increasing its lead in the polls over the Social Democrats in Germany, have helped ease investor anxiety.

Tepid local price movement also contributed to a quiet quarter. There was some buying activity on the price dips, but not much. In contrast, equity markets performed relatively well, with the German and French bourses proving more enticing than gold for some investors.

The US market was weak. A range-bound gold price, coupled with the S&P 500's steady march higher, resulted in Q2 bar and coin demand falling to 10.2t, its lowest level since Q3 2013. H1 2017 was 21.5t lower than H1 2016 - this was the biggest y-o-y fall in bar and coin tonnage globally.

Central banks and other institutions

Central bank demand up 20% y-o-y, but overall pace remained restrained

- **Central banks purchased 94.5t in Q2, bringing the H1 total to 176.7t**
- **Turkey bought 21t in Q2; its first significant addition to reserves since the 1980s**
- **Central bank of Russia continued to add to its gold holdings, which now account for 17% of total reserves**

Tonnes	Q2'16	Q2'17	YoY
Central banks & others	78.4	94.5	▲ 20%

Central bank net purchases totalled 94.5t in Q2, 20% higher than the same quarter of 2016 but below the 5-year average of 135.2t. The increase in global gold reserves was almost entirely driven by sizable purchases from a small number of central banks. Net purchases reached 176.7t y-t-d, 3% lower than H1 2016 (182.5t).

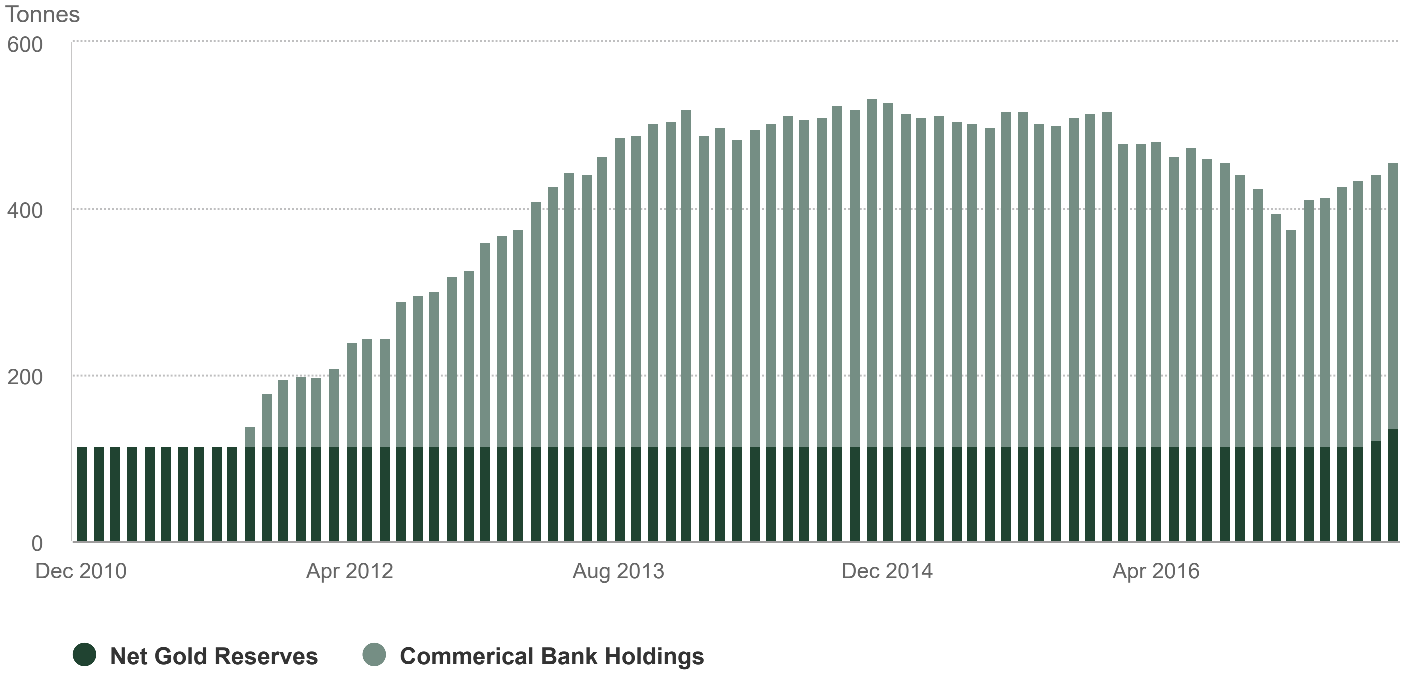
The Central Bank of Russia added 35.7t to its gold reserves in Q2, bringing H1 gold purchases to 100.6t. Russian gold reserves stood at 1,715.8t at end-June, accounting for 17% of total reserves. Should buying continue at a similar pace, the full-year increase in gold reserves could closely match the 200t increases seen in both 2015 and 2016.

Kazakhstan extended its buying run to 57 consecutive months, with gold reserves growing by 11.3t during Q2. Since the National Bank of Kazakhstan began buying in October 2012, its gold reserves have ballooned by 167.5t to 279t. In May, the bank announced that it would begin selling small gold bars to create a more liquid gold market [12] within the country.

Q2 also marked the Central Bank of Turkey's return to purchasing. Turkey bought 21t during the quarter, bringing its gold reserves – net of commercial bank holdings – to 137.1t. We understand the decision to increase holdings was strategic, reflecting Turkey's commitment to gold as a key reserve asset. Since October 2011, Turkey's official gold reserves have included commercial banks' gold holdings stored at the central bank under a policy known as the Reserve Option Mechanism. This policy aims to encourage greater use of gold within the financial system.[13] Between October 2011 and March 2017, the 310t-plus increase in Turkey's gold reserves was entirely accounted for by changes in commercial bank holdings.

Sales were again minimal. Germany sold 3.8t from its gold reserves in Q2 as part of its ongoing coin-minting programme.

Turkey's central bank bought 21t of gold in Q2



Source: IMF IFS; Central Bank of the Republic of Turkey; World Gold Council

Technology

Gold used in technology rose 2% y-o-y, driven by growth in demand for bonding wire, Printed Circuit Boards (PCBs) and LEDs

- **Strong memory chip demand generated double-digit y-o-y growth in gold bonding wire**
- **Demand for LEDs, particularly in the automotive sector, continued its recovery**
- **PCB usage was buoyed by continued adoption of wireless charging and ongoing smartphone demand**

Tonnes	Q2'16	Q2'17		YoY
Technology	80.1	81.3	▲	2%
Electronics	63.0	64.3	▲	2%
Other Industrial	12.5	12.7	▲	1%
Dentistry	4.6	4.3	▼	-5%

Overall demand for gold in technology was 81.3t in Q2, marking the third consecutive quarter of y-o-y growth.

Electronics

Gold used in electronics rose 2% y-o-y to 64.3t in Q2. Bright spots were seen across key sectors, from bonding wire to LEDs and PCBs. The bonding wire sector grew by 11% y-o-y. Tight supply of memory chips, at a time of strong demand, saw manufacturers producing at full capacity. We expect supply conditions to remain tight throughout 2017; a situation that may be exacerbated by the expected launch of new generation smartphones in the latter part of the year. As a point of reference, Samsung expected its Q2 operating profit to increase 72% y-o-y [14] due to the seemingly insatiable global demand for memory chips.

LED demand continued to recover, showing steady improvement in the automotive sector in particular, where LEDs are used extensively in sensor technology. New features, such as collision avoidance and intelligent sensing, rely on state-of-the-art sensor chips containing gold. Additionally, an industry upgrade to Organic LED lighting – with its versatility and energy saving benefits – is expected to lend further support to gold demand and could help offset the switch to gold-free Chip Scale Packaging (CSP) seen in the sector.[15]

PCBs, which enjoyed positive spill-over benefits from strong smartphone shipments, continued to benefit from increasingly widespread adoption of wireless charging. The wireless sector remained resilient as leading smartphone manufacturers, such as Samsung and Huawei, placed healthy orders for new models scheduled for release in H2. Electronic demand in both China and South Korea grew 6% y-o-y. Meanwhile, Japan lost 3% as its market share in bonding wire was eroded by China and Taiwan.

Research into new applications for gold continued to grow: Q2 saw healthy numbers of patent applications and research articles across a broad range of sectors. 'Two faced' spherical particles, where one face is made of gold layers topped by silver nanoparticles, have been designed to trap bacteria in contaminated water and transform it into clean and safe drinking water. [16] And researchers at Osaka University have developed a material coated with gold nanoparticles with the aim of improving conversion of sunlight into clean energy. [17]

Supply

Total gold supply declined 8% in Q2: mine production was steady while recycling levels continued to drop back after the 2016 surge

- **Mine production in Q2 was virtually flat y-o-y, in line with our expectation that growth will soon end**
- **Net de-hedging continued, albeit by a modest 5t, in the subdued Q2 price environment**
- **Recycling fell 18% y-o-y as the market continued to normalise after the strong 2016**

Tonnes	Q2'16	Q2'17	YoY
Total supply	1,160.3	1,065.9	-8%
Mine production	793.8	791.2	0%
Net producer hedging	24.0	-5.0	-
Recycled gold	342.5	279.7	-18%

Mine production

Mine production was virtually unchanged from Q2 2016, dropping by less than 3t to 791.2t – the lowest second quarter since 2014. H1 output was also virtually flat at 1,557.1t. As with most quarters, increased production at some mines was offset by reductions at others.

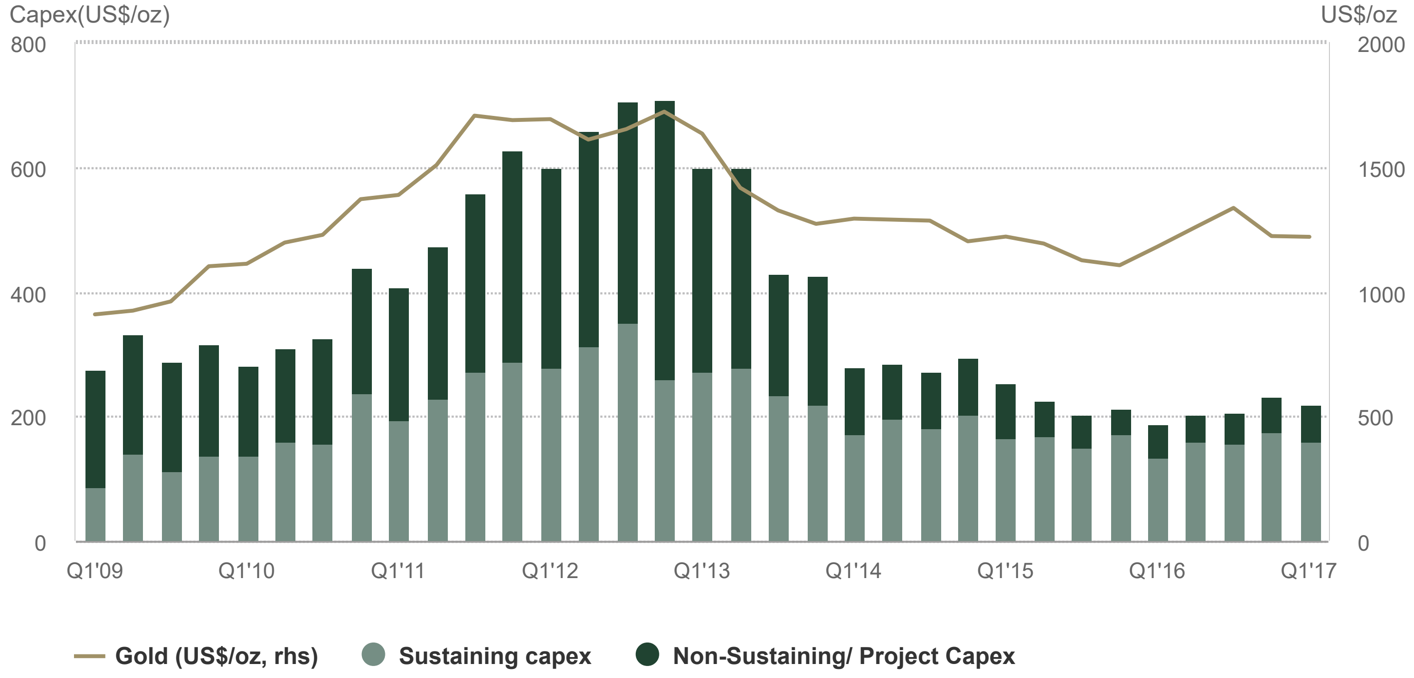
Mine output fell in several countries. Q2 saw a sharp 8% decline in China's mine production as the industry continued to adapt to more stringent environmental regulations. This crackdown has forced some marginal operations to close, steepening the decline in aggregate output. In Tanzania, an ongoing dispute between the government and Acacia Mining slashed production (-20% y-o-y). In March, the government imposed a ban on the company exporting gold/copper concentrate, leading to greater stockpiles within the country. Acacia accounted for around 45% of Tanzania's 2016 gold production, which explains the magnitude of the effect on total output in Q2. And production in Mongolia fell 30% y-o-y, as Oyu Tolgoi continues through a planned phase of low grading (the mining of higher grades is expected to resume in 2018).

Gains elsewhere offset this drop. In Indonesia, gold production got a hefty boost (30% y-o-y) from the resumption of concentrate exports from Grasberg. This allowed production to ramp back up in Q2, as well as releasing some of the blocked production from Q1. The y-o-y comparison is somewhat deceptive, however, as Q2 2016 was the weakest quarter for Grasberg last year. In Suriname, the continued ramp up of Newmont's Merian gold mine helped swell output by 80% y-o-y. The mine reached commercial production in October 2016 and is expected to produce around 10t annually.

In Canada, Q2 output rose by 8% y-o-y, partly due to the start-up of the Hope Bay and Brucejack mines. Once at steady-state operating levels the former should add 5t per year, while the latter is expected to add 7t per year. Tambomayo (Peru) and Fortnum (Australia) also entered production in Q2, the latter having re-opened after 10 years due to further brownfield exploration and a more favourable economic situation. Both are expected to add 2-3t per year to global production.

We expect mine production to fall from 2019 onwards. Although a small number of major projects are expected to come online by the end of 2017, the project pipeline remains weak. And while major miners have improved cashflow and reduced debt over the last few years, production development expenditure remains at multi-year lows. We expect the project pipeline to see a small pick-up in 2017 and 2018 before global mine production levels begin to decline in 2019.

Project capital expenditure languished at multi year lows



Source: Metals Focus Gold Peer Group Analysis; World Gold Council

Early 2017 saw costs rise again: Q1 all-in sustaining costs were 12% higher y-o-y. The stronger performance of some key producer currencies against the US dollar was the main driver, although higher mine-site costs and an increase in sustaining capital expenditure also contributed to the increase. But costs remain below their 2013 peak.

Hedging

Deliveries into existing hedge positions slightly outweighed fresh hedges, leading to overall net de-hedging of 5t in Q2. De-hedging for H1 totalled 22.5t, in stark contrast to the 72.5t of hedging in H1 2016. The global hedgebook now stands at 228t, 22% lower y-o-y.

The gold price environment in H1 2017 provided scant incentive for gold miners to add to the hedgebook. The respectable 8% increase in the US$ gold price during this half year was well below the 25% increase in H1 2016 - the best H1 performance since 1980. Even in key producer currencies, the price performance in the first half of 2017 cannot compare to the previous year. But some hedging was evident. Higher local prices in April and June triggered hedging by some Australian and Canadian mines: for example, in June Gold Fields announced it had hedged 75% of its H2 2017 Australian output to protect cashflow during construction of the Gruyere project. [18]

Project and debt financing were again the primary motivations for gold hedging rather than any change in sentiment. As we see it, many shareholders remain scarred by memories of the large-scale hedging programmes of the late 1990s/early 2000s and the practice is generally frowned upon due to the risk of missing out on any upside in the gold price. But we believe sporadic small-scale hedging, which can be useful for managing financing needs, is likely to remain a feature of the industry.

Recycling

Q2 saw a sizable decline in recycling, dropping 18% to 279.9t from 342.5t in Q2 2016. The y-o-y comparison was again affected by the elevated levels of recycling seen in the first three quarters of 2016, when the rapidly increasing global gold price, along with a tax amnesty in Indonesia, enticed consumers to cash in. The first half of 2017 represents a continued 'normalisation' of recycling in most markets. And it was East Asian and Middle Eastern markets that bore the brunt of the decline.

Political tensions across the Middle East prompted caution amongst consumers, who tightened their grip on holdings. In Turkey, recycling activity was curtailed as consumers remained wary of selling back their gold holdings amid the ongoing political uncertainty that has plagued the country in recent years. Many preferred to hold onto their gold, recognising its wealth protection attributes in testing times. In Egypt, the y-o-y decline masks a situation where recycling volumes are still significantly higher than normal, as local currency weakness has kept local gold prices buoyant.

In East Asian markets, the story was one of strength last year rather than weakness this year. In Indonesia, 2016 recycling volumes were boosted by a tax amnesty, while in Thailand rumours of a government crackdown on undeclared incomes prompted a rush to sell. Collectors in Vietnam were eager to take advantage of a local discount in H1 2016, selling across the border at the higher international gold price. Against last year's volumes, H1 2017 compared unfavourably.

A notable outlier this quarter was India, where recycling bucked the general trend by increasing y-o-y. Q2 saw the highest level of recycling in the country (29.6t) since 2014, as three key factors converged. Firstly, farmers sold gold to fund their impending crop-sowing activities; a common practice ahead of the sowing season. This gold has usually been repurchased after the harvest season. Secondly, anecdotal evidence suggests volumes were boosted as some consumers who bought gold during last year's demonetisation – to dispose of old Rs500 and Rs1,000 notes – were selling this gold back in small quantities due to the fact that stability in the currency has been restored. Thirdly, the impending GST encouraged some retailers to sell gold to avoid the burden of additional reporting required under the new tax system.

In the west, the UK saw higher volumes (+6% y-o-y) despite the depletion of near-market stocks. The higher gold price – in sterling terms – prompted some consumers to cash in. However, recycling in the UK has been on a downward trend since jumping in Q3 2016 when the pound devalued sharply in the immediate aftermath of the Brexit vote. Quarterly volumes have averaged 9t since the start of 2016.

Footnotes

1. For more detail on the impact of GST on India's gold market, please see Market Update: GST's impact on India's gold market http://www.gold.org/research/market-update/gst-impact-on-indias-gold-market.
2. Read more: https://www.emarketer.com/Article/Tencents-Honor-of-Kings-Finds-Massive-Audience-China/1016185
3. Read more: https://www.ft.com/content/cb77ac42-ccff-11e6-864f-20dcb35cede2?mhq5j=e1
4. Read more: http://www.gold.org/data/gold-etf-holdings
5. Read more: http://www.gold.org/download/file/5633/gdt-q1-2017-investment.pdf
6. Chinese cities are divided into four (sometimes five) tiers depending upon various economic, political and social factors. Beijing and Shanghai have always been Tier 1 cities and they are currently joined by Guangzhou and Shenzhen. In the second tier are the municipalities of Chongqing and Tianjin plus provincial capitals like Chengdu and Kunming. According to a study by Deloitte, Tier 2 consists of some 34 cities, Tier 3 249 cities and Tier 4 368 cities.
7. Circular No.03/2017 amends some of the Articles of Circular No.16/2012 and Decree No.24/2012 on controlling gold trading activities.
8. For a broader overview of our outlook for India's gold market in 2017, please see Market Update: Indian demand will recover from 2016's lows. http://www.gold.org/research/market-update/indian-demand-will-recover
9. Read more: http://www.gold.org/research/gold-demand-trends/gold-demand-trends-q2-2017/jewellery
10. Read more: http://www.oecd.org/eco/outlook/economic-forecast-summary-turkey-oecd-economic-outlook-june-2017.pdf
11. Napoleon premiums can vary a lot. During periods of net selling, they can trade at a small discount. More recently premiums have averaged 1-2%.
12. Read more: http://astanatimes.com/2017/06/kazakh-national-bank-launches-sale-of-gold-bars/
13. 'Maximising gold's monetary value', Gold Investor, February 2017 http://www.gold.org/research/gold-investor/gold-investor-february-2017
14. Read more: https://www.reuters.com/article/samsung-elec-results-idUSS6N1HW00V
15. OLED technology uses a series of thin, light-emitting films rather than an array of individual LED bulbs, to produce brighter light while using less energy.
16. Read more: http://www.thestatesman.com/science/microbots-to-remove-harmful-bacteria-from-water-developed-1498819683.html
17. Read more: https://www.asianscientist.com/2017/06/tech/solar-energy-hydrogen-fuel/
18. Read more: https://www.goldfields.co.za/news_article.php?articleID=5014