What does sub $1,200 mean for the gold industry?

Ross Strachan

Manager, Precious Metals Demand – GFMS

Commodities Research and Forecasts

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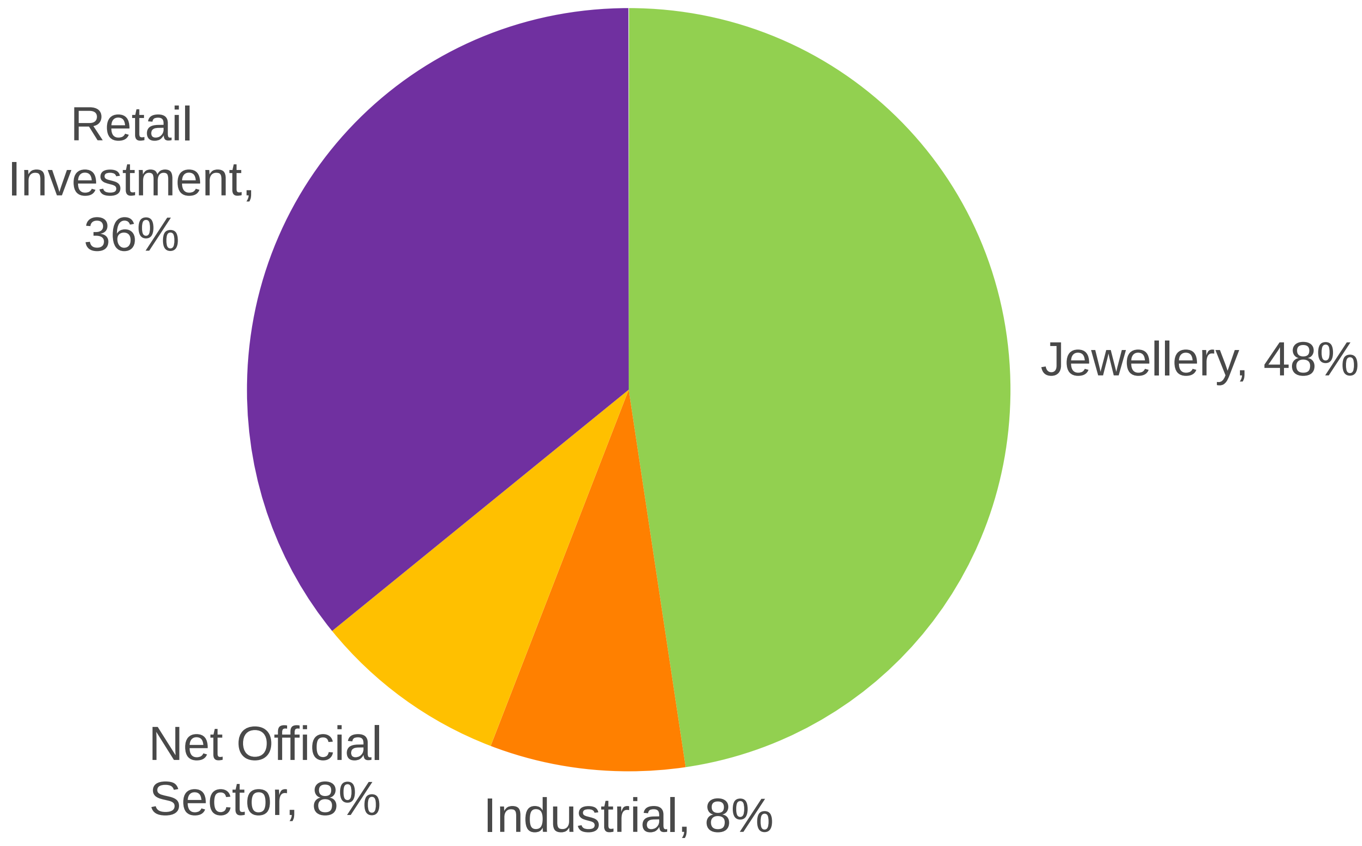
DISCLAIMER

WORLD GOLD DEMAND (2013)



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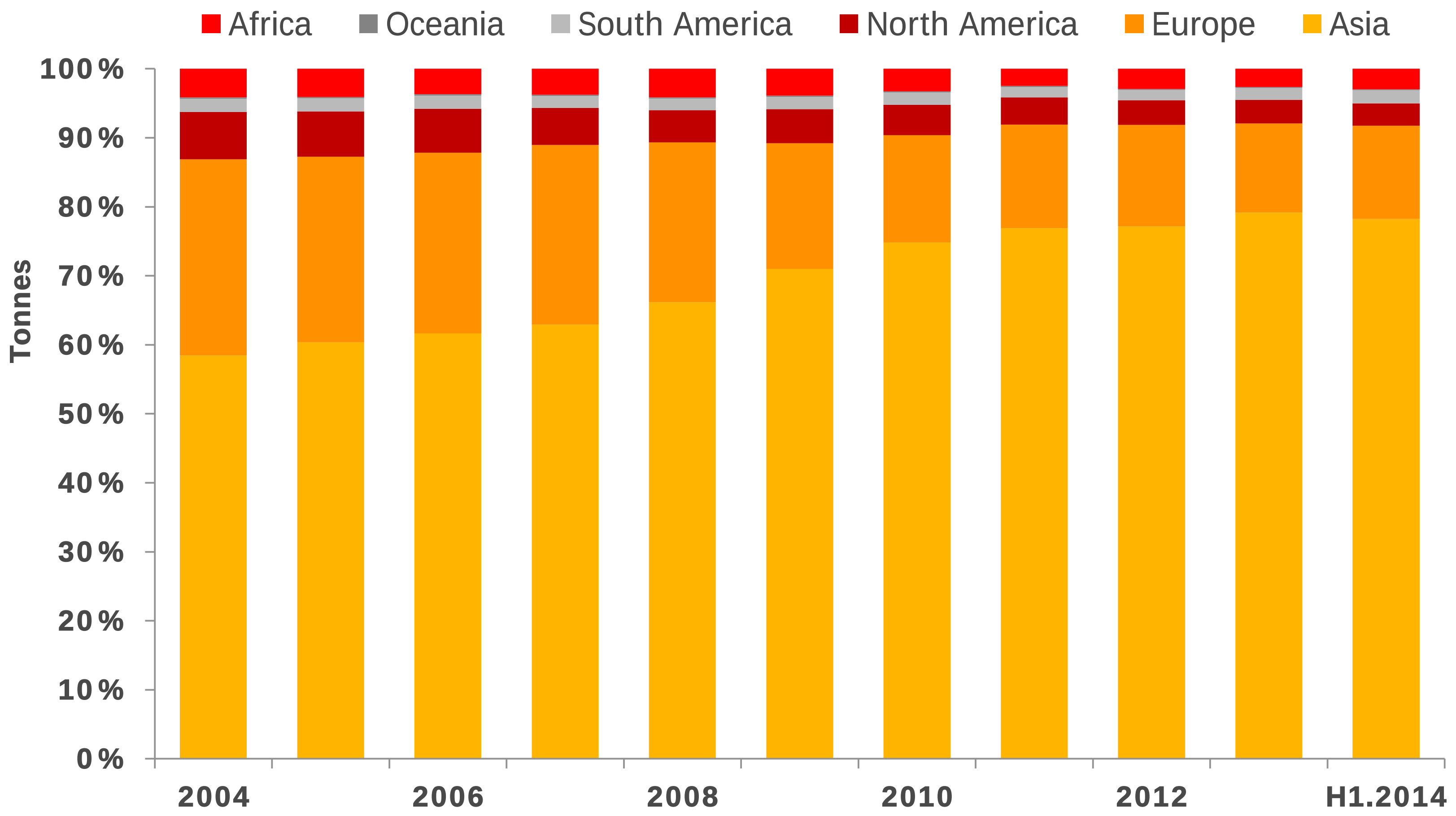
What a difference…

…a year makes

GOLD JEWELLERY FABRICATION BY REGION(%)



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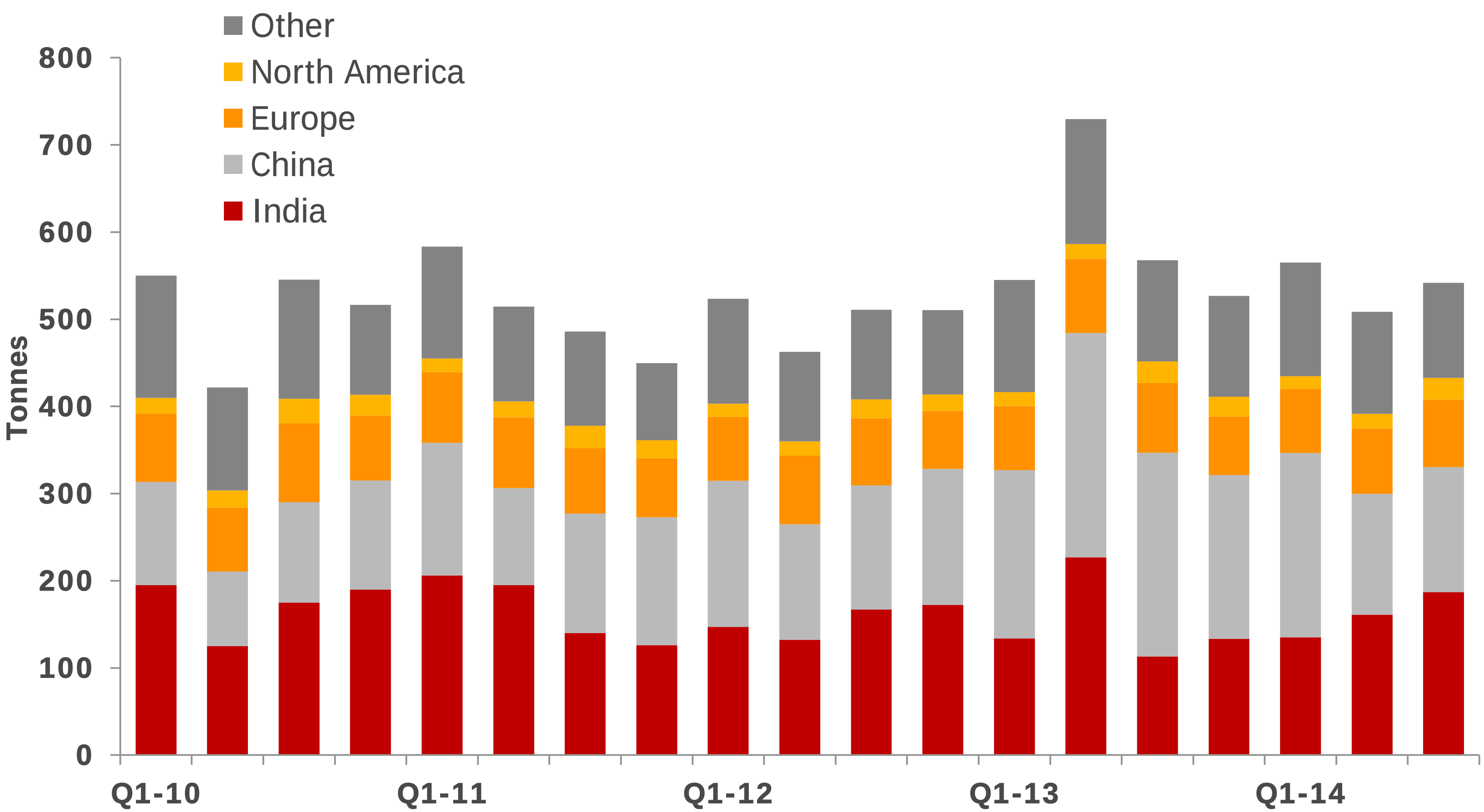
JEWELLERY FABRICATION



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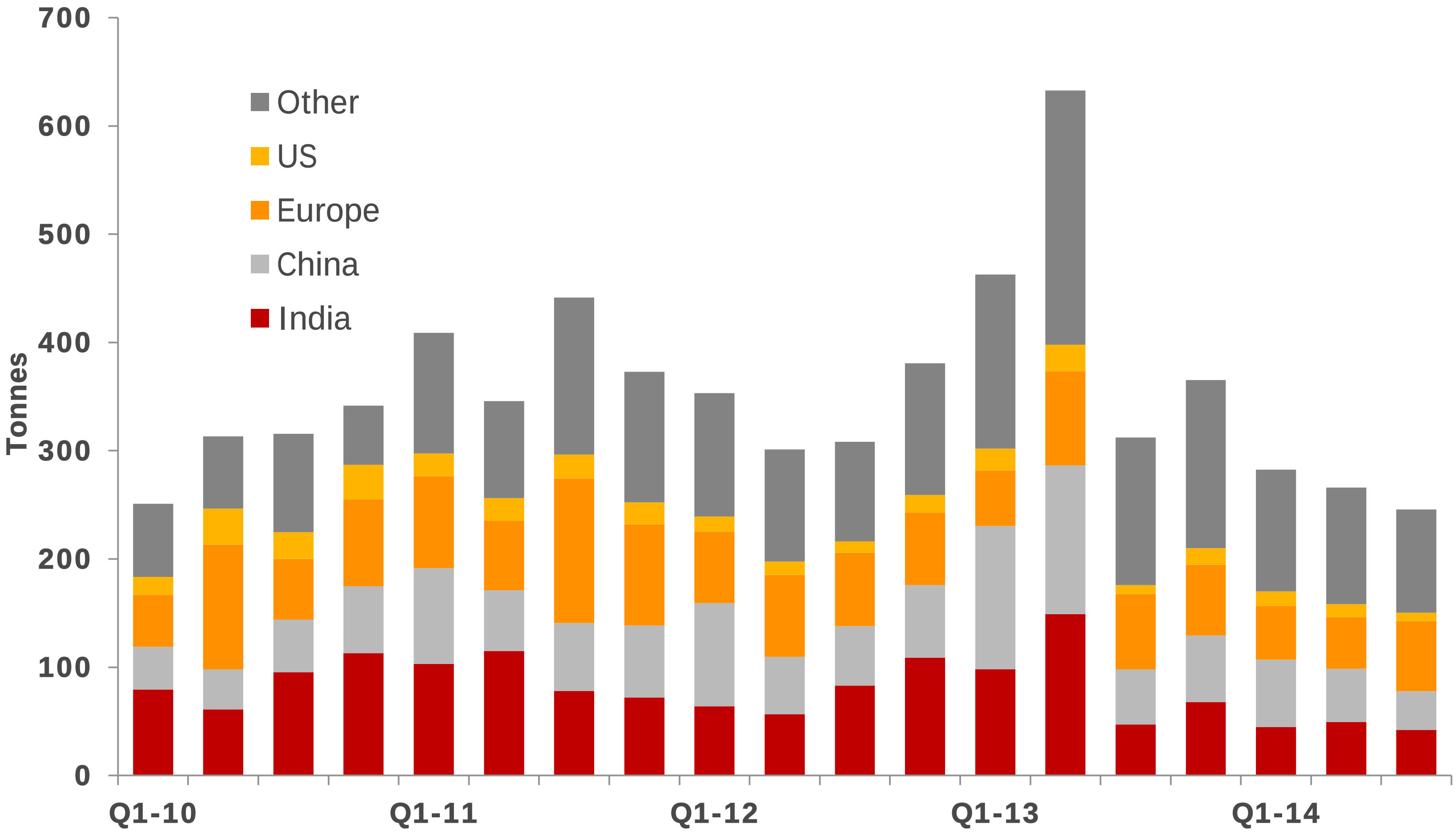
RETAIL INVESTMENT



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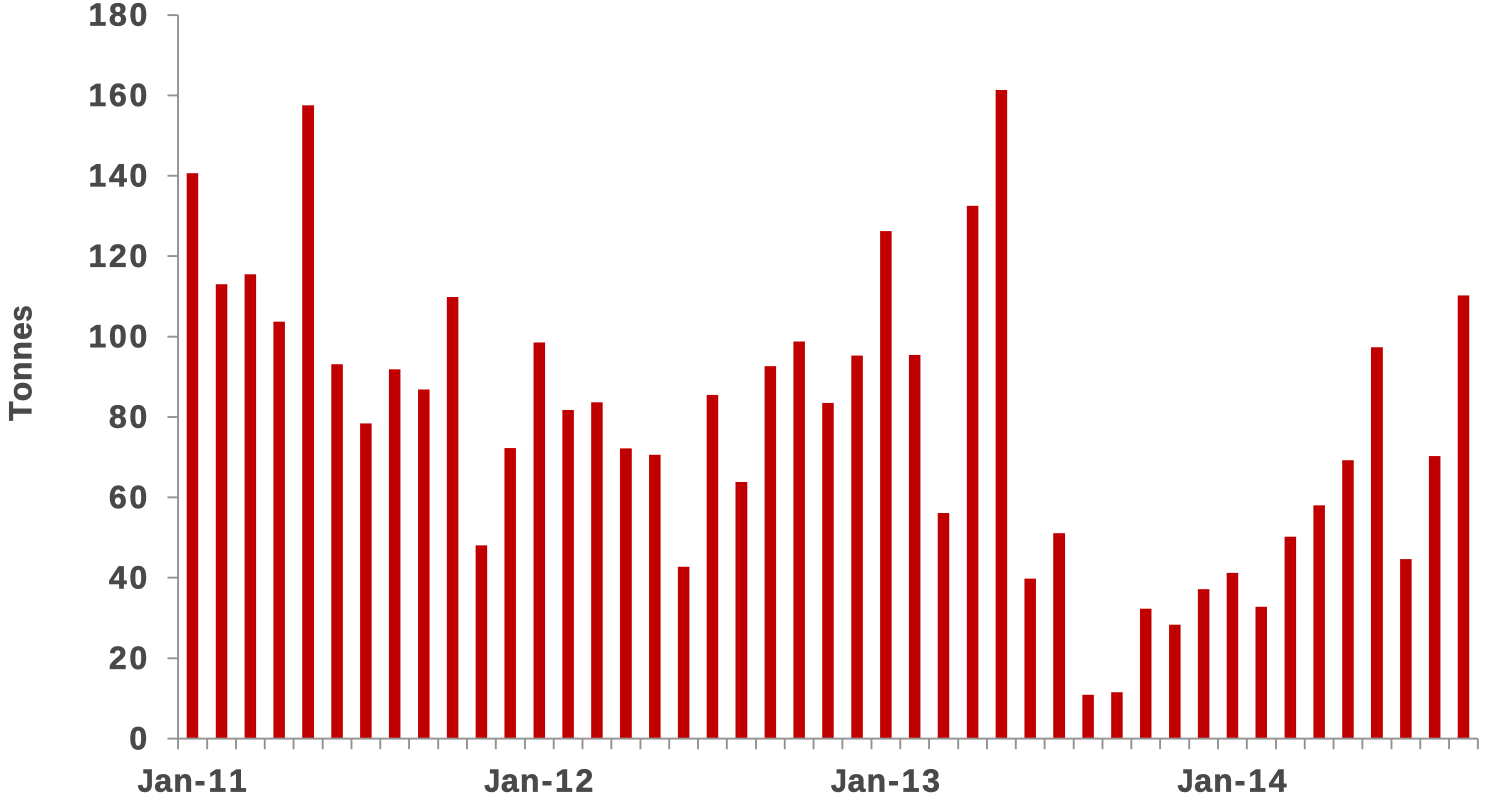
INDIAN GROSS IMPORTS



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CHINA'S GOLD MARKET REMAINED RESTRAINED DURING THE RECENT SHARP PRICE FALL.

14-Nov-2014 16:35

The gold price broke the US$1,180/oz psychological level on the 31st October, trended lower towards US$1,130/oz on 7th November, and while recovering some lost ground remains subdued. Despite the price drop, the Chinese market reaction was muted and failed to deliver a significant rise in demand as consumers wait for another down leg in the price.

By Sara Zhao.

Chinese demand in September rebounded sharply with the SGE withdrawal number registering a new high since February 2014 of 202 tonnes, and net gold imports from Hong Kong reaching 69 tonnes, 2.5 times the monthly import recorded in August, driven predominately by National Day Holiday preparation across the supply chain. The following month benefited from restocking after the holiday season and registered a 201 tonnes withdrawal on the SGE, a 45% increase compared to the same period last year when the off-season market was worsened by over-purchasing in the second quarter when gold fell dramatically. Demand was lacklustre towards the end of October, reflecting a lack of demand after the holiday season, despite the declining price trend. The SGE / loco London differential in the last week of October dropped to US$1.40/oz, while the average for the full month of October was US$3.03/oz, down from the US$3.91/oz average recorded in September.

The gold price retraced sharply during the last two days of October during which the London pm fix dropped US$59.2/oz, breaking through the psychologically significant level of US$1,180/oz on 31st October. However, Chinese consumers failed to react to the price drop, contrary to what we saw last year when price slumped in April. Indeed, according to several of our contacts, bullion demand in China was close to its weakest point this year at the end of October. This is well supported by the data on the SGE, where on the 31st October the trading price on the SGE international board was US$12.16/oz higher than on its domestic board, the highest differential since the second day of the launch of the international board on 20th September, indicating sluggish domestic demand.

The price fell further in the following week, reaching a low just above US$1,130/oz, the level last seen in October 2010. In terms of jewellery demand , the recent price decline saw retail prices drop back to below RMB300/g (US$ 1,523/oz), some even to as low as RMB250/g (US$1268/oz). However, this price sensitive sector remained surprisingly quiet, with only limited signs of bargain hunting among consumers. There was certainly no repeat of the 2013 surge when jewellery retails stores were filled with crowds fighting for gold jewellery.

Research on the ground reveals two quite different views of the market within the Chinese public. Some consumers, , with no professional financial knowledge, over-consumed last year during the price crash seeking a cheap deal by purchasing gold at the perceived discounted price. However, this backfired for many, leaving bargain hunters out of pocket and extremely cautious about jewellery purchasing this year even when the price has fallen to the lowest level since 2011. Meanwhile others who were anticipating a drop in the gold price are prepared to wait for another leg down before they re-enter the market. Their decisions are supported by some Chinese media outlets which recently claimed the price would fall below US$1,000/oz within a year. For this group of consumers, we could see strengthening demand if the price drops towards this level.

Despite the floundering jewellery market, the investment sector provided a slightly better outcome, as the physical bar sales in some retail stores saw increased demand. This disparity partially stemmed from the price difference between the jewellery and investment bar sector; the latter declined to RMB223/g (US$1,132/oz) during the week while the former traded between RMB250/g and RMB300/g, making bar purchases the vehicle of choice for investment and bargain hunting purposes. However, a number of investors are still waiting for lower prices, with the RMB200/g (US$1,115/oz) level for investment bars regarded as the next entry level.

14 Nov 14 16:35

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14 Nov 14 09:56

CHINA STEPS UP ITS GAME TO PREPARE FOR RENMINBI INTERNATIONALISATION

While the US may have its hands full dealing with the advancement of ISIS in the Middle East and trying to kick start the economy, China has made significant progress already this year preparing the Renminbi to be fully and freely convertible in the future. Indeed this may occur much sooner than many would have initially expected.

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13 Nov 14 10:41

THE LBMA PRECIOUS METALS CONFERENCE 2014; BEARISH BUT NOT DOWNCAST

The great and the good of the bullion markets gathered in Lima in early November for the annual LBMA Precious Metals Conference. While moderately bearish, the mood was not especially downbeat and overall the market is expected to battle through the current cautious times and come out relatively healthy on the other side.

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13 Nov 14 09:25

GOLD USED IN ELECTRONICS CONTINUES TO DECLINE.

Over the last decade the amount of gold consumed in the electronics segment has seen a dramatic change as higher gold prices and improvements in technology have curtailed the use of the yellow metal in industrial applications. In the first in a series on industrial demand we take a look at what lies ahead for not just gold but the other emerging metals in the bonding wire and semi conductor markets.

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10 Nov 14 11:34

TROUBLED WATERS: THE VIABILITY OF MINE SUPPLY AT LOWER GOLD PRICES

With gold prices falling to its lowest in over four years, below $1,150/oz, what would the effect be on the mining industry of gold at $1,100/oz and $1,000/oz?

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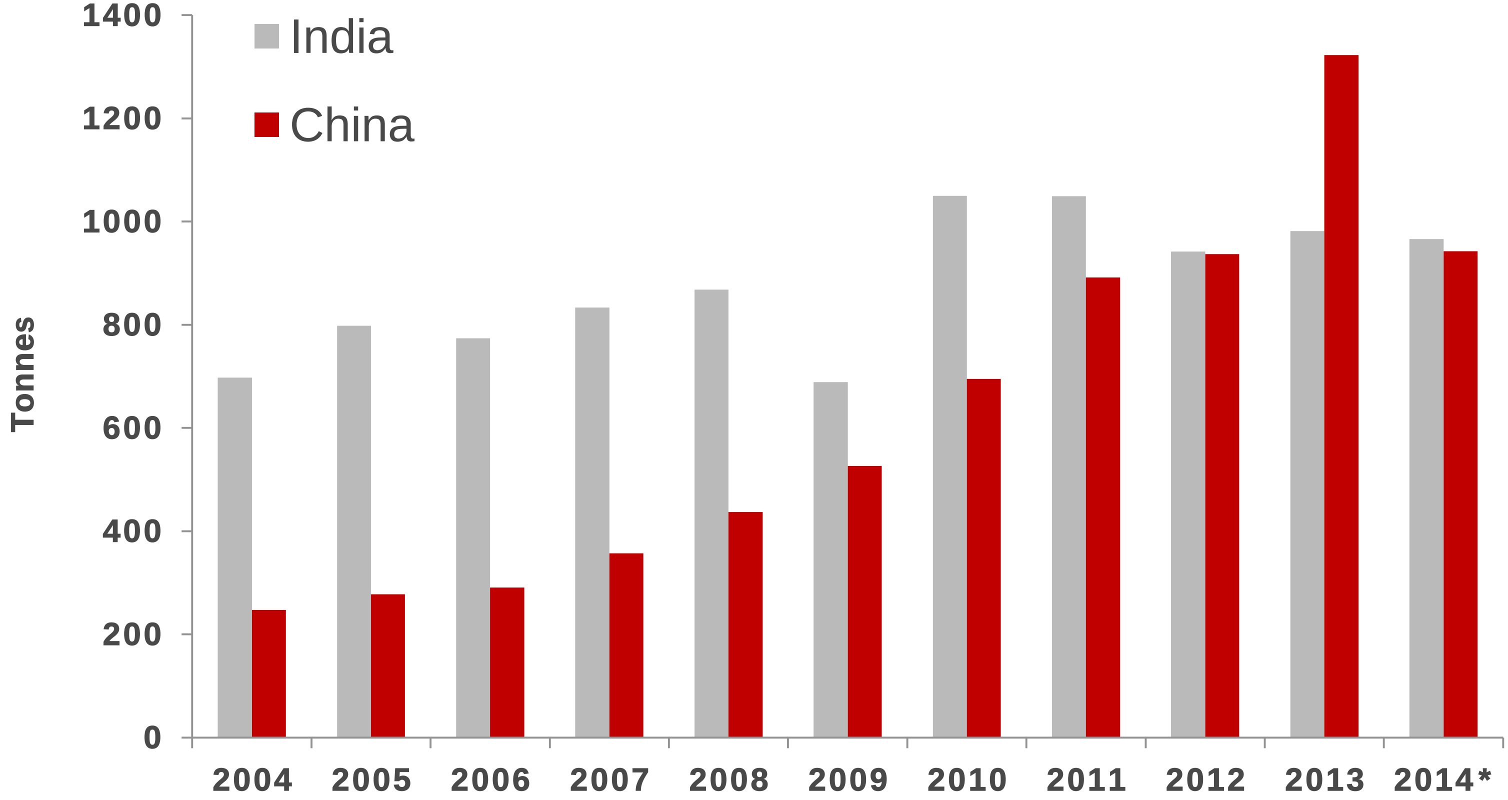
"Will Chinese gold demand come to the rescue?"

Source: Thomson Reuters, Eikon

INDIAN DEMAND NUDGES BACK PAST CHINA - BRIEFLY



* Forecast

Source: GFMS, Thomson Reuters

**Demand consists of jewellery fabrication, industrial fabrication and retail investment

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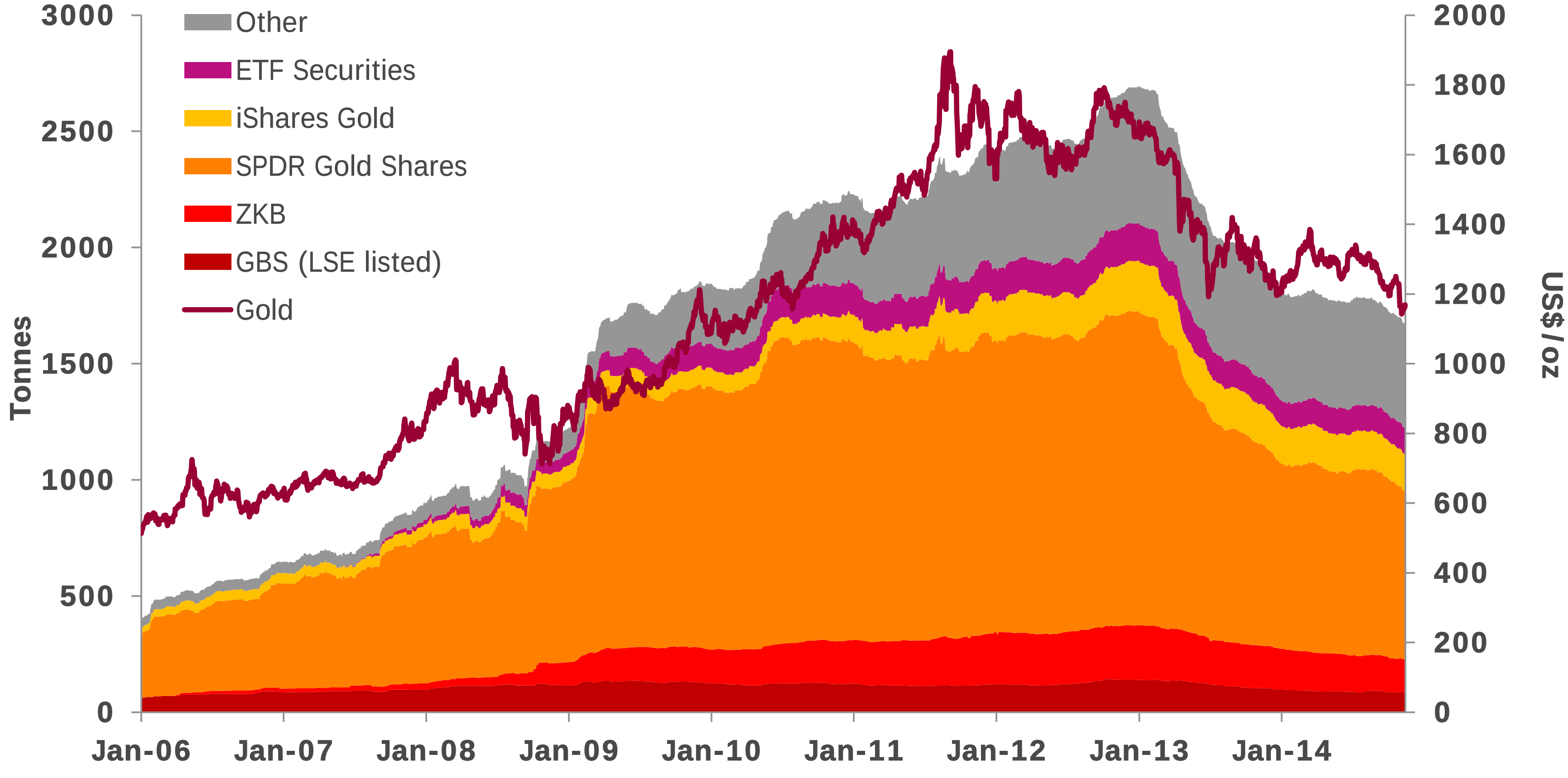
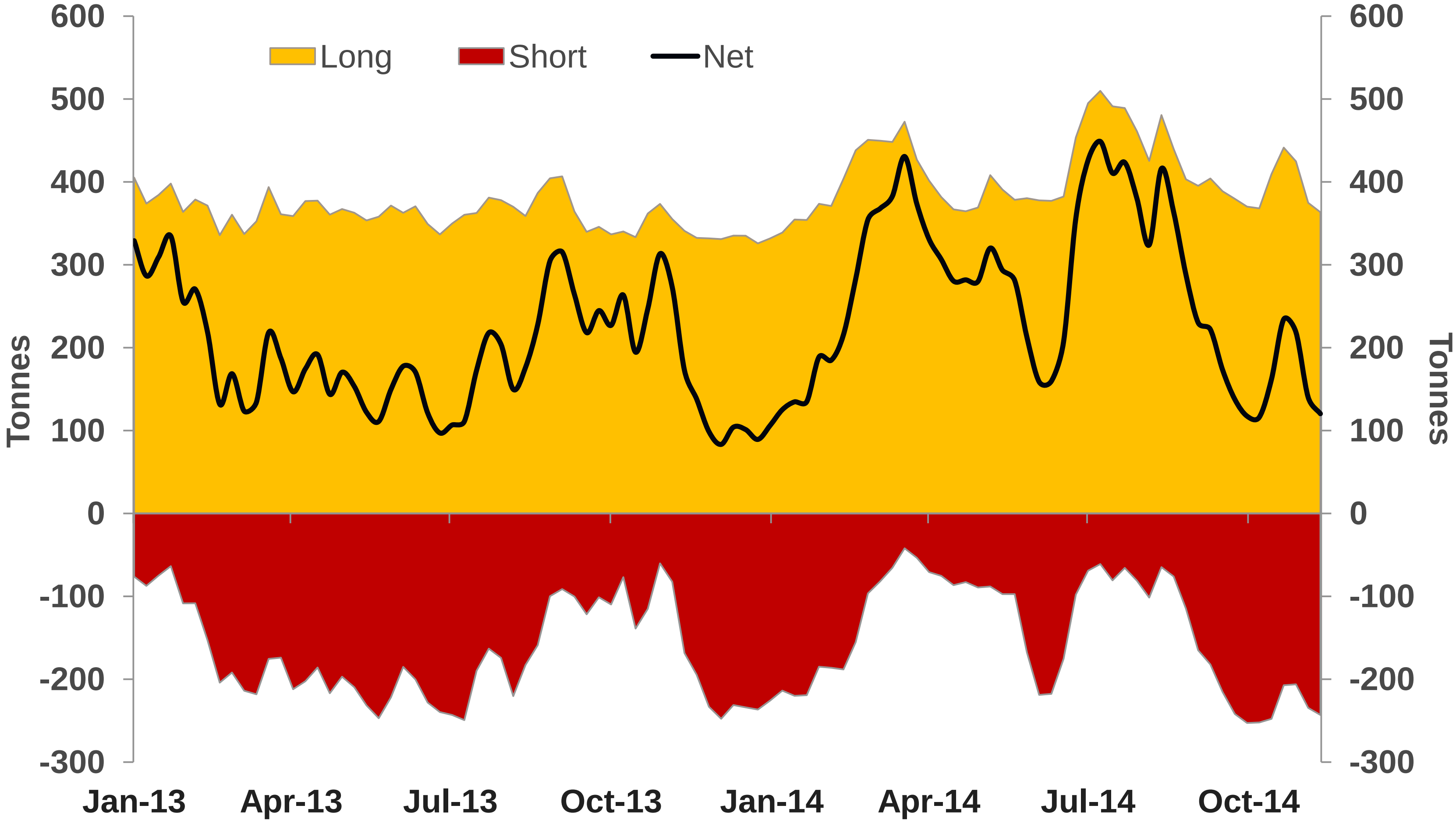
GOLD ETFs AND OTHER SIMILAR PRODUCTS



Source: GFMS, Thomson Reuters, collated from respective ETF issuers' data

CFTC MANAGED MONEY



Source: GFMS, Thomson Reuters, CFTC

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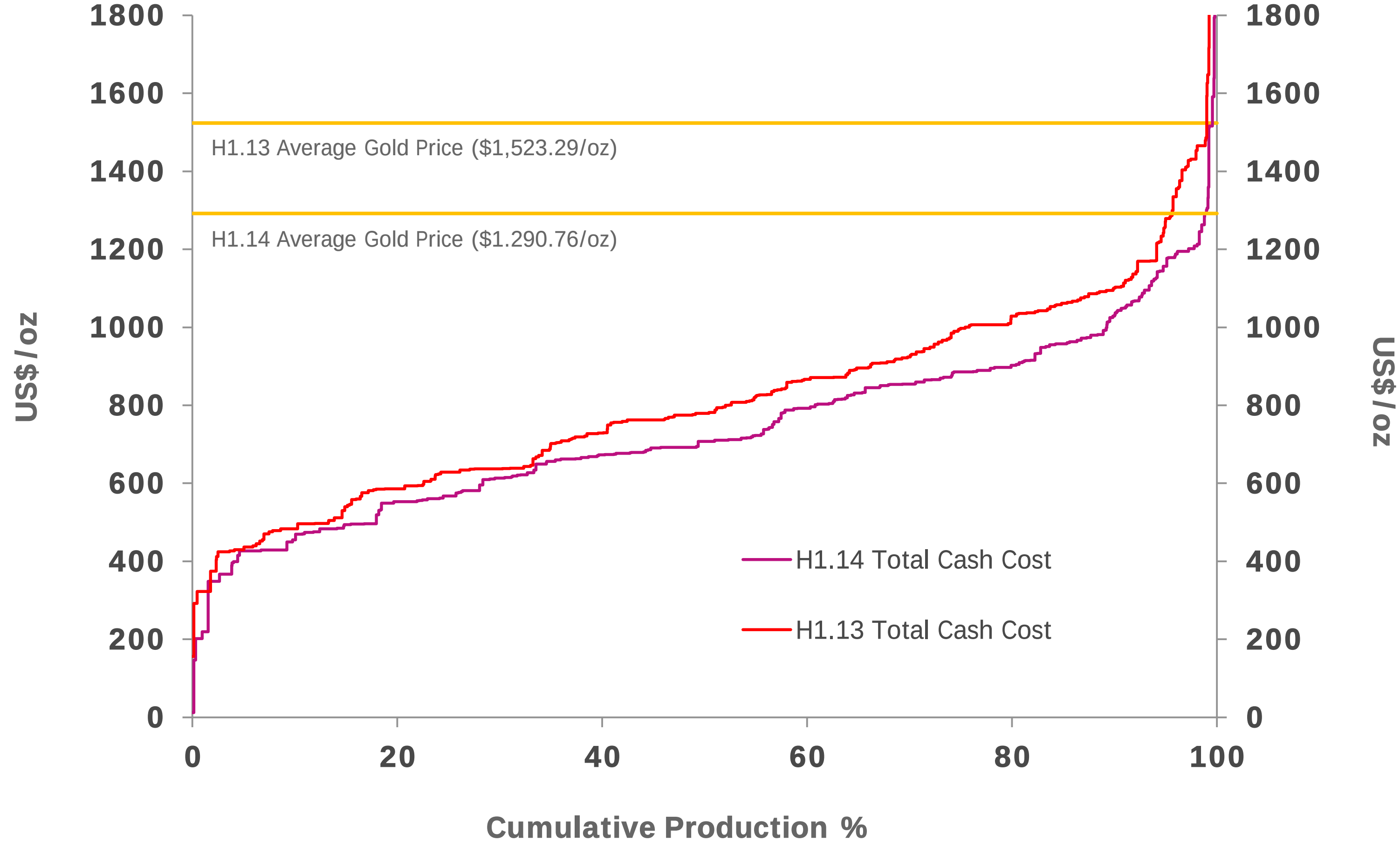
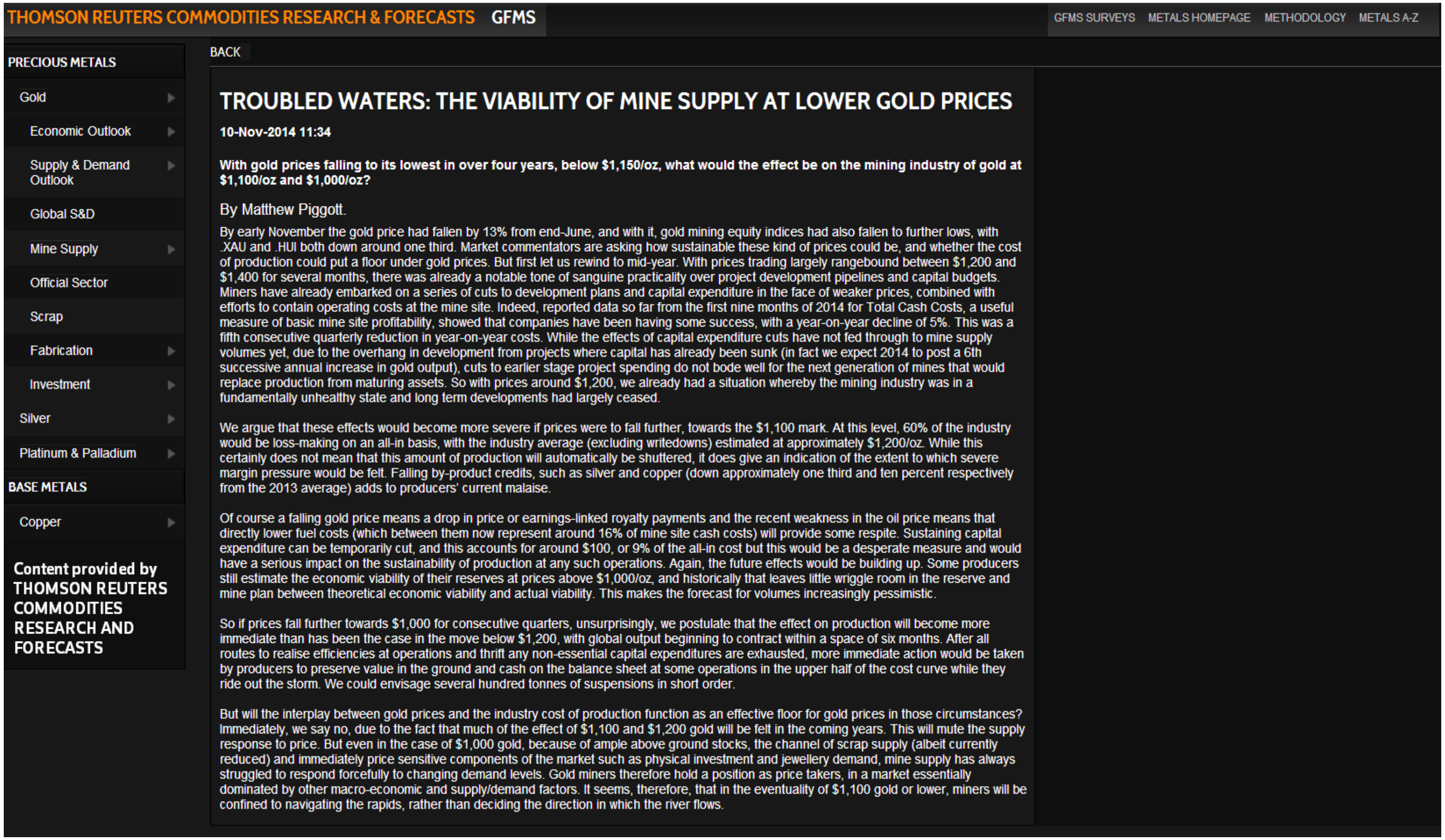
WORLD TOTAL CASH COST CURVES
H1. 2014 VERSUS H1. 2013



Source: GFMS, Thomson Reuters



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BACK

TROUBLED WATERS: THE VIABILITY OF MINE SUPPLY AT LOWER GOLD PRICES

10-Nov-2014 11:34

With gold prices falling to its lowest in over four years, below $1,150/oz, what would the effect be on the mining industry of gold at $1,100/oz and $1,000/oz?

By Matthew Piggott.

By early November the gold price had fallen by 13% from end-June, and with it, gold mining equity indices had also fallen to further lows, with .XAU and .HUI both down around one third. Market commentators are asking how sustainable these kind of prices could be, and whether the cost of production could put a floor under gold prices. But first let us rewind to mid-year. With prices trading largely rangebound between $1,200 and $1,400 for several months, there was already a notable tone of sanguine practicality over project development pipelines and capital budgets. Miners have already embarked on a series of cuts to development plans and capital expenditure in the face of weaker prices, combined with efforts to contain operating costs at the mine site. Indeed, reported data so far from the first nine months of 2014 for Total Cash Costs, a useful measure of basic mine site profitability, showed that companies have been having some success, with a year-on-year decline of 5%. This was a fifth consecutive quarterly reduction in year-on-year costs. While the effects of capital expenditure cuts have not fed through to mine supply volumes yet, due to the overhang in development from projects where capital has already been sunk (in fact we expect 2014 to post a 6th successive annual increase in gold output), cuts to earlier stage project spending do not bode well for the next generation of mines that would replace production from maturing assets. So with prices around $1,200, we already had a situation whereby the mining industry was in a fundamentally unhealthy state and long term developments had largely ceased.

We argue that these effects would become more severe if prices were to fall further, towards the $1,100 mark. At this level, 60% of the industry would be loss-making on an all-in basis, with the industry average (excluding writedowns) estimated at approximately $1,200/oz. While this certainly does not mean that this amount of production will automatically be shuttered, it does give an indication of the extent to which severe margin pressure would be felt. Falling by-product credits, such as silver and copper (down approximately one third and ten percent respectively from the 2013 average) adds to producers' current malaise.

Of course a falling gold price means a drop in price or earnings-linked royalty payments and the recent weakness in the oil price means that directly lower fuel costs (which between them now represent around 16% of mine site cash costs) will provide some respite. Sustaining capital expenditure can be temporarily cut, and this accounts for around $100, or 9% of the all-in cost but this would be a desperate measure and would have a serious impact on the sustainability of production at any such operations. Again, the future effects would be building up. Some producers still estimate the economic viability of their reserves at prices above $1,000/oz, and historically that leaves little wriggle room in the reserve and mine plan between theoretical economic viability and actual viability. This makes the forecast for volumes increasingly pessimistic.

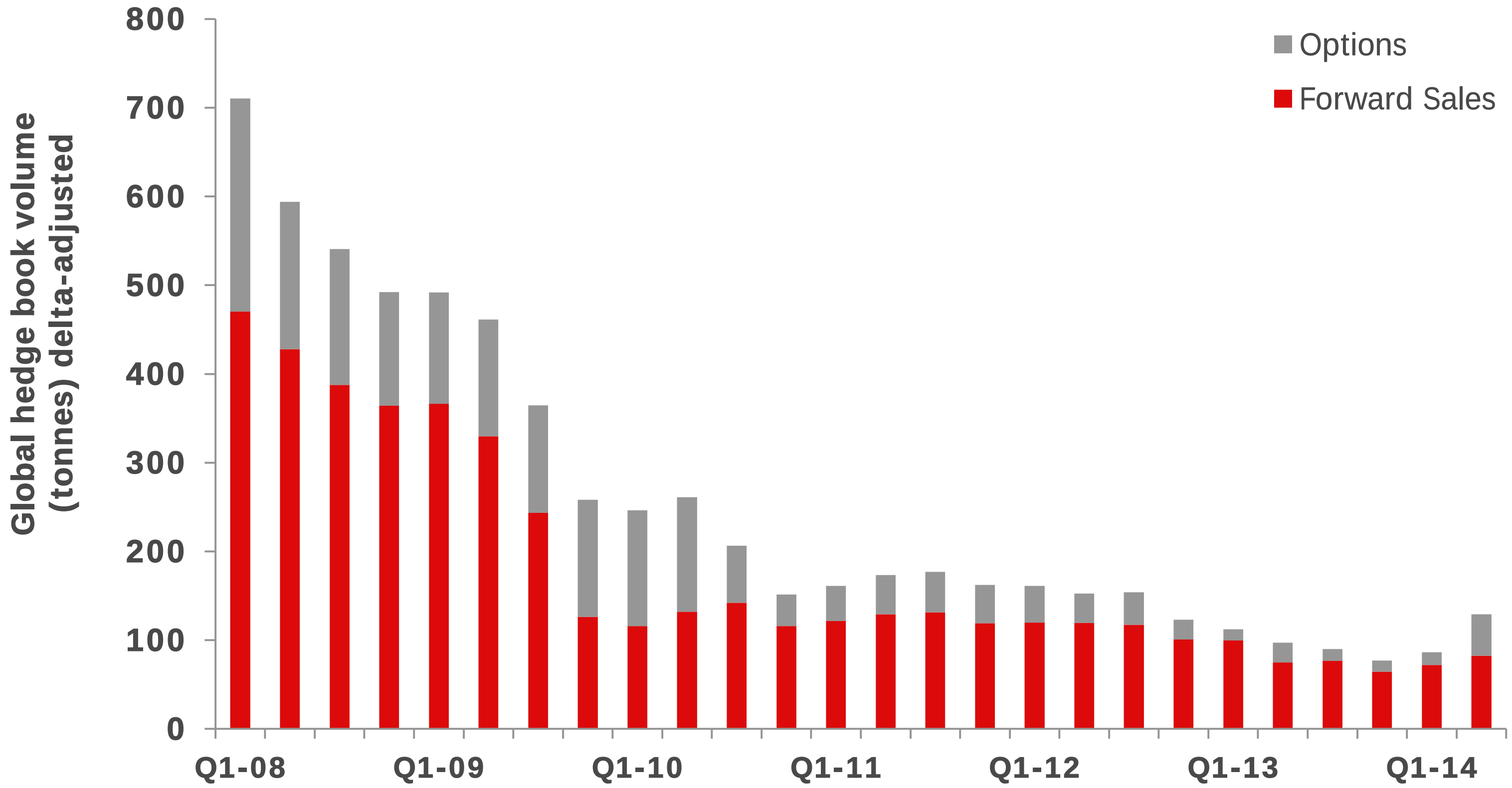
So if prices fall further towards $1,000 for consecutive quarters, unsurprisingly, we postulate that the effect on production will become more immediate than has been the case in the move below $1,200, with global output beginning to contract within a space of six months. After all routes to realise efficiencies at operations and thrift any non-essential capital expenditures are exhausted, more immediate action would be taken by producers to preserve value in the ground and cash on the balance sheet at some operations in the upper half of the cost curve while they ride out the storm. We could envisage several hundred tonnes of suspensions in short order.

But will the interplay between gold prices and the industry cost of production function as an effective floor for gold prices in those circumstances? Immediately, we say no, due to the fact that much of the effect of $1,100 and $1,200 gold will be felt in the coming years. This will mute the supply response to price. But even in the case of $1,000 gold, because of ample above ground stocks, the channel of scrap supply (albeit currently reduced) and immediately price sensitive components of the market such as physical investment and jewellery demand, mine supply has always struggled to respond forcefully to changing demand levels. Gold miners therefore hold a position as price takers, in a market essentially dominated by other macro-economic and supply/demand factors. It seems, therefore, that in the eventuality of $1,100 gold or lower, miners will be confined to navigating the rapids, rather than deciding the direction in which the river flows.

“How viable is mine supply at lower gold prices?”

Source: Thomson Reuters, Eikon

EVOLUTION OF THE GLOBAL HEDGE BOOK



Source: GFMS, Thomson Reuters

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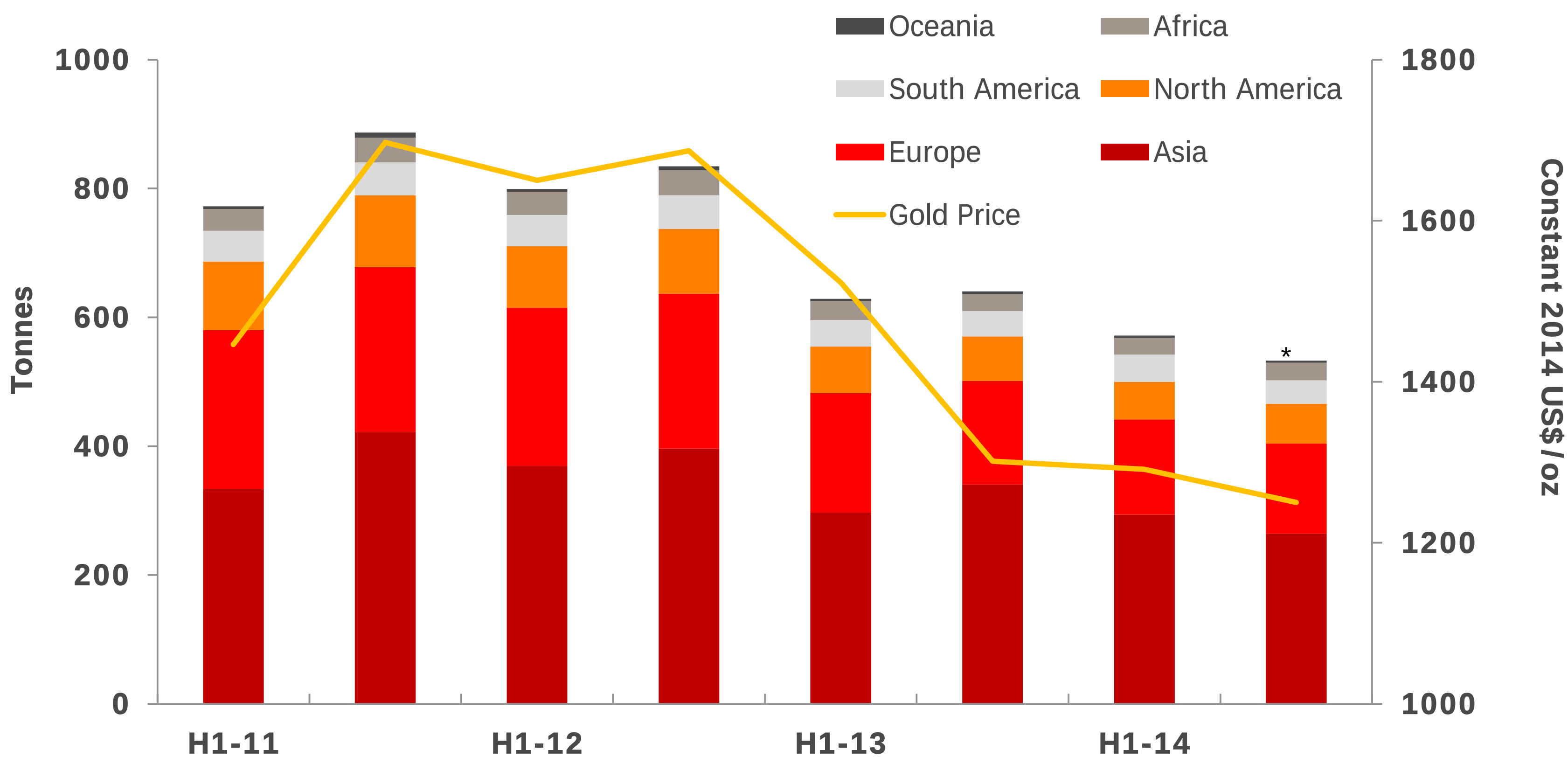
WORLD SCRAP SUPPLY



* Forecast Source: GFMS, Thomson Reuters

GOLD AGAINST EURO/DOLLAR RATE SINCE 2013

Source: Thomson Reuters, Eikon

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