Commodity Spotlight Precious Metals

18 September 2013

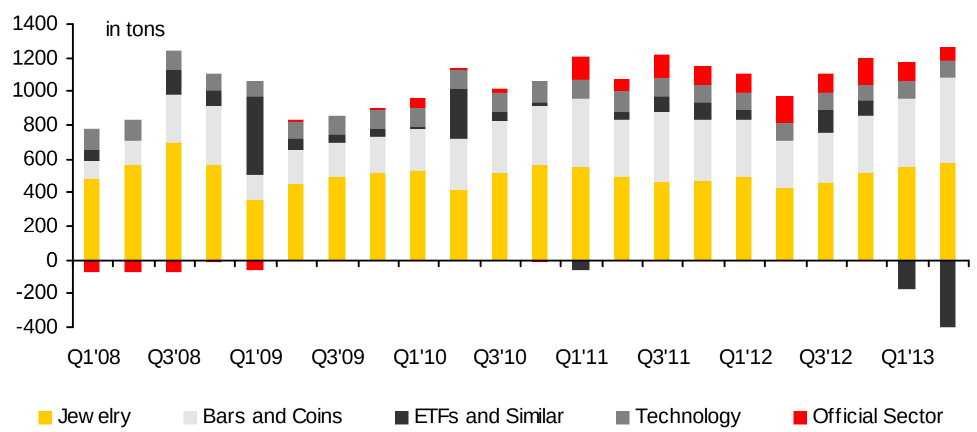
From West to East: gold demand is shifting

Overshadowed by the investment boom in the West, Asia's gold demand has been enjoying strong growth for years. It was only the massive outflows from gold ETFs in the first half of the year, however, that revealed that China has meanwhile established itself as a key player on the gold market alongside India. Even if Indian gold demand may falter somewhat in the short term, the growing Asian interest in gold will doubtless become an increasingly important driver on the gold market in the medium term and thus lend support to the price recovery we anticipate in the coming year. Silver should then also be able to make significant gains in gold's slipstream.

The gold price managed to recover between late June and late August from its massive price slide in the spring and gained 18% within two months. At a good $1,430 per troy ounce, it climbed to a 3½-month high in late August. However, the price was unable to hold these gains and has already corrected 50% of the upward move again. What is currently making the recovery so prone to setbacks, and which factors could drive it further forward?

A glance back to the second quarter reveals that the drivers on the gold market have shifted significantly of late. The weakness seen by investment demand in the industrialized countries in the West, which until the end of last year drove gold prices up, was the most remarkable issue thereby. It is evidenced above all in the massive outflows from the ETFs, which in the second quarter totalled a good 400 tons (chart 1). That said, the World Gold Council statistics also indicate that a new driver has become established: the sharply rising gold demand in Asia. Overshadowed by the demand boom in the West, Asian interest in gold has been rising for years, though it is the lower prices of late that have allowed second quarter demand to make a significant leap upwards. The demand growth is essentially concentrated on two countries: on India for one, whose high jewellery demand has meant that it has always played a key role on the gold market. On top of this there is now a strong increase in demand for coins and bars, which in the second quarter totalled 122 tons, which is more than twice as high as last year – in the 12 months to June 2013, it was more than 50% higher than twelve months earlier. For another thing, China's gold demand has seen huge growth in recent years. Jewellery demand in China has meanwhile reached almost the same level as in India. By way of comparison: it was not even half as high in 2005 (chart 2, page 2). Chinese demand for coins and bars has developed even more dynamically than the country's jewellery demand: It has increased 30 times in volume vs. 2005. Whilst it accounted for only 5% of jewellery demand in 2005, its share rose to three quarters of jewellery demand in the second quarter.

CHART 1: **Jewellery, coin and bar demand cushion strong outflows from gold ETFs**



Source: WGC, Commerzbank Corporates & Markets

Commerzbank Forecasts 2013/14

	Q4	Q1	Q2
Precious metals			
Gold	1300	1400	1400
Silver	21	23	24
Platinum	1425	1500	1525
Palladium	700	725	750

USD per troy ounce

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Rising Chinese and Indian demand for jewellery, coins and bars cushions decline in gold ETFs

China has thus established itself as a key player on the gold market alongside India: together, the two countries accounted for over half of global "consumer demand" in the past twelve months, that is to say total combined demand for jewellery, coins and bars (chart 2). On balance, therefore, the sharp rise in Asian gold demand has been able at least to cushion the massive outflows from the gold ETFs to a large extent, even if it has been unable to offset it completely. Incidentally, the shift in demand from West to East is also evident in the trade flows: according to a Financial Times article, 798 tons were exported in the first half of the year from Great Britain, where a large part of physical ETF gold holdings are stored, to Switzerland, where the bigger bars are no doubt melted down into smaller ones which are particularly popular with Asian buyers. China imported around 631 tons of gold from Hong Kong on balance in the first seven months of the year, which is more than in the entire year 2012.

China's gold demand likely to grow further as incomes rise

Will the Asian interest in gold continue to grow? In our view, the indicators for China and India, the two major consumers, differ at present: in China, the higher gold demand is first and foremost a consequence of rising incomes, a trend which has been additionally boosted recently by the poor performance of equity markets and by restrictions on the real estate market, while the sharp fall in prices on the gold market simultaneously offered investors attractive entry opportunities. Even if these boosters have lost some of their impetus now, the strengthening of the Chinese economic upswing and the higher incomes that this entails will continue to drive Chinese gold demand up sharply in the coming months and years.

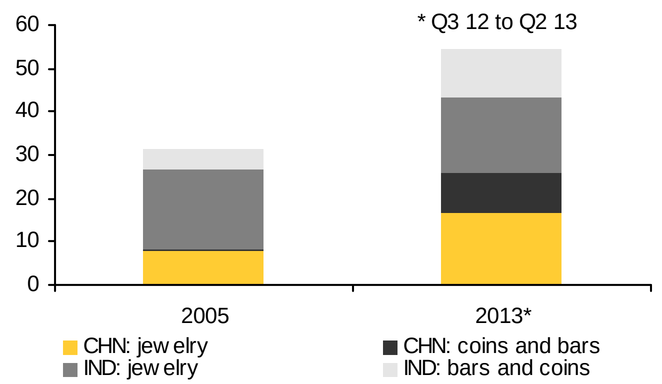
State measures in India only likley to dampen gold demand in short term

In India, on the other hand, where gold has traditionally always enjoyed high status, the indicators are rather different at present: in view of the massive increase in the country's current account deficit, the government and central bank are attempting to curb gold demand among Indian households. Import duties have already been hiked and import restrictions tightened a number of times. In addition, the dramatic depreciation of the Indian rupee is acting as a brake, causing the gold price in rupees to climb to an all-time high in early September (chart 3). Ultimately, all these factors will probably only slow Indian gold demand in the short term, since interest in gold will essentially remain high here too, and indeed will grow further as incomes rise.

Uncertainty still prevailing in the West

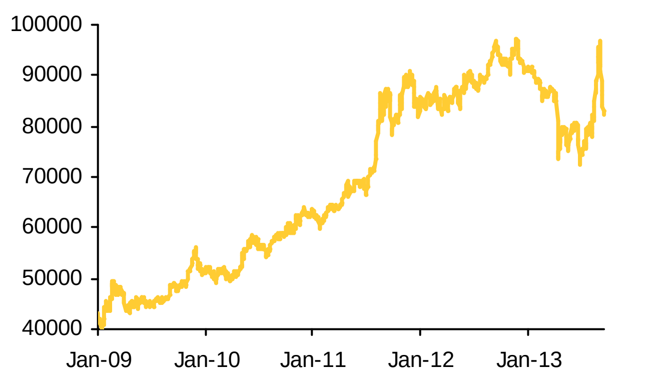
All in all, gold demand in Asia will thus continue to enjoy strong growth. Investment demand in the West will determine to some extent how much the gold price is able to profit as a result, however. Investment demand has been rather weak until recently. ETF outflows have picked up again of late after holdings appeared to stabilize between early August and early September. In August, sales of US gold coins plunged to their lowest level for six years, and there is no evidence to date of any marked revival in sales in September, either. Even if the rising prices on the back of the Syrian conflict have shown that gold is still in demand as a safe haven in times of crisis, investors are still hesitant about taking the plunge. The uncertainty following the dramatic price slide is considerable. Other factors currently weighing on the gold price include rising equity markets and growing conviction that the Fed is about to begin scaling back its bond purchases.

CHART 2: **Sharp increase in demand in China and India**
in % of global consumer demand



Source: WGC, Commerzbank Corporates & Markets

CHART 3: **Gold price in India rose to an all-time high of late**
Gold price in Indian rupees per troy ounce



Source: Bloomberg, Commerzbank Corporates & Markets

Investment demand should pick up again in 2014

We therefore do not expect the gold price to recover in any lasting fashion before this year is out, and envisage an average gold price of $1,300 per troy ounce by year-end. In the longer term, however, gold should also enjoy increased demand in the West again. After all, the problem of high debt levels in the industrialized countries is far from resolved, which means that the risks of inflation remain elevated. This makes it unlikely that central banks in leading industrialized countries will quickly scale back their ultra-expansionary monetary policy. Meanwhile, a gradual phasing out of the Fed's bond purchases by mid-2014 is already priced in. Undesirable speculation about interest rate hikes is likely to be quashed by the Fed. As a result, we envisage low real interest rates for the foreseeable future, meaning that the opportunity costs of holding gold will likewise remain low. This suggests that investment demand will pick up again; in the second quarter, it totalled only 106 tons as a result of the ETF outflows and thus accounted for less than 20% of jewellery demand.

Sustained price recovery not until next year

The pace of ETF outflows has already slowed considerably in the current quarter. In the past 2½ months, "only" a good 100 tons of gold was withdrawn from the ETFs – compare this with first and second quarter figures of 180 tons and a good 400 tons tons respectively. This trend should be maintained in the fourth quarter. By 2014, the "weak hands" are likely to have exited and ETFs should record inflows again. The central banks in emerging economies should also continue to shore up prices with their purchases. For the current year, the World Gold Council anticipates central bank purchases to the tune of 350 tons, while the figure predicted by GFMS, a consultant firm specialized in precious metals, is 361 tons. This may be well below last year's figure, but it's still the second-highest volume since the end of Bretton Woods. Thus the gold price is likely to resume its upswing in the coming year and climb to $1,600 per troy ounce by the end of 2014.

Silver

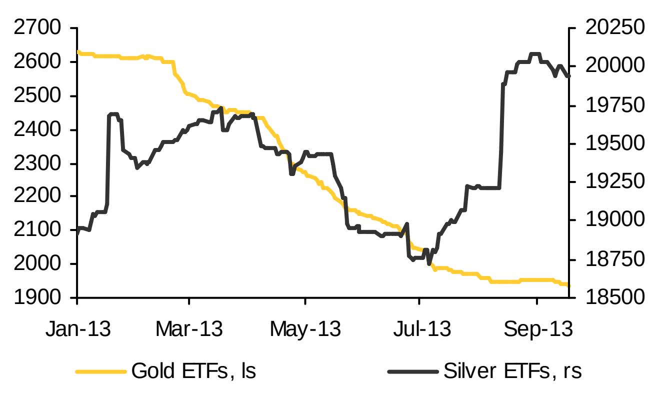
Silver price recoups part of its losses

In August, silver surged for a time by 26% to reach a 4½-month high of $25 per troy ounce, thus recouping in a short period of time more than half of the losses it had suffered since the beginning of the year. Similarly to gold, however, the upward move was not lasting, and silver has already declined 14% again from the high reached in late August. The latest price rise was driven above all by a significant increase in investment demand. In August, the silver ETFs tracked by Bloomberg had seen inflows of just under 850 tons (chart 4). For the first time ever, total holdings exceeded the 20,000 ton mark – this is almost ten times the monthly global mining production. In contrast to gold ETFs, holdings of silver ETFs have been increased by more than 1,000 tons since the start of the year.

Demand for US silver coins has already reached last year's total

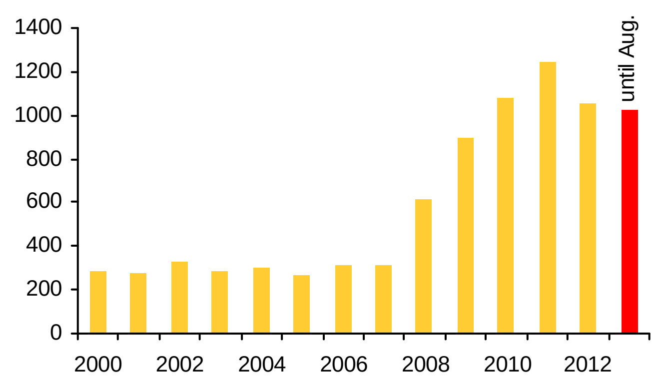
Demand for coins is also very robust. In the first eight months of the year, the U.S. Mint for example has already sold 33.1 million ounces of silver coins (equivalent to 1,029 tons). This means that sales have already reached almost the level achieved in the whole of last year – 33.7 million ounces (around 1,050 tons) were sold in 2012 (chart 5). What is more, money managers had sharply increased their net long positions to a 6½-month high of 17.6 thousand contracts, in early September. Just 2½ months weeks ago, these investors had been betting on falling silver prices on balance.

CHART 4: **Sharp inflows into silver ETFs of late**
Gold and silver ETF holdings in tons



Source: Bloomberg, Commerzbank Corporates & Markets

CHART 5: **Buoyant silver coin sales in the US**
US silver coin sales in tons



Source: U.S. Mint, Bloomberg, Commerzbank Corporates & Markets

Little upward potential in the short-term, but higher prices expected in the mid- to long-term

Thus short-term correction potential had built up and recently materialised. We do not expect silver to go into free fall, however. In fact, the investment demand should lend relatively good downside support to the price. After all, at a gold/silver ratio of 60 silver is still good value relative to gold, which in the coming months should also be reflected in increased coin sales and a better performance of ETF demand. Nonetheless, silver is unlikely to resist gold's development, so we see little upside potential for the silver price in the short term. By year's end we envisage an average silver price of $21 per troy ounce. In the mid- to long-term we expect to see higher silver prices again, particularly on the back of the economic recovery in China and the US, the two countries which consume the most silver. Industrial demand accounts for almost 50% of the total silver demand. In China, for example, surprisingly positive economic data were recently published, suggesting that the economy is stabilizing. This is also reflected in Chinese silver imports – in July, the country imported more than 200 tons of silver again for the first time in six months. This trend should continue in the coming months and next year. As a result, silver is likely to increase in price to $28 per troy ounce by the end of 2014 and thus also somewhat outperform gold.

At a glance

TABLE 1: **Our forecasts**

	Quarterly average									Yearly average		
	17/09/13	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14	Q4 14	2012	2013	2014
Gold	1311	1632	1417	1325	1300	1400	1400	1500	1600	1669	1425	1475
Silver	21.8	30.1	23.2	21.5	21.0	23.0	24.0	26.0	28.0	31.2	24.0	25.5
Platinum	1423	1632	1467	1450	1425	1500	1525	1600	1700	1553	1500	1575
Palladium	704	742	714	725	700	725	750	775	825	645	720	770

Quarterly averages, based on spot prices; Source: Bloomberg, Commerzbank Corporates & Markets

TABLE 2: **ETF holdings (weekly data)**

			Total net change			% change	52 weeks	
	Date	Holdings	1 week	1 month	1 year	1 year	High	Low
Gold ETFs (in '000 ounces)	13.09.13	62381.3	-431.1	-329.2	-18111.3	-22.5	84615.7	62381.3
Silver ETFs (in '000 ounces)	13.09.13	643057.2	-844.0	1078.5	52532.3	8.9	645640.6	590524.9
Platinum ETFs (in '000 ounces)	13.09.13	2231.4	-11.9	38.5	745.9	50.2	2243.3	1468.4
Palladium ETFs (in '000 ounces)	13.09.13	2223.6	-2.0	9.3	294.9	15.3	2282.4	1816.6

Source: Bloomberg, Commerzbank Corporates & Markets

TABLE 3: **Net long positions of money managers (weekly data)**

			Total net change			% change	52 weeks	
	Date	Level	1 week	1 month	1 year	1 year	High	Low
Gold (in '000 contracts)	10.09.13	64.780	-10.620	26.792	-72.833	-52.9	167.473	21.384
Silver (in '000 contracts)	10.09.13	15.096	-2.551	3.634	-11.659	-43.6	36.485	-2.497
Platinum (in '000 contracts)	10.09.13	30.708	-1.830	3.079	7.037	29.7	40.846	18.006
Palladium (in '000 contracts)	10.09.13	21.250	-1.284	-3.257	14.052	195.2	25.676	6.073

Source: Bloomberg, Commerzbank Corporates & Markets

TABLE 4: **History**

	Current	% change				History							
	USD per troy ounce	1 week	1 month	y-t-d	y-o-y	Q111	Q211	Q311	Q411	Q112	Q212	Q312	Q412
Gold	1311	-4.8	-5.5	-22.4	-26.6	1388	1509	1706	1683	1691	1612	1653	1718
Silver	21.8	-7.3	-7.6	-29.2	-38.3	32.0	38.5	38.9	31.8	32.7	29.5	29.9	32.6
Platinum	1423	-3.6	-6.8	-7.7	-12.9	1793	1785	1771	1531	1609	1501	1500	1598
Palladium	704	1.2	-8.0	-0.5	5.2	791	760	752	630	683	629	613	654

Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

TABLE 5: **World Official Gold Holdings (monthly data)**

Country	tonnes	Country	tonnes
USA	8,133.5	Switzerland	1,040.1
Germany	3,390.6 (-0.7)	Russia	1,002.8 (+6.7)
IMF	2,814.0	Japan	765.2
Italy	2,451.8	Netherlands	612.5
France	2,435.4	India	557.7
China	1,054.1	ECB	502.1

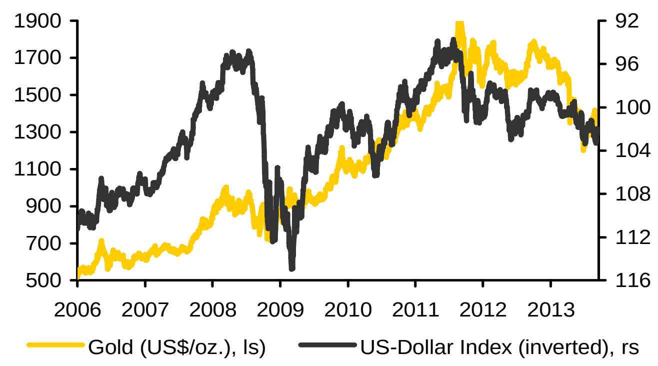
Source: World Gold Council, Commerzbank Corporates & Markets

TABLE 6: **Upcoming Events**

17/18 September	USA	FOMC meeting and press conference
22 September	GER	General elections
1 October	USA	Vehicle sales, September
2 October	EUR	ECB meeting and press conference
9 October	USA	Minutes of 17/18 September FOMC meeting
16 October	EUR	EU new car registrations, September
29/30 October	USA	FOMC meeting

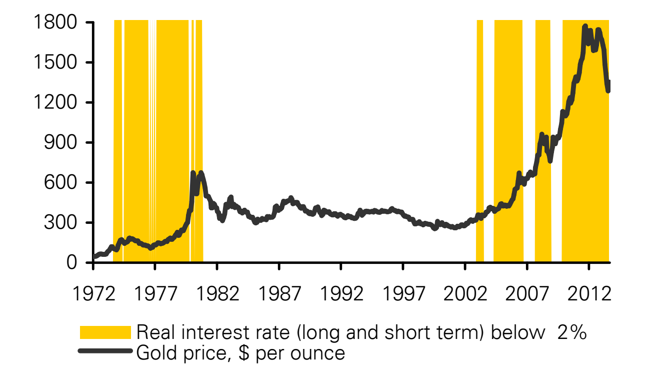
Source: Commerzbank Corporates & Markets

CHART 6: **Gold versus US dollar**



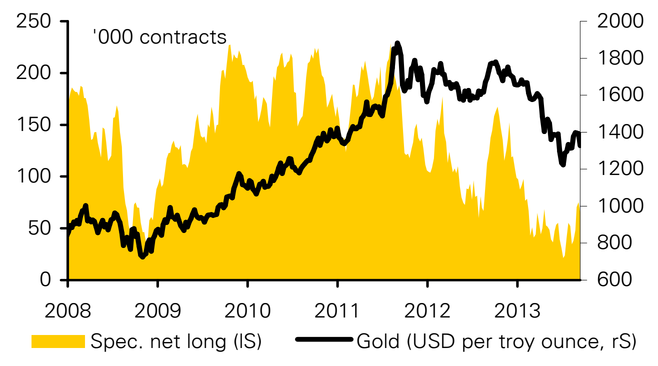
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 7: **Gold price and real interest rates**



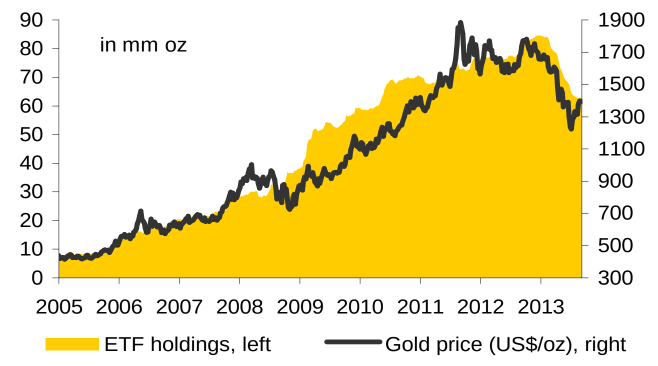
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 8: **Net long positions of money managers (Gold)**



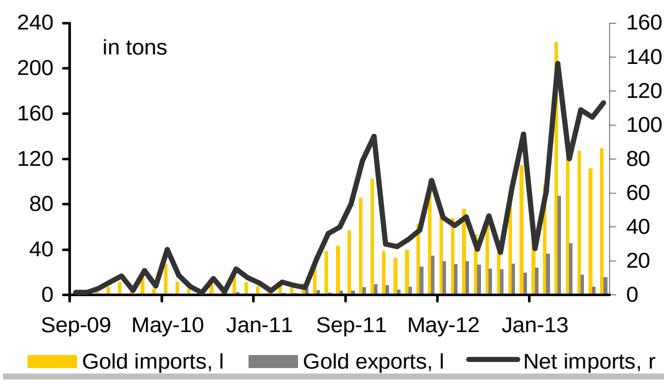
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 9: **Gold: ETF holdings**



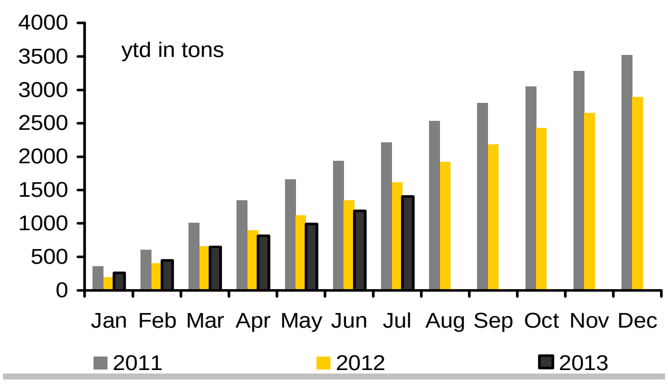
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 10: **Chinese gold trade via Hong Kong**



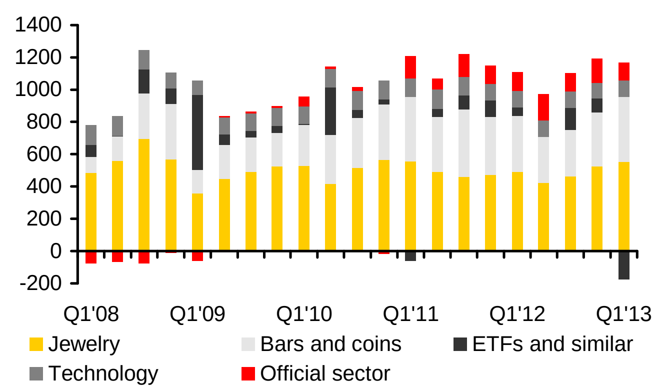
Source: Statistics Department of HK, Reuters, Commerzb. Corp. & Markets

CHART 11: **Chinese silver imports**



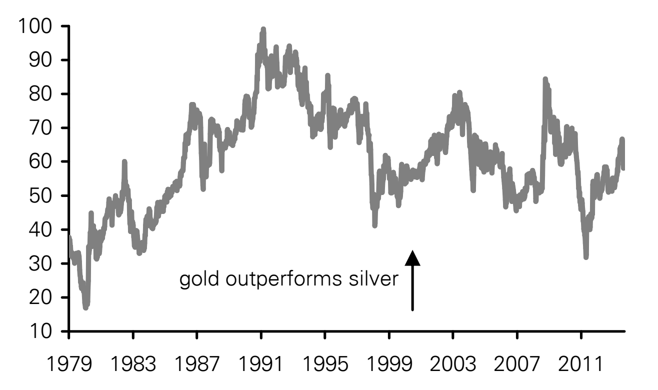
Source: Chinese Customs Authority, Commerzbank Corporates & Markets

CHART 12: **Gold demand per quarter in tons**



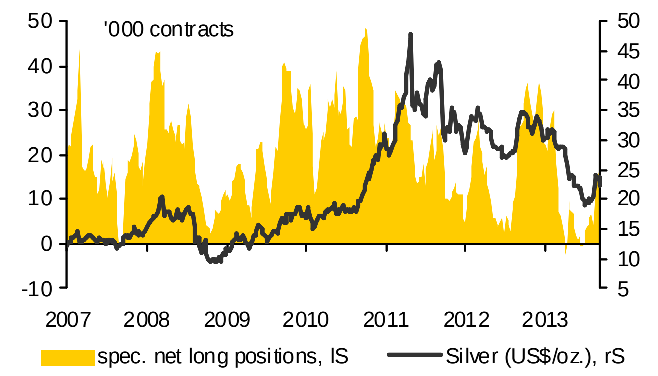
Source: WGC, Commerzbank Corporates & Markets

CHART 13: **Gold/Silver ratio**



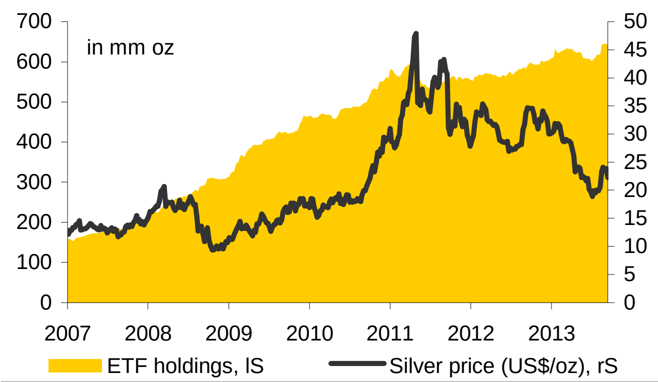
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 14: **Net long positions of money managers (Silver)**



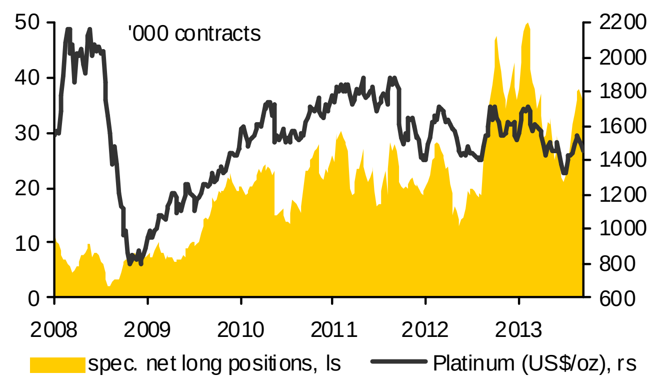
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 15: **Silver: ETF holdings**



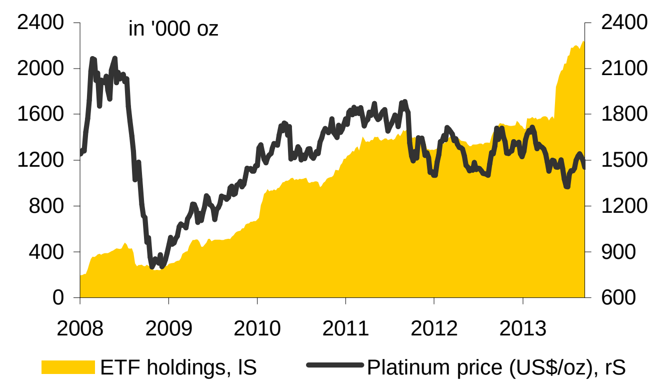
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 16: **Net long posit. of non-commercials (Platinum)**



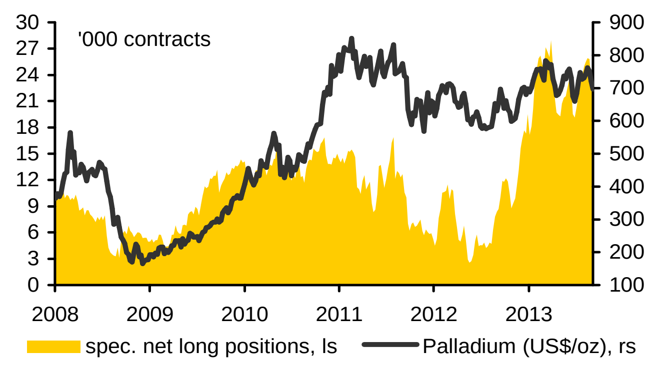
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 17: **Platinum: ETF holdings**



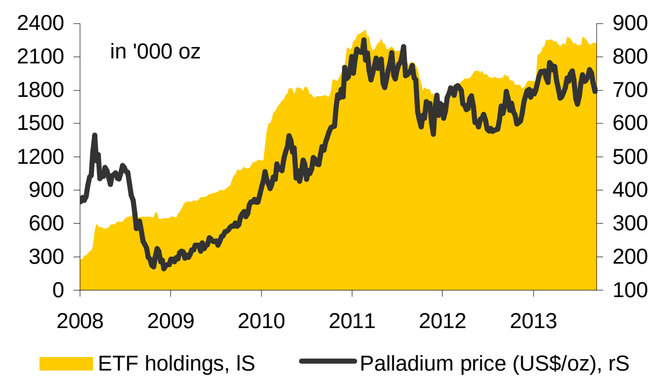
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 18: **Net long posit. of non-commercials (Palladium)**



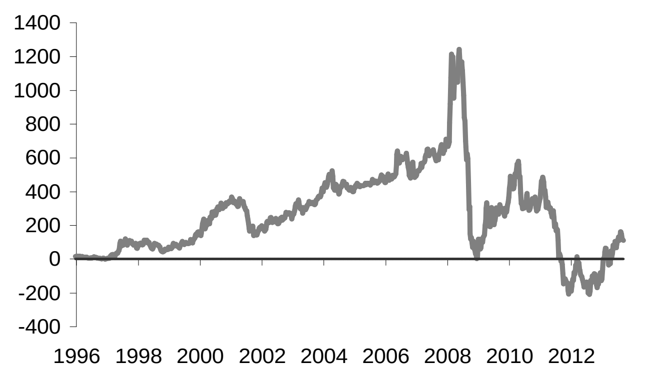
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 19: **Palladium: ETF holdings**



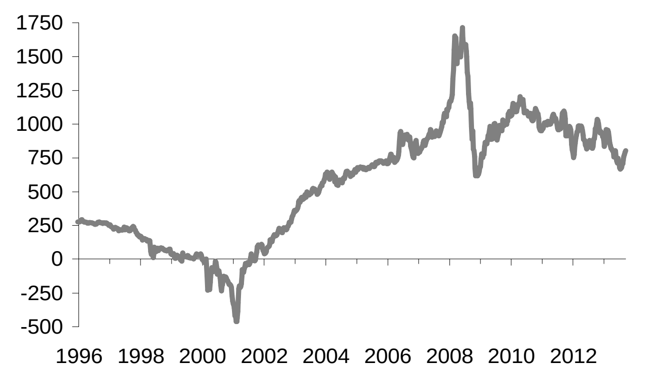
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 20: **Price difference platinum vs gold (US$/oz)**



Source: Bloomberg, Commerzbank Corporates & Markets

CHART 21: **Price difference platinum vs palladium (US$/oz)**



Source: Bloomberg, Commerzbank Corporates & Markets

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