Precious Metals Monthly
China in focus

Group Economics
Macro Research
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3 March 2014

Gold investment demand outlook to remain negative and to overshadow an increase in jewellery demand

For 2014 we expect lower total investment demand for precious metals, mainly driven by more attractive alternatives in financial markets that pay income and that are less sensitive to higher US interest rates and a higher US dollar. Moreover, we expect safe haven demand to wane, because of an overall improvement in investor climate and continued low inflation. We judge that total ETF positions will be cut further again this year. Positions in the futures market were sharply reduced and overall positions are now relatively small. However, speculative investors could turn net short if the gold sell-off restarts again. We judge that the largest risk comes from possible liquidation of bar & coins demand. We expect demand for bar & coins to move lower.

Chinese gold demand unlikely to be as strong as last year

In this monthly, our special focus is on Chinese gold demand. 2013 was a strong year for Chinese gold demand. In our base scenario, we don't expect a repetition of last year though. An overall improvement in investor sentiment, confidence in the Chinese policymakers' ability to manage the transition of their economy and less uncertainty about the yuan will hurt gold investment demand. Demand for jewellery will likely increase in line with the ongoing strong growth of the ranks and wealth of the middle class. We expect Chinese car sales to rise slightly.

What if…

Given that financial reforms and high leverage have raised concerns about a hard landing in China, we have looked in to the impact on precious metals, even though we see this is as a low probability scenario. We think such a scenario would have a mixed impact on gold prices as different drivers balance each other out, while such event will be negative for palladium (lower autocatalyst demand) and platinum (lower jewellery demand).

Precious Metals Forecasts (end of period)

In ounces

	03-Mar	Mar-14	Jun-14	Sep-14	Dec-14	Dec-15
Gold	1,344	1,150	1,100	1,050	1,000	800
Silver	21.5	17.5	16.0	18.0	18.0	22.0
Platinum	1,451	1,300	1,250	1,350	1,450	1,650
Palladium	746	640	600	650	700	750

Source: ABN AMRO Group Economics

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China impact in our base scenario

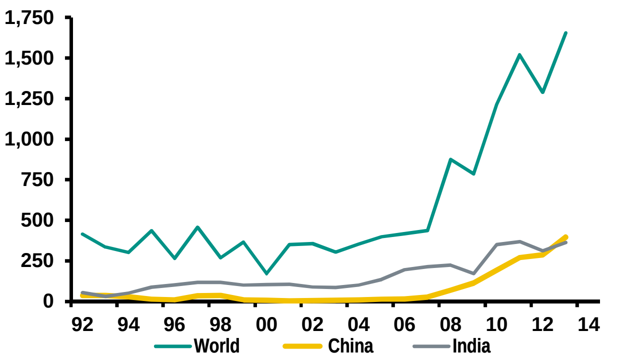
- **Strong Chinese gold demand in 2013**
- **Lower expected investment demand 2014**
- **…but a modest increase in Chinese jewellery consumption 2014**
- **Car consumption to grow slightly in 2014**

What happened last year?

Last year, more than 28% was shaved off the gold price. This was the first negative year since 2000. Last year was not only memorable for the sharp decline in the gold price, but also for an exceptionally strong year for Chinese gold demand. China surpassed Indian jewelry sales and Indian bar & coins investment demand. So India was pushed off its throne of being the world's largest market for jewellery demand. This strong Chinese gold demand failed to prevent gold's slide last year. The question remains how large the fall in the gold price would have been if Chinese demand was not as strong. The answer is a significantly larger decline than the 28%; a drop of 50% would not have been unthinkable.

Investment demand bar & coins

In tonnes, annual

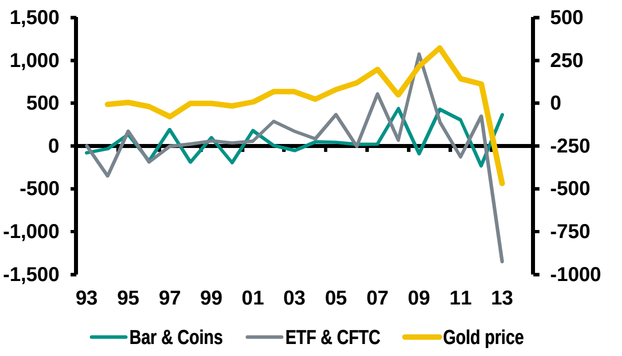


Source: Thomson Reuters Datastream

So what forces were stronger than the Chinese gold demand last year? In two words: investor liquidation. The graph above shows the annual absolute changes in the different demand categories versus the change in the gold price. The large liquidation of total gold ETF positions and futures market positions (CFTC) resulted in a sharp fall in the gold price. Bar & coins demand is also a form of investment demand. The surge in this demand was mainly concentrated in the first half of 2013 where more than 60% of the total demand took place.

Change in investment demand, change in gold price

In tonnes, annual absolute change



Source: Thomson Reuters Datastream, Bloomberg

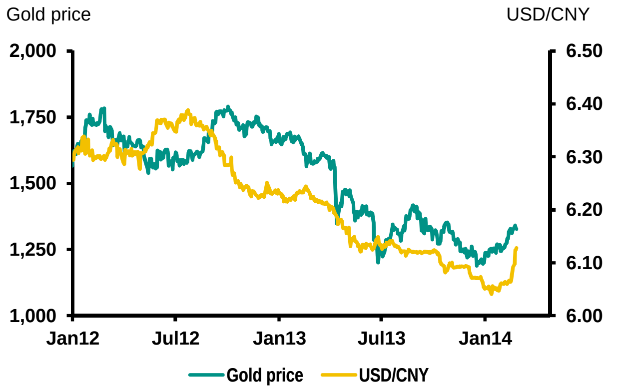
Expectations for investment demand in 2014?

For 2014 we expect lower total investment demand, mainly driven by more attractive investment alternatives in financial markets that pay income and that are less sensitive to higher US interest rates and a higher US dollar. Moreover, we expect safe haven demand to wane, because of an overall improvement in investor sentiment. We judge that total ETF positions will be cut further again this year. Positions in the futures market were sharply reduced and overall positions are now relatively small. However, speculative investors could turn net short if the gold sell-off restarts again. Even though position liquidation in these categories will have a significant negative impact on gold prices, the largest risk comes from possible liquidation of bar & coins' demand. What were the drivers behind this strong demand in the recent years? This demand category has surged substantially in an environment of high systemic risks (credit & liquidity crisis), the eurozone debt crisis and emerging market sell-off. Moreover, in emerging markets, inflation fears were on investors' minds. So investors preferred gold coins & bars to shield themselves against these risks. Going forward we expect overall sentiment to improve and we do not foresee another emerging market crisis. The slide in most emerging market currencies has come to a halt, reducing significantly the risk of imported inflation.

Where is China in all of this?

For 2014 we expect Chinese gold jewellery demand to increase, but investment (portfolio, speculative) demand to ease. Chinese investment gold demand will be driven by expectations about the domestic economy. If Chinese consumers fear a sharp weakness in real estate prices, a weaker economy and a lower Chinese yuan they will be motivated to buy more gold. In CNY terms gold was cheap last year and this was probably one of the reasons why they bought gold. But since the start of this year, the gold price in CNY has increased, which is a reflection of Chinese demand and more uncertainty surrounding the Chinese economy and its currency. We expect the Chinese authorities to restore trust in their process of managing the transformation of its economy without a hard landing. Therefore, there will likely be lower Chinese investment demand.

Gold, USD/CNY



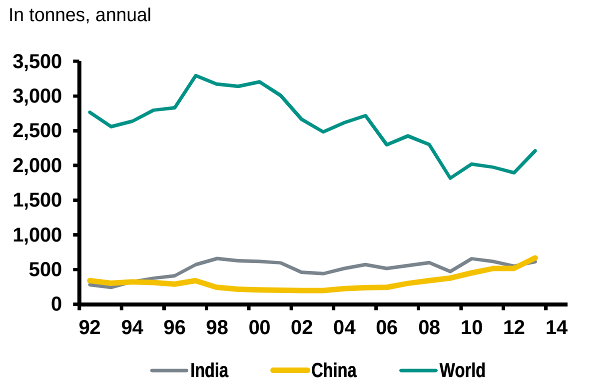
Source: Thomson Reuters Datastream, Bloomberg

The relationship between gold and the Chinese yuan is not that straightforward. One the one hand, there is domestic gold (portfolio, speculative) investment and jewellery demand supporting the gold prices. This has been reflected by a premium on gold in Shanghai. On the other hand, there has been demand for the Chinese yuan, driven by appreciation expectations and "safe-haven" attributes (its resilience in the wake of EM uncertainty). Investors believed that a higher Chinese yuan was a sure bet. When gold prices topped out in 2012, investors started to realize that the Chinese yuan may have more upward potential than gold had, and moved more into CNY than into gold. From the moment that the market has become concerned about Chinese trust funds, real estate and Chinese authorities have induced a weaker Chinese yuan by fixing it lower versus the US dollar to create more a two-way market, gold prices have received support. So the idea that the Chinese yuan may also weaken, has created uncertainty in its appreciation path and its "safe-haven" attributes. Going forward, we expect Chinese authorities to calm concerns about the economy, real estate, shadow banking and the CNY. Therefore, we expect the Chinese yuan to strengthen. However, investors may be more cautious to take CNY appreciation positions. Furthermore, we expect the global economy to recover and investor sentiment to improve, reducing safe-haven support for gold.

Expectations for jewellery consumption in 2014?

After years of decline followed by stabilization and a recovery in 2013, we expect jewellery demand to increase modestly in line with the increase of income in China. This will manifest itself in an increase of gold and platinum jewellery demand. China is the largest market for platinum jewellery as platinum will compete with white gold. Jewellery demand from India will likely be depressed again this year, because we expect that import measures will likely remain in place. Therefore, we judge that a strong increase of global jewellery demand is not realistic.

Jewellery sales



Source: Thomson Reuters Datastream

Expectations for car consumption 2014

The outlook for global car sales has improved. Car sales in the US and China have been strong, while the market in the eurozone is improving. We expect this trend to continue for this year. Car sales in China are already at a relatively high level. A combination of a wealthier middle class, slower pace of economic growth and more stringent emission standards will likely result in only a slight increase in car sales this year. The Chinese market is an important market for gasoline cars, which mainly have palladium converters. An improvement in the eurozone market for diesel cars is mainly positive for platinum. While developments in the US markets are more positive for palladium. All in all, demand for platinum and palladium auto catalysts is likely to grow modestly this year. However, in the first half of 2014, this will be more than offset by investor liquidation sending prices lower.

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China impact in a downside risk scenario

- **A Chinese hard landing will have a mixed impact on gold investment**
- **…while it will negatively impact jewellery consumption**
- **…and lower Chinese car consumption will hurt palladium**

What is a Chinese economic hard landing?

A Chinese hard landing is not our base scenario. If it were to happen we can think of two risk scenarios. For starters, a sharp fall in real estate investment could trigger a slowdown in Chinese economic growth to 5% in 2014. China's financial sector would be highly exposed given the excessive growth of credit in recent years. An even more severe hard landing could be triggered by a combination of negative events – for example drop in real estate prices, bankruptcies in trusts, sharp sell-off in the CNY, capital leaving the China, global economy faltering - all playing out at the same time or the perfect storm. As a result, China will face bankruptcies and financial stress, with contagion moving to global markets.

What is the hard landing impact on investment?

We judge that the impact of a hard landing will be mixed for Chinese gold investment demand. On the one hand, such hard landing will trigger consumer demand for safe haven assets and gold in the form of bars& coins is the perfect candidate for this. On the other hand, gold demand via ETFs and the futures market will likely be lower. Moreover, a hard landing could have a profound negative impact on sentiment in global financial markets. They could become risk averse, which generally supports gold.

What is the hard landing impact on jewellery consumption?

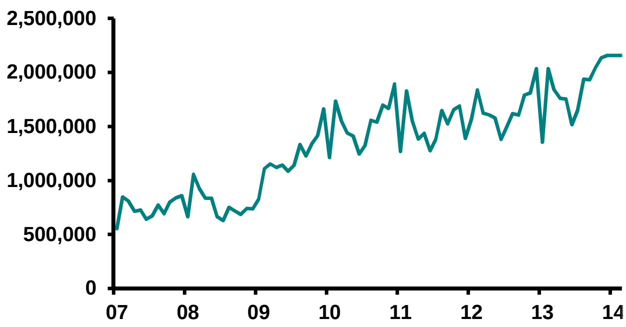
In case of a hard landing, economic growth will slow more rapidly than foreseen. As a result, the wealth creation of the middle class will also be at a lower pace. Therefore, there will be less demand for gold and platinum jewellery, which will be a negative driver for the gold and the platinum price.

What is the hard landing impact on car sales?

The growth in demand for car sales will likely plummet in line with lower Chinese GDP growth momentum. This will have more serious implications for palladium than for platinum as palladium is more exposed to the Chinese car market.

China car sales

Volume, not-seasonally adjusted



Source: Thomson Reuters Datastream, Bloomberg

If we take all these forces together a hard landing in China will have a mixed impact on gold prices as different drivers balance each other out, while such event will be negative for industrial precious metals palladium (lower autocatalyst demand) and platinum (lower jewellery demand).

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