THE PERTH MINT AUSTRALIA | TREASURY

Gold Corporation
(trading as The Perth Mint)
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A statutory authority under the *Gold Corporation Act (1987)* of Western Australia

Founded in 1899, the Perth Mint is an integrated precious metal operation refining circa 10% of world gold production; servicing investors with legal tender bullion coins and bars and the Perth Mint Depository custodial facility; providing collectors with innovative and high quality numismatic coins; supplying mints with precious metal blanks; and operating a leading Perth tourist attraction.

REASONS FOR GOLD'S WEAKNESS

SUMMARY

- Reasons include MF Global, flows into US dollar and tax-loss selling
- Indian demand also a factor, weakening during 2011 due to high Rupee gold price
- Indian demand forecasted to remain weak
- Perth Mint sees tentative signs of bar demand returning in the region

TESTING INVESTOR TENACITY

In the past four months gold has dropped from just above $1900 to settle around $1600. While this 15% correction has not broken gold's bull market trend (as discussed in this earlier post), a $300 drop is severe enough to test the most committed of investors, especially in the face of mainstream financial media chatter that gold's bull run is over.

In response, Jeff Clark from Casey Research says that investors should not *"confuse short-term volatility with long-term forces"* and stay the course. In his article Why Has Gold Been Down? Jeff notes the following short-term reasons behind gold's drop:

> *1. The MF Global bankruptcy, the seventh-largest in US history, forced a high degree of liquidation of commodities futures contracts, including gold. …*
>
> *2. The dollar has been rising. Money fleeing the Eurozone has to go somewhere, and some of it is heading into US bonds, which means first converting the foreign currency into dollars.*
>
> *3. It's tax-loss selling season, something that's also impacting gold stocks.*

I agree with Jeff's reasons and believe MF Global will have a continuing impact, certainly until the freezing of customer segregated funds issue has been resolved (see this article by James Koutoulas, who is representing more than 7,000 MF Global customers). The CME's handling of the bankruptcy is not likely to engender confidence in retail investors trading futures, particularly as they halted trading for MF Global customers for over an hour and then only allowed liquidation only orders.

This is not necessarily negative in the long run, as these investors may instead opt for direct physical investment, but in the meantime any contraction in leveraged paper positions puts pressure on the gold price.

INDIAN DEMAND

In addition to Jeff's reasons, I would add in the decline in Indian consumer demand. Mineweb reports that gold imports *"crashed to 35 tonnes in December, from the 75 tonnes registered in December 2010"* in addition to a decline in November from 80 tonnes to 20 tonnes, year-on-year. Prithviraj Kothari, president of the Bombay Bullion Association, was reported by Mineweb as saying that *"demand would continue to remain dull for the next couple of months, 'unless prices come down appreciably'."*

Indian demand is a significant factor in the gold market. The World Gold Council reports Indian consumer demand for the year ended September 2011 as 1059 tonnes compared to world consumer demand of 3427 tonnes, or 31%. Greater China is not far behind at 809 tonnes, or 24%. Chart 1 below shows the trends in these two key markets.

Chart 1: Consumer Demand in Tonnes

The decline in Indian demand has been consistent over the past few quarters.

Source: World Gold Council, Gold Demand Trends report Q2 2009 through to Q3 2011

While Indian consumer demand has been declining during 2011, the recent significant Rupee gold price increase has exacerbated the trend (see Chart 2 on the following page). This situation has occurred before – see the World Gold Council's Q1 2009 Gold Demand Trends report where they noted that:

> *In Rupee terms, gold peaked at an all-time high of Rs.15,780 per 10 gms in the Mumbai market on 24th February as a weaker Indian Rupee exacerbated the rise in the international price of gold. This had the dual impact of discouraging new demand for jewellery (since the high prices made it considerably less affordable) and also encouraging the selling-back of older pieces.*

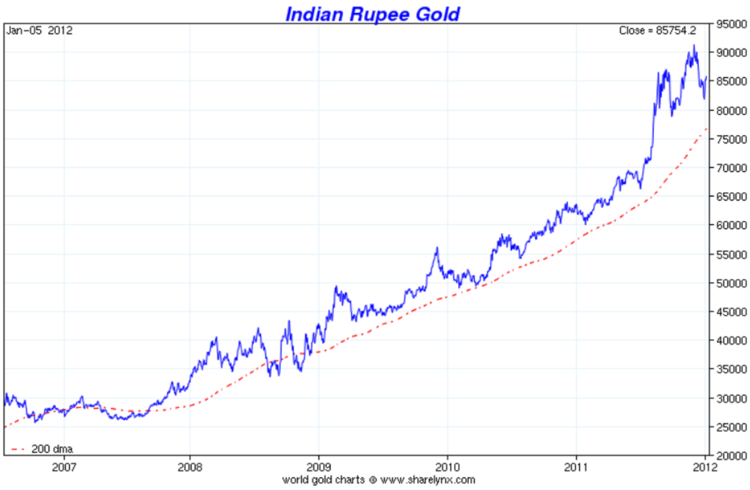
Chart 1 shows a significant drop in Indian demand in Q1 2009 but it did return and continued through 2010 even though subsequent Rupee gold prices were higher than the February 2009 peak. While demand in tonnes has been lower during 2011, in value terms it is up, indicating that Indians are spending the same amount of Rupees on gold, but as a result of higher Rupee gold prices that money is buying less ounces.

Physical Indian ounce demand will return eventually but in the short run the situation continues to be negative, with Reuters reporting Prithviraj Kothari as saying *"Still prices are high. Interest rates are high. Liquidity is tight. I think imports in the first quarter of 2012 will be 50 percent lower than last year."*

Chart 2: Gold Price in Indian Rupee

Since August 2011 the Rupee Gold Price has increased 20% due primarily to a decline in the Rupee /US Dollar exchange rate.

Source: www.sharelynx.com



The Perth Mint can confirm that towards the end of 2011 we experienced a complete halt in bar demand from India and Asia (the traditional destination for most of our refining output) to the point where we were shipping 400oz bars to London. There would be no doubt that bullion bank trading desks would have seen this weakening Indian demand.

By way of explanation, Bullion banks supply physical to, and fund, Indian gold wholesalers, who usually seek 180 day payment terms necessary to distribute gold throughout India. As a result, bullion banks would be the first to “see” the drop in Indian demand ahead of other players and officially reported figures. In positioning themselves to ride this trend they would have thus magnified the impact on the gold price.

On a positive note, the Perth Mint has started to see some bar demand from this region, but it is small and hesitant. Our experience of Indian demand during this 10+ year bull market is one of cooling interest at new highs (US or Rupee price) but once a view has formed that the price has reached a new level, demand returns strongly.

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