THE PERTH MINT AUSTRALIA | TREASURY

Gold Corporation
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A statutory authority under the *Gold Corporation Act (1987)* of Western Australia

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PREDICTIONS

HSBC: "cut our 2012 average gold price forecast by 5%, to USD 1,760/oz … anticipate higher gold prices in the 2H … average gold price for 2013 is 1% lower at USD 1,775 /oz, our 2014 forecast is unchanged at USD 1,750/oz"

Citibank: "We've already iterated a target in the more medium to long-term of $3,400, and over the next twelve months as high as $2,400."

STUDENT OF THE PHYSICAL MARKET

Eric Sprott and David Baker have a new article out discussing central bank buying of gold and particularly China. I agree with his conclusion that this is an important demand side shift in the market but I think Sprott overplays the point with statements like:

"... there isn't a physical market on earth that can withstand that type of demand increase without higher prices over the long-run, and the gold market is no different. There are no sellers of physical gold that we know of who can satiate that scale of new demand ..."

"Who is going to give up their gold purchases to make room for this scale of new demand? Where is the gold going to come from? We ask because we don't actually know."

"We have written at length about the disconnect between the paper gold price and the physical gold market. If the demand changes stated above applied to any other market, the investing public would lose their minds."

"The paper market for gold can continue its charade, but demand in the physical market will soon overpower it through sheer momentum - there's only so much physical to go around, and it appears that there are some very large buyers that are eager to take it."

If Sprott and Baker *"are students first and foremost of the physical market"* then they would be aware that the one thing which makes gold different from all the other physical markets on earth are the large above ground stocks relative to new mine supply - 170,000 tonnes versus 2800 tonnes.

This, I suggest, is a quite material fact and one which may be where "the gold is going to come from". Unlike "any other market", to which conventional supply/demand analysis can be applied, one cannot understand the gold market by just looking at annual supply/demand numbers when there is such a large overhang of stock.

What drives the gold price, I would therefore argue, is not so much demand, but to what extent existing holders of the 170,000t will withhold it from the market. It is actually supply – or more specifically, the withholding of supply - that matters most. If even a small fraction of these holders decide to sell, then that supply "will soon overpower" the physical market, China or no China. Don't take this as a negative statement. The decade long gold bull market is a message that existing holders are requiring higher and higher gold prices to let go of their gold and that the new holders are more likely to withhold it.

The reason you don't often see this approach to analysing the gold market is because there are only sketchy numbers on the flow of gold from existing holders to new holders - ETF volumes, futures warehouses and scrap - and therefore it is difficult, if not impossible, to get any handle on total real supply. The result is most analysts just avoid it. It doesn't mean you should.

This unique feature of the gold market, which we can describe as "a stock overhang so large relative to new supply which would normally push the price of any other commodity to zero, but for some reason for gold it doesn't", is often referred to as monetary demand or by references to gold as a monetary metal.

This monetary motivation is not just about central banks holding gold (the only non-fiat currency thing they do hold as reserves) but also describes the motivations of most gold investors. Therefore understanding and tracking this motivation is crucial to managing your gold investment.

Gold is monetary in nature, with only a small commodity component. So when you see analysis taking a commodity-style focus on supply/demand, exercise some caution with the resulting conclusion.

GOLD STILL AMERICANS' TOP PICK

Talking of motivations, this Gallup poll reports that gold *"leads four other types of investments in Americans' perceptions of which is "the best long-term investment," although the 28% choosing it today is down slightly from 34% in August."*

Apparently, *"gold does particularly well among men, adults 35 years and older, those without a college degree, middle-income Americans, and Republicans."*

However, while this poll shows gold is on the radar of investors, it is not translating into action, as the value of US gold ETFs and physical coins and bars is nowhere near 28% of Americans' total investments. With analysts reporting around 1% of investor money in gold, should talk turn into action then the impact on gold prices will be significant. However, given the poll was only *"based on a random half-sample of 516 national adults"* I'm not about to bet the farm on it.

RORO

Douglas Noland has an interesting piece on RORO, or risk-on/risk-off. He concludes that *"the marketplace faces a single decision: Make a big red or black bet or, if you have a functioning brain, do what "still works" – "momentum investing." And this does a respectable job of explaining why markets have evolved into pathological trend-following speculative Bubbles – everywhere - and why hedge funds, ETFs and other market wagering vehicles proliferate."*

His concern is that this creates greater systemic fragilities. Gold is caught up in this RORO mentality. The question for investors is which asset will hold up when the system breaks?

STATE OF THE PHYSICAL MARKET

A few articles supporting the weak physical market that the Perth Mint is experiencing at this time. First we have Bullion Vault reporting that Swiss refiner MKS saying that the physical market is *"not as one might have hoped for"* with a Hong Kong dealer saying *"There's no support from the physical market"*.

Mining.com reports that Indian demand is not being helped by the Rupee price of gold *"reaching an all-time high of Rs29,590 ($600) per ten grams in Delhi on Monday"* and notes that a Reuters poll held at the end of March forecasted *"consumption on the sub-continent could fall 30% to 655 tonnes this year from a record 969 tonnes in 2011."*

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