# DEVELOPMENTS IN GOLD MARKETS

## Key statistics

**14.6% increase** in expenditure **on gold exploration** year-on-year in Q4 2017

**$16,139.6m in revenue** over 2016-17 in the gold ore mining industry

**67.7% of gold ore** mining industry revenue is **generated in WA**

**3% increase** in **global jewellery** demand year-on-year in Q4 2017

**6% increase** in **technology** demand year-on-year in Q4 2017

## Trends in financing gold projects

Net de-hedging

IPO pipeline flowing strongly

## Factors that have shaped the Australian gold market so far in FY17/18

WA royalty given the axe

Uncertainty in global markets

Accommodative monetary policy

China and United States trade war

## Gold M&A activity so far in FY17/18

**36 transactions** announced

**$11.92m** in **average deal value**

**59 transactions closed**, are **effective** or **expired**

**$882.39m** in **total deal value**

**95 merger** and **acquisitions transactions** in **total**

## Gold market trends

**Global jewellery** demand **increasing**

Australian **exploration increasing**

**Technology** demand **increasing**

**Global production decreasing** but **Australia performing strongly**

**Investment** demand **drying up**

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# Developments in gold markets

## Gold market trends

### Australian exploration increasing

The Department of Mines, Industry Regulation and Safety in WA has published data revealing that there was a 43% increase in Programme of Work applications received by the Department in the 2017 calendar year.

The Department received 2575 Programme of Work applications in 2017, compared to 1799 in the previous calendar year. Mining legislation in WA requires a Programme of Work to be approved before an explorer can conduct any ground disturbing activities with mechanised equipment.

Strategic Projects Senior Adviser, Graham Cobby, attributed the increase in exploration applications to increasing interest in two commodities, one being gold. Exploration applications in the December 2017 quarter remained steady and Mr Cobby considers it likely that the high interest in gold in 2017 will continue in 2018.

Notably, Newmont Mining announced late in 2017 that it will spend $350m-400m on gold exploration in 2018 which is nearly double its $200m budget in 2017. Some of that exploration expenditure can be expected to flow into Newmont Mining's Australian operations.

Nationally, gold exploration expenditure was up 14.6% year-on-year in Q4 2017 which indicates that gold exploration expenditure is also increasing outside WA.

### Global production decreasing but Australia performing strongly

Total world gold supply in 2017 was down 4% on the previous year, from 4591 tonnes to 4398 tonnes. While world gold production reached a record high in 2017 of 3268.7 tonnes, it was only marginally higher than the 2016 record of 3263.0 tonnes and the global production results for Q4 2017 indicate that production is decreasing.

Tighter environmental regulations in China saw national production for the world's largest gold producer decrease by 10% year-on-year in Q4 2017. Mine production was also down in Tanzania by 15% in Q4 which was attributable to the continuing Tanzanian Government ban on concentrate exports from Acacia Mining's Buzwagi project.

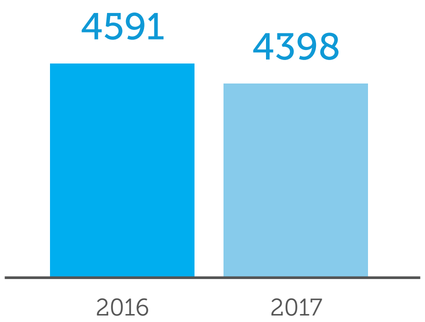
**43% increase**

in Programme of Work applications received by the Department in the 2017 calendar year

The supply of recycled gold levels also returned to normal when they fell 10% year-on-year in 2017 following the abnormally high levels seen in 2016.

In Australia, gold mine production increased by 2.6% year-on-year in Q3 2017. Higher production was attributable to increased output at various mines, including at AngloGold Ashanti's operations at Sunrise Dam and the Tropicana joint venture where production increased during the quarter by 24% and 15% respectively.

Recent market developments indicate that Australian mine production is showing no signs of slowing down. Numerous gold miners have announced higher gold production towards the end of 2017 and in early 2018, including Blackham Resources at the Matilda-Wiluna operation, Red 5 at its Darlot gold mine, Ramelius Resources across its Edna May, Mt Magnet and Vivien gold mines, RNC Minerals at its Beta Hunt gold mine, Pantoro at its Nicolsons operation and Doray Minerals at its Deflector mine. Other producers such as OceanaGold reported record output in Q4 2017 and Newcrest Mining reported a large increase in production in Q4 2017 off the back of a 50% increase in production at its Cadia Valley gold mine.




Total world gold supply in 2017 was down 4% on the previous year

**Australian gold mine production increased by 2.6% year-on-year in Q3 2017**

# Developments in gold markets

## Global jewellery demand increasing

For the first time since 2013, there was an annual increase in jewellery demand in 2017.

Demand from India, China and the United States drove the annual increase. Incomes in India and China have been rising which is expected to fuel higher discretionary spending on gold in 2018 and 2019.

Developments in the Indian gold market were most notable and contributed to the 12% increase in the demand for gold in India in 2017. The introduction of stricter regulations in India in July 2017 surrounding jewellery sales encouraged consumers to bring forward their gold purchases. This led to gold jewellery consumption decreasing by 3.4% year-on-year in Q3 2017. However, Indian jewellery demand bounced back in Q4 and reached the highest Q4 on record when demand hit 190 tonnes. Demand in Q4 was driven by the wedding and festival season as well as a drop in the rupee gold price. A further boost in demand was driven by the Indian Government granting the gold market an exemption from burdensome anti-money laundering initiatives which removed the burden of consumers and retailers having to prove the legitimacy of their cash transactions.

## Technology demand increasing

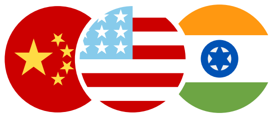
Demand in the technology sector for gold increased 6% year-on-year in Q4 2017. Driving this demand was the volume of gold being used in smartphones, laptops and vehicles. In the electronics sector, gold bonding wire is used in memory chips for smartphones and also in sensors for smartphones, laptops and vehicle safety features.

Demand from the wireless electronics sector was the strongest performer. Demand was fuelled by wireless chip manufacturers and an increased usage of sensors in smartphones which power new smartphone features such as 3D video, virtual reality, augmented reality, iris recognition and gesture recognition.

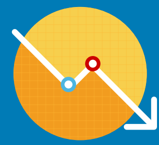
## Investment demand drying up

There were strong inflows into gold backed exchange traded funds (ETFs) in 2016. Those inflows dried up in 2017, down a substantial 63% which led total investment inflows in 2017 to shrink 23%. The outflows from gold backed ETFs largely occurred in the second half of 2017. Those outflows are explainable to a degree given that gold prices were up over 10% in mid-2017 from the opening prices of 2017 and investors were likely capturing gains as opposed to further buying.

We expect this trend to continue in 2018 as investors seek to capture gains as gold prices continue to make ground over the opening prices of 2018.



**India, China & the United States** have **driven** an **annual increase** in **jewellery demand** for the **first time since 2013**



## Case study

### Gold and the market selloff on 5 February 2018

Stock markets fell sharply on 5 February 2018. The ASX200 fell over 3% following a selloff on US markets which saw the Dow Jones Industrial Average fall by 4.6%. So what can be learnt from the performance of gold?

As would be expected of an asset used to diversify risk and as a hedge against economic downturns, the gold price made gains as stocks dived during the later trading hours on 5 February. However, short lived like the market selloff, so too was the upwards momentum in the gold price. Gold prices initially rose as stock markets shed value but lost momentum and started trending downwards as stock markets recovered losses over the course of the week.

The performance of gold during the market selloff on 5 February reinforces the role of gold as a diversifier and hedge against economic downturns. However, gold's performance also indicates that the gold price does not rally strongly during short lived selloffs. Consistent with gold's performance following the 2008 global financial crisis, the effectiveness of gold as a diversifier and hedge improves during economic downturns which are broader and last longer.

As observed by the World Gold Council, the 5 February market selloff and the gains gold made as stocks dived serve as timely reminders of gold's role as a strategic asset that can deliver returns and reduce portfolio risk.

# Developments in gold markets

## Trends in financing gold projects

### Net de-hedging

Three consecutive years of moderate net hedging came to an end in 2017 as total net de-hedging increased. The total net de-hedge position in 2017 was largely contributed to in Q4 as gold miners closed out 15 tonnes of hedge positions.

Whether to hedge gold given the prevailing market conditions is a decision which is largely dependent on a company's risk appetite. However, the uncertainty in global markets brought about by political risk is creating a favourable environment for those with exposure to gold. The total net de-hedge position in 2017 indicates that those with exposure to gold have a stronger appetite for risk and are more confident in the direction of the gold price.

> "Average **deal value** has **dropped** for **FY17**, **indicating a greater interest in small cap gold M&A activity** and the **lower end** of the **mid-market**"

New gold hedges in the Australian gold market were still prevalent in late 2017. New hedge positions included:

- St Barbara hedging 90,000 ounces of the production from its Simberi operation;
- Resolute Mining hedging 96,000 ounces of the production from its Syama gold mine, with a further hedge of 72,000 ounces following a few months later;
- Gascoyne Resources hedging 164,000 ounces of the production from its Dalgaranga gold project; and
- Westgold hedging a further 15,000 ounces to bring its total hedge position to 93,750 ounces.

More recently in February and April 2018, Gold Road hedged another 16,000 ounces, bringing its total hedge position to 41,000 ounces while St Barbara hedged another 25,000 ounces.

Fresh gold hedges in the Australian market appear to be largely strategic in nature and were set up to provide certainty in projected cash flows or to lock in higher Australian gold prices seen in late 2017 and early 2018.

### IPO pipeline flowing strongly

Initial public offerings (IPO) in the resources sector accounted for the most listings by sector in 2017. One industry commentator, PCF Capital Group managing director Liam Twigger, said at a WA Mining Club panel in mid-February 2018 that a 'wall of money' is coming into the market. Another commentator, Hartleys chairman Ian Parker, described the inflows into resources since early 2016 as a 'tsunami'.

With more than half of the 110 IPOs in 2017 involving a gold project, it is evident that equity financing was a strong source of financing for gold projects in 2017.

The pipeline for IPOs in 2018 is showing no signs of slowing down. At the time of writing, there have already been 11 resources floats since January 2018 and 9 of those floats involved companies that have gold projects. Of the upcoming 41 floats disclosed on the ASX's website, another 7 of those upcoming floats involve a gold project. With 16 resources floats involving gold projects in total in 2018 that are either upcoming or completed, equity financing continues as a strong source of financing for gold projects in 2018.

### Gold M&A activity so far in FY17/18

Australia's M&A activity in 2017 saw a record high in terms of deal volume with over 580 deals, having a total value of $113b. Most notably, 2017 was a record breaking year in terms of Australia inbound M&A value with a significant increase of 141.5% over 2016, bringing the value of total inbound M&A to $80.5b.

FY17/18 is shaping up to be a strong year for gold M&A activity. Deals announced for the gold industry so far have reached 36 which is considerably higher than the 20 deals announced in FY16/17. Average deal value has dropped from 15.55m in FY16/17 to 11.92m so far in FY17/18, indicating a greater interest in small cap gold M&A activity and the lower end of the mid-market. An increase in inbound M&A into these markets throughout the rest of 2018 can be expected, with higher commodity prices improving the cash reserves of larger mid cap and large cap companies.

# Developments in gold markets

## Factors that have shaped the Australian gold market so far in FY17/18

### Uncertainty in global markets

Uncertainty in global markets continues to be a key factor driving gold prices.

As a counter-cyclical commodity, gold is considered to be a safe haven investment in times of economic uncertainty. While the global economy improved in 2017 and risk assets rose in value (for example, the ASX200 was up 7.1% and the S&P500 was up 19%), uncertainty in global markets drove and underpinned the performance of the gold price.

Geopolitical instability has been a strong source of uncertainty. Political risk heightens investor uncertainty which can fuel inflows into gold as investors seek to diversify and reduce the risk of their portfolios.

**Geopolitical instability has increased the attractiveness of gold for investors as a hedge against economic uncertainty**

Political instability in the United States is the major contributor. In the lead up to the US presidential election in 2016, political uncertainty saw gold prices hit three-year price highs.

While gold prices fell sharply following President Trump's conciliatory speech in November 2016, political uncertainty in America continues. Over a year on since President Trump was sworn in, his governance style has emerged as unpredictable. This unpredictability fuels inflows into gold and makes gold an attractive asset for investors to hold on to in their portfolios as a hedge against economic uncertainty.

Continued tensions between Western nations and North Korea also contribute to the current state of political uncertainty and the attractiveness of gold as a safe haven investment. We expect these tensions to continue leading up to the proposed meeting between President Trump and North Korean Supreme Leader Kim Jong-un.

Equities had a strong year in 2017 with many assets, including major stock indices, achieving new highs. Despite this, gold continues to perform well. This indicates that investors may be fearful of a correction in equities and are managing their risk exposure by increasing their gold reserves.

### WA royalty given the axe

In late 2017, WA Treasurer Ben Wyatt revealed a revised proposal to increase the gold royalty rate by 50%, effective 1 January 2018.

The revised proposal came a few weeks after Treasurer Wyatt's initial proposal was voted down by the Upper House. Under the initial proposal, the royalty rate was to increase from 2.5% to 3.75% when the gold price was above A$1200/oz. Under the revised proposal, the royalty rate was also to increase by 1.25% but only when the gold price was above A$1400/oz and a 2500 ounce royalty free threshold would also apply.

Industry backlash was widespread. The Association of Mining and Exploration Companies and the Chamber of Minerals and Energy of WA expressed concerns over the significant negative impact a rate hike would have on the gold industry and its associated industries. Of main concern was the potential detrimental effect a rate hike could have on employment.

Despite the expectation that the rate increase would raise $332 million over four years, other political parties publicly opposed it. Only soon after its revival, Treasurer Wyatt's revised proposal was given the axe when a number of political parties teamed up to pass a disallowance motion.

In WA at least, gold miners are assured for the time being that their margins will not be affected by an increase in the gold royalty rate.

# Developments in gold markets

## Accommodative monetary policy

2017 was a year of synchronised global economic growth which saw global GDP grow in excess of market expectations. A contributing factor to that growth was the accommodative monetary policy set by central banks globally as quantitative easing policies were maintained.

This accommodative monetary policy helped underpin the gold price in 2017 and so far in 2018 as gold retains its appeal as a valuable asset to hold in portfolios despite not being an interest bearing asset.

Another year of synchronised global growth is expected by the market in 2018. With this growth, central banks can be expected to rein in their quantitative easing measures and increase interest rates to counter inflationary pressure. Signs of changing monetary policy globally are emerging. In the United States, Federal Reserve Chairman Jerome Powell informed US Congress members in late February that gradual interest rate increases in 2018 will proceed.

In the United Kingdom, the Bank of England lifted its benchmark interest rate for the first time in a decade from 0.25% to 0.5% in November 2017. In the Eurozone, the European Central Bank has indicated that it will shift away from its expansionary monetary policy stance. However, in Australia, the Reserve Bank decided in early April 2018 to maintain the cash rate at 1.5% which is the rate that has prevailed since August 2016 and is the 20th consecutive month the rate has remained unchanged. Downwards pressure on the gold price due to changing monetary policy globally can be expected in 2018 as rising interest rates will attract investors to interest bearing assets.

## China and United States trade war

Looming fears of a trade war breaking out between China and the United States has contributed to the uncertainty in global markets which is driving gold prices.

Whether China and the United States are in the midst of a 'trade war' is open for debate. However, President Trump and the President of the People's Republic of China, Xi Jinping, have certainly been going back and forth in an exchange of tariffs over imports into the United States from China and imports into China from the United States.

Most notably, President Trump issued proclamations imposing tariffs on the imports of steel and aluminium into the United States from all countries except Canada and Mexico.

These tariffs have significant ramifications for China as a strong exporter of steel and aluminium.

The Chinese Government responded by announcing it will impose tariffs on imports from the United States worth around US$3 billion which includes taxes on United States agricultural products. Following this, the United States and China exchanged announcements of potential tariffs in early April 2018 ranging from US$50 billion to US$100 billion which target imports into the United States from China and imports into China from the United States.

With China and the United States continuing to go back and forth in an exchange of tariffs, there is little sign of the trade tensions resolving soon. We expect this to continue to create uncertainty in global markets and drive the gold price in the near future.

### Case study

### Are cryptocurrencies a substitute for gold?

Perhaps no market attracted more attention in 2017 than the cryptocurrency market. Cryptocurrencies were catapulted into the spotlight in 2017 following rapid price growth which was not seen in other markets.

Cryptocurrencies such as Bitcoin went from considerably niche investments to household recognised names. According to the World Gold Council (WGC), some industry commentators even claimed that cryptocurrencies could replace gold. So is there any merit in such a claim?

As observed by the WGC, gold and Bitcoin have similar supply characteristics. Bitcoin has a supply limit while gold is a scarce resource with marginal annual growth in the mining production rate. Both Bitcoin and gold are also independent from government and can act as potential substitutes for government backed currencies.

In a paper released in January 2018, the WGC argues that cryptocurrencies are no substitute for gold. The WGC mounts various arguments to support that position, including that gold:

- is less volatile;
- has more liquid markets;
- trades in an established regulatory framework; and
- has a well understood role in investment portfolios.

These characteristics, among others, led the WGC to conclude that they 'underpin gold's role as a mainstream financial asset that will likely continue to resonate in today's digital world'.

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## Sources include:

Australian Bureau of Statistics; IBISWorld; World Gold Council; S&P Capital IQ; Department of Mines, Industry Regulation and Safety; MiningNews; Department of Industry, Innovation and Science; ASX; Mergermarket; Australian Financial Review; Reserve Bank of Australia and Business News Western Australia.