

November 2013

Gold has held firm above USD1,300 a troy ounce on expectations that the US Federal Reserve would keep the size of its asset purchase programme unchanged at USD85 billion a month for some time.

The possibility of the Fed's delay in tapering its asset purchases could be seen as a positive factor for gold in the near term, but sooner or later such a move will still happen. This upcoming shift in the Fed's support for the economy could therefore weigh on gold later on.

Outflows from gold exchange traded funds (gold ETFs) have been countered, but not fully offset, by the rise in jewellery demand. With slowing economic growth in India and mainland China, it is doubtful the consumer demand could sustain, and that adds uncertainty over the outlook for gold.

Gold stays above USD1,300

- ◆ Gold held firm above USD1,300 a troy ounce in late October on expectations that the US Federal Reserve would continue its asset purchases of USD85 billion a month for an extended period. It hit USD1,361.93 an ounce on October 28, the highest in five weeks.

Exhibit 1. Spot Gold Prices

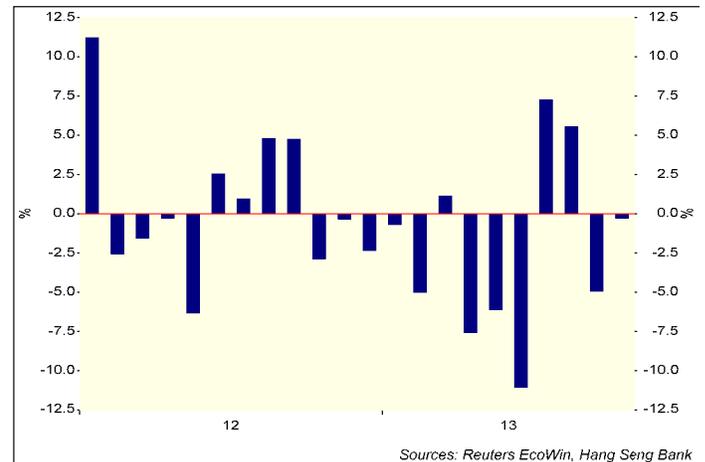


- ◆ In the first weeks of October, the precious metal came under pressure as the US political stalemate over a new fiscal year's budget resulted in a government shutdown and brinkmanship over the debt ceiling raised the prospect of a US default for the first time in history. The price of gold briefly traded at USD1,251.84 an ounce on October 15, the lowest in more than three months.
- ◆ The US fiscal crises failed to support gold, unlike in the summer of 2011 when in similar circumstances the yellow metal breached USD1,900, hitting a record high of USD1,913.50 an ounce on August 23. One possible explanation is that this time an eleventh hour deal to prevent a default had been fully priced in. Also, gold has now been on a downward trend, falling more than 20% in the year-to-date and 4.7% in September. In contrast, the gold price was on the rise from the beginning of 2011 to a peak in August that year.

Exhibit 2. Spot Gold Prices and The US Dollar Index



Exhibit 3. Monthly Change in Spot Gold Prices



Downside risks for gold persist

- ◆ Gold has now rebounded more than 5% from its three-month low, but it does not change much the fact that it is deep into bear market territory, widely defined as a decrease of 20% or more in a 12-month period, and is on course for its first annual decline in 13 years.
- ◆ Looking ahead, the US Federal Reserve is likely to maintain its monetary stimulus programme for some time as recent economic indicators have been mixed, inflation is low, and the US fiscal policy remains a source of downside risk to the economic outlook. The possibility of the Fed's delay in scaling down, or tapering, its asset purchases could be seen as a positive factor for gold in the near term.



- ◆ Nevertheless, the Fed is still expected to reduce the pace of asset purchases some time in 2014 as the US economy remains on track to expand moderately, and thus the question is just the timing of such a move. After all, US economic output has now surpassed its pre-recession peak by nearly 5% whereas the eurozone and the UK have both remained below their previous highs. The upcoming shift in the Fed's support for the economy could therefore weigh on gold in the medium term.
- ◆ The Fed's intention to taper sooner or later has come into focus since early months of the year, and data from gold exchange traded funds (gold ETFs) show how investor sentiment towards the metal has shifted. Gold ETFs posted two consecutive quarters of outflows for the first time in recent years, suggesting that investors headed for the exit from the gold market amid fears that the Fed, at some point, would reduce its asset purchases. Latest data from Bloomberg showed that outflows still continued in the third quarter, albeit at a slower pace.
- ◆ Jewellery demand rose for four quarters in a row in the second quarter, according to the World Gold Council, but the increase has not fully offset the retreat by investors, resulting in a decline in overall world gold demand. It is doubtful the demand could sustain with slowing economic growth in both India and mainland China, which together account for 60% of world jewellery consumption. In particular, the Indian government has long tried to reduce its current account deficit by limiting inflows of gold. As such, the downside risks for gold remain.

Exhibit 4. ETF Gold Holdings

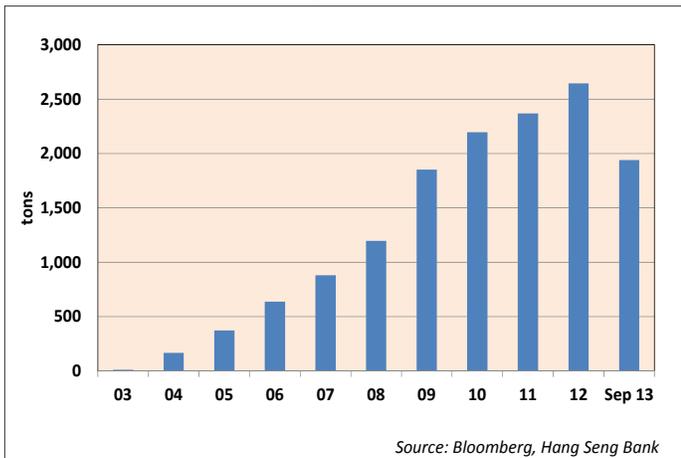


Exhibit 5. World Jewellery Consumption



Nov 2013

Precious Metals and Crude Oil								
(USD/oz)	2011	2012	1Q 2013	2Q 2013	3Q 2013	Aug 2013	Sep 2013	Oct 2013
Gold	1,563.70	1,675.35	1,598.75	1,234.57	1,328.94	1,395.15	1,328.94	1,323.10
Silver	27.84	30.35	28.46	19.67	21.70	23.53	21.70	21.92
Platinum	1,401.00	1,539.25	1,571.50	1,327.4	1,404.05	1,523.00	1,404.05	1,449.35
Palladium	655.25	704.50	772.00	659.00	724.05	721.75	724.05	737.40
Crude Oil (USD/barrel)	98.83	91.82	97.23	96.56	102.33	107.65	102.33	96.38

Note: 1. All are end-of-period figures unless specified

2. Crude oil prices refer to WTI Cushing

Source: Bloomberg L.P.

US Dollar Exchange Rates								
	2011	2012	1Q 2013	2Q 2013	3Q 2013	Aug 2013	Sep 2013	Oct 2013
EUR/USD	1.2959	1.3192	1.2820	1.3010	1.3527	1.3222	1.3527	1.3583
USD/JPY	76.90	86.75	94.21	99.14	98.25	98.18	98.25	98.36
GBP/USD	1.5549	1.6248	1.5199	1.5212	1.6186	1.5504	1.6186	1.6038
USD/CHF	0.9376	0.9156	0.9493	0.9451	0.9049	0.9297	0.9049	0.9069
AUD/USD	1.0205	1.0395	1.0418	0.9138	0.9317	0.8900	0.9317	0.9458
NZD/USD	0.7774	0.8287	0.8367	0.7740	0.8299	0.7727	0.8299	0.8262
USD/CAD	1.0212	0.9922	1.0176	1.0520	1.0309	1.0537	1.0309	1.0431
Dollar Index	80.18	79.77	82.98	83.14	80.22	82.09	80.22	80.20

Note: All are end-of-period figures unless specified

Source: Bloomberg L.P.

Global Interest Rates (%)			
HK Discount Window Base Rate	0.50	Japanese Overnight Call Rate	0 to 0.10
US Fed Funds Target Rate	0 to 0.25	Canadian Overnight Rate Target	1.00
British Repo Rate	0.50	Australian Cash Rate	2.50
Euro Refinancing Rate	0.50	New Zealand Cash Rate	2.50

Source: Central bank data

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