Mining Journal



# How big is gold demand?

I upset the World Gold Council (WGC) recently when I accused it of exaggerating. The WGC said my analysis contained numerous inaccuracies. What do you think?

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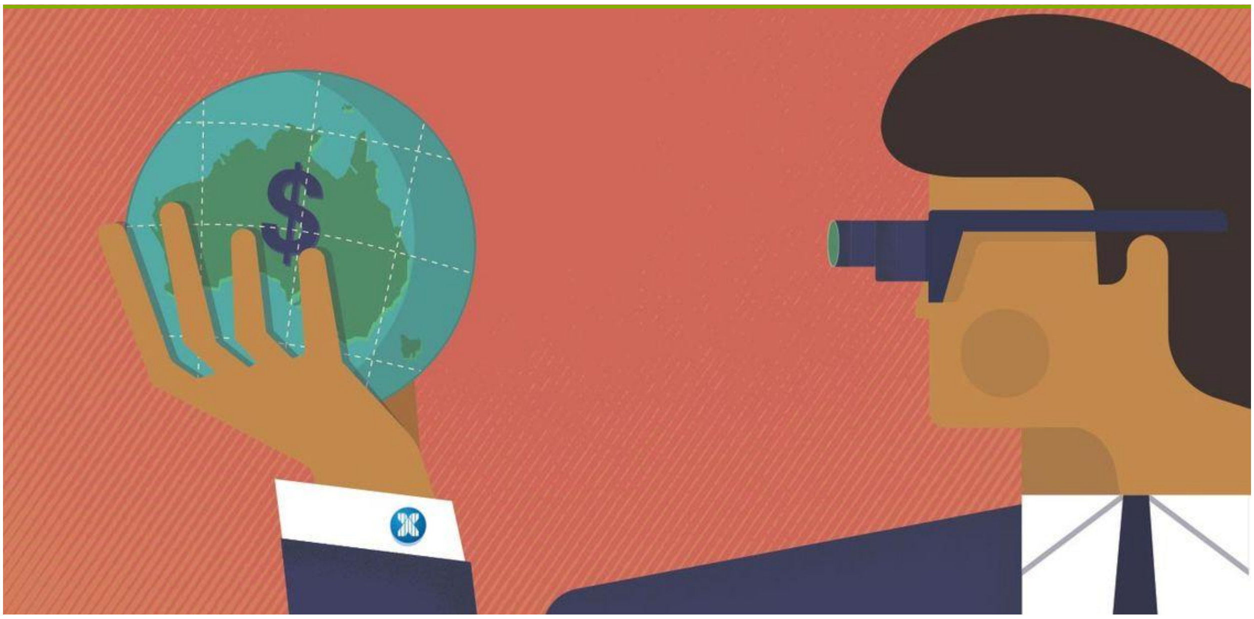

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My May 16 column about WGC gold statistics prompted a fuming letter from the Council to the Mining Journal editor.

The WGC chief investment strategist said I would have come to a different conclusion if I had read the relevant WGC documents. I would have realised that my conclusions were not robust, according to the gold industry's chief mind reader. My response, rejected any need for a rethink.

My observations about the WGC data revolved around how they were reported, not about the quality of the underlying collections on which I have expressed no opinion.

An occasional lurch into hyperbole is to be expected from the world's official promoter of gold. But, as an unbiased user of statistics, I find the often breathless reporting of implausibly high growth in demand analytically counterproductive.

My column last month was precipitated by WGC promotional materials heralding a 7% rise in gold demand over the year ended March 2019. Such a large move seemed at odds with the acknowledged size of existing gold holdings, estimated by the WGC itself at 190,040 tonnes, and observable quantities of new gold supplies.

I was also intrigued at how gold demand in the first quarter, according to the opening paragraph of the Gold Demand Trends report, managed to exceed supply.

In short, the narrative did not make sense. And, in looking more closely, two reasons stood out. One relates to the interpretation of 'demand'. The other arises from an apparent discretion among the report authors about which measure of demand they choose to highlight.

To cut through some of the emotion permeating discussions about the precious metal, think of the difference between toothpaste and passenger motor vehicles.

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Toothpaste is used once and effectively destroyed in the process. More must be continually bought to ensure that the same usage rate can be maintained. Demand is easily thought of as the amount purchased over any relevant period of time.

Motor vehicles are a quintessential consumer durable. A car will provide an ongoing service not forever but possibly for many years. Investors may choose to focus on new car sales or registrations - estimated at 79 million in 2018 - to track macroeconomic conditions or fluctuations in car manufacturers' earnings but the number of cars being used is closer to 1.1 billion.

The relevant analytical question can be framed in this way. Is demand for a durable such as a car best measured by the stock of vehicles being used or the flow of new cars?

Let's say that 100 cars are in use during period one. Let's say, then, that new car sales in the second period amount to two units. That is a 2% increase in the stock of motor cars. Let's assume that three new cars are bought in the third period. With none scrapped, the stock of cars will have grown by 2.9% in period three although the increase in new car sales would have been a much higher 50%.

Did demand for cars rise by 2.9% or 50%? Both are legitimate measures of something. One measures the change in the stock. The other measures the change in the rate of increase in the stock. A mathematician might refer to the distinction between the first and second derivatives.

Back to gold. When the WGC reports what it calls demand, it is reporting the second derivative, not the change in the stock of gold.

When the WGC says that gold demand rose by 7%, it is not saying that the amount of gold held rose by 7%. It is saying that the increment in the amount of gold held was 7% more than the increment in the amount of gold held a year earlier.

This is a less useful measure, in my judgement, than knowing the extent to which gold holdings - the intuitively obvious measure of demand - have risen. In any event, the 7% growth estimate is itself questionable.

Intuitively, one knows that the increase in the amount of gold owned cannot outpace the amount of gold mined.

According to the WGC, the amount of gold mined in the March quarter was 9.2t higher than in the corresponding period a year earlier, while its measure of metal demand underpinning the 7% reported growth was 69.1t higher in the latest quarter than it had been a year earlier.

The explanation for the difference is evident from the published WGC statistics and confirmed by the WGC letter to the Mining Journal editor.

The WGC knows that the market is always in balance. If the aggregated estimates of gold flows do not maintain the balance, an adjustment is needed to the estimates. This adjustment amounted to 638t of gold between 2010 and 2018 and 90t in the March quarter, according to the WGC.

The WGC objected to me referring to this quantity as an unexplained statistical discrepancy, insisting that it comprised identifiable sources of gold demand that were simply not allocated to other categories.

If this category of demand is added back, the increment in gold holdings in the March quarter amounted to 1,150.0t. On a comparable basis, the amount in the first quarter of 2018 was 1,153.1t, according to the WGC's own assessment of the market.

This is no trivial matter. The WGC evidently cherry picked an eye-catching number lacking analytical merit and contrary to its view of how other people should interpret the data. In doing so, it hugely exaggerated the change in gold flows.

Honesty would have required the industry mouthpiece to report a slight 0.3% decline, using its own definition of demand, and not a headline grabbing increase of 7%. At the same time, gold miners would have added about 1.8% to the global stock of gold.

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