Mining Journal

Exaggerated gold demand claims

Behind an eye-catching headline trumpeting 7% growth in gold demand over the past year is a confusing statistical picture offering little guidance about market conditions for the precious metal.

John Robertson*

16 May 2019

My Twitter feed alerted me earlier this month to the release by the World Gold Council (WGC) of its latest demand and supply estimates covering the period to the end of March 2019.

The WGC broadcast message teased with a surge in demand "boosted by central bank buying and gold-backed ETF inflows".

The more detailed online reports and data to which the Twitter message led also touted the roles of central banks and ETFs with growth rates of 68% and 49%, respectively, in their demand for gold.

The WGC statistics turned out to be more sizzle than steak, as they so often do.

Immediately evident in a review of the latest WGC report is a mismatch between the statistics quoted and the data released separately in time series form.

The report says "Global gold demand grew to 1,053.3 tonnes in Q1, up 7% year-on-year" whereas the statistical tables refer to gold demand of 1,059.7t which would round to an increase of 8% over the equivalent estimate for the corresponding period of 2018.

That carelessness aside, only 185.8t of either of the two reported demand measures came from the two headlined sources. The majority of the quarterly demand was attributable to jewellery fabrication. Bar and coin demand contributed another 257.8t.

The WGC has given itself the devilishly complicated job of tracking every gold

transaction in every corner of the world. With that data in hand, the WGC faces the further daunting analytical task of trying to say something meaningful about the gold market through a focus on changes in flows when gold's primary role as a store of value rests on the size of accumulated inventories.

The WGC and its agents attempt to mimic the efforts of analysts studying the industrial metal markets. Copper market analysts, for example, try to measure metal use and production with a view to calculating a physical market balance. The size of the resulting surplus or deficit, implying a change in inventory holdings, signifies the extent to which prices might move.

Even accepting the WGC definition, gold demand could have been overstated by more than one third over the last five years, including in the latest quarter

Market balances are not necessarily conclusive but remain important inputs into judgements about prospective investment returns. Typically, a large industrial metal deficit would flag upward price pressure. A move to surplus would suggest downside price risks.

Since gold has both store of value roles and industrial uses, this approach does not work. A building inventory of gold could just as validly be construed as a burgeoning appetite among investors for more of the precious metal, signalling buoyant market conditions, as a price debilitating slump in industrial use.

Knowing what is happening in the physical gold market is nowhere near as analytically important as a similar understanding of physical balances in the markets for industrial metals.

The WGC defines demand as the amount of newly used gold in fabrication or net purchases of gold for use as a store of value.

In the case of official holdings, the International Monetary Fund (IMF) is the primary source of data. According to the IMF, such holdings of gold in March 2019 amounted to 34,024t, a 378t or 1.1% rise over estimated holdings a year earlier.

The WGC 68% increase of 58.8t in official demand was measuring something different, namely, the change in the rate of change - or the second derivative - of the total demand for official gold assets.

The WGC reported a 623.8t increase in central bank gold holdings in 2013, for example, followed by successively lower rises in each of the following four years.

On the WGC's methodology, this was four years of declining demand whereas, by the end of that period, central bank gold holdings had risen by 1,832t. Central bank demand had unequivocally risen, not fallen. The rate of rise had fallen.

Even accepting the WGC definition, gold demand could have been overstated by more than one third over the last five years, including in the latest quarter.

The WGC's treatment of recycled gold as a fresh supply source exaggerates the amount of new demand by failing to recognise that recycled gold would have already been counted as 'in use'.

Under the WGC methodology, all the mines in the world could close but the supply of gold could keep rising, as could demand, even though no change in the amount of gold owned could occur.

Adoption of the industrial metal methodology for the way in which recycled gold is treated does not sufficiently acknowledge that gold never stops being gold. The same equivalence between gold in different forms does not exist between a discarded drink container and an aluminium ingot or a galvanised sheet and a slab of zinc.

The WGC must also sandbag the numbers to take account of inevitable measurement difficulties. So, for example, a 90.3t difference exists between the WGC estimate of total supply in the March quarter and gold demand attributable to its five identifiable fabrication, investment and official categories.

Rather than honestly describing this difference as an unattributed statistical discrepancy, the WGC dressed it up as a surplus. The surplus/deficit characterisation has no meaning in the gold market

despite its strong analytical implications in industrial metal analysis.

Over 600t of gold has been characterised as "surplus" since 2010. Of course, none of this has been dumped or gone unowned. If it remains unused in fabrication, it is sitting in vaults doing its job as a store of value. There is no such thing as surplus gold.

My initial excitement at the prospect of fresh insights into what might have been happening in the gold market were dashed by one fundamental reality. No matter how the data are dressed up, tonnages of gold used cannot increase any faster than the amount of gold being mined.

**John Robertson is the chief investment strategist for PortfolioDirect, an Australia-based equity research and resource stock rating group. He has worked as a policy economist, business strategist and investment professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia*