WORLD GOLD COUNCIL

Gold mid-year outlook 2021

Creating opportunities from risks

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors.

We provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

Based in the UK, with operations in India, China, Singapore and the USA, the World Gold Council is an association whose members comprise the world's leading and most forward thinking gold mining companies.

For more information

Research and Strategy

Adam Perlaky
adam.perlaky@gold.org
+1 212 317 3824

Louise Street
louise.street@gold.org
+44 20 7826 4765

Bharat Iyer
bharat.iyer@gold.org
+1 212 317 3823

Mukesh Kumar
mukesh.kumar@gold.org
+91 22 317 3826

Johan Palmberg
johan.palmberg@gold.org
+44 20 7826 4786

Ray Jia
ray.jia@gold.org
+86 21 2226 1107

Krishan Gopaul
krishan.gopaul@gold.org
+44 20 7826 4704

Juan Carlos Artigas
Global Head of Research
juancarlos.artigas@gold.org
+1 212 317 3826

John Reade
Chief Market Strategist
john.reade@gold.org
+44 20 7826 4760

Distribution and Investment:

Claire Lincoln
Head of Sales – EMEA
claire.lincoln@gold.org
+44 20 7826 4788

Matthew Mark
Head of Sales – Americas
matthew.mark@gold.org
+1 212 317 3834

Fred Yang
Head of Sales – China
fred.yang@gold.org
+86 21 2226 1109

Sheela Kulkarni
Head of Sales – India
sheela.kulkarni@gold.org
+91 22 6157 9114

Jaspar Crawley
Head of Sales – ASEAN
jaspar.crawley@gold.org
+44 20 7826 4787

Contents

Gold mid-year outlook 2021: Creating opportunities from risks

Interest rates will likely remain a key driver for gold in the short and medium term. Yet, the negative impact that higher rates could bring will likely be offset by the longer-lasting effects and unintended consequences of expansionary monetary and fiscal policies created to support the global economy. These may include inflation, currency debasement, and higher exposure to risk-on assets in portfolios. Combined with attractive entry levels, these factors could prompt strategic investors to add gold to their allocation strategies and support central bank demand during the second half of the year. However, while consumers may also benefit from the economic recovery and recent price pullback, new COVID variants may limit uptake in gold jewellery in key markets.

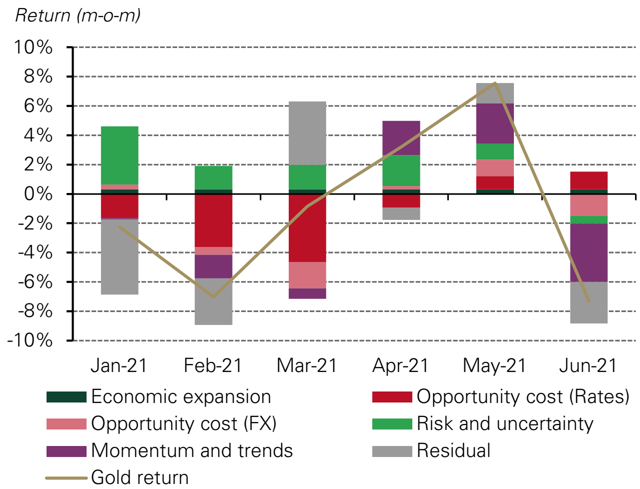
High rates upstage inflation as gold underperforms

The first half of 2021 provided a good example of how gold's diverse sources of demand and supply interact. The gold price dropped by 6.6% in H1,[1] as gains during most of Q2 were thwarted by a significant pullback in late June. Gold's price also underperformed in most key currencies except for the Japanese yen and the Turkish lira, which weakened against the US dollar (**Table 1**).

Overall, gold's performance was driven primarily by higher interest rates – especially during Q1 and then again in late June on the back of a more hawkish-than-expected statement by the US Federal Reserve.[2] Gold was also influenced by upbeat investor sentiment as the global economy started to recover from the impact of COVID-19. However, there were supporting factors for gold. Concerns of higher inflation offset part of the drag that interest rates brought. And the strong response from governments to aid economic recovery in the form of monetary and fiscal policies has made some investors worried about currency risks and capital preservation. In addition, gold benefited from a recovery in consumer demand in Q1, although second waves of the virus and new lockdowns presented challenges in Q2. Our short-term model shows that these factors, combined with the effects of price momentum and investor positioning, help to explain the vast majority of gold's performance year-to-date (**Chart 1**).

Chart 1: Gold's performance in H1 was driven by interest rates, inflation expectations and momentum

Contributions of gold price drivers to periodic gold returns*



*To 30 June 2021. Our short-term model is a multiple regression model of monthly gold price returns, which we group into the four key thematic driver categories of gold's performance: economic expansion, market risk, opportunity cost, and momentum. 'Residuals' represents the percentage change in the gold price that is not explained by factors currently included in the model. Results shown here are based on estimates using monthly data from February 2007 to June 2021. The gold price return is based on the LBMA Gold Price PM.

On Goldhub, see: Short-term gold price drivers.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

1 As of 30 June 2021, based on the LBMA Gold Price PM in USD.

2 *Federal Reserve FOMC statement*, 16 June 2021.

Table 1: Gold underperformed in most currencies during H1 2021

Gold return in key currencies*

	USD (oz)	EUR (oz)	JPY (g)	GBP (oz)	CAD (oz)	CHF (oz)	INR (10g)	RMB (g)	TRY (oz)	RUB (g)	ZAR (g)	AUD (oz)
Q1	-10.4%	14.3%	18.4%	20.8%	22.4%	13.8%	27.6%	17.0%	55.6%	48.4%	30.9%	13.5%
Q2	4.3%	-6.7%	-4.1%	-11.2%	-11.6%	-4.6%	-10.4%	-10.2%	-0.2%	-8.5%	-9.9%	-9.2%
H1	-6.6%	-3.6%	0.4%	-7.6%	-9.2%	-2.3%	-5.0%	-7.7%	9.2%	-7.7%	-9.2%	-4.0%

*As of 30 June 2021. Based on the LBMA Gold Price PM in: US dollar (USD), euro (EUR), Japanese yen (JPY), pound sterling (GBP), Canadian dollar (CAD), Swiss franc (CHF), Indian rupee (INR), Chinese yuan (RMB), Turkish lira (TRY), Russian rouble (RUB), South African rand (ZAR), and Australian dollar (AUD).

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

Risks for gold remain but there are also opportunities

Using Qaurum[SM],[3] our web-based valuation tool, we analysed hypothetical scenarios[4] based on research by Oxford Economics,[5] covering various potential macroeconomic developments. Namely,

- an accelerated economic recovery
- a consumer-led economic boom
- an environment where rapid rate rises offset inflation in later years
- a more cautious economic recovery
- an environment where new COVID variants severely impact the global economic recovery.

The results suggest that there is still upside potential for gold's implied hypothetical performance during the second half of this year based on the conditions under consideration (**Chart 2**).[6] However, this is unlikely to come without challenges.

Interest rates as key drivers

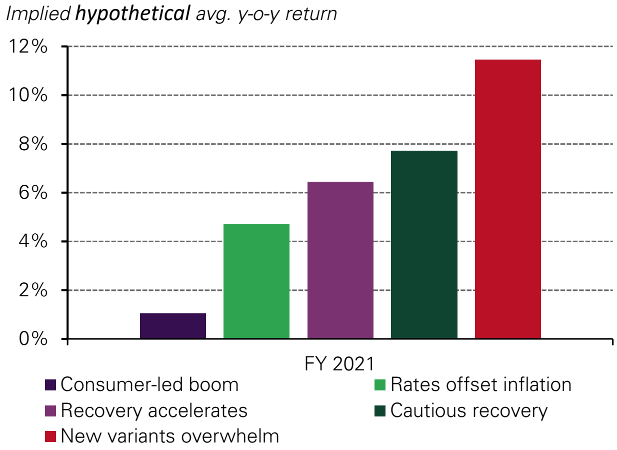
The analysis indicates that gold's performance could be heavily influenced by the movement of interest rates and the success of vaccination campaigns.

For example, a further rise in interest rates could continue to create headwinds for gold. This is consistent with gold's historical behaviour in periods when monetary policy becomes tighter, often resulting in price pullbacks.

However, we believe that central banks will be cautious in terms of the speed at which they start to remove asset purchase programmes or increase interest rates. A hasty move could result in large market swings and potentially destabilise the economic recovery.

Chart 2: Oxford Economics scenarios and our valuation methodology indicate that there could be upside potential for gold

Full-year 2021 implied hypothetical returns*



*Based on Oxford Economics scenarios published in Q2 2021 and calculations using the Gold Valuation Framework methodology available through Qaurum. Returns represent implied average y-o-y changes. A detailed description of these scenarios and their implications can be found at Goldhub.com

IMPORTANT: The World Gold Council does not forecast the price of gold. GVF is a methodology that allows investors to understand how gold's demand and supply may react to various macroeconomic variables, based on historical relationships. Our web-based tool, Qaurum, is customisable and users can modify any of the variables included on the available hypothetical scenarios to best reflect their own view on the global economy.

Source: Oxford Economics, World Gold Council

In addition, investors have experienced a prolonged ultra-low interest-rate environment, and this is creating structural changes in asset allocation. Investors are adding more risk to their portfolios in search for returns which, in turn, has required them to revisit their risk management strategies.

3 Qaurum is a web-based quantitative tool powered by the Gold Valuation Framework (GVF). An academically validated methodology, GVF is based on the principle that the price of gold and its performance can be explained by the interaction of demand and supply. In turn, demand and supply are influenced by macroeconomic scenarios that can be customised to calculate gold's implied performance based on these hypothetical conditions over various time periods. See **Important information and disclosures** at the end of this report.

4 As of Q2 2021. A detailed description of these scenarios can be found in Goldhub.com. See **Important information and disclosures** at the end of this report.

5 Oxford Economics is a leader in global forecasting and quantitative analysis and a specialist in modelling. Their scenarios are based on their Global Economic Model updated as of 26 May 2021.

6 All results herein are hypothetical. See **Important information and disclosures** at the end of this report.

Our analysis suggests that this could increase the need to hold assets such as gold for downside protection and diversification.

This applies not only to private individual and institutional investors; central banks have steadily increased their allocation to gold so far in 2021 and our research suggests they will continue to do so. And we believe that, collectively, they may deliver net purchases at the same rate or potentially higher than in 2020.

Inflation could come in different flavours
Inflation has become a key concern for many investors. But while inflation has been on the rise, there are mixed views as to whether the increase in consumer prices will be temporary or more sustained. If price inflation becomes persistent, history shows that gold could perform well. For example, gold had an annual average return of 15% in years when the US Consumer Price Index (CPI) was higher than 3%.[7] Our research also indicates that gold may respond to factors other than higher CPI inflation. Gold is highly correlated to broader inflation metrics such as money supply which is on the rise, and this could later result in inflation bubbles, currency debasement, and potential market volatility around the world. Global investors may thus look to gold as a means to protect against the erosion of capital.

Entry opportunities on price pullbacks
Following the significant price pullback in late June, the gold options market showed interesting dynamics. The so-called 'put skew'[8] suggested that some of the selloff was likely softened by buyers. The price selloff also pushed gold's relative strength index down significantly. And while some investors may remain concerned about downside risks, these metrics signal that others may see it as an entry opportunity – whether tactical or as a means to build strategic positions.

Consumer demand shows mixed signals
Overall, the global economic recovery and the recent price pullback should continue to support gold consumer demand. In China, for example, government stimulus, sales promotions, and seasonal patterns suggest stronger gold consumption during H2. In contrast, however, surges in COVID-19 cases due to new variants are significantly impacting key markets such as India.

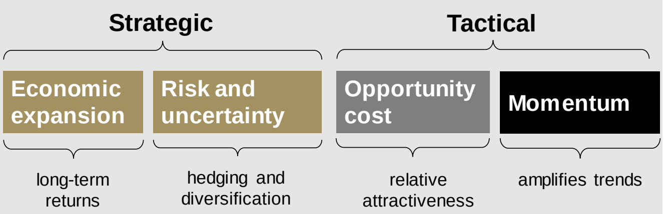
Conclusion

The performance of gold responds to the interaction of the various sectors of demand and supply, which are, in turn, influenced by the interplay of four key drivers (**Focus 1**). In this context, we anticipate that the need for effective risk hedges will continue to support investment demand, but gold's performance will also be influenced by the direction of interest rates and the robustness of the economic recovery.

Focus 1: Drivers of gold performance

Gold's behaviour can be explained by four broad sets of drivers:

- **Economic expansion:** periods of growth are very supportive of jewellery, technology and long-term savings
- **Risk and uncertainty:** market downturns often boost investment demand for gold as a safe haven
- **Opportunity cost:** interest rates and relative currency strength influence investor attitudes towards gold
- **Momentum:** capital flows, positioning and price trends can ignite or dampen gold's performance.



7 As of 31 December 2020. Based on y-o-y changes since January 1971 for gold based on the LBMA Gold Price PM USD, and for inflation on US CPI.

8 Defined as the difference in price between at-the-money options and options that are struck out-of-the-money.

World Gold Council
7th Floor, 15 Fetter Lane
London EC4A 1BW
United Kingdom

T +44 20 7826 4700
F +44 20 7826 4799
W www.gold.org

Published: July 2021