# Outlook 2020
## Global economic trends and their impact on gold

## 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, the Far East and the US, the World Gold Council is an association whose members comprise the world's leading gold mining companies.

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# Gold outlook 2020:
# Risk appetite amid high uncertainty

We expect that the interplay between market risk and economic growth will drive gold demand in 2020. In particular, we focus our attention on:

- financial uncertainty and lower interest rates
- weakening in global economic growth
- gold price volatility.

We also explore the performance of gold implied by Qaurum[SM], our innovative valuation tool, across various hypothetical macroeconomic scenarios.

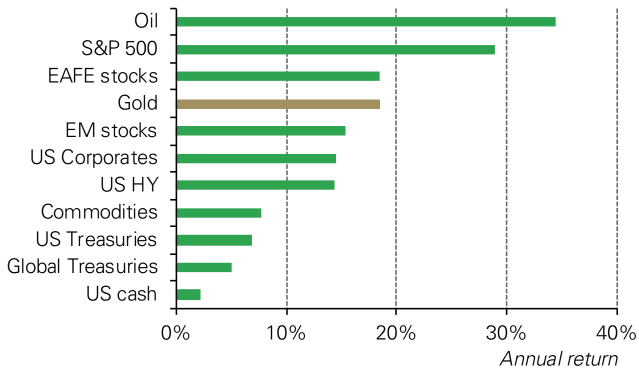
## Gold shined in 2019

Gold had its best performance since 2010, rising by 18.4% in US dollar terms last year. It also outperformed major global bond and emerging market stock benchmarks over that period (**Chart 1**). In addition, gold reached record highs in most major currencies except the US dollar and Swiss franc (**Table 2** on page 5 in the Appendix).

Gold rose most between early June and early September as uncertainty increased and interest rates fell. But investors' appetite for gold was apparent throughout the year, as seen by strong ETF flows, robust central bank demand and an increase in COMEX net longs positioning.

**Chart 1: Gold outperformed bonds and EM stocks**

Annual performance of major global assets*




*As of 31 December 2019. Annual returns based on the LBMA Gold Price, Bloomberg Barclays US Treasury Index and Global Treasury Index ex US, ICE BAML US 3-month T-bill Index, Bloomberg Barclays US Corporate and High Yield Indices, MSCI EM Index, Bloomberg Commodity TR Index, MSCI EAFE Index, S&P 500 Indices, and Bloomberg Oil TR Index.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

## High risks and low rates on the horizon

We expect that many of the global dynamics seeded over the past few years will remain generally supportive for gold in 2020.

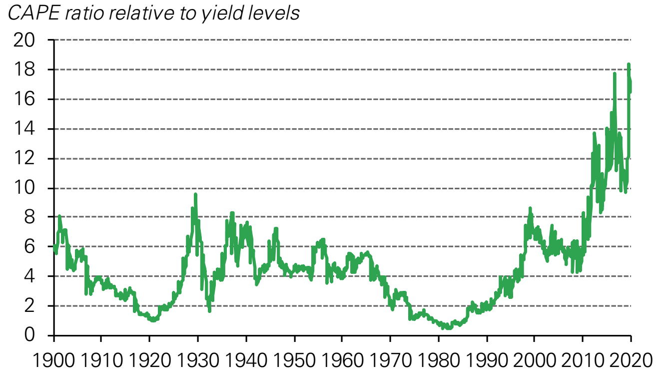
In particular, we believe that:

- Financial and geopolitical **uncertainty** combined with **low interest rates** will likely bolster gold **investment demand**
- Net gold purchases by **central banks** will likely **remain robust** even if they are lower than the record highs seen in recent quarters
- **Momentum** and speculative positioning may keep gold price **volatility elevated**
- And that gold price volatility, as well as expectations of weaker economic growth, may result in **softer consumer demand** near term but structural economic reforms in India and China will support demand in the long term.

## A supportive environment for gold investment

Looking ahead, we believe investors – including central banks – will face an increasing set of geopolitical concerns, while many pre-existing ones will likely be pushed back rather than being resolved. In addition, the very low level of interest rates worldwide will likely keep stock prices high and valuations at extreme levels (**Chart 2**). And although investors may not step away from risk assets, anecdotal evidence suggests they are increasing exposure to safe-haven assets like gold as a means to hedge their portfolios.

**Chart 2: Stock valuations are near record highs relative to the level of yields***



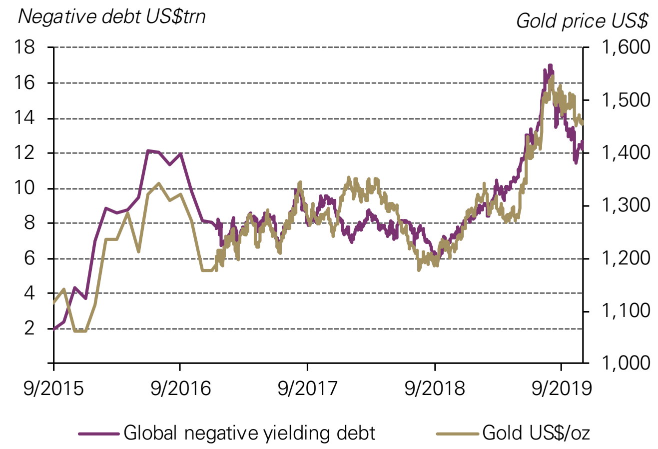

*As of 31 December 2019. Based on Yale Prof. Robert Shiller's research. The line reflects the SD&P 500 cyclically-adjusted P/E (CAPE) ratio divided by the 10-year US nominal rate.

Source: Bloomberg, World Gold Council

One of the key drivers of gold, especially in the short and medium term, is the opportunity cost of holding it relative to other assets, such as short-dated bonds. Unlike bonds, gold does not pay interest or dividends because it does not have credit risk. This perceived lack of yield can deter some investors. But in an environment where a whopping 90% of developed market sovereign debt is trading with negative real rates, we believe the opportunity cost of gold almost goes away. And it may even provide what can be seen as a positive "cost of carry" relative to bonds.

This is further evidenced by the strong positive correlation between the amount of debt and price of gold over the past four years (**Chart 3**). To some degree this illustrates the erosion of confidence in fiat currencies due to monetary intervention.

**Chart 3: The gold price has tracked the expansion of global negative yielding debt***




*As of 31 December 2019. Negative yielding debt level based on the Bloomberg Barclays Global Aggregate Yielding Debt Market Index.

Source: Bloomberg, World Gold Council

And the low rate environment is unlikely to change any time soon. Many central banks – the highest number since the global financial crisis – are cutting rates, expanding or implementing quantitative (or quasi-quantitative) easing and, in some instances, doing both.

In fact, gold has historically performed well in the 12- to 24-month period following policy shifts from tightening to "on-hold" or "easing" – the environment in which we currently find ourselves. And, historically, when real rates have been negative, gold's average monthly returns have been twice as high as the long-term average. Even slightly positive real interest rates may not push gold prices down. Effectively, our analysis shows that it has only been in periods with significantly higher real interest rates – an unlikely outcome given the current market conditions – that gold returns have been negative (**Table 1**).

**Table 1: Gold performance nearly doubles in periods of negative interest rates**

Gold performance in various real rate environments*

| | Long-term average | Low (<0%) | Moderate (0%-2.5%) | High (>2.5%) |
|---|---|---|---|---|
| Monthly return | 0.6% | 1.2% | 1.0% | 0.3% |
| Standard error | 0.2% | 0.4% | 0.4% | 0.3% |
| Different from 0? | Yes | Yes | Yes | No |

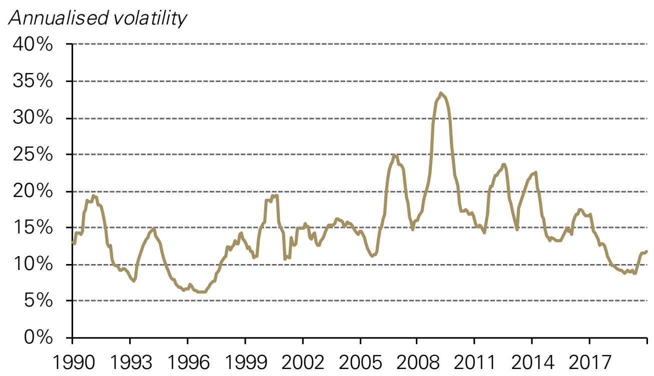
*Based on nominal gold returns between January 1971 and December 2019. Real rate regimes based on the 12-month constant maturity US T-bill minus the corresponding y-o-y CPI inflation. Difference from zero computed as a two-way T test at a 5% significance level.

Source: Bureau of Labour Statistics, Federal Reserve, ICE Benchmark Administration, World Gold Council

## Gold volatility may rise

As the gold price significantly rose in 2019 so did volatility, but, similarly to other assets, it remains well below its long-term trend (**Chart 4**). And we don't anticipate a reduction in gold volatility near term. Should the economic and political environment deteriorate, it may even rise, especially as gold volatility historically exhibits a positive skew in such circumstances, tending to increase as stocks pull back.

**Chart 4: Gold price volatility increased but remains low**




*As of 31 December 2019. Based on 260-day rolling gold price volatility.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

# Weak economic growth may affect consumers

Market surveys indicate that the majority of economists expect positive growth in 2020 for most countries, with a few forecasting contractions in major economies by 2021 or 2022.[1] However, median forecasts also show an expectation of softer global economic growth relative to 2019.[2]

This, combined with gold price volatility at or above current levels, may discourage jewellery consumers and cause technology demand to soften.

**Budgets of Chinese consumers are shrinking and their habits changing**
The slowdown in Chinese economic growth and rising staple prices have been squeezing consumer budgets. And while ostensible progress in trade negotiations with the US may restore some confidence, uncertainty lingers.

With tighter budgets and higher expenditure on staple goods, consumers will likely limit their consumption of luxury items, putting pressure on China's jewellery demand.

In addition, demand from younger consumers is shifting towards innovative jewellery pieces with fashionable designs and lighter weights – a divergence in sales of traditional and innovative products that we expect will continue in 2020.

**Gold price volatility and higher taxes may deter Indian consumers**
The Indian Goods and Services Tax (GST) – introduced in 2017 – rose last year across many categories.[3] And gold import duty increased from 10% to 12.5%. Until tax cuts are introduced as a credible incentive to spur economic growth – the infrastructure for which may not be available until 2021 – higher taxes are exacerbating the impact of the record high local gold price on consumption.

And while the introduction of mandatory hallmarking for gold jewellery at the beginning of the year may enhance consumer trust, this potential initial disruption should not be ignored.

In all, we believe consumer and gold trade sentiment may remain soft through 2020.

**Economic reforms may improve long-term demand**
Both China and India are implementing economic reforms geared towards strengthening growth and internal consumption. In China, the "belt and road" initiative should also strengthen its regional role and reduce dependence on the West. In India, policy reforms designed to bring transparency and an orderly trade structure to many sectors of the economy are expected to improve confidence, remove inefficiencies and promote growth. We expect these factors to be a long-term positive for gold demand although their effects may take time to become apparent.

# Valuing gold through demand and supply

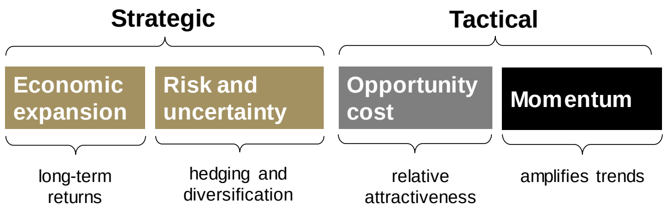
Gold does not conform to most of the common valuation frameworks used for stocks or bonds. Without a coupon or dividend, typical discounted cash flow models fail. And there are no expected earnings or book-to-value ratios either.

Its dual nature as a consumer good and an investment means that jewellery demand can be boosted by economic growth even if investment demand may fall amid lower uncertainty or higher interest rates. These seeming contradictions can pose challenges but they can make gold an effective strategic asset.

In fact, our research shows that valuing gold is intuitive. In essence, its equilibrium price is determined by the intersection of demand and supply (**Focus 1**, page 5).

In particular gold's performance 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:** the price of competing assets, especially bonds (through interest rates), currencies, and to a lesser degree other assets, influence investor attitudes towards gold
- **Momentum:** capital flows, positioning and price trends can ignite or dampen gold's performance.




1 Bloomberg consensus forecasts are available by using the function ECFC <GO> in their data terminals.

2 Ibid.

3 https://www.indiabudget.gov.in/budgetspeech.php

# Generally positive implied performance for 2020

Gold rallied by 4% in December 2019, increasing by an additional 6% by 7 January 2020. While we believe that there are various reasons for this move, tensions in the Middle East linked to the US-Iran confrontation ultimately pushed the gold price to an almost seven-year high in early January.

Subsequent comments by President Trump aimed to ease concerns, pushing the price down to the US$1,560/oz-US$1,550/oz level as of 10 January 2020. Yet, gold still remains still 2.6% higher relative to the end of 2019.[4]

We expect that investor positioning related to this specific event will likely influence gold's performance in the near term. But over the medium term, broader financial and geopolitical uncertainty and developments in monetary policy will play a more important role.

For example, using Qaurum (**Focus 1**), we analysed the performance of gold as implied by four different hypothetical macro-economic scenarios provided by Oxford Economics.[5] These included:[6]

- a global deceleration (their base-case scenario)
- a US-led recession
- a more pronounced slowdown in China
- an economic improvement in emerging markets.

The results of the analysis suggest that, in general, gold may see a positive performance in 2020. Some of the scenarios – with the exception of an economic upturn in emerging markets – could result in lower consumer demand. But the dampening effect of consumer demand on price performance will likely be offset by potentially robust investment demand on the back of deteriorating credit conditions and stable to lower interest rates.

It is important to note, however, that this is not a comprehensive list of possible scenarios. Instead, they reflect key investor concerns captured by Oxford Economics' Global Risk Survey. Hypothetically, improving market sentiment – for example, a reduction on perceptions of risk, or tighter monetary policy by the Fed or other major central banks – could put downward pressure on gold's price performance relative to the scenarios currently available on Goldhub.com.[7]

## Focus 1: Qaurum[SM] – Your gateway to understanding gold performance

Qaurum is a web-based quantitative tool that helps investors intuitively understand the drivers of gold performance.

Behind its user-friendly interface, Qaurum is 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.

Accessible from Goldhub.com, the World Gold Council's data and research site, Qaurum allows investors to assess how gold might react across different economic environments in three easy steps:

- select a hypothetical macroeconomic scenario provided by Oxford Economics, a leader in global forecasting and quantitative analysis, or customise your own
- generate forecasts of demand and supply and view the impact of key macro drivers
- calculate and visualise implied returns for gold.

Based on these, investors can use Qaurum to calculate the hypothetical performance of gold over the next five years as well as long-term 30-year returns implied by GVF and the available (or user-constructed) scenarios.

Additional details on GVF methodology can be found at Goldhub.com.

# Appendix

**Table 2: Gold price and 2019 return in key currencies***

| | US dollar | Euro | Japanese yen | Pound sterling | Canadian dollar | Swiss franc |
|---|---|---|---|---|---|---|
| Return | 18.4% | 20.6% | 17.3% | 13.9% | 12.4% | 16.3% |
| Price per oz | 1,514.8 | 1,349.4 | 164.6K | 1,143.4 | 1,964.3 | 1,466.8 |
| Record high? | No | Yes | Yes | Yes | Yes | No |
| | **Indian rupee** | **Chinese yuan** | **Turkish lira** | **Russian ruble** | **South African rand** | **Australian dollar** |
| Return | 21.1% | 20.2% | 32.5% | 6.0% | 15.1% | 18.6% |
| Price per oz | 108.1K | 10.5K | 9,014.3 | 94.1K | 21.2K | 2,154.9 |
| Record high? | Yes | Yes | Yes | Yes | Yes | Yes |

*As of 31 December 2019. Based on the LBMA Gold Price in local currencies.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

4 Based on the LBMA Gold Price PM as of 10 January 2020, as published by ICE Benchmark Administration.

5 Oxford Economics is a leader in global forecasting and quantitative analysis and a specialist in modelling. Headquartered in Oxford, with offices around the world, Oxford Economics employs 400 staff, including over 250 economists and analysts – making it the largest independent forecaster. Its fully-integrated and transparent Global Economic Model provides a rigorous and consistent framework that enables it to evaluate the effects of different assumptions on the global economy.

6 Visit Goldhub.com for a detailed description of each scenario and their respective impact on gold demand, supply and performance.

7 Users can modify currently available hypothetical scenarios by utilising Qaurum's customisation functionality.

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