Gold Market Commentary
Transitory or not, inflation is already impacting consumers

September 2021 www.gold.org

August research highlights:

Investment Update: ECB policy may shift, but its long-term effects keep gold relevant

Gold: the most effective commodity investment

Blogs:
** Central banks maintain interest in gold in July*
** India's gold market in July: imports rebound as retail demand improves with easing of lockdown restrictions*
** China's gold market in July: despite the gold consumption off season, local gold ETFs continued to see inflows*
** The three-child policy and its implications for China's gold consumption*

Upcoming research:

Chinese gold jewellery market insights/survey – ***Early September***

Monthly China blog – ***Mid September***

Monthly India blog – ***Mid September***

New Climate report – ***Late September***

Key highlights:

- Despite a small-hours flash crash, gold finished August only slightly lower m-o-m, on firmer interest rates and marginal ETF weakness **(p2)**
- COVID-related concerns grew, particularly in Europe, Oceania, and the US **(p5)**

Looking Forward:

- Inflation may be transitory, but it's already impacting consumers **(p3)**

Most asked investor questions:

- What caused the gold 'flash crash' early in the month? **(p6)**
- When is a good time to buy gold and how can it be added to a portfolio? **(p7)**
- Why has gold not rallied with real rates moving further into negative territory? **(p8)**
- Are institutional investors adding gold to their portfolios and why? **(p9)**

Gold fell marginally on firmer rates and ETF weakness

August was a relatively quiet month, despite geopolitical news

Gold fell slightly during August, down 0.6% in US dollars, on modestly firmer interest rates following strong US jobs data.[1] Gold is now approximately 4% lower on the year. Global financial markets were relatively quiet during the month, which is common in August, with most stock markets drifting higher on lighter volumes. Geopolitical news was a focus as the US abruptly pulled its forces out of Afghanistan; now that the Taliban has assumed control of the Afghan government, there are concerns that certain global geopolitical tension – which had subsided since the 2020 US Presidential election – could be reignited.

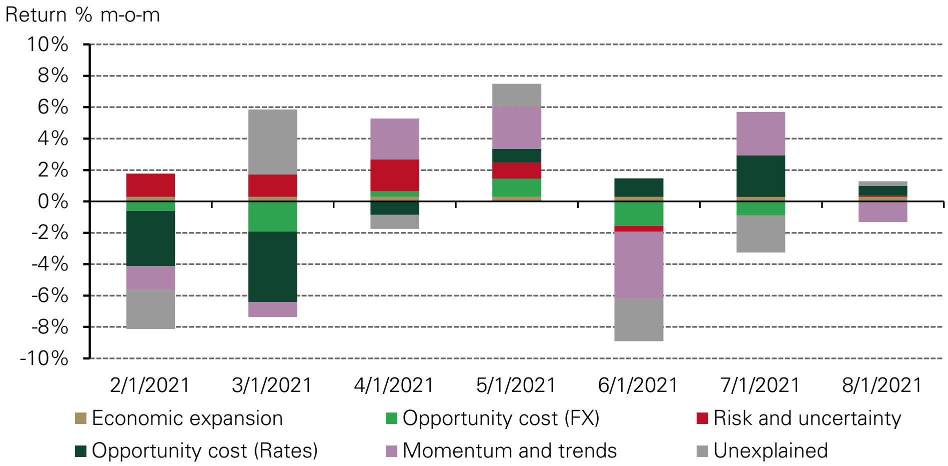
However, despite the slight price weakness there were signs of green shoots for gold. Federal Reserve Chairman, Jerome Powell, spoke at the Jackson Hole summit on 27 August, with his "lack of substantial further progress" comments positively impacting the price of gold, up 1.4% on the day; the move reflected his widely anticipated comments, and it appears tapering will be pushed into 2022, particularly as just last week US jobs data came in much lower than expected – the lowest in seven months.

Momentum factors drove gold prices in August

According to our short-term model (**Chart 1**), the slight fall in the gold price in August was primarily driven by *momentum* factors, led by ETF outflows and a reversal from the strong July gold return, as well as modestly higher rates. Countering their negative impact was follow-through from interest rate declines in July. Despite the August 9th flash crash (**p6**), gold ended an otherwise uneventful month resiliently flat.

Chart 1: Firmer interest rates, ETF outflows and a strong July, countered by lagged rate effects left gold near-flat by month-end

Contributions of gold price drivers to periodic gold returns*



*To 31 August 2021. Our short-term model is a multiple regression model of weekly 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. These themes capture motives behind gold demand; most poignantly, investment demand, which is considered the marginal driver of gold price returns in the short run. 'Residuals' represent the percentage change in the gold price that is not explained by factors currently included in the model. Results shown here are based on analysis covering an estimation period from February 2007 to 31 August 2021.

Source: On Goldhub, see: **Short-term gold price drivers**

1 Based on the LBMA Gold Price PM in USD as of 31 August 2021.

Inflation may be transitory, but it's already impacting consumers

Inflation is rearing its head in numerous ways like "shrinkflation" and "hedonic adjustments"

Central banks, including the US Federal Reserve (Fed) and the European Central Bank (ECB) have generally characterized the uptick in inflation as transitory. However, not everybody agrees. Strategists from financial institutions including Invesco, JP Morgan, and Morgan Stanley have suggested that inflation could be here to stay. In addition, there are a number of company CEOs who have, during recent quarterly earnings calls, commented specifically on rising input costs having a material impact on their costs – and, ultimately, the consumer. Importantly this has occurred across three bellwether industries of healthcare, retail/consumer, and banking, as noted by the CEOs of HCA Healthcare, Walmart and JPMorgan Chase. Regardless of the actual duration, inflation is already impacting consumers today.

There are some clear less-talked about examples of inflation. "Shrinkflation",[2] or the idea that you receive less of something for the same price (a nifty way around price increases) has become more common.[3] So-called "hedonic adjustments",[4] often in the context of electronics where the price of goods are adjusted down to reflect innovation – such as increased functionality or processing capacity – create a deflationary effect, despite the fact that the total amount spent by consumers may remain the same or potentially increase.[5] These deflationary effects have shifted, as recent supply-chain disruptions have, for example, led Taiwan Semiconductor to announce that chip prices will rise between 10% and 20% - something that has not occurred in decades.[6]

With labour shortages in some countries, particularly those like the US, continued stimulus aid may discourage people from entering the workplace, which could be a reason why some companies have had to entice workers with higher wages and bonuses. These costs could ultimately be passed on to the consumer.

While inflation may be transitory in the eyes of central banks, consumers – and investors – may feel differently. This could lead to increased allocations of real assets like real estate, TIPS, and commodities, like gold, which have performed well in higher inflationary environments.

North American outflows hurt ETF investment demand

ETF Commentary: Gold ETFs lost US$1.3bn (-22.4t) to global assets under management (AUM) in August, a reversal from inflows each month since April (**Table 1** and **Chart 12, p13**). Global AUM stood at US$211bn (3,611t) at the end of the month, still 12% shy of the August 2020 high of US$240bn and 8% shy of the October 2020 tonnage high of 3,909t. We believe these outflows were largely a function of reduced investment demand in North America driven by large US funds following the selloff in gold prices early in the month, while continued interest in low-cost ETFs remains across regions, strengthened by high reported inflation and economic growth concerns. Read our full August gold ETF flow commentary on Goldhub.

[2] https://www.investopedia.com/terms/s/shrinkflation.asp

[3] Many snack products, chips, and pre-packaged meals have seen their weight per unit decrease over 10%, with no change in price because of higher input costs and supply shortages. Consumer staples products like paper towels have been affected, with Costco reducing the number of sheets per package by over 15%.

[4] https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwif7tD_oO7yAhWQTN8KHW9XA-AQFnoECCQQAQ&url=http%3A%2F%2Fwww.oecd.org%2Fsdd%2Fna%2F1907790.doc&usg=AOvVaw1OsOm19iMvtYmHUGSO9lua

[5] Moore's law says, basically, that transistors/speed doubles about every two years, accounting for our computers becoming faster over time.

[6] https://www.slashgear.com/smartphone-prices-could-rise-as-tsmc-raises-chip-fees-06689819/

https://finance.yahoo.com/news/taiwan-semi-gains-report-raising-092031519.html

Table 1: Regional changes in gold-backed ETF holdings*

	AUM (US$bn)	Holdings (tonnes)	Change (tonnes)	Flows (US$mn)	Flows (% AUM)
North America	107.0	1,833.5	-32.2	-1,831.2	-1.7%
Europe	92.4	1,584.3	9.6	550.1	0.6%
Asia	8.0	132.8	0.8	39.7	0.5%
Other	3.5	60.4	-0.5	-30.2	-0.8%
Total	**210.9**	**3,611.1**	**-22.4**	**-1,271.6**	**-0.6%**

*To end August 2021.

On Goldhub, see: Gold-backed ETF flows.

Source: Bloomberg, Company Filings, ICE Benchmark Administration, World Gold Council

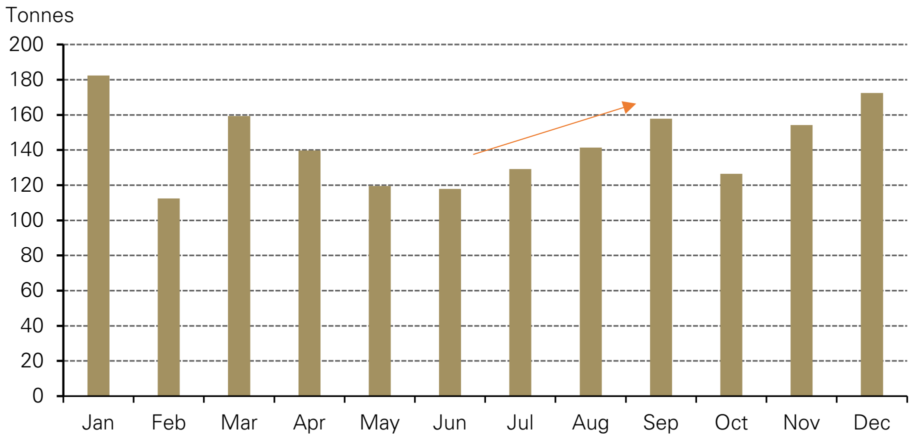
Regional insights

Chinese gold ETF holdings continued to see inflows

China: *Inflows into Chinese gold ETFs continued in August:* Total holdings of Chinese gold ETFs increased by 0.8t in August, standing at 72t, the second highest in history on a monthly basis. Chinese gold ETFs' popularity among local investors following its worst month since October 2018, was driven by the volatile CSI300 stock index weighing on local investors' risk appetite, as many investors took advantage of the local gold price's plunge in early August to enter the market or increase their gold ETF holdings.

Physical gold demand rose in August: Trading volumes of Au9999 – a high frequency physical gold demand indicator – reached 296t in August,[7] 38% higher m-o-m and 14% higher y-o-y. Historical data shows that China's wholesale physical gold demand tends to rise after the offseason for gold consumption in Q2 and early Q3 (**Chart 2**).

Chart 2: Chinese wholesale gold demand tends to rise in August and September



*Average monthly gold withdrawals from the SGE between 2010 and 2019.

Source: Shanghai Gold Exchange, World Gold Council

The Shanghai-London gold price spread rose further in August: As China's wholesale physical gold demand increased, the local gold price premium also witnessed a rise, averaging US$5.8/oz in August, US$4/oz higher m-o-m.

India: Following the improvement in July, retail demand strengthened in August. The correction in the domestic gold price on 9 August of 2.4% provided a fillip to demand in the first half of the month – largely driven by wedding purchases – although this tailed off slightly after the subsequent price recovery. Demand was also supported by buying on Onam, with anecdotal evidence suggesting an improvement y-o-y due to the low base of

[7] The volumes include both the buy and sell order which is often referred to as 'counting both sides of the trade'.

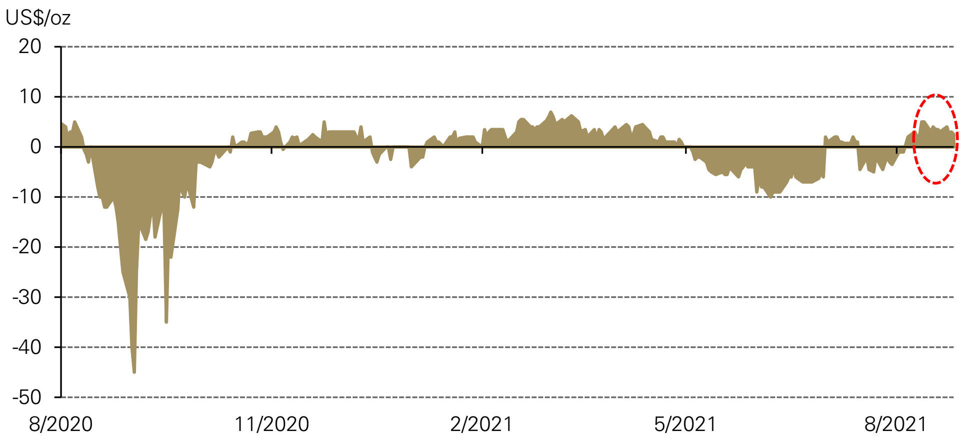
2020 and improved consumer sentiment following the economic revival after the second wave of COVID-19.[8]

Based on our interactions with the trade, we expect official imports to remain healthy in August following their revival in July. Imports will be supported by jewellery retailer restocking (ahead of festivals and weddings in Q4) and the boost in manufacturing activity ahead of India's leading business to business (B2B) jewellery exhibition, the India International Jewellery Show (IIJS), which is held from 15-19 September 2021.

The local market flipped to a small premium of ~US$0.5-1/oz by the end of the first week of August and further widened to US$4-5/oz by the second week following the price drop, but narrowed to US$2-3/oz by third week, and US$1-2/oz by the end of the month as the gold price recovered (**Chart 3**).

Chart 3: Domestic market flipped back to a premium after demand strengthened in August

Difference between MCX Gold Spot price and landed gold price in India derived from LBMA Gold price AM



*As of 31 August 2021

Source: NCDEX, ICE Benchmark Administration, World Gold Council

Europe: ZEW eurozone inflation expectations fell in August but CPI rose to 2.2% (the highest level since 2018), supporting the view that inflation is increasing globally. Furthermore, there has been speculation over inflation and the economic outlook in the region; the September ECB policy meeting will consider how inflation will be managed moving forward. The Bundesbank said that Germany's economic rebound might be weaker than expected – a sign that European equity markets could face a setback. And concerns about the Delta variant have ticked higher, prompting the EU to suspend travel from the US.

Delta variant is impacting Oceania significantly

Elsewhere: Covid is clearly impacting some regions in the East

- NZ imposed lockdown and its central bank postponed a widely-expected rate rise after a few COVID cases were recorded
- Australia, hit by the Delta variant, has seen widespread protests in response to continued lockdown measures
- The Delta variant has also had a serious impact across the SE Asian region, with varying degrees of lockdown across countries such as Vietnam, Malaysia, and Thailand.
- Gold premiums jumped in Sri Lanka as economic conditions deteriorated. Reportedly, the country's scrap supply pricing has also increased.

[8] Onam is a harvest festival celebrated in Kerala; in 2021 the festival fell on 21 August. Kerala is one of India's major gold consuming states.

WORLD GOLD COUNCIL

Most asked investor questions

Here are our thoughts on the key questions we have received from investors during the past month:

What caused the gold 'flash crash' early in the month?

During Asian market trading hours on Monday 9 August, gold dropped 4% over the course of 15 minutes to below US$1,700/oz, in what some have deemed a 'flash crash'.[9] We've been asked about the potential causes (**Chart 4**).

The early August "flash crash" was short-lived

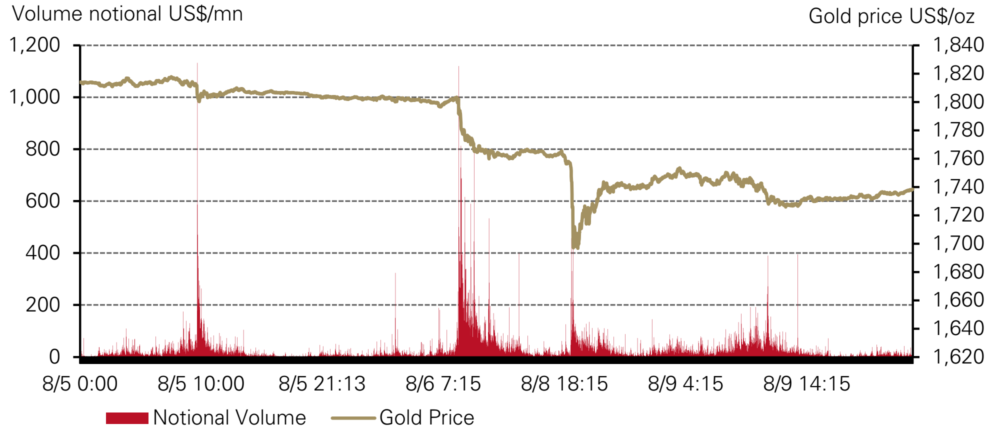
First, gold traded weaker on Friday 6 August, down 2.3% as strong US payroll data suggested the Fed may taper earlier than expected. Second, on the same day, the US dollar strengthened, as did yields.

But on Monday of the following week in Asian market trading, the price of gold sold off quickly on over US$4bn of volume; this happened during a period where there is generally less liquidity in global markets across all assets. There were some technical components that could have created this quick sell-off. First, technicians highlighted the recent "death cross" where the 50-day moving average fell below the 200-day moving average, which is considered bearish. Second, the quick sell-off likely initiated some stop-loss orders that were probably situated around the US$1,700 level, and this created a snowball effect causing additional selling.

The key takeaway from what happened that day was that gold finished down less than 2% in US market hours. It's a testament both to opportunistic investors who took advantage of the selloff as well as the trading support for gold once Western markets opened.

Chart 4: Gold sold off sharply during off-trading hours, but recovered late in the day

Price of gold and volume traded for the active month based on COMEX gold futures in US market hours*



*Based on Comex gold active month futures price.

Source: Bloomberg, World Gold Council

[9] A flash crash is a very rapid, deep, and volatile fall in security prices occurring within a very short time period.

When is a good time to buy gold and how can it be added to a portfolio?

We're frequently asked about the right time to add gold to a portfolio, but this question has come up more frequently over the past few months. We generally don't comment on timing the market or price targets of where to add or reduce gold positions but take the approach of pointing out that we believe all portfolios should have an allocation to gold.

We believe all portfolios should have an allocation to gold

There are short-term drivers and tactical positioning that can move the price in the short run but it is the long-term strategic positioning of gold that has the most important impact on a portfolio over time.

That said, as we noted in last month's commentary, September has been one of the strongest months historically for the price of gold, and this could present an opportunity for investors as we head into the fourth quarter of the year (**Chart 5**).

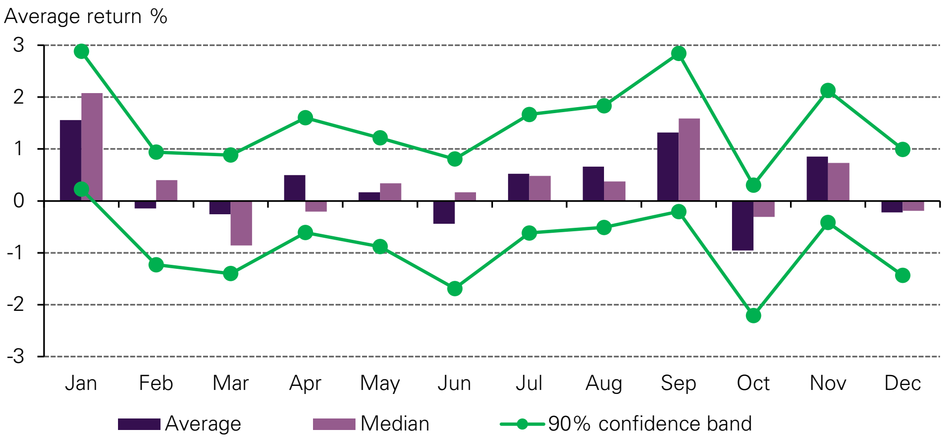
Our analysis shows that, historically, gold has delivered positive returns during September, with a confidence level just shy of 90%. This is likely driven by a combination of two trends: a period of strong demand linked to the Indian wedding season and other festivals in October and early November, and higher global investment activity following typically quieter summer months. As such, investors have often used September as an opportune time to add gold to their portfolios.

In addition, Qaurum^SM, our web-based valuation tool, suggests that there could still be upside for gold during 2021 based on various hypothetical macroeconomic scenarios.[10]

There are several ways investors can gain exposure to gold. Futures, options, gold-backed ETFs, bars and coins, and OTC, along with ownership in gold mining companies. Each is a valid way to gain exposure in its own right; the choice boils down to the needs of the specific investor, their time horizon, goals, mandates, etc., all of which should be considered when planning. And in many cases, we see investors choose an approach that gives them exposure to gold through multiple channels.

Chart 5: September has the second strongest historical average returns by month

Gold return seasonality



*Based on monthly returns for the gold price from December 1982 to July 2021.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

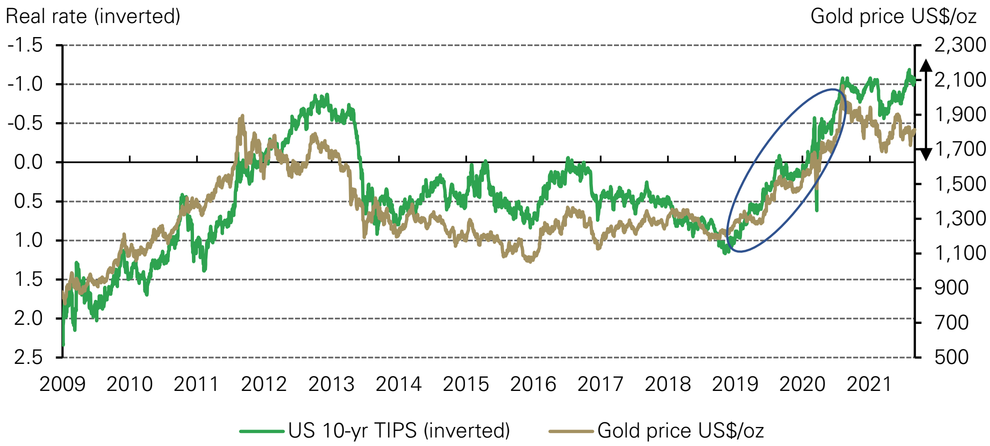
10 Based on Oxford Economics' scenarios published in Q2 2021 and calculations using the Gold Valuation Framework (GVF) methodology available through Qaurum. A detailed description of OE's scenarios and their implications can be found at Goldhub.com. The World Gold Council does not forecast the price 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. See **important information and other disclosures** at the end of this document.

Why has gold not rallied with real rates moving further into negative territory?

Real government bond yields via the US-10-year TIPS yield hit all-time lows in early August, which is normally a positive for gold as its opportunity cost improves. Despite the very strong correlation over recent years, we've seen the gold price lag this move at times, which appeared to be the case in August. This was likely a product of a stronger US dollar. We would not be surprised to see an uptick in the price of gold should real rates hold below -1%, particularly as month-end jobs data was weaker.

Chart 6: Real yields hit an all-time low in early August

Long-term real yields of US 10-year TIPS



*As of 31 August 2021.

Source: Bloomberg, World Gold Council

Are institutional investors adding gold to their portfolios and why?

Investor appetite for commodities has grown[11] and we note that gold could serve as the optimal way to gain that exposure in **Gold: the most effective commodity investment - 2021 Edition**.

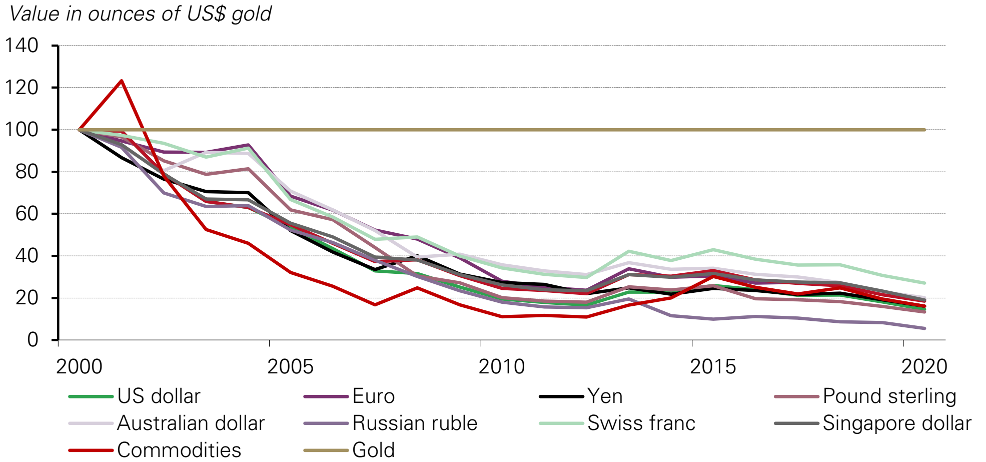
But outside of financial market research and surveys, well known institutional investors often publicly voice their opinions on gold - something we've seen more of recently. Those opinions have primarily carried a positive tone suggesting they are adding to gold positions over the past month. Two are worth highlighting:

Mark Mobius from Mobius Capital Partners commented late in the month that investors should have a 10% allocation to gold, based on his view that world currencies will devalue in 2022 as a bi-product of COVID-related stimulus packages. He believes devaluing will be also driven by consumer inflation. The principle of gold as a store of value is one of our key messages for investing in gold; we have seen the purchasing power of fiat currencies decrease substantially over recent years, a trend that has continued from the last century (**Chart 7**).

John Paulson of Paulson and Company became famous for his performance during the Global Financial Crisis when he shorted subprime housing mortgage bonds. Paulson is no stranger to gold, having offered his investors the ability to settle their investments in gold versus traditional dollars. When asked whether gold is a good investment today, he said "Yeah, we do [think gold is a good investment]. There's a very limited amount of investable gold. It's in the order of several trillion dollars, while the total amount of financial assets is closer to $200 trillion. So as inflation picks up, people try and get out of fixed income. They try and get out of cash. And the logical place to go is gold." His belief is that inflation will shoot much higher than people expect, a scenario where gold would perform strongly.

Chart 7: Fiat currencies and other commodities have been significantly devalued against gold since 1971 and more so since 2000

Value of currencies and broad commodities relative to gold (January 2000 = 100)*



*As of 31 December 2020. Relative value between 'gold': LBMA Gold Price PM 'commodities': Bloomberg Commodity Index, and major currencies, since 2000. Value of commodities and currencies measured in ounces of gold and indexed to 100 in January 2000.

On Goldhub, see: **Gold prices**.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

[11] *"Rethink, Rebalance, Reset: Institutional Portfolio Strategies for the Post-Pandemic Period"*, July 2021, Coalition Greenwich (formerly Greenwich Associates) and Asia pension funds allocate 8% to alternatives, highest in the world, Mercer says

Gold market monitor

Figure 1: Gold return in key currencies during 2021*

	USD	EUR	JPY	GBP	CAD	CHF	INR	RMB	TRY	RUB	ZAR	AUD
June	-7.2%	-4.3%	-5.8%	-4.5%	-4.9%	-4.6%	-5.0%	-5.7%	-4.9%	-7.6%	-3.4%	-4.3%
July	3.6%	3.6%	2.4%	2.9%	4.4%	1.5%	3.7%	3.5%	0.4%	3.7%	6.1%	5.8%
August	-0.6%	-0.1%	-0.5%	0.4%	0.6%	0.5%	-2.5%	-0.5%	-1.9%	-0.5%	-1.7%	0.0%
YTD	-3.9%	-0.3%	2.3%	-4.5%	-4.6%	-0.4%	-3.9%	-5.0%	7.6%	-4.8%	-5.3%	1.5%

*As of 31 August 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

Chart 8: Year-to-date performance*

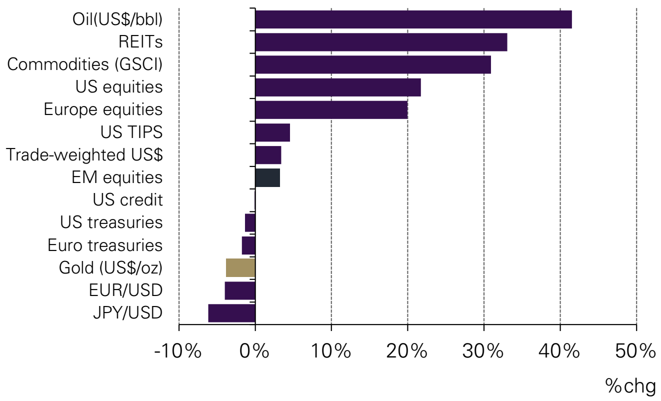


Chart 9: Gold price and moving averages*

*To 31 August 2021. Note: Return computations for 'EM equities': MSCI Emerging Markets Total Return Gross; 'Gold (US$/oz)': LBMA Gold Price PM; 'US treasuries': Bloomberg Barclays US Treasury Total Return Unhedged USD; 'Commodities (GSCI)': S&P GSCI Total Return; 'Europe equities': MSCI Daily Gross TR Europe; 'US equities': MSCI Daily Total Return Gross USA. 'US credit': Bloomberg Barclays US Credit Total Return Value Unhedged; 'US TIPS': Bloomberg Barclays US Treasury Inflation Notes Total Return Index Value Unhedged; 'Euro treasuries': Bloomberg Barclays EuroAgg Treasury Total Return Index Value Unhedged; 'Oil (US$/bbl)': US Crude Oil WTI Cushing OK Spot; 'REITs': Dow Jones US Select REIT Total Return.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

Chart 10: COMEX net long positioning*

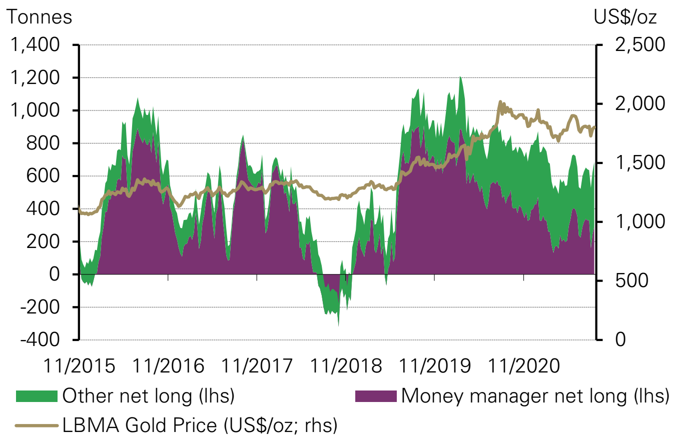
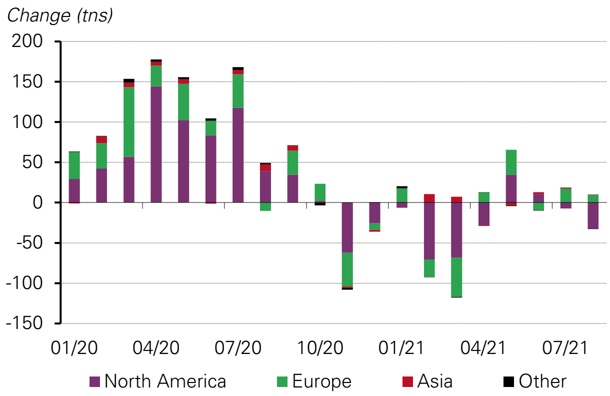


Chart 11: Gold ETF flows by region*



*To 24 August 2021. Note: The Commitment of Traders (COT) report provides information on the positioning of speculative investors in the US futures markets. Short positioning reflects bearish sentiment while long positioning reflects bullish sentiment in the gold futures markets.

Source: Bloomberg, World Gold Council

*To 31 August 2021. Note: 'Gold (US$/oz)': LBMA Gold price PM (end-of-period).

On Goldhub, see: **Global gold-backed ETF holdings and flows.**

Source: Bloomberg, Company Filings, ICE Benchmark Administration, World Gold Council

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 gold mining companies.

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