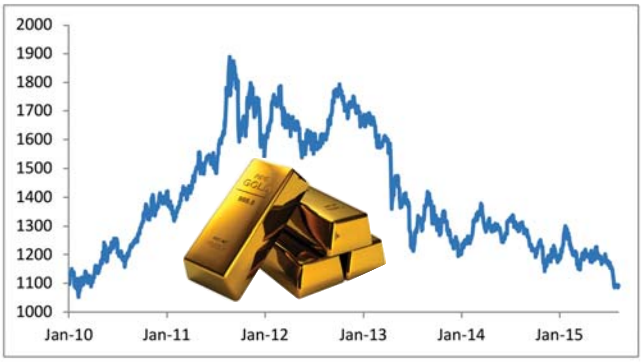
Gold: Losing it Sheen



■ ***Rajesh Agarwal***

Gold prices have been on the slide globally. Prices fell to a five-and-a-half year low of $1,072.30 on July 24 amid speculation the Federal Reserve will raise interest rates in September for the first time since 2006. Gold prices are more than 40% below its August 2011 peak. US nonfarm payrolls increased 215,000 in July, less than the 223,000 rise that economists had expected, although still seen in line with a tightening labor market. Payrolls data for May and June was revised to show 14,000 more jobs created than previously reported.

While on the one hand the expectations of rake hike from the Fed looms large, negative data from China, the top gold consumer is adding salt to the injury. China is under growing pressure to further stimulate its economy after disappointing data showed heavy fall in factory gate prices and a slump in exports. China's foreign exchange reserves fell by $42.5 billion in July to $3.65 trillion, the sharpest monthly drop since March amid signs of capital outflows. The value of China's gold reserves dropped to $59.24 billion from $62.4 billion.

The fall in gold prices that has always been considered as a safe haven investments is surprising. It used to be the first place investors rushed to in a crisis. There are financial problems in Greece and China, geopolitical problems in West Asia, Russia and Ukraine, and slow global growth. Under such circumstances, gold usually gets bullish. But its inflation that is playing spoilsport. Gold is seen as a great hedge against inflation and low inflation makes it less attractive. Almost all major economies are struggling with deflation. Even China's inflation is below 1.5 %.

Despite prices falling, demand for consumer gold has yet to pick up in the two largest markets—China and India—that account for over 50% of sales. Historically, buying has emerged from domestic household when gold prices has corrected drastically, in fact, the high level of Indian purchases was cause for concern when the rupee came under pressure in 2013. Gold was the second largest contributor to imports besides crude oil. This time it seems to be different. Investors are opting for Equity and Debt. It's becoming a double edged sword, while Indians are not buying – China has witnessed selling pressure.

The rout has taken a toll on gold ETF too. Gold ETFs were launched by India's mutual funds in 2006-07. In March 2007, the asset class had an AUM of ` 96 crore, rising to ` 11,648 crore in March 2013 and since then it has witnessed a downward journey. The assets under management of gold ETF have declined by 14% in the last one year, and 35% in the last three years. As per the latest data, the AUM of the gold ETF category stood at ` 5957 crore (as of July 31, 2015). The gold ETF category has seen net outflows consecutively for the last 24 months.

Internationally, $980-1,000 an ounce is the psychological mark. Since this is the average mining cost for most companies, further fall will lead to supply cut by mining companies.

From a fundamental perspective, movements in gold prices will largely depend on the US' interest rate decision. The markets will continue to move in a range unless the view for US rates becomes clearer. Until a clearer picture emerges, gold prices are likely to remain soft. Cost of production and demand from traditional consuming centers will act as a support for prices, limiting the downside risks.

On the domestic front, Domestic prices have seen sharp correction. Strengthening dollar, possible hike in rates by the US Fed and considerable fall in demand, has dragged down the prices below the psychological ` 25,000-mark. Demand for gold might pick up from the coming festive / wedding season. Moreover, the demand or price of gold will also be impacted because of the monsoons. Rural spending depends hugely on the monsoon, crucial for kharif crop. Nearly 60 % of the total gold demand in India comes from rural areas.

India has its festive season coming and if that coincides with lower gold prices, it could spark renewed buying. Similarly, if the Chinese stock market loses more ground, Chinese retail investors might again start looking at gold as an asset. Gold will gain if global growth slows and there's higher inflation, or some sort of currency collapse occurs. Gold will lose more ground if global growth improves, even if inflation rises. Gold could also lose ground if growth slows and inflation does not occur. The chances are there is still a downside.■

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