# The SA Bullion Gold Report

Q4 2012

SA Bullion

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Table 1: Gold Performance to 31 December 2012 (% per annum)[1]

| | Quarter[2] | 1 Yr | 2 Yr | 3 Yr | 5 Yr | 10 Yr |
|---|---|---|---|---|---|---|
| Gold in US Dollar | - 6.7 | 8.3 | 8.6 | 15.1 | 14.7 | 16.9 |
| Gold in Rand | - 4.3 | 13.6 | 22.9 | 20.6 | 19.8 | 16.8 |
| Gold in Euro | - 9.0 | 6.2 | 9.4 | 18.2 | 17.1 | 14.2 |

*[1] Based on LBMA Afternoon Fixes*
*[2] not annualized for periods of less than 1 year*

Table 2: Year-End Gold Prices and Exchange Rates[1]

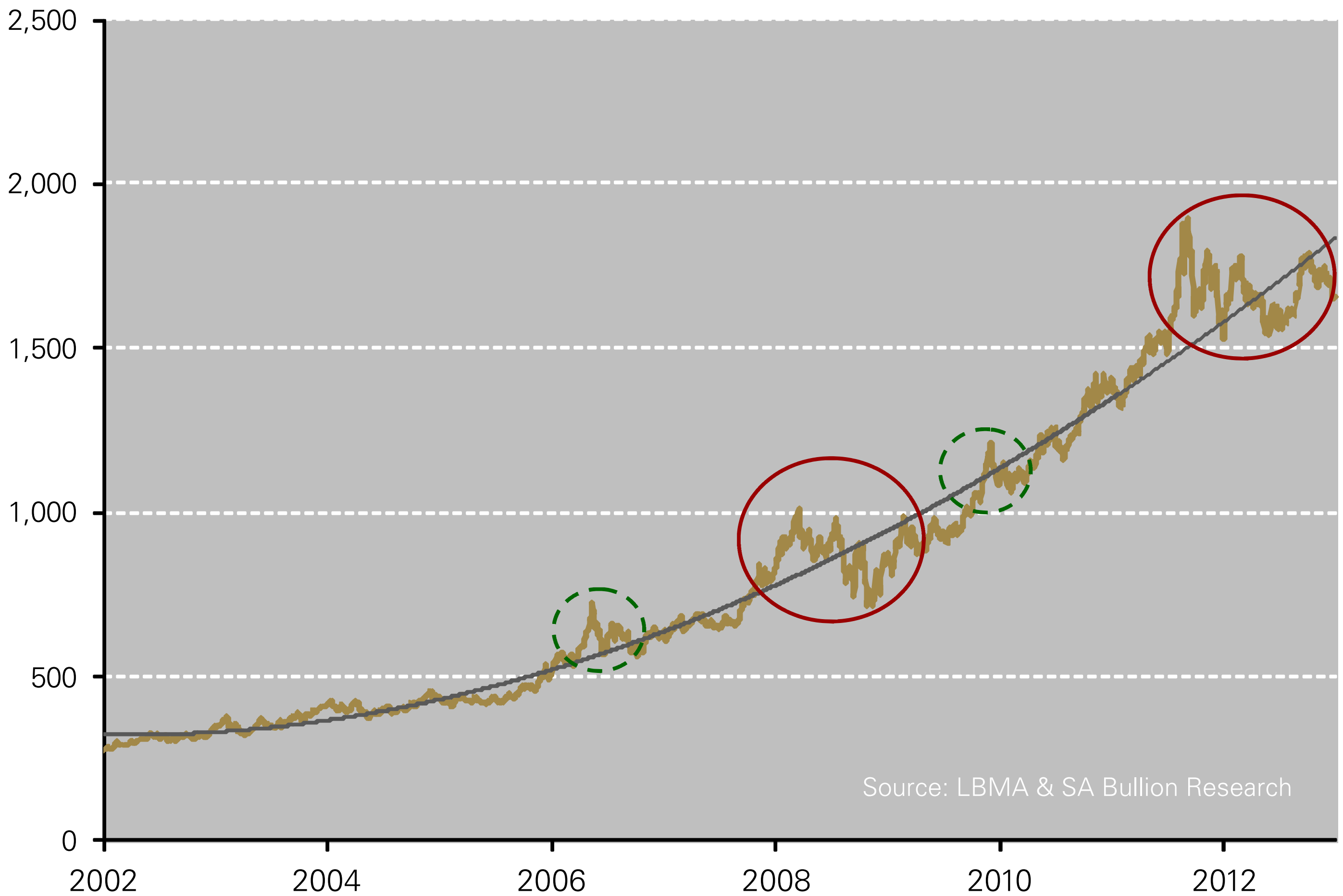
| | Gold in US$/oz | R/$ rate | Gold in R/oz | $/€ rate | Gold in €/oz |
|---|---|---|---|---|---|
| 31 Dec 2002 | 347.20 | 8.58 | 2,979.15 | 1.05 | 330.86 |
| 31 Dec 2003 | 416.25 | 6.67 | 2,778.47 | 1.26 | 330.00 |
| 31 Dec 2004 | 435.60 | 5.63 | 2,454.06 | 1.36 | 320.47 |
| 31 Dec 2005 | 513.00 | 6.32 | 3,253.70 | 1.18 | 434.91 |
| 31 Dec 2006 | 632.00 | 7.05 | 4,456.07 | 1.32 | 479.28 |
| 31 Dec 2007 | 833.75 | 6.83 | 5,698.14 | 1.46 | 570.26 |
| 31 Dec 2008 | 869.75 | 9.24 | 8,040.84 | 1.39 | 625.70 |
| 31 Dec 2009 | 1,087.50 | 7.36 | 8,008.08 | 1.43 | 757.97 |
| 31 Dec 2010 | 1,405.50 | 6.61 | 9,298.44 | 1.34 | 1,047.67 |
| 31 Dec 2011 | 1,531.00 | 8.07 | 12,360.37 | 1.30 | 1,179.37 |
| 31 Dec 2012 | 1,657.50 | 8.50 | 14,044.10 | 1.32 | 1,253.02 |
| 30 Sep 2012[3] | 1,776.00 | 8.26 | 14,671.89 | 1.29 | 1,377.27 |

*Note 1: The above prices are LBMA Afternoon Fix prices*
*Note 2: 31 Dec 2012 R/$ rate and Gold in R/oz from 21 December 2012 due to local market closure.*
*Note 3: Previous quarter-end prices*

Table 3: Calendar Year Performance of Gold

| | % US Dollar | % ZA Rand | % Euro |
|---|---|---|---|
| 2003 | 19.9 | - 6.7 | - 0.3 |
| 2004 | 4.6 | - 11.7 | - 2.9 |
| 2005 | 17.8 | 32.6 | 35.7 |
| 2006 | 23.2 | 37.0 | 10.2 |
| 2007 | 31.9 | 27.9 | 18.9 |
| 2008 | 4.3 | 41.1 | 9.7 |
| 2009 | 25.0 | - 0.4 | 21.1 |
| 2010 | 29.2 | 16.1 | 38.2 |
| 2011 | 8.9 | 33.0 | 12.6 |
| 2012 | 8.3 | 13.6 | 6.2 |

Figure 1: Ten-Year Chart of Gold Price in US Dollar [LBMA PM Fix]




## Gold Price Action

Once again gold provided a very decent return for the calendar year (see table 3 above). Compared to interest rates for cash in the bank gold produced a highly satisfactory result - this notwithstanding a dreadful fourth quarter.

We wrote, last quarter, about an interesting chart pattern where we had a very similar recent repetition of a pattern made in 2008. Remarkably, that pattern has extended itself so that 2008 and 2012 appear to be cast from the same die. Starting at the beginning of 2008 we saw a drawn out 18-month consolidation for gold. Beginning in mid-2011 we again witness an 18-month consolidation. We do not place any great significance in repeating pictures but we do sense that the period ahead could well mirror the period following the last big consolidation i.e. mid-2009 onwards.

The decline in the gold price from its all-time high of $1,895.00 on 6 September 2011 is largely attributable to short selling by a relatively small number of institutional speculators and traders. The Hulbert Gold Sentiment indicator is presently at an extreme-low only observed six brief times in the last five years – which contrary to what you might expect presages rising gold prices ahead. We have even witnessed the return to gold of some of the large profit-takers like Paulson and Soros. The speculative action and consolidation appear to have run their course and to be behind us.

## Central Bank Gold Dealings

Central Banks of the major emerging nations are extremely underweight in gold and appear eager to increase their gold holdings while simultaneously decreasing their US Dollar and Euro exposures. These nations include China, Russia, India, Mexico and Saudi Arabia.

Whereas the United States, Germany, Italy and France hold currency reserves where gold exceeds 70% of the total, China has official gold holdings totaling 1,054 tons, which is equivalent to only 1.7% of their currency reserves. In the first 11 months of 2012 China imported a net 281 tons of gold equivalent in value to $15.3 billion. In the same period China purchased just marginally more US Treasuries - to the value of $18.2 billion. China would appear to be very eager to increase its gold exposure.

We are likely to see continued buying by the official sector and a tightening of the physical gold market fundamentals.

*Snippets:*

The Bank of Japan, following political instruction to target inflation at 2% p.a. has implied quantitative easing without limit. This follows escalating political tensions (apropos China) that have contributed to a rapidly deteriorating trade and current account balance. (Note: political tensions always come at a cost)

Germany's Bundesbank has announced that it plans to repatriate some of its gold holdings from the vaults of the New York Fed and from the vaults of the French central bank in Paris, to Frankfurt at the rate of 50 tons per year for eight years. This exercise will result in Germany's largest holdings in Frankfurt, less in New York, and a smaller amount in London. We would not be surprised to see further trickling of gold holdings back to Germany a decade hence. Repatriation of gold is one half of the story. The other part is that Germany will be upgrading the gold bars (many of which are likely to be of poor quality – what are known as "deep storage bars"). These actions are very positive and supportive of gold's re-emergence as a hard currency form of money.

## The Present-Day Financial Crisis

We have been hearing of late that the US is producing positive economic growth, that unemployment statistics are improving, that major corporations have produced record profits, that house prices and stock prices are rising and that all things considered, the picture is looking reasonably rosy for Uncle Sam. Talk is one thing, but what we're most interested in are the confessions when we interrogate the numbers. Put another way, we prefer facts over hot air.

Of course gold is priced in US Dollars, and so as always, we are primarily concerned with the health (or lack of health) of the greenback. So: whereto for the Dollar? In order to meaningfully answer this vital question we need to ascertain the likelihood of a continuation of negative real interest rates (i.e. financial repression) and establish the state of monetary and fiscal affairs in the United States.

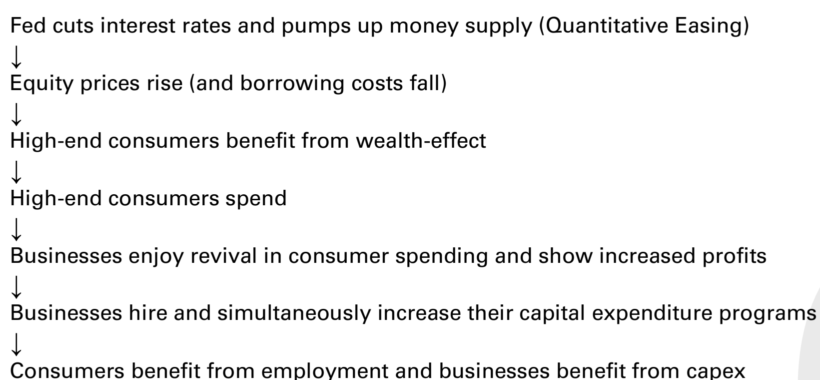
The US Federal Reserve (the 'Fed') launched QE3 (i.e. the third round of quantitative easing) in September with a plan to buy $40 billion per month in Mortgage Backed Securities. In December the Fed boosted the program to $85 billion per month by adding $45 billion per month in purchases of Treasuries. Of course the asset purchases are intended to bring down long term interest rates and thereby spur economic activity. According to Fed President Richard Fisher, the Fed's aggressive monetary policy stance has not brought down mortgage rates as much as hoped and that quantitative easing seems to be having a lesser impact as more time passes. This is no surprise to us. Economic history teaches us that massive reflation following a Credit Crisis offers diminishing returns and is ultimately futile as the bad debts have to wash out of the system.

## Turning to some important metrics...

The December U3 Unemployment Rate actually rose by 0.1% to 7.8%. The more meaningful U6 Unemployment Rate came in at 14.4% and the most believable ShadowStats Unemployment Rate came in at 23.0%. Following four years of unprecedented stimulus these are not heartening figures. The Fed recently announced that it would keep rates at the current staggeringly low levels until U3 Unemployment fell below 6.5%. That could be a long time coming.

US tax receipts are still massively overwhelmed by outlays, and once again in calendar 2012 the US has racked up a deficit that is well in excess of one trillion dollars ($1,089 billion). When we scrutinize the Department of the Treasury budgets as well as forecasts made by other institutions such as the Congressional Budget Office we cannot see how the US government will manage anything than huge budget deficits for decades to come. This translates into a mounting, and rather worrisome, national debt that has recently passed the 100% of GDP level. In their excellent work titled 'Growth in a Time of Debt', Reinhart and Rogoff demonstrate that once a country's debt/GDP ratio exceeded 90%, economic growth slowed by approximately 2% for approximately a decade. This does not augur well for the US and its hoped-for tax collections, which in our opinion are wildly optimistic.

The key objective of Fed monetary stimulus (quantitative easing and financial repression) and of government fiscal stimulus (deficit spending) is sustained economic growth. We wrote on this subject in the Q2 2012 report to you, where we explained the transmission mechanism as follows:



At the time of the Q2 report we explained that the transmission mechanism was not working beyond the fifth step where businesses enjoy a revival. We revisit this critical subject.

The bad news, for the US economy, is that the US Bureau of Economic Analysis' Net National Savings Rate data demonstrate that notwithstanding all the staggering stimulus measures, corporations are not investing in new business. The money is chasing after stocks and other assets but not finding its way into investment in business. The new money is being consumed and the rest is being hoarded. This is classic financial crisis behavior and was last observed in the 1930s during the Great Depression.

In summary, we would have to say that conditions in the US are far from rosy and that economic difficulties will endure for many years. These tough times will call for continued stimulus and repression and therefore continued weakening of the Dollar, which will become observable in increasing consumer inflation in the years ahead. And a rising gold price.

### A Comment on the South African Rand

In mid-October S&P cut South Africa's credit rating by one notch to BBB and tacked on a negative outlook. A month or two later, Moody's cut the rating to A3 with comments relating to labour unrest. In the first week of January Fitch cut the sovereign credit rating to BBB. Fitch qualified their move with comments of political tensions, deteriorating economic prospects and the knock-on effects for public finances and social tension.

Whilst not dramatic, these rating cuts are unhealthy (as of course are the underlying reasons!) and can only lead to Rand weakness, which in turn leads to mounting inflationary pressures. The awful mess that was Marikana may be behind us but all of South Africa will pay a hefty price for a long time to come.

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