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Delta—impact on fundamentals, Fareast & Indian physical demand

We published a view of Delta variant and its impact on the macro backdrop (it could be risk friendly given expectations that a post-Delta world implies more liquidity and/or a later taper or hike), but that's not a complete view. With investor outflows really testing the physical floor in Gold recently (showcasing weak demand, otherwise $1700 wouldn't have broken) and the fact the COVID cases have intensified in Asia, the below summarizes physical gold demand and the outlook from this key segment; which now has to really show up to stave off a 2nd leg lower through the triple low of $1675.

Asia COVID Update: the new Delta hotspot. But with Asian currencies tumbling, and already low interest rates (activated in 2020), there is little (monetary) policy room to lower interest rates, for fear of pushing much needed foreign capital away. The combo of more Delta cases and less policy space will make the return to normality very arduous and it will likely need some policy help from the (vaccinated) West —vaccines, a pause of booster shots, but just easier monetary policies. Page 2.

China: extremely negative (political and economic) news cycle. Gold demand improving but still weak and participation rates not near historical 'could-be' levels given Gov intervention. Pages 3-4

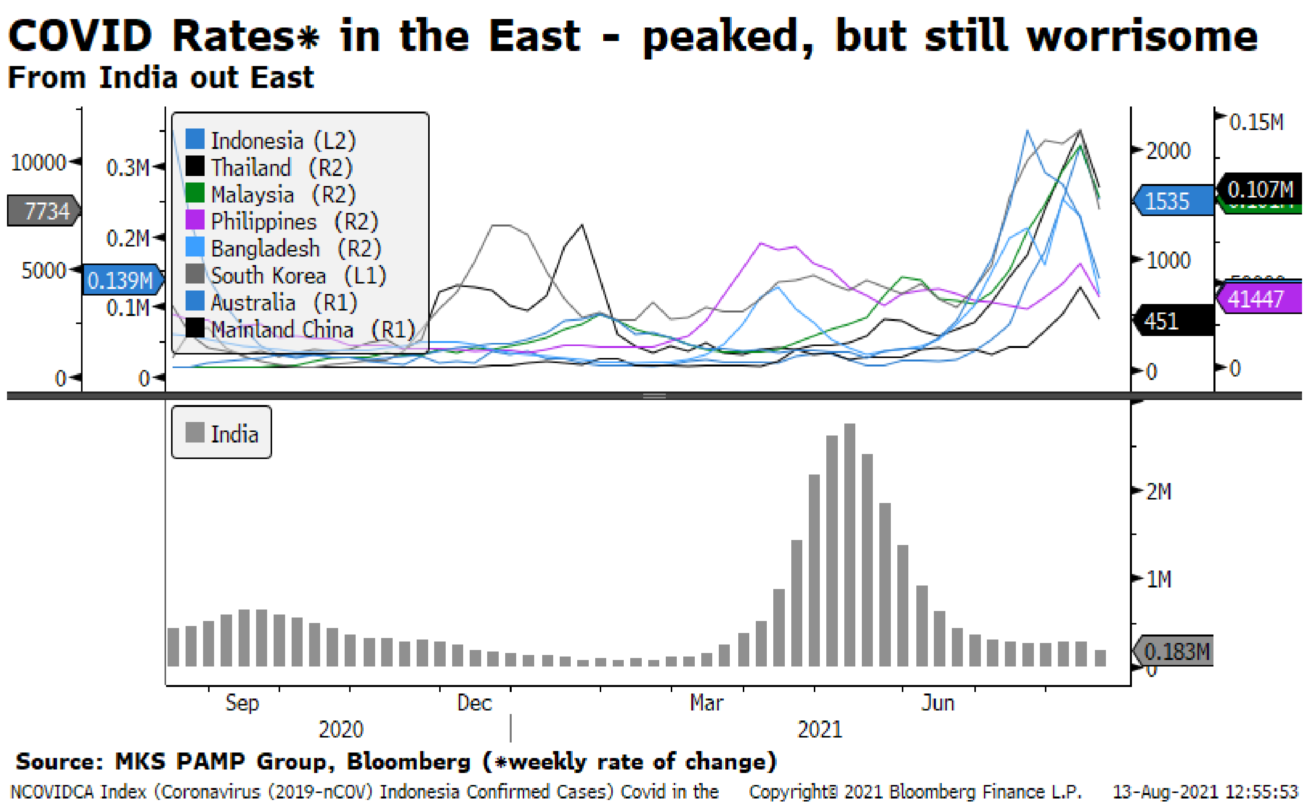
India: pent-up demand and lower pricing as COVID restrictions eased, driving decent demand. A rebound story, especially for Silver, with momentum potential into 2H for Gold given seasonals. Page 5

South East Asia / Thailand: demand is usually a net positive on weaker prices, now perhaps even a net negative given some need to raise cash (sell gold jewelry). Page 6.

---> As a whole, Eastern physical gold demand is improving, with greenshoots in certain areas, but its still a very fragile contestant if a second wave of taper-driven paper selling reemerges.

COVID Update in Asian, including China, India and South East Asia

South-East Asia was praised for preventing large outbreaks of COVID-19 last year, but with the vast majority of South-East Asians still unvaccinated, the Delta toll has been severe. Indonesia, Malaysia, and Thailand are reporting record cases (although the curve has peaked. New daily cases in Vietnam are 3x higher than the total for all of 2020. Beijing added new curbs, and travel restrictions were introduced across the nation as the outbreak grew to more than 500 cases in 15 provinces (the ICO said the Winter Olympics may go ahead without spectators). Chinas NIA has continued to restrict unnecessary / non-urgent travel abroad and imposed a stricter policy on issuing passports and/or other travel documents to mainland residents; people just cannot leave… Melbourne entered lockdown for the sixth time since the pandemic began. Infections in Tokyo also hit a new high even as they remain in a state of emergency. India was arguably the gateway for Delta to spread East, as the graph simply depicts, and like in the West, it matters how policymakers react—and that varies, a lot. But with Asian currencies tumbling, and already low interest rates (activated in 2020), there is little (monetary) policy room to lower interest rates, for fear of pushing much needed away foreign capital. The combo of more Delta cases and less policy space will make the return to normality very arduous and it will likely need some policy help from (vaccinated) West —vaccines, a pause of booster shots, but just easier monetary policies.



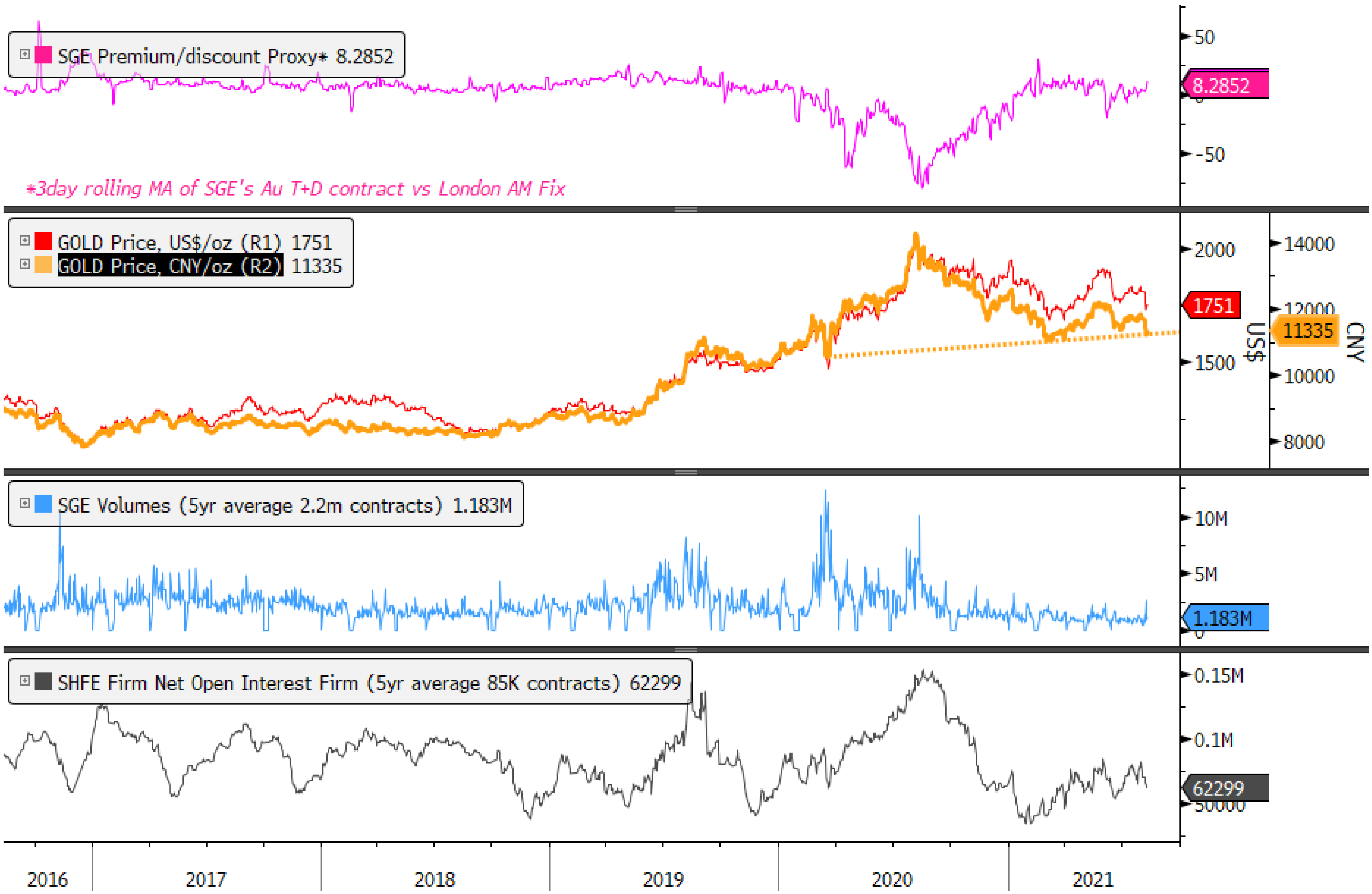
China:

- The news cycle around China is at its most negative in a while (the recent floods, Delta spread & associated restrictions within and, leftfield regulatory overhaul of key sectors, PBOC uncertainty around QE, Taiwan, Western arrests etc) , which has complicated both Gold flows and demand.
- Chinese Gold demand, at $100 higher, was somewhat improving. But that was from a very weak base, when SGE fell to a discount of around $50 vs London in June, when a combo of resurgent COVID cases and new regulations on metals trading*, hit. Chinese net gold imports via HK jumped nearly 42% in June to ~31tonnes (after a slump in May of only 22tonnes) and **so long as Gold prices remain below $1800, and the CNY does not continue to depreciate, Gold imports and thus demand could provide some short-term reprieve.** That's visible with SGE trading at a premium to London gold ($8-10) which, note, shouldn't be taken as a standalone proxy for decent demand.
- The larger medium-longerterm issue is that participation rates—whether that's via trading, or investing in precious—has plummeted. That is unlikely to return back to historical highs, as Chinas clampdown on commodities and more recently on retail gold accounts, continues. That's visible through many metrics - SGE positioning has halved over the past year (indicated by SGE Open Interest falling from 300K to 150K contracts), SHFE speculative length has exited vs past averages, SGE volumes are down & SGE inventory is at 300tonnes (vs historical average twice as much). Local demand has been met by internal stock or production, implying weak local consumption. **Even if China wants to buy, & provide more sustainable Gold support, there isn't as much direct Exchange access to markets within mainland as in the past and ultimately lower participation rates, in any sector, is a disinflationary price phenomenon.**
- Ultimately, as Chinas economy slows, the country is responding by leveling out the hoarded wealth & humbling (tech) tycoons (through massive regulatory overhaul) and trying to increase the nations birth rate. After the announcement of the 3-child policy in June, policy makers unveiled reforms in the private education industry, aimed at easing families' burdens of raising children (20-30% of annual income is spent on education and related services!) and encouraging new births. **IF—and that's a big IF—higher birth rates do rise in the longer-term, that's ultimately supportive of Gold price action / general gold or jewelry consumption.**

*There is no specific 'gold agenda' for banning retail interest in Precious Metals (unless the outlandish conspiracy belief is that the PBOC is keeping gold prices suppressed so they can accumulate cheaper). The crackdown on commodities is merely a continuation of 1) the controversial Yuan you Bao crude oil trading incident in 2020 and 2) an extension of curbing property speculation (as its seen as one of the key ways in which income inequality has worsened in China). Theres a preference for banks to focus on traditional banking services/ products and retail interest in commodities and the associated risks/exposure retail speculation brings, is not. Retail interest in precious metals has been a fraction of its larger size for over a year now, but as is usually the case with China, suppressing overspeculation in one area, just redirects it elsewhere…

Chinese Gold participation

Volumes, OI, stocks - down, not out, but a limited contributor



Source: MKS PAMP Group, Bloomberg

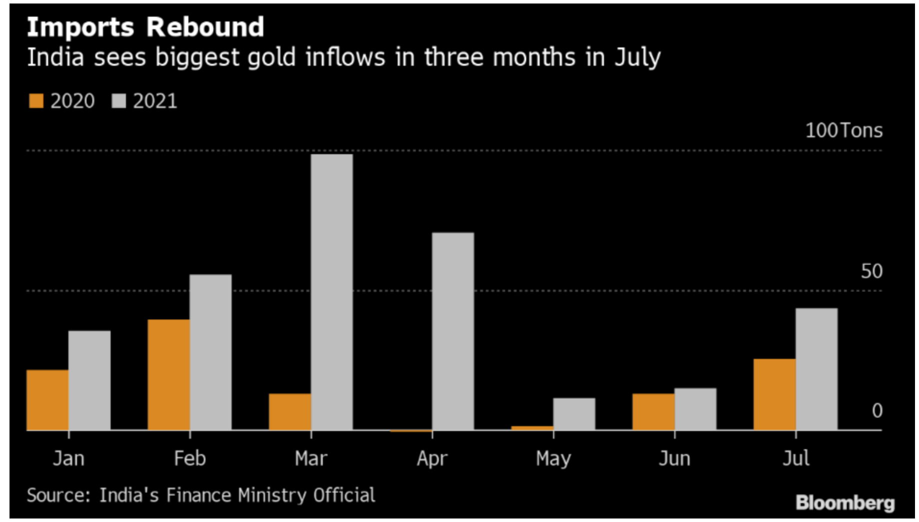
.SHANGPRE U Index (shanghai prem > Golds) SGE arb vs Gold and vols Daily 12AUG2 11-Aug-2021 13:19:12

India—rebound story with momentum potential into 2H for Gold. Solid Silver demand.

- COVID cases peaked in May and with many Indian states slowly removing/ed restrictions on businesses and the movement of people, the increased traffic at stores, and a fall in local prices revived Gold demand. That was evident with July Gold imports leaping 71% YoY to ~44 tons (the largest since April) as pent-up demand resurges.

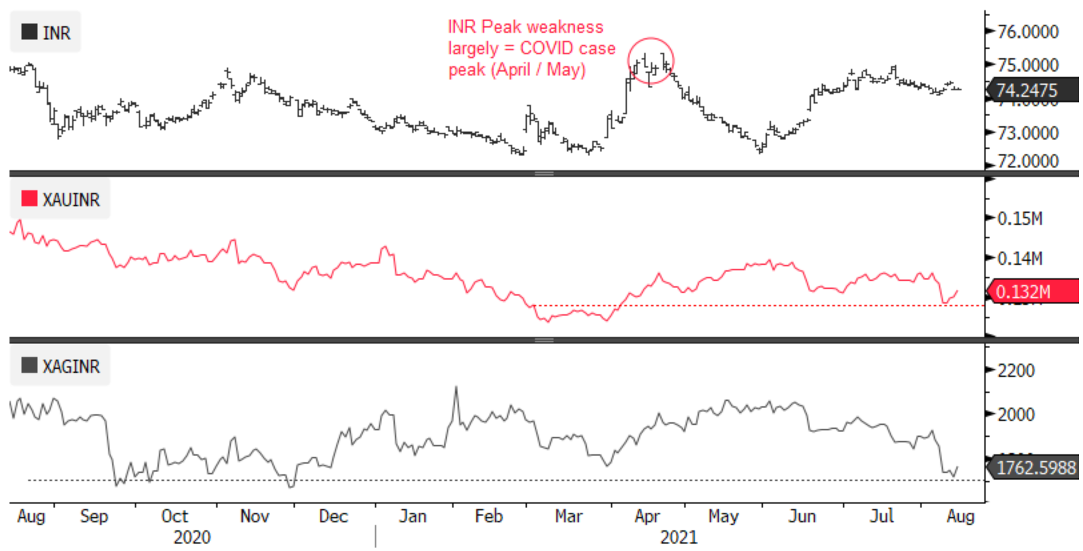
- India is known to be notoriously price sensitive, but at the same time, consumers also adapt to the ever inflationary Gold price over time (driven by the tailwind of a structurally weaker Rupee/INR). April imports were ~70tons when XAUINR averaged 131K INR, while Julys imports of 44tons were against an average monthly price of 135K INR. Given the recent price dip below 130K INR, the return of the onshore consumer demand post Delta, the upcoming wedding & festival season, 2H 2021 is likely to be much stronger than 1H 2021

- By the same token, given even weaker/cheaper Silver prices in local/INR terms (its ear 1year lows in XAGINR whereas XAUINR is only at March 2021 levels) theres been an even larger consumer reaction for inbound Silver material. This should help to offset some of the persistent producer-related flow which seems to be keeping Silver prices distortedly lower vs Gold.



Gold & Silver in local currency terms (INR)

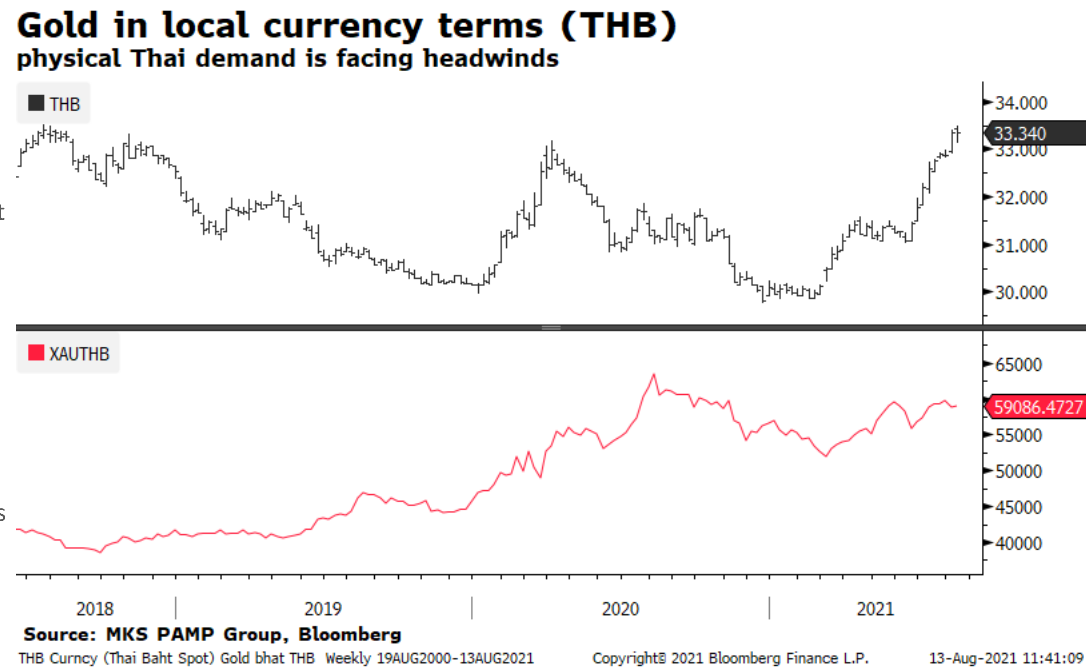
physical Indian demand is slowly enticed in with pullback



Source: MKS PAMP Group, Bloomberg

INR Curncy (Indian Rupee Spot) Gold INR vs imports Daily 13AUG2020-13AUG2021 Copyright© 2021 Bloomberg Finance L.P. 13-Aug-2021 10:28:15

South East Asia—Thailand—usually a net positive on weaker prices, now perhaps even a net negative given some need to raise cash (sell gold)



- In any usual / pre-COVID situation, the South East Asian Gold market would respond splendidly to these lower prices, however that region has become the new Delta hotspot (see page 1 on COVID spread). During the recent quasi-lockdown which has been in effect since April, medical concerns/illnesses becomes a priority, which in effect leads to sales of jewelry/holdings to shore up cash. There is very limited, if any ‘fear buying’.
- In addition, the majority of Thai Gold volumes are driven by bullion gold traders (not necessarily retail jewelry names), who view Gold as trading / investment asset, not a “buy-and-hold” store of value/safe haven. Thus with the recent Gold capitulation (and in local/bhat terms) but associated strong rebound, interest/participation may pick up, which is generally mildly supportive.
- The Thai bhat has weakened considerably into this new resurgence of cases, hitting almost 3year peak weakness vs the USD of 33.43. That ultimately has taken Gold in local terms to within 7% of All Time Highs (seen recently) and will weaken gold purchasing power; consumers simply buy quantitively less and theres less incentive to purchase gold as a currency hedge against the weakening local currency.
- Given the lockdowns there are transportation restrictions between cities and zone together with a curfew at 9PM, that makes it difficult to shift physical gold around. That’s especially true between Bangkok center and the outlying cities. Ultimately, the supply-chains within the commodity/metals markets were shaken last year, triggering massive dislocations within markets and while that’s much improved, participants are wary that these physical dislocations can return in some COVID hit regions.

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