Gold and the World Economy

Presentation to

2012 Precious Metals Summit Colorado

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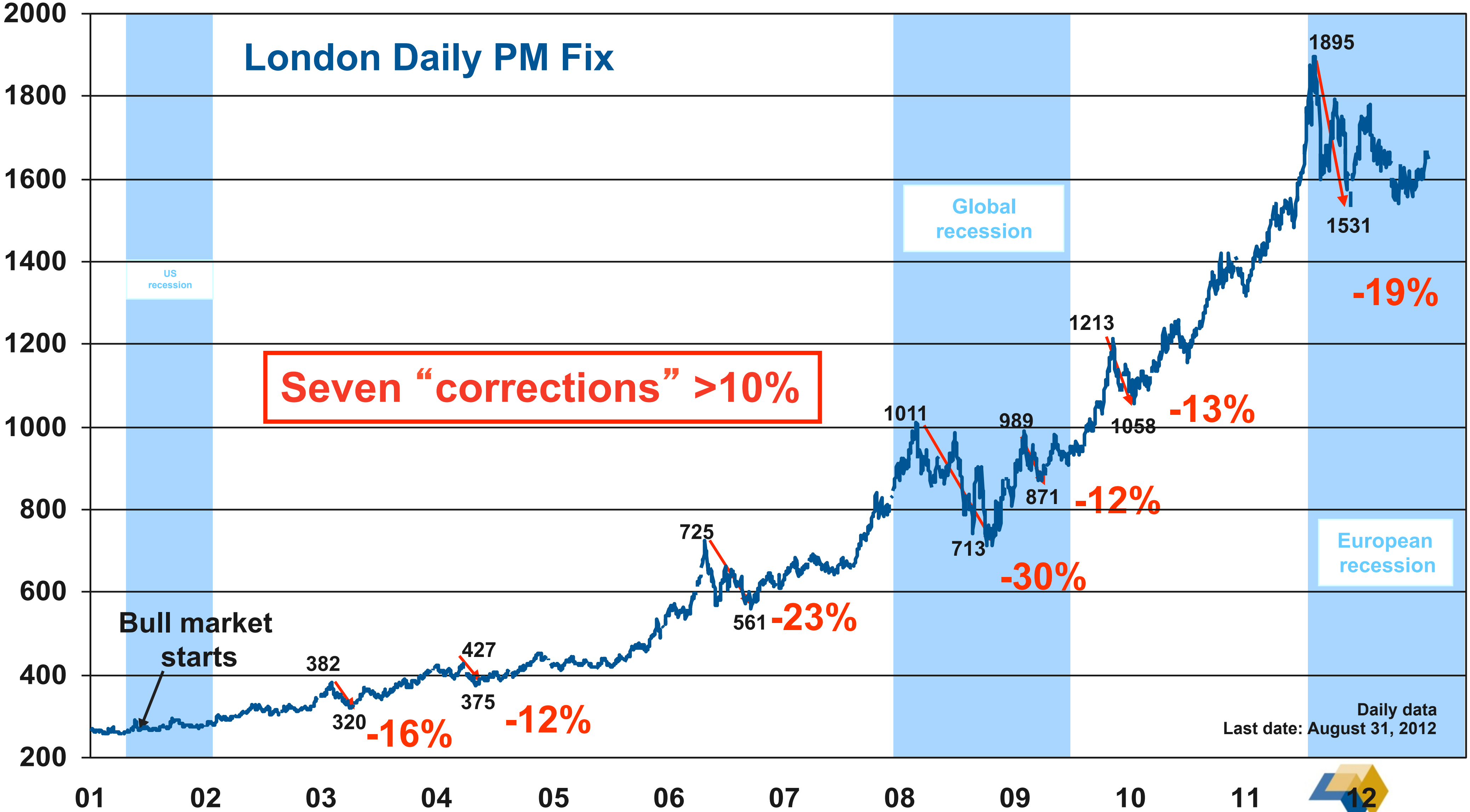
Overview: Gold Price Corrections



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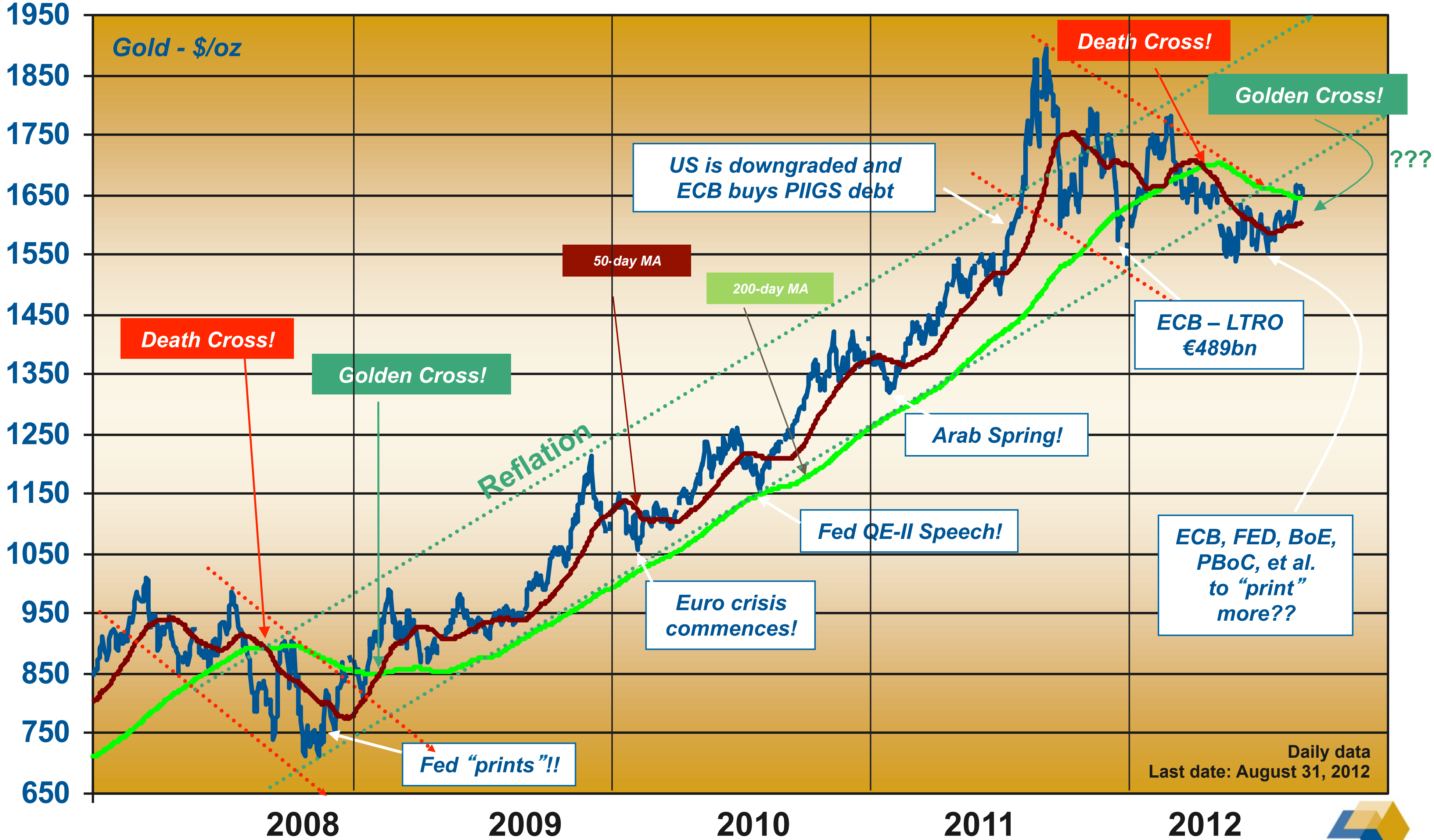
Overview: The Technical Picture



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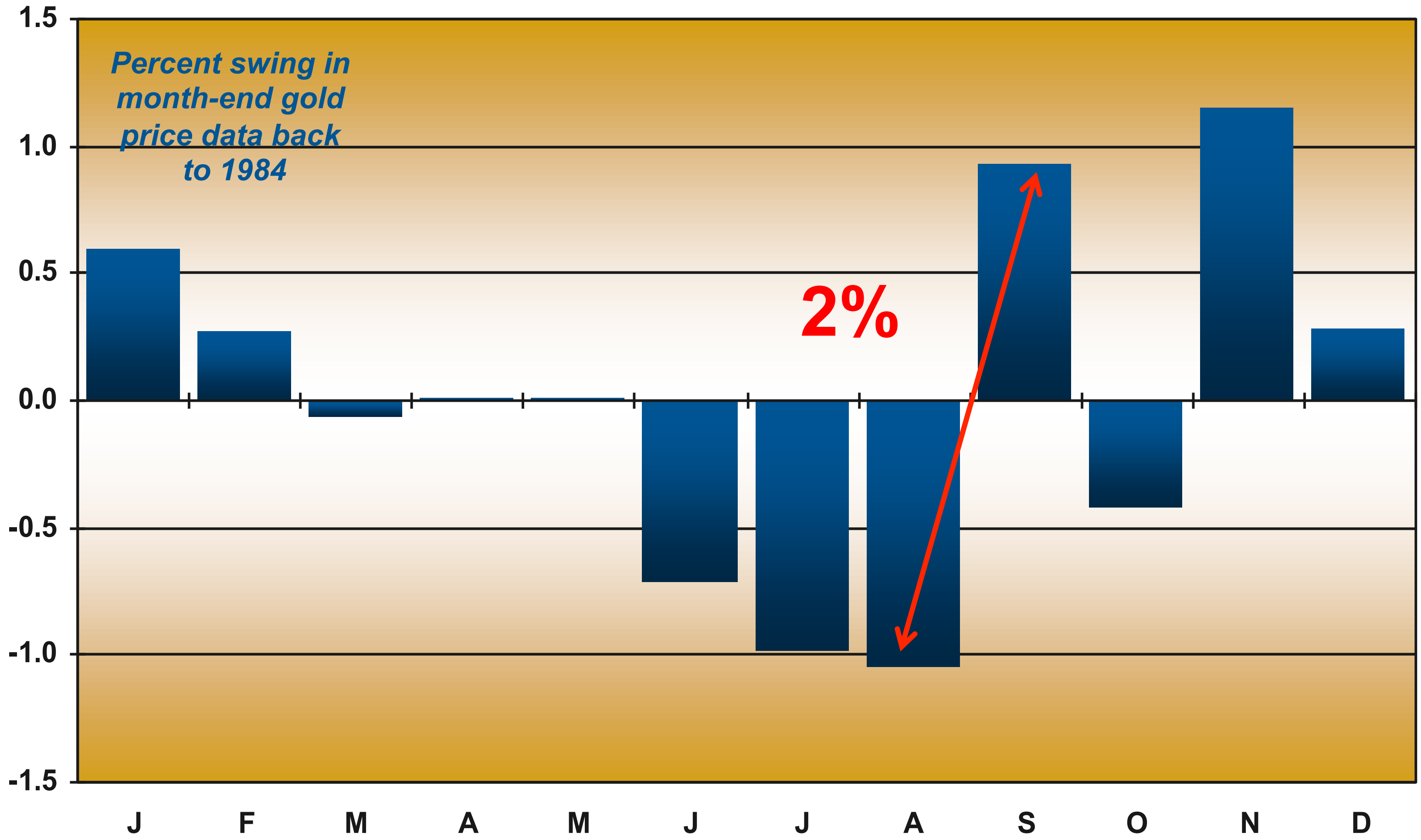
Overview: The Seasonal Factors



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Eight Bullish Factors for Gold

1. ***Global debt crisis:*** ***more monetary reflation***
2. ***CB's buying gold:*** ***huge attitude change***
3. ***Investment demand:*** ***Asian market deregulation, ETF***
4. ***Gold not in a bubble:*** ***room to rise***
5. ***Commodity price cycle:*** ***many years to run (BRIC)***
6. ***Global imbalances:*** ***dollar needs to decline further***
7. ***Geopolitical environment:*** ***Iran?***
8. ***Mine supply up only modestly:*** ***gold costly to find***

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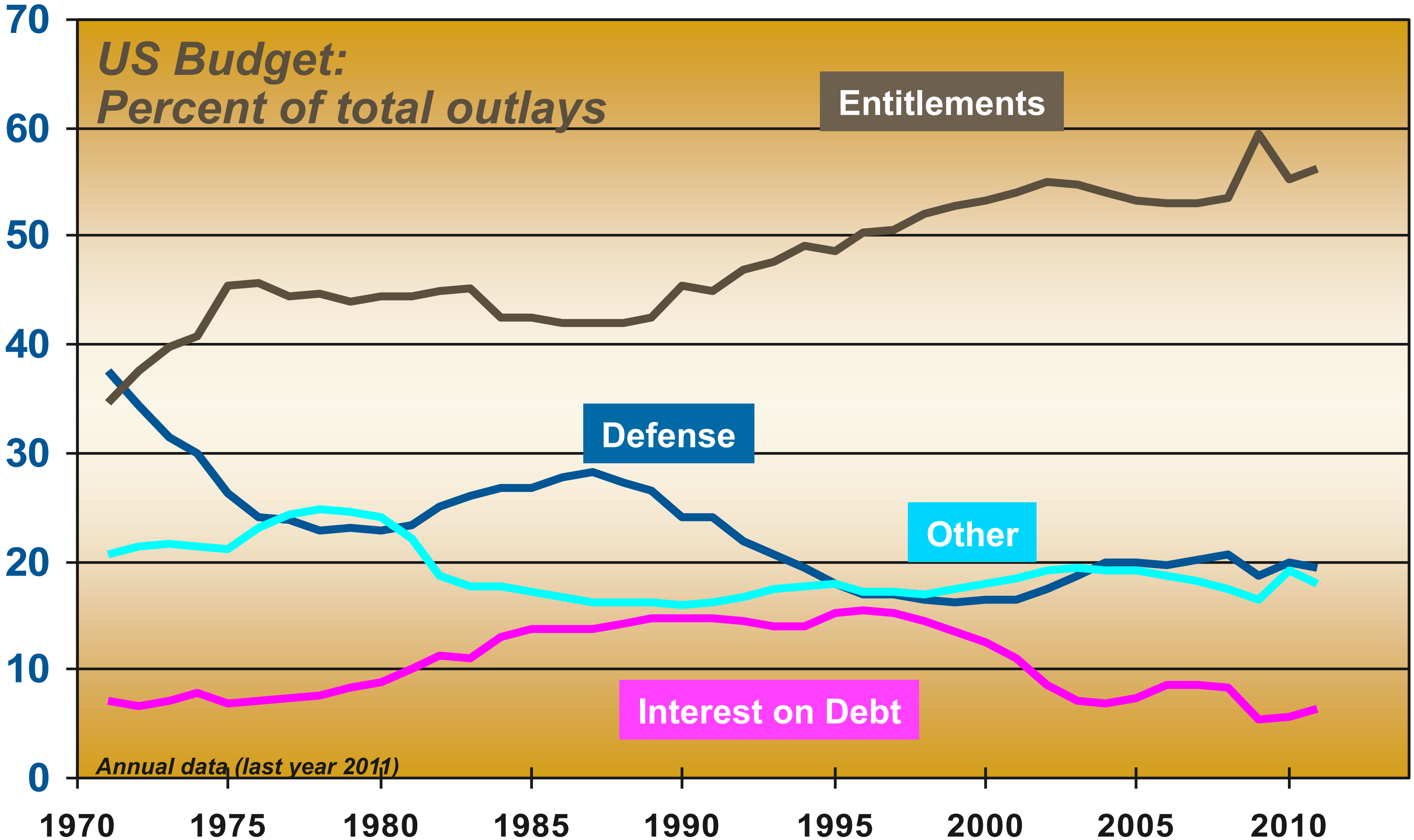
Bullish: (1) Global Debt Crisis

Antecedents of the global debt crisis

1. **40-50 Years of Liberal-Democratic Social Policies:** voters demanded more social welfare
2. **Baby-Boomer Retirement:** Creates huge fiscal costs going forward on account of over-promises by governments
3. **The Great Recession:** Pushed budgets into record deficit – just when early boomers were starting to retire
4. **The Euro Common Currency:** Membership in the Euro System allowed "undisciplined" governments to borrow (excessively) at German interest rate levels
5. **Massive FX Reserves:** high oil prices and undervalued currencies led to large FX reserves which were recycled to fund all the demands for funds by governments, home buyers, etc.

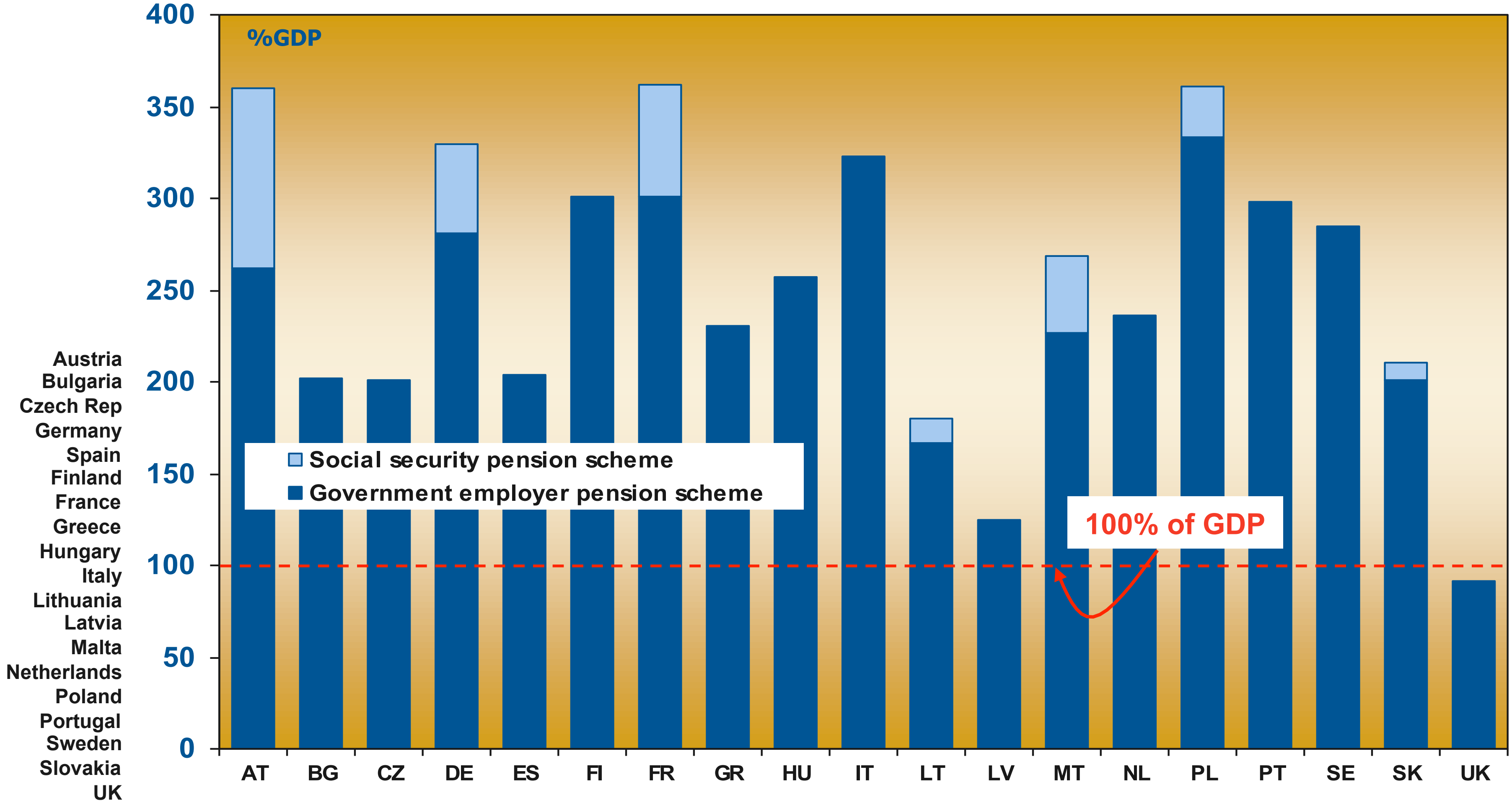
Bullish: (1) Global Debt Crisis

Entitlements are killing Western economies



Bullish: (1) Global Debt Crisis

Europe's pension liabilities are massive, for example



Source: *Research Center for Generational Contracts, January 2009*
NB – Future contributions are not taken into account

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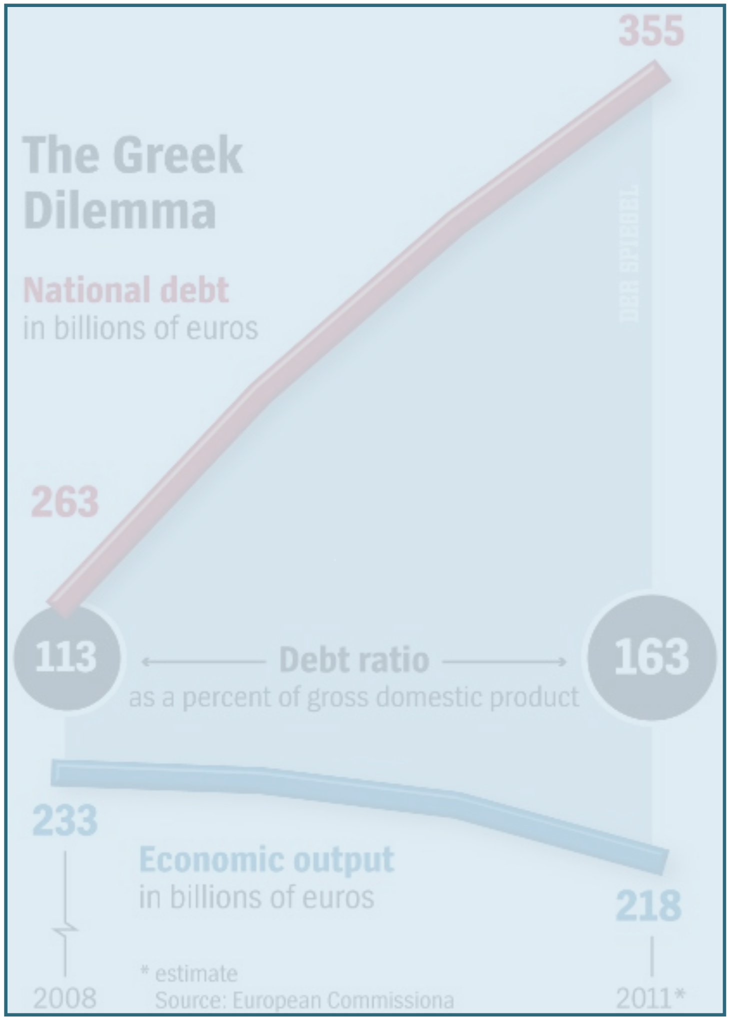
Bullish: (1) Global Debt Crisis

Is "Greece" in every country's future??



Source: ***Der Spiegel***

The Greek economy is in a depression!

When an economy is this weak government support for the economy automatically rises (because of "automatic stabilizers": unemployment insurance and the welfare safety net, and because of new policy initiatives). Meanwhile, tax revenues contract.

Hence government debt levels rise!

Then markets become more reluctant to lend and interest rates rise, meaning debt servicing costs rise, and debt/GDP ratios rise further …. until default occurs … and/ or central banks print …?

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Bullish: (1) Global Debt Crisis

It isn't easy to reduce debt/GDP levels!

SCENARIO 2 -- ASSUME "GERMANY"											
NGDP	3%										
INTEREST RATE	2%										
PRIMARY SURPLUS	1%	YEAR									
		1	2	3	4	5	6	7	8	9	10
DEBT	80	80.6	81.2	81.7	82.3	82.8	83.3	83.8	84.2	84.6	85.0
NGDP	100	103.0	106.1	109.3	112.6	115.9	119.4	123.0	126.7	130.5	134.4
DEBT/NGDP	80%	78%	77%	75%	73%	71%	70%	68%	66%	65%	63%

The growth of nominal GDP plus the primary surplus must exceed interest rates on the debt.

SCENARIO 3 -- ASSUME "SPAIN"											
NOMINAL GDP	1%										
INTEREST RATE	6%										
PRIMARY DEFICIT	-4%	YEAR									
		1	2	3	4	5	6	7	8	9	10
DEBT	85	94.1	103.8	114.1	125.1	136.7	149.1	162.3	176.4	191.3	207.1
NGDP	100	101.0	102.0	103.0	104.1	105.1	106.2	107.2	108.3	109.4	110.5
DEBT/NGDP	85%	93%	102%	111%	120%	130%	140%	151%	163%	175%	188%

If NGDP is 1% and the interest rate is 6% than the primary surplus must be 5% or greater for debt/GDP decline.

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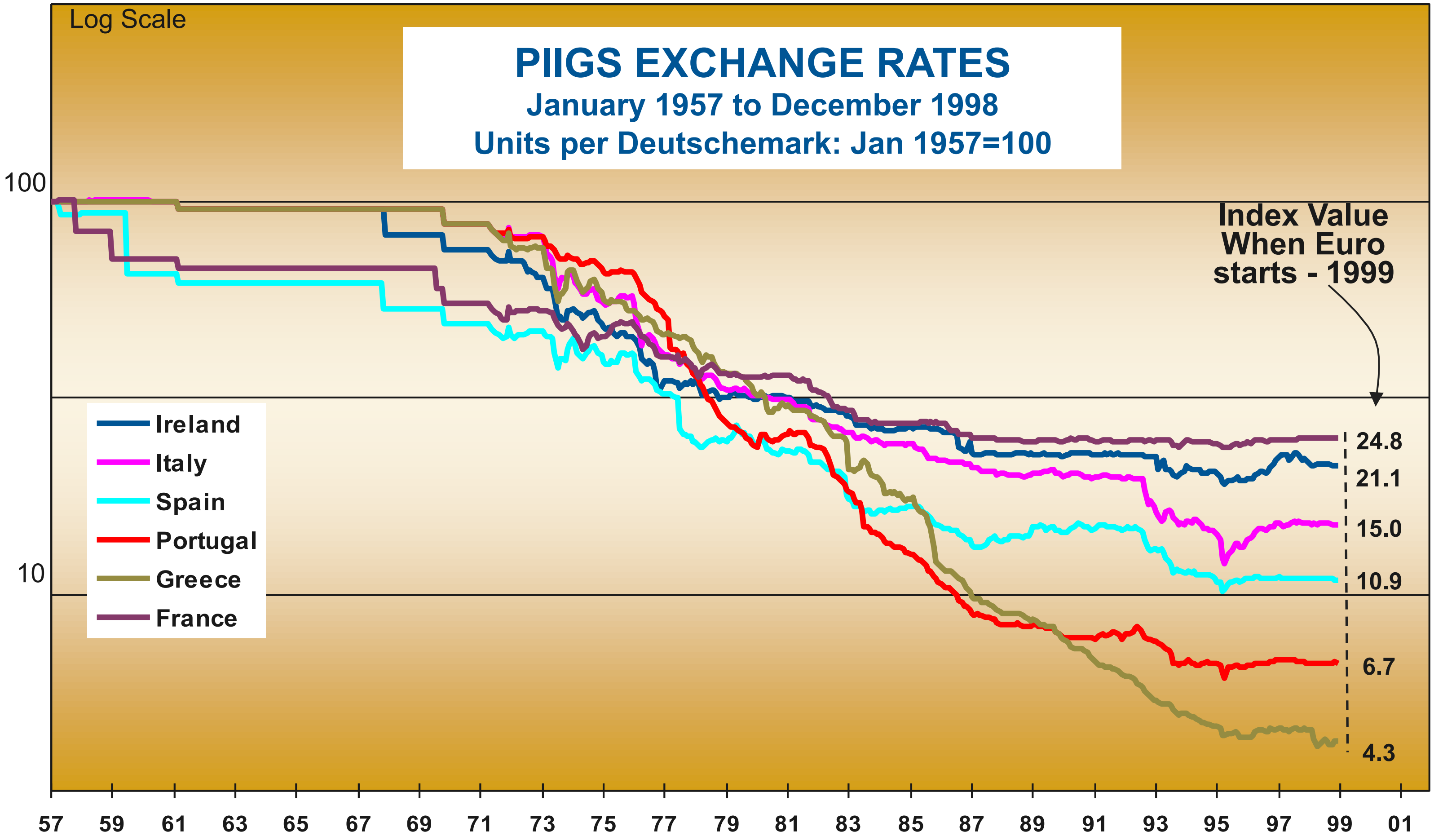
Bullish: (1) Global Debt Crisis

Before euro: PIIGS regularly devalued



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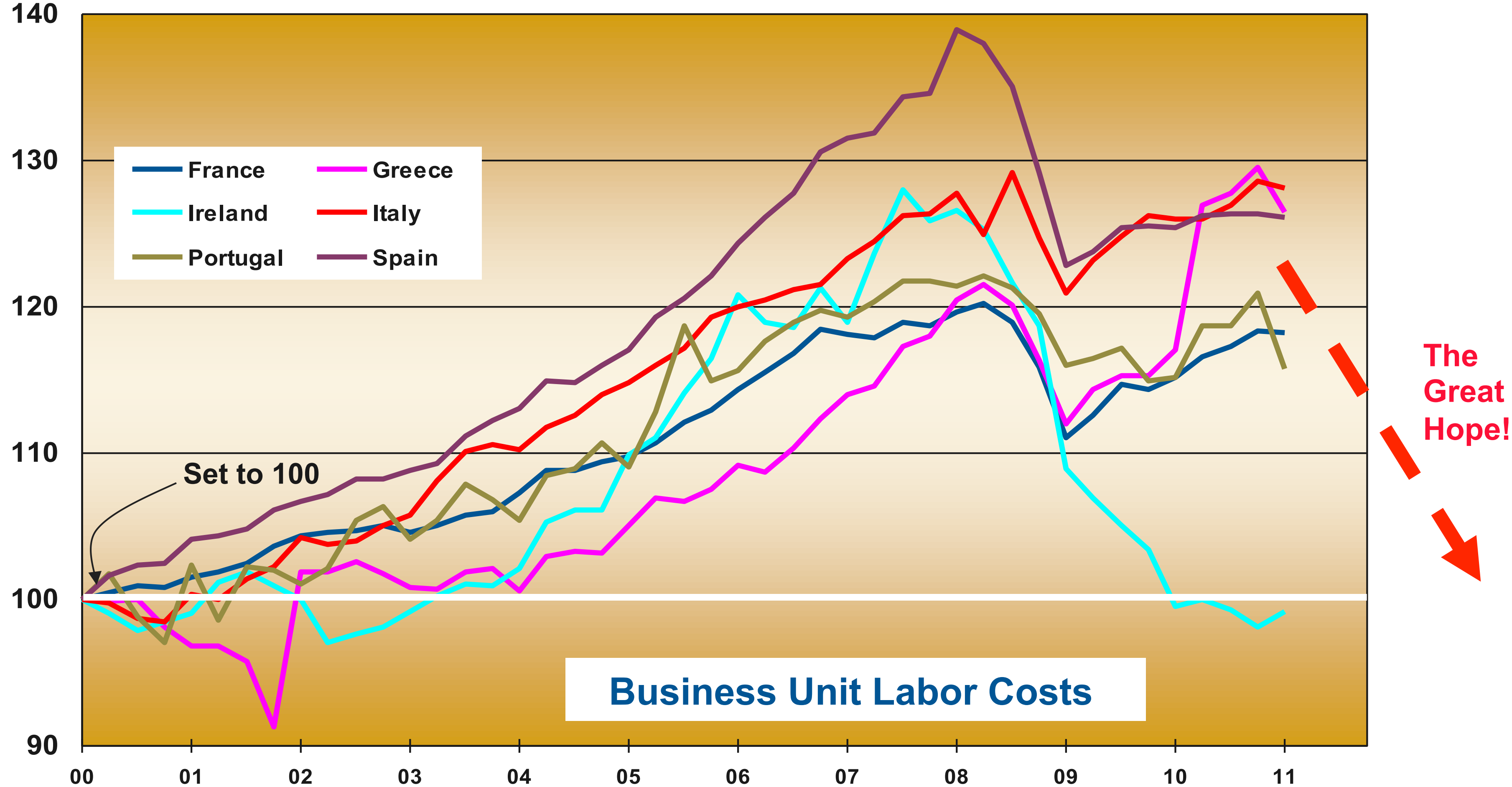
Bullish: (1) Global Debt Crisis

After euro: labor costs continued to widen



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Bullish: (1) Global Debt Crisis

Some "currencies" are seriously overvalued

ESTIMATES OF CURRENCY REALIGNMENT

	Against Euro*	Against DM*	Against US$**	Murenbeeld Against US$
Germany	1.3%	100.0	5.0%	10.0%
Finland	-6.7%	92.0		0.0%
Austria	-6.8%	91.9		0.0%
Netherlands	-7.1%	91.6	5.0%	5.0%
France	-9.4%	89.3	-7.0%	-10.0%
Belgium	-23.9%	74.8		-15.0%
Italy	-27.3%	71.4	-12.0%	-25.0%
Ireland	-28.6%	70.1	7.0%	-5.0%
Spain	-35.5%	63.2	-20.0%	-30.0%
Portugal	-47.2%	51.5	-15.0%	-45.0%
Greece	-57.6%	41.1		-50.0%

* Source: Nomura

** Source: Bank of America

Ideally a number of euro-currencies should be devalued!

Bullish: (1) Global Debt Crisis

If Spain and Italy lost access to financial markets …

SPAIN and ITALY: What if?

Re-financing Needs in €billion

	2012	2013	2014	2015	2016
ITALY	427	230	201	194	139
SPAIN	161	132	107	99	102
Total	**588**	**362**	**308**	**293**	**241**
Cumulative	**588**	**951**	**1,259**	**1,552**	**1,793**

Source: Italian Treasury, Spanish Treasury, IMF and authors' calculation.

CEPS Commentary: *How High the Firewall* , March 30, 2012

The EFSF/ESM etc. would have to kick in €1800 billion over the next few years!

Bullish: (1) Global Debt Crisis

Will Germany pay …?

It can all work provided there are never-ending transfer payments from North to South …

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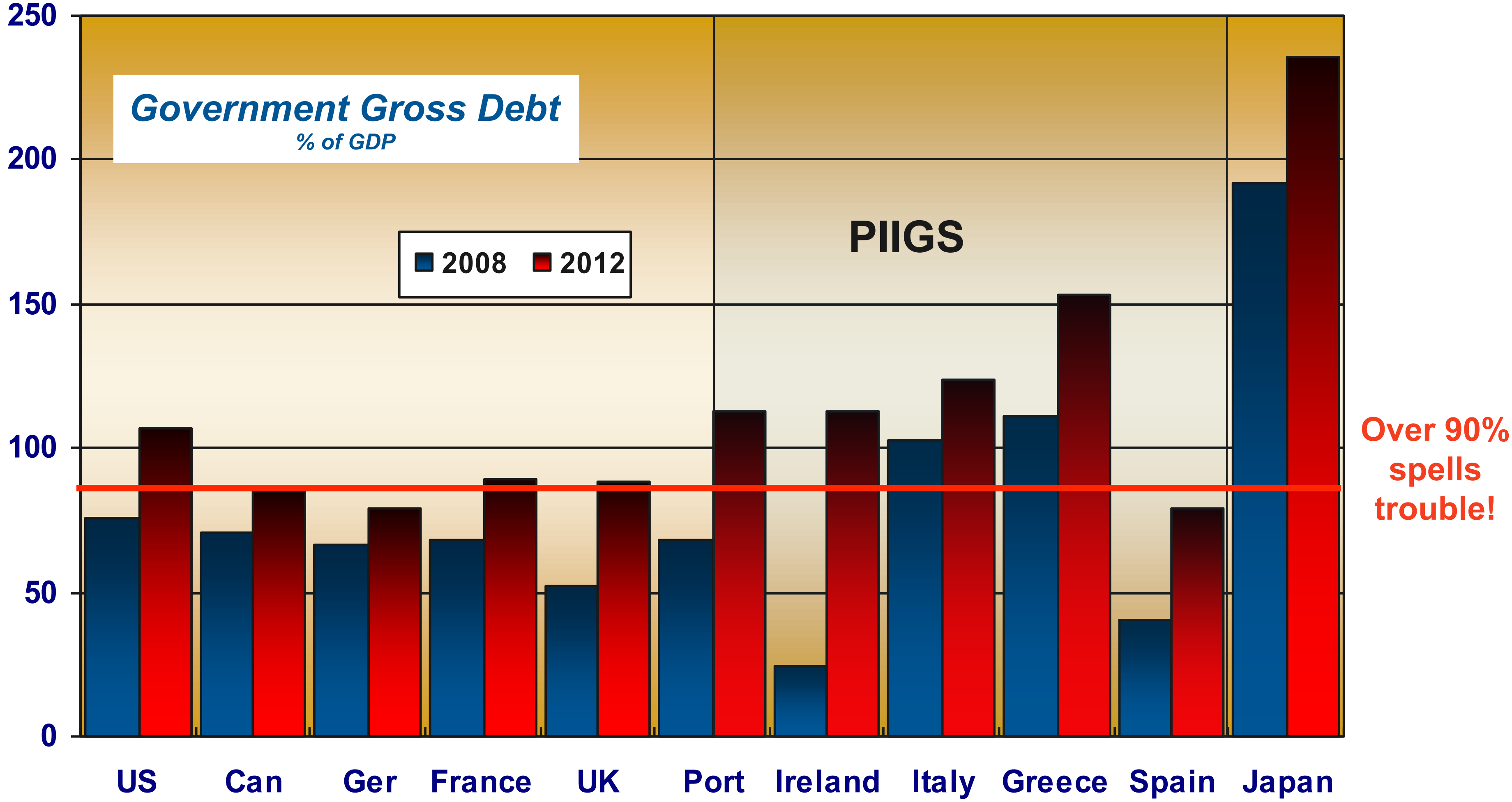
Bullish: (1) Global Debt Crisis

Bottom Line: most countries have excessive debts …



Source: *IMF Fiscal Monitor, April 2012 and IMF World Economic Outlook, April 2012*

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Bullish: (1) Global Debt Crisis

So how will governments deal with their debts?

Government Choices:

Renege on promises

Cut other services

Raise taxes

Print more money

Bullish: (1) Global Debt Crisis

Print more money?

"Throughout history, feckless governments have dodged their fiscal responsibility by turning to their monetary authority to devalue the currency, monetize debt and inflate their way out of structural deficits"

Richard Fisher:
President and CEO of the FRB of Dallas
March 10, 2011

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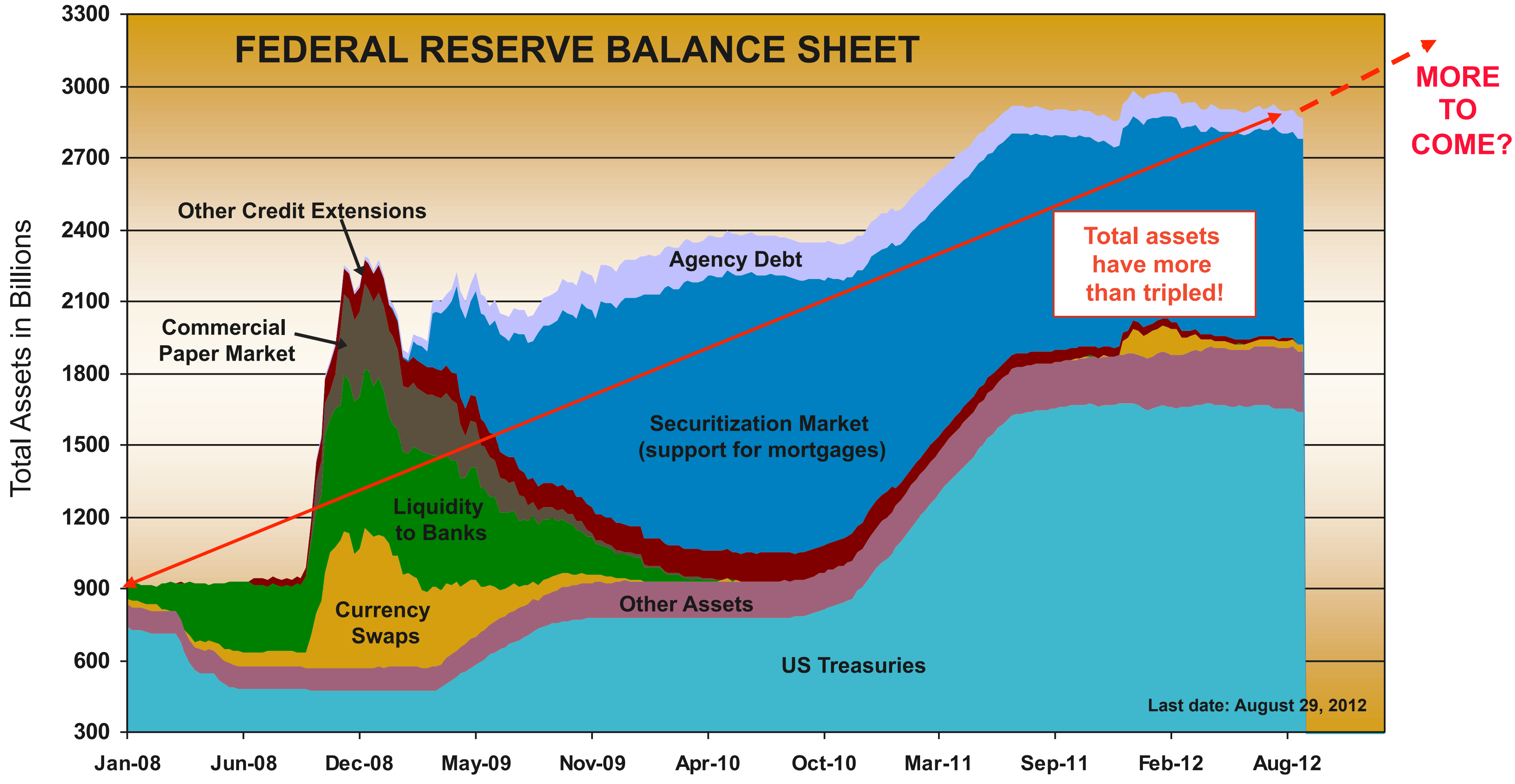
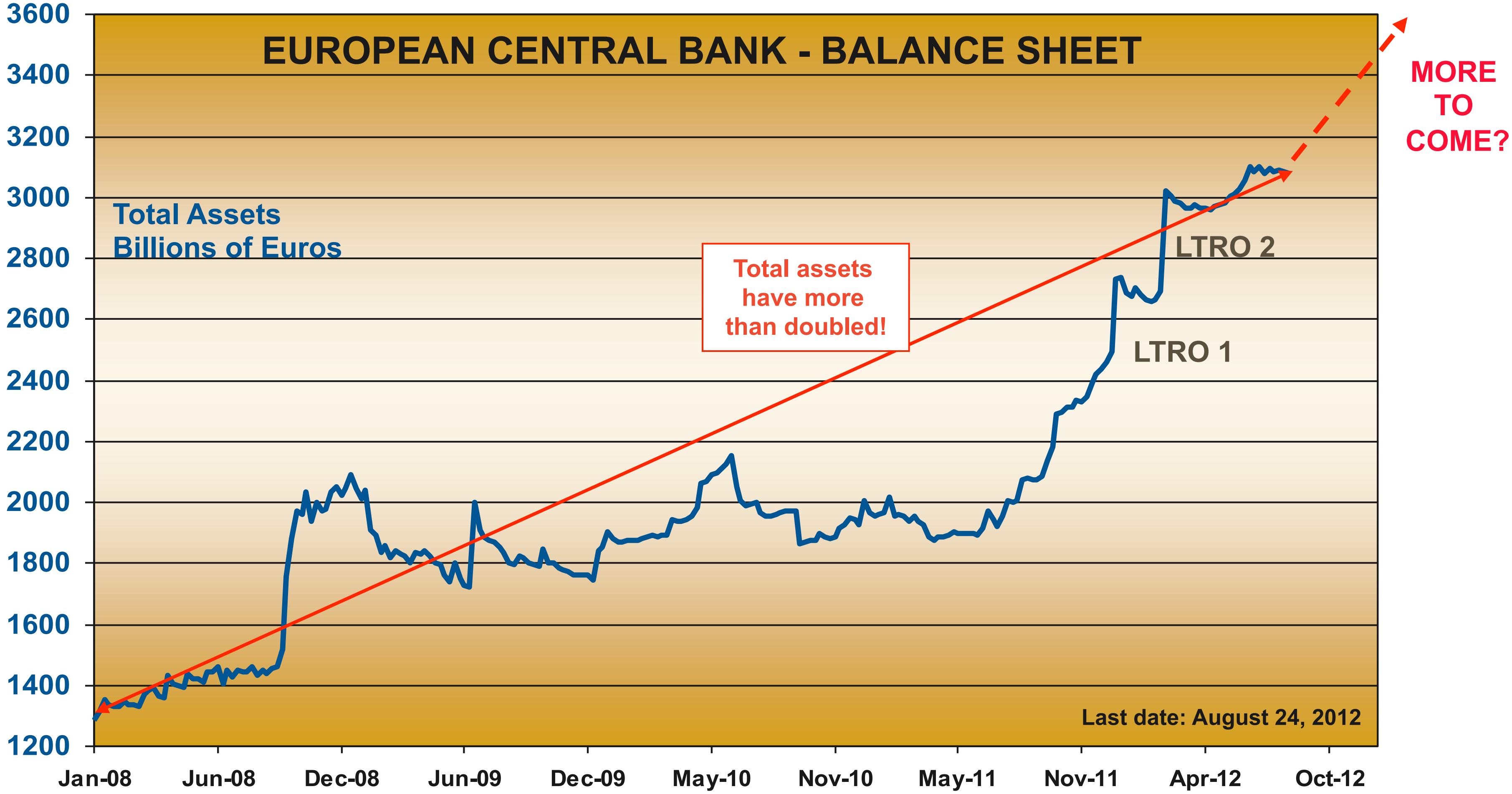
Bullish: (1) Global Debt Crisis

The Fed balance sheet has blown up …



Bullish: (1) Global Debt Crisis

The ECB balance sheet has blown up



Bullish: (1) Global Debt Crisis

The ECB and Fed have suggested "more to come"!

On July 26 Draghi said:

> ***"Within our mandate, the ECB is ready to do <u>whatever it takes</u> to preserve the euro. And believe me, it will be enough"***

On August 22 FOMC minutes* revealed that:

> ***"Many members expected that at the end of 2014, the unemployment rate would still be well above their estimates of its longer-term normal rate and that inflation would be at or below the Committee's longer-run objective of 2 percent …***
>
> ***Many members judged that additional <u>monetary accommodation</u> would likely be <u>warranted fairly soon</u> unless incoming information pointed to a substantial and sustainable strengthening in the pace of the economic recovery."***

**(meeting Jul 31-Aug 1)*

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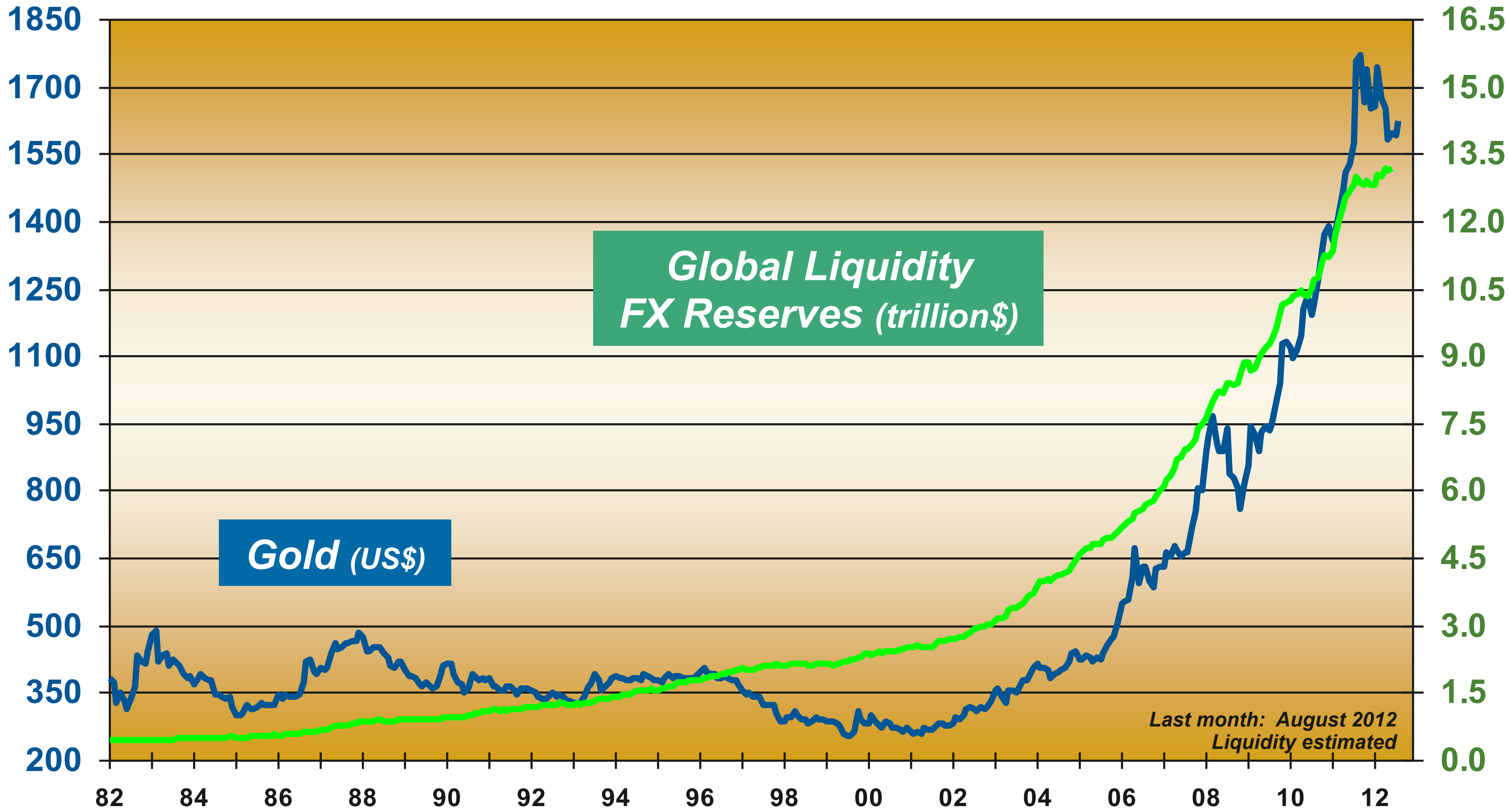
Bullish: (1) Global Debt Crisis

Money drives gold …



Global Liquidity: FX Reserves + US MBase
Source: IMF, Federal Reserve

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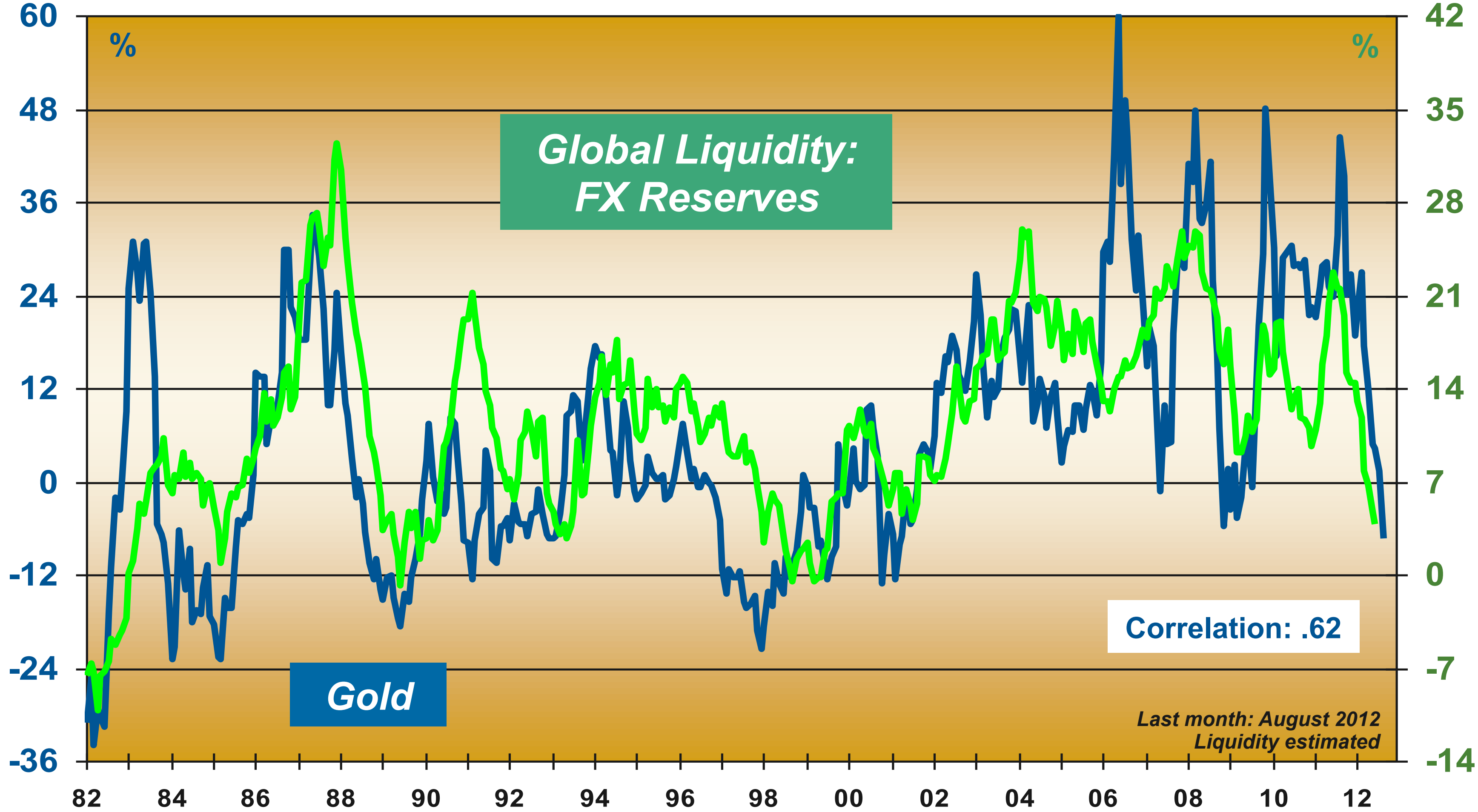
Bullish: (1) Global Debt Crisis

Gold rises and falls with FX liquidity



Global Liquidity: FX Reserves + US MBase
Source: IMF, Federal Reserve

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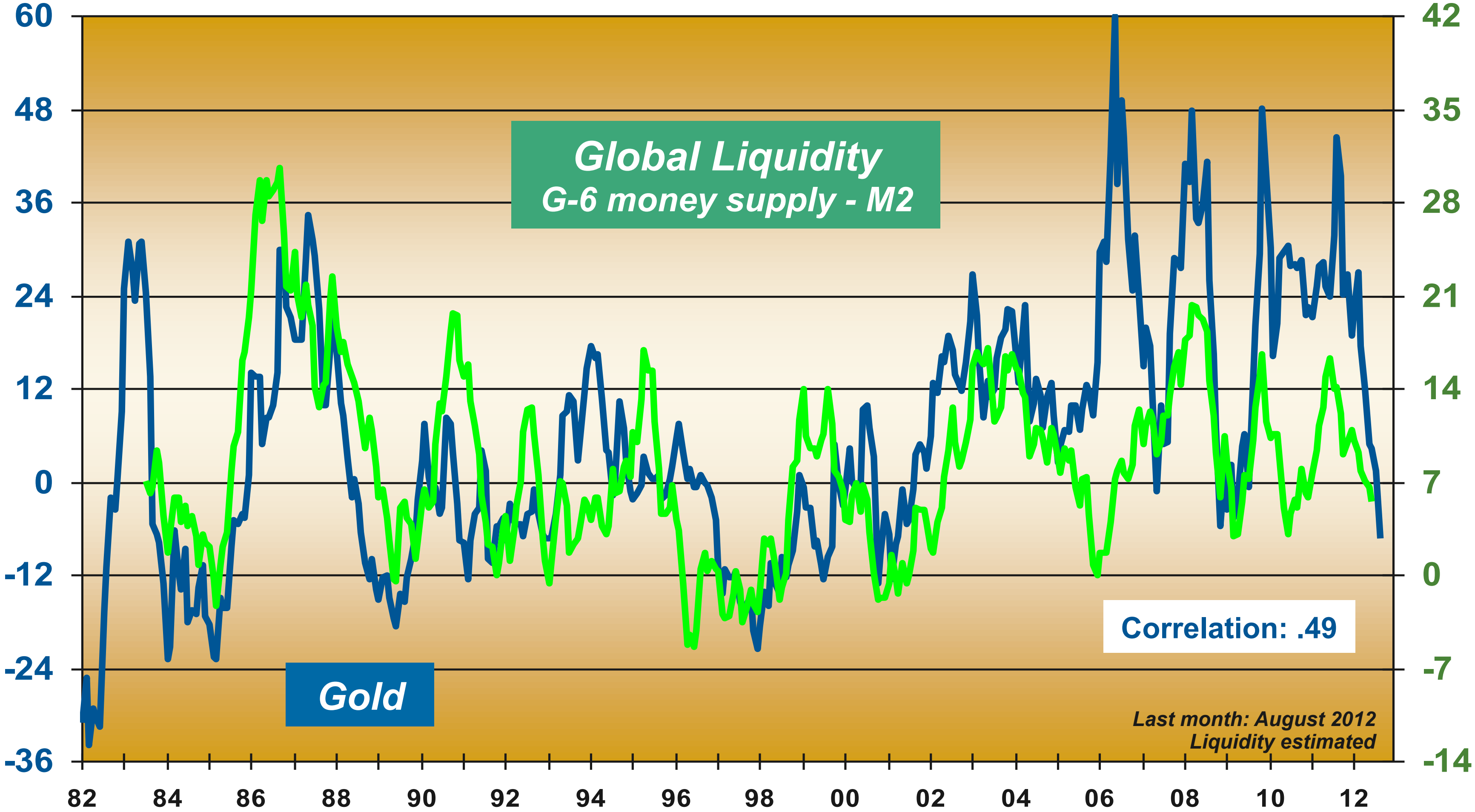
Bullish: (1) Global Debt Crisis

Gold also rises and falls with M2 liquidity



G-6 M2 Money Supply: US, China, EU, Japan, UK, Canada
Source: IMF, Federal Reserve

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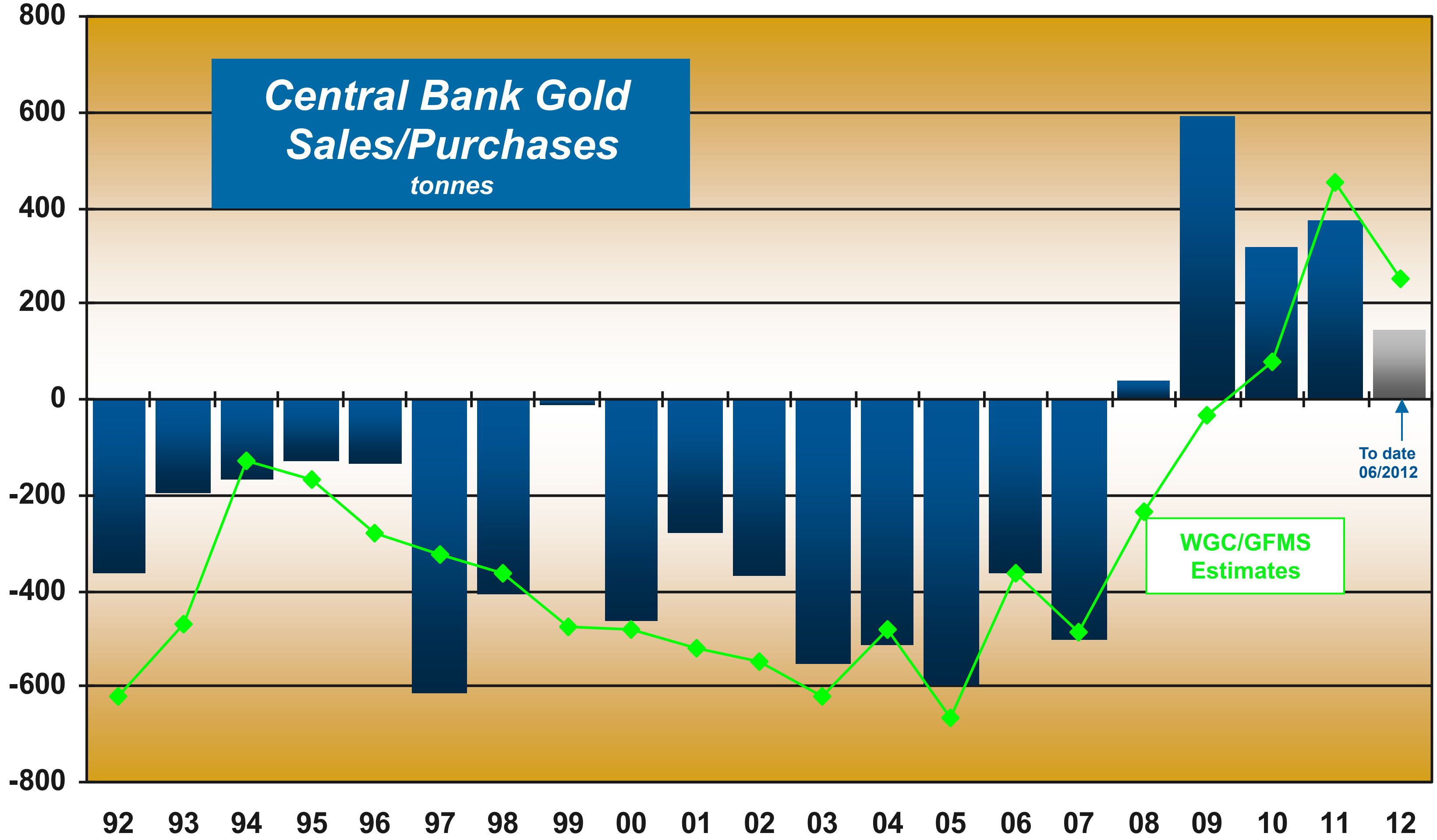
Bullish: (2) CB's Buying Gold

Central banks were selling – now buying



Source: *IMF: All countries plus official institutions*
IMF data do not necessarily agree with WGC/GFMS date because some countries (Saudi Arabia and China) only report long after the fact

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Bullish: (2) CB's Buying Gold

Global reserves are excessive …

Foreign Exchange Reserves
(countries over $100 bn)

	bn$		bn$
China	3290.1	Korea	303.8
Japan	1196.2	Hong Kong	294.4
Saudi Arabia	600.4	India	256.2
Russia	448.2	Algeria	187.8
Taiwan	391.1	Thailand	165.0
Switzerland	383.9	Mexico	152.5
Brazil	368.9	Malaysia	129.6
		TOTAL	8168.0

Addendum: Fuel Exporters $1645 bn

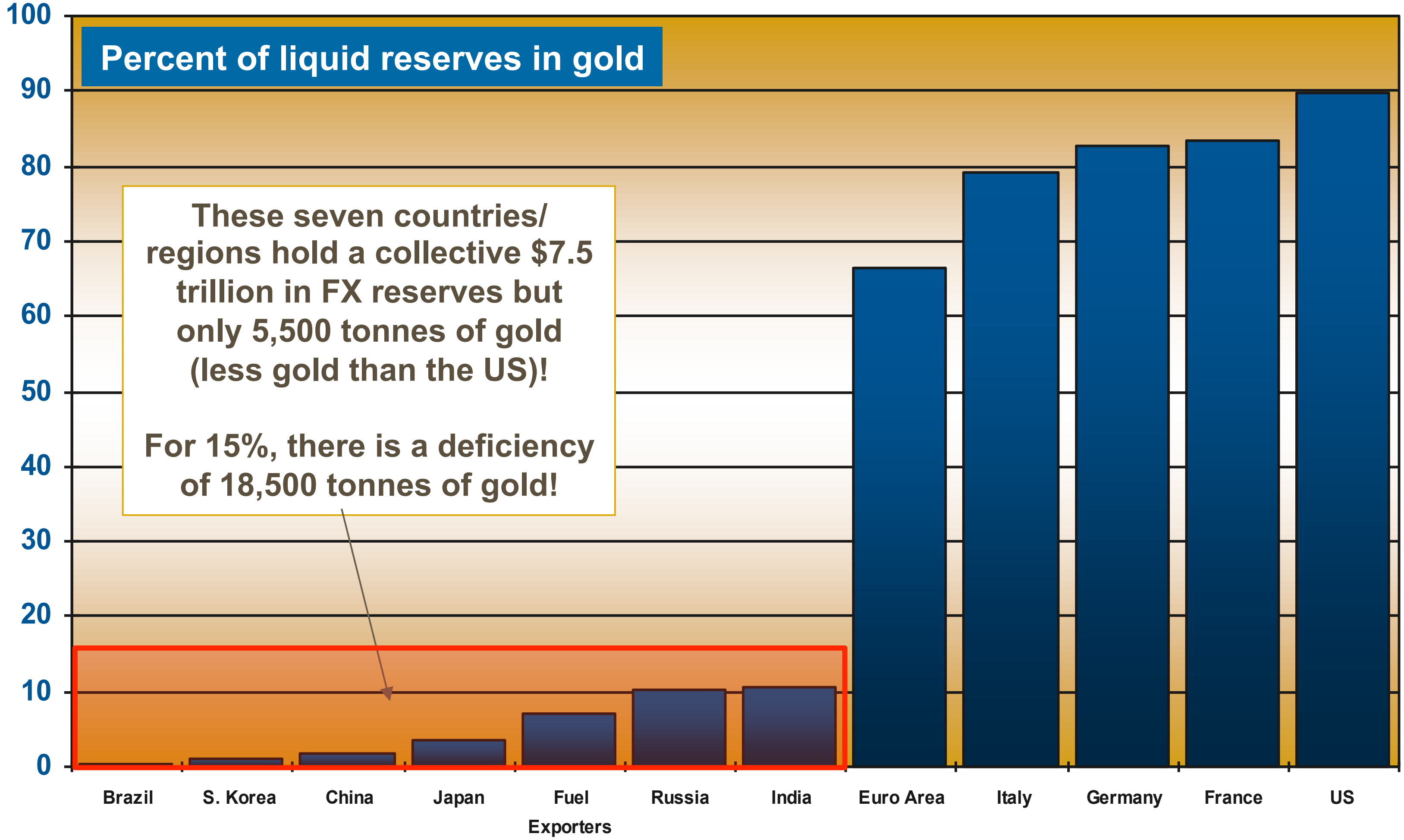
Central banks are rediscovering that gold is not another central bank's liability!

Japan and China alone would need to buy 12000 tonnes to bring gold reserves to 15% of liquid reserves!

Source: ***IMF, IFS July 2012***

Bullish: (2) CB's Buying Gold

Percent of liquid reserves in gold



Source: IMF, DundeeWealth Economics calculations

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Bullish: (3) Investment Demand

Investment demand should continue to grow

1. *The private sector is increasingly worried about currency debasement*
2. *The private sector is discovering that gold has attractive portfolio characteristics (improves the "efficient frontier")*
3. *Commodities and gold are morphing into an "investment asset class"*
4. *Private investment and central bank monetary demand was historically dominant, not jewelry demand*
5. *Deregulation of Asian gold markets encourages local gold demand*

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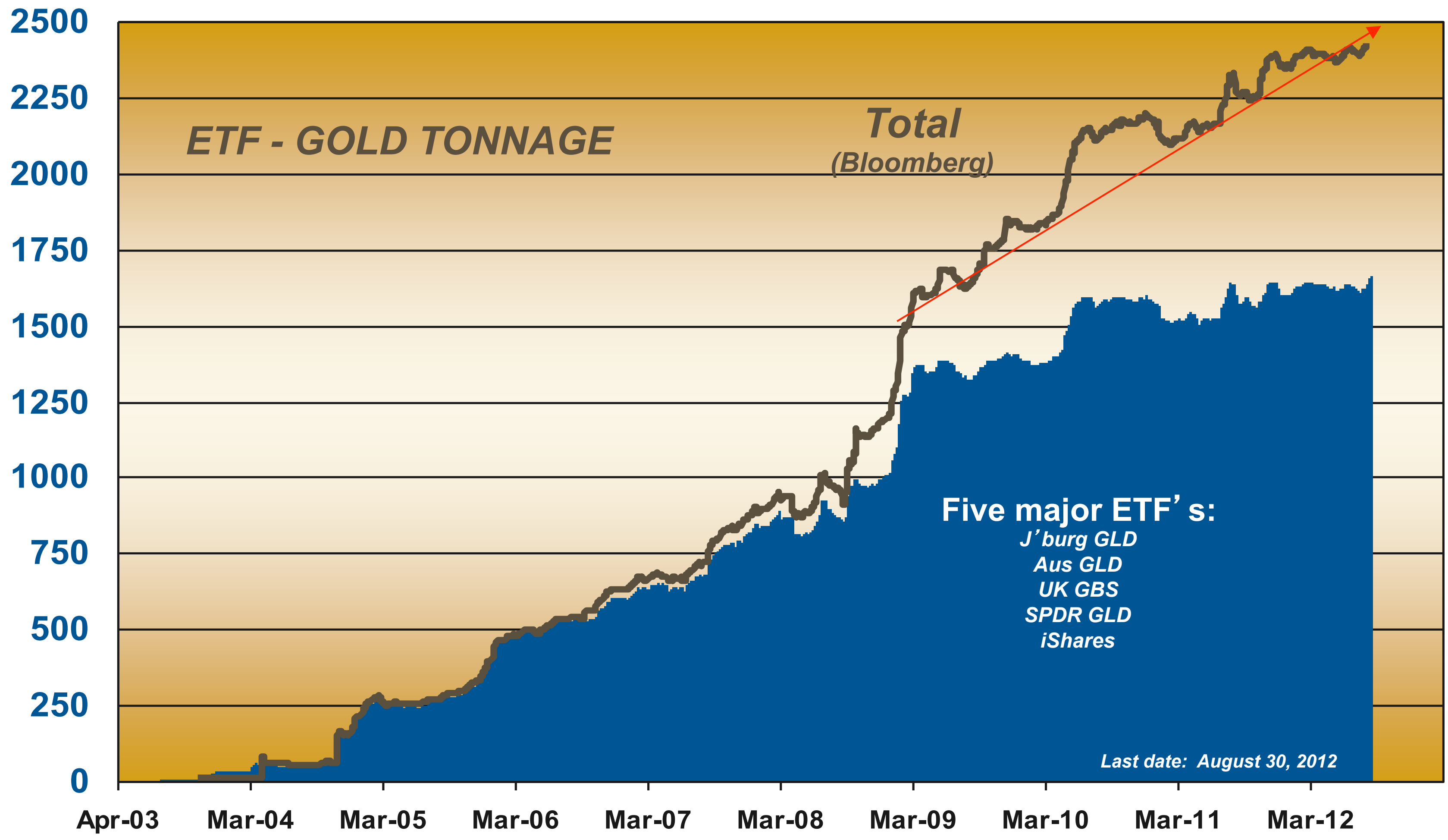
Bullish: (3) Investment Demand

Gold ETF demand strong since introduction



Source: *ExchangeTradedGold.com; Bloomberg*

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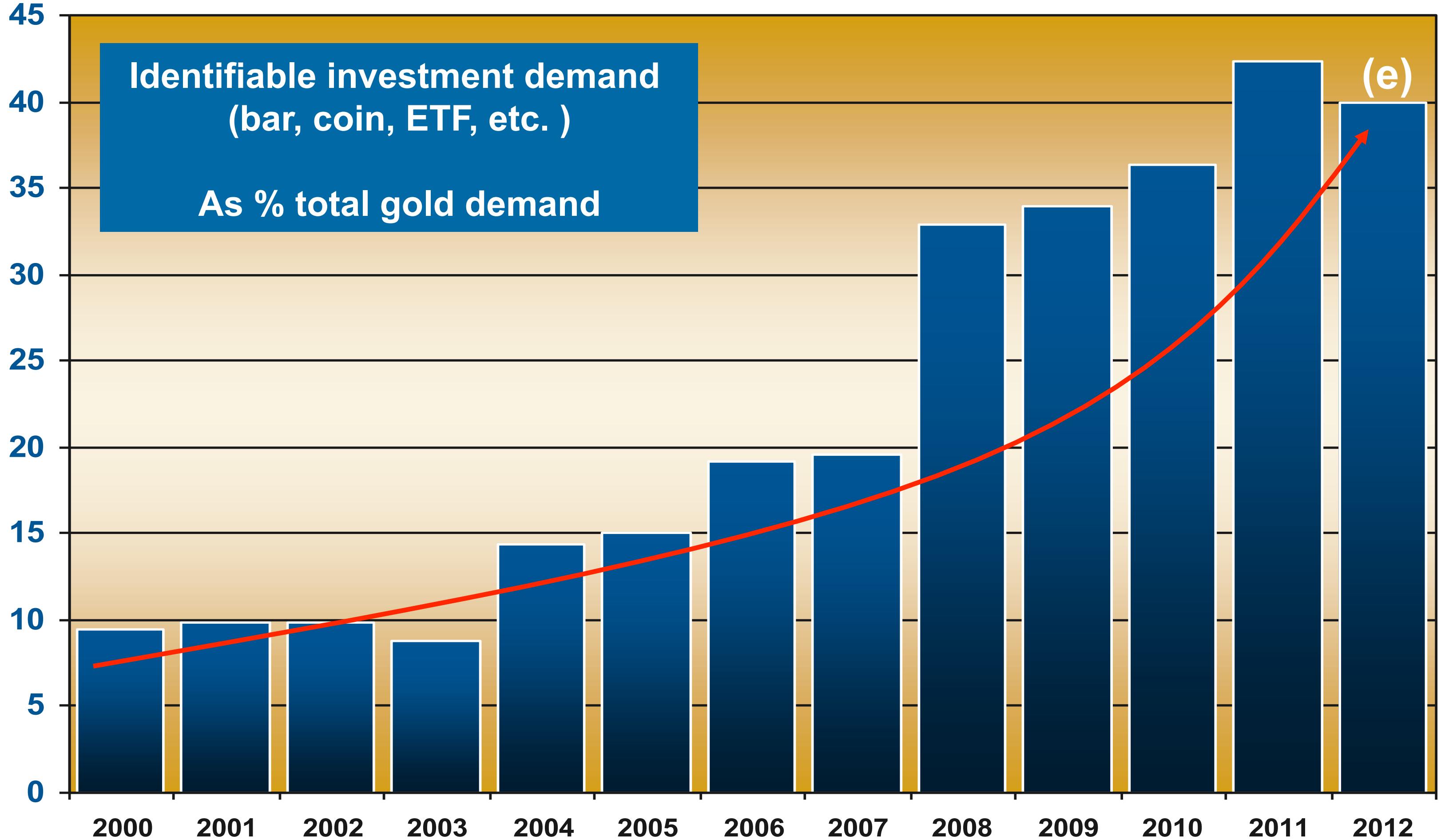
Bullish: (3) Investment Demand

Identifiable investment demand is growing …



Source: *World Gold Council "Gold Demand Trends 2012-Q2"*
data tabulated by Thompson Reuters GFMS
Estimate for 2012 by DundeeWealth Economics

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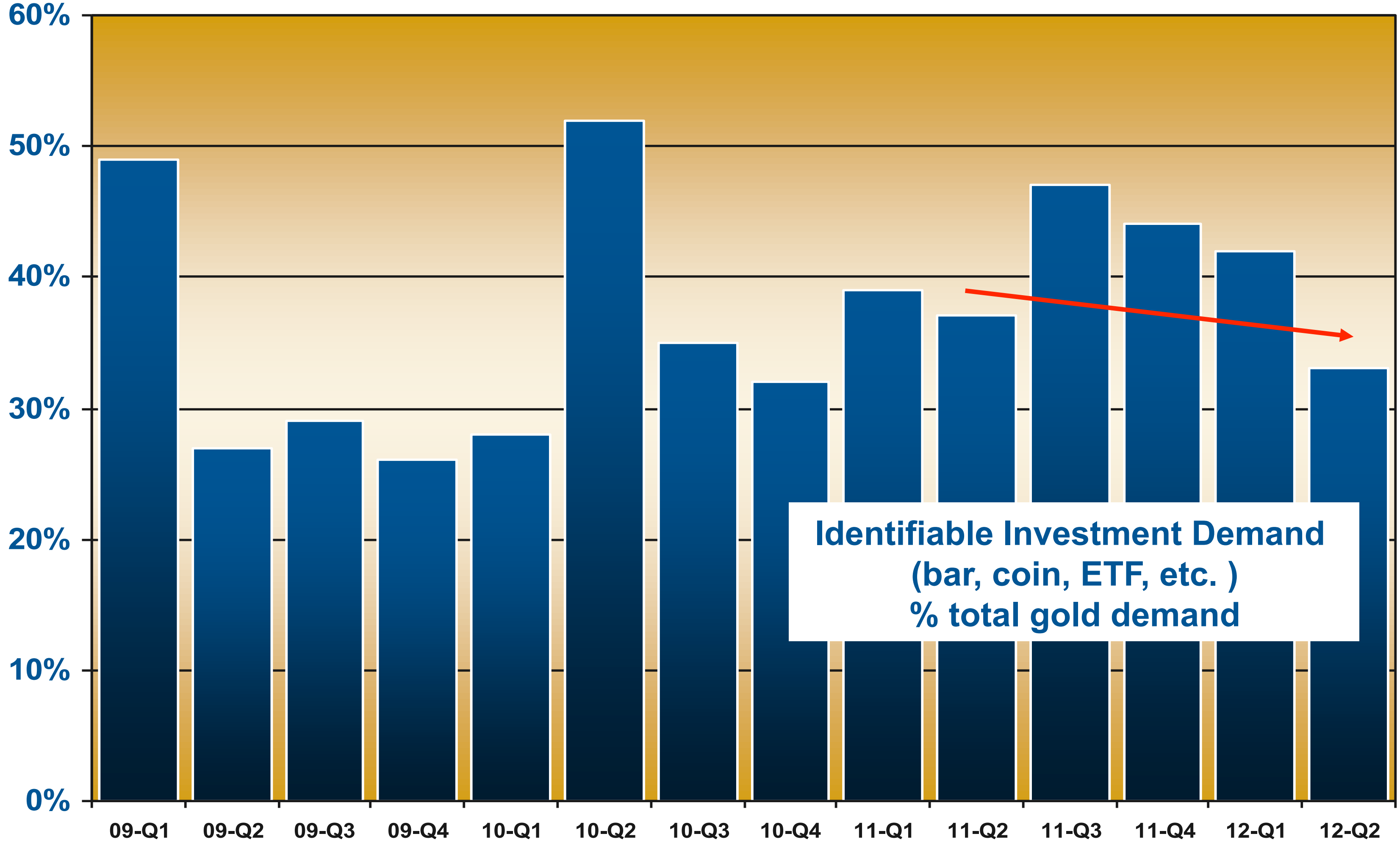
Bullish: (3) Investment Demand

… although recessions have an impact …



Source: *World Gold Council "Gold Demand Trends 2012-Q2" data tabulated by Thompson Reuters GFMS*

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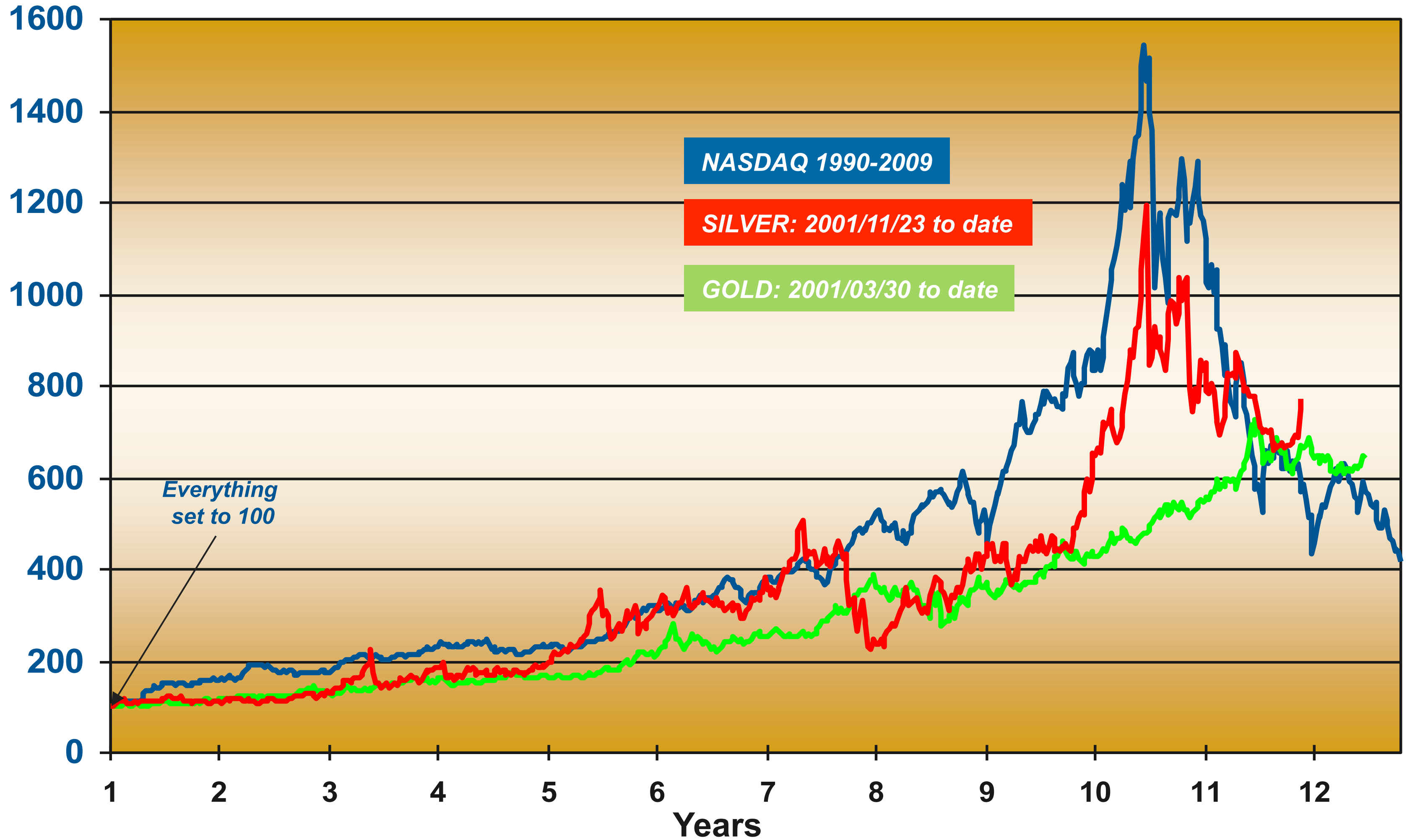
Bullish: (4) Gold Not in a Bubble

The NASDAQ was a real bubble …



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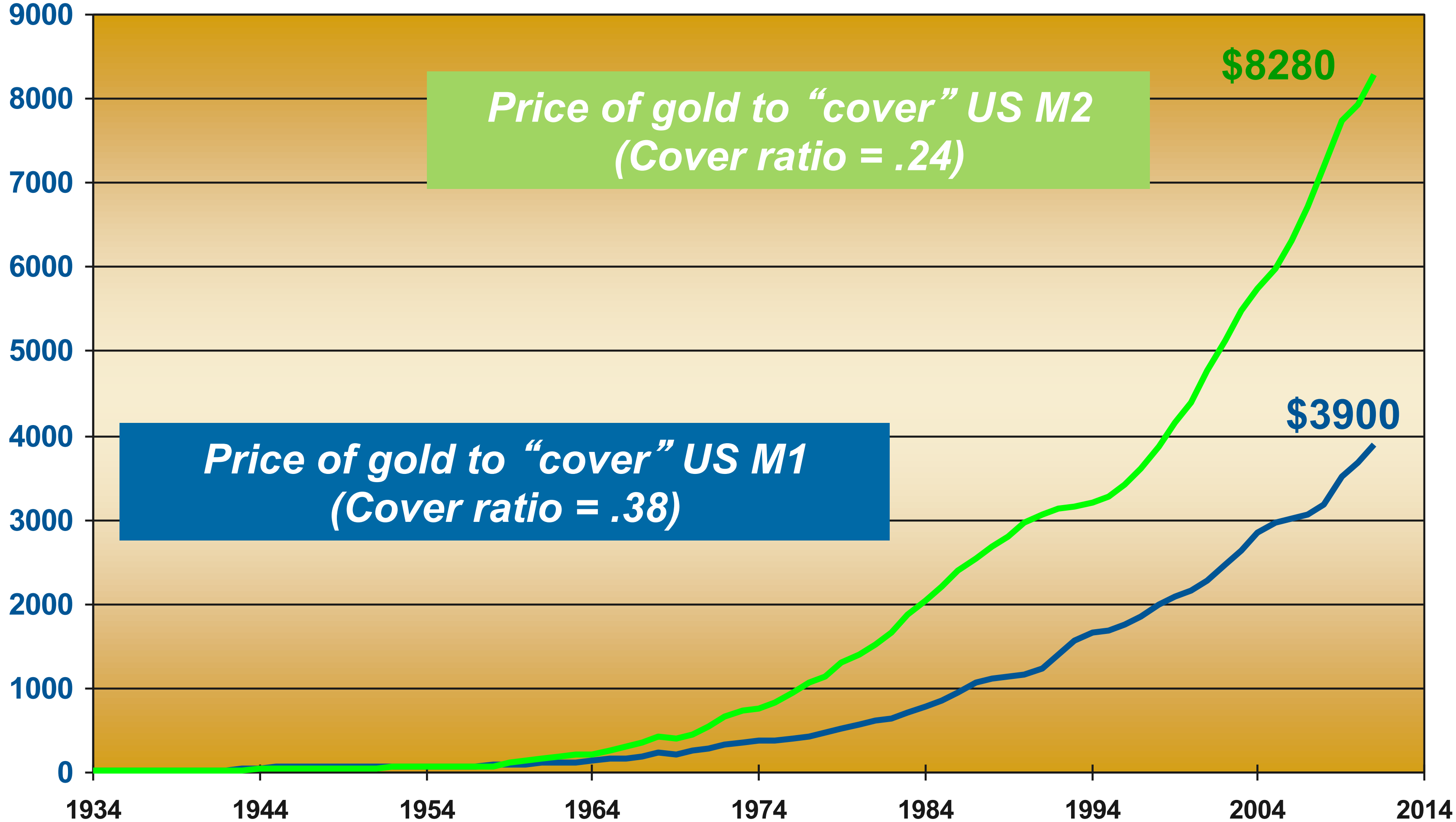
Bullish: (4) Gold Not in a Bubble

To back US money supply higher prices needed



"Cover ratio" as determined in 1934 when gold was revalued to $35

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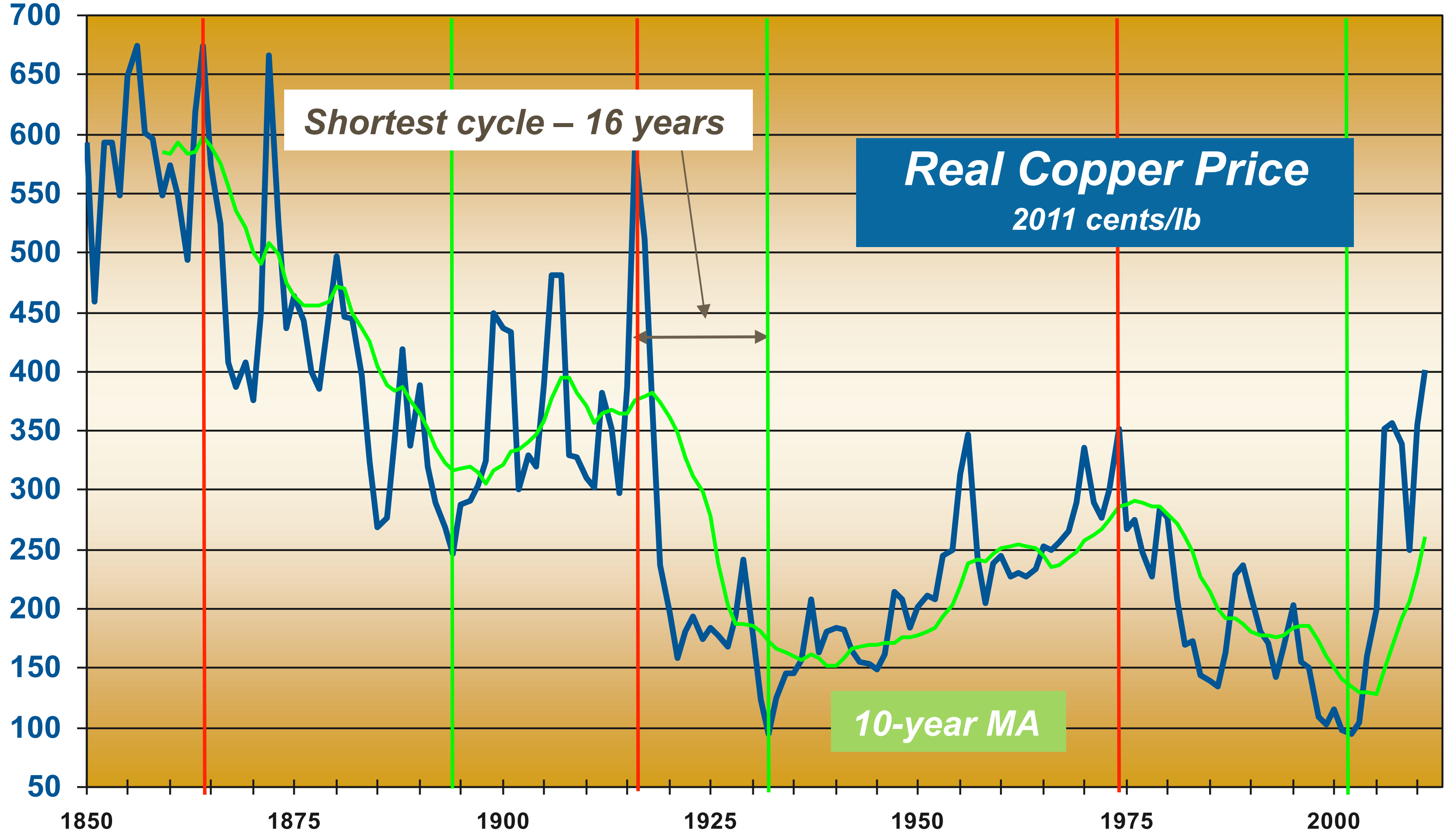
Bullish: (5) Commodity Cycle

*The shortest copper cycle lasted 16 years**



**despite reversals – which are common in all cycles*

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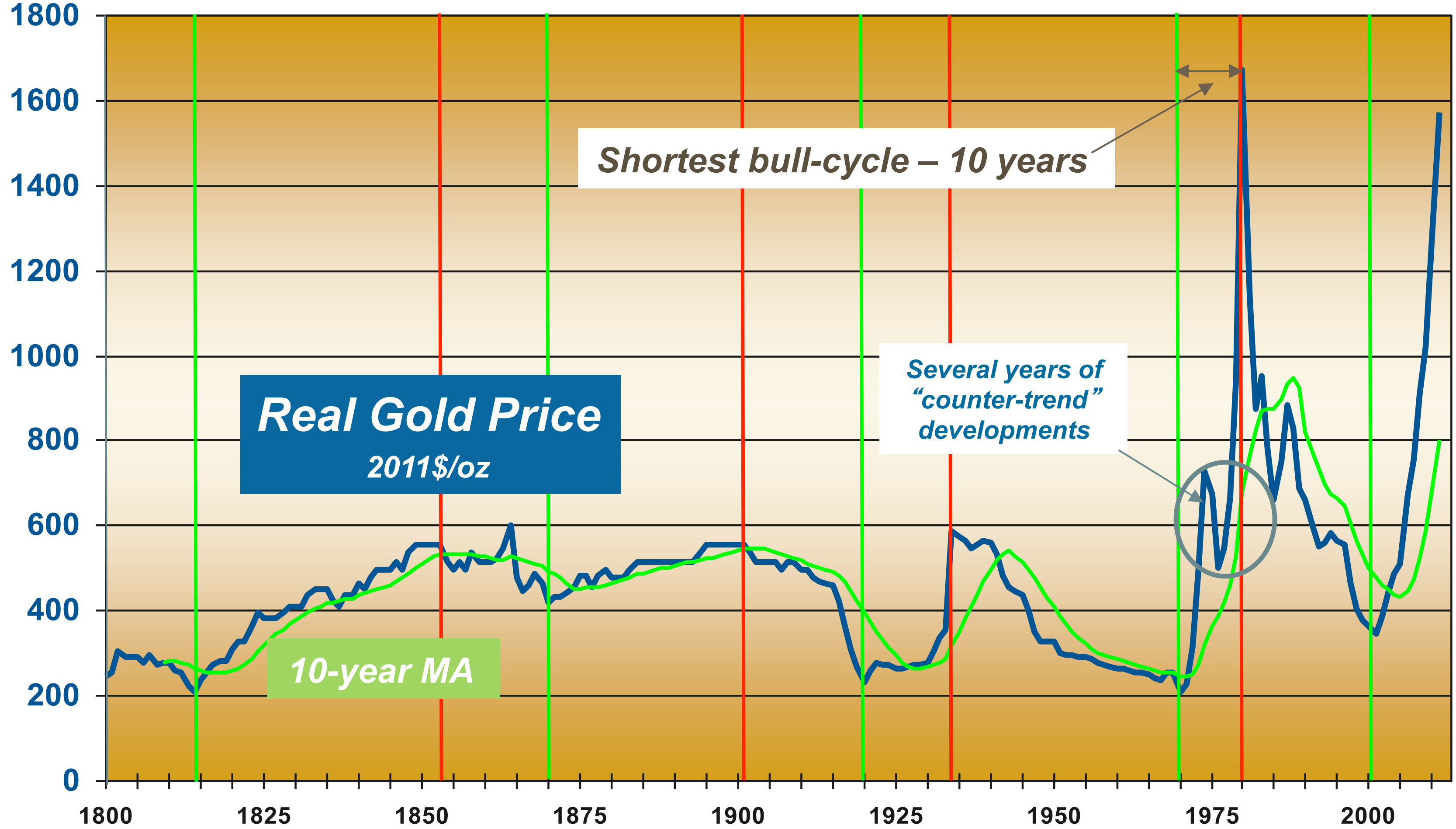
Bullish: (5) Commodity Cycle

The shortest gold cycle lasted 10 years



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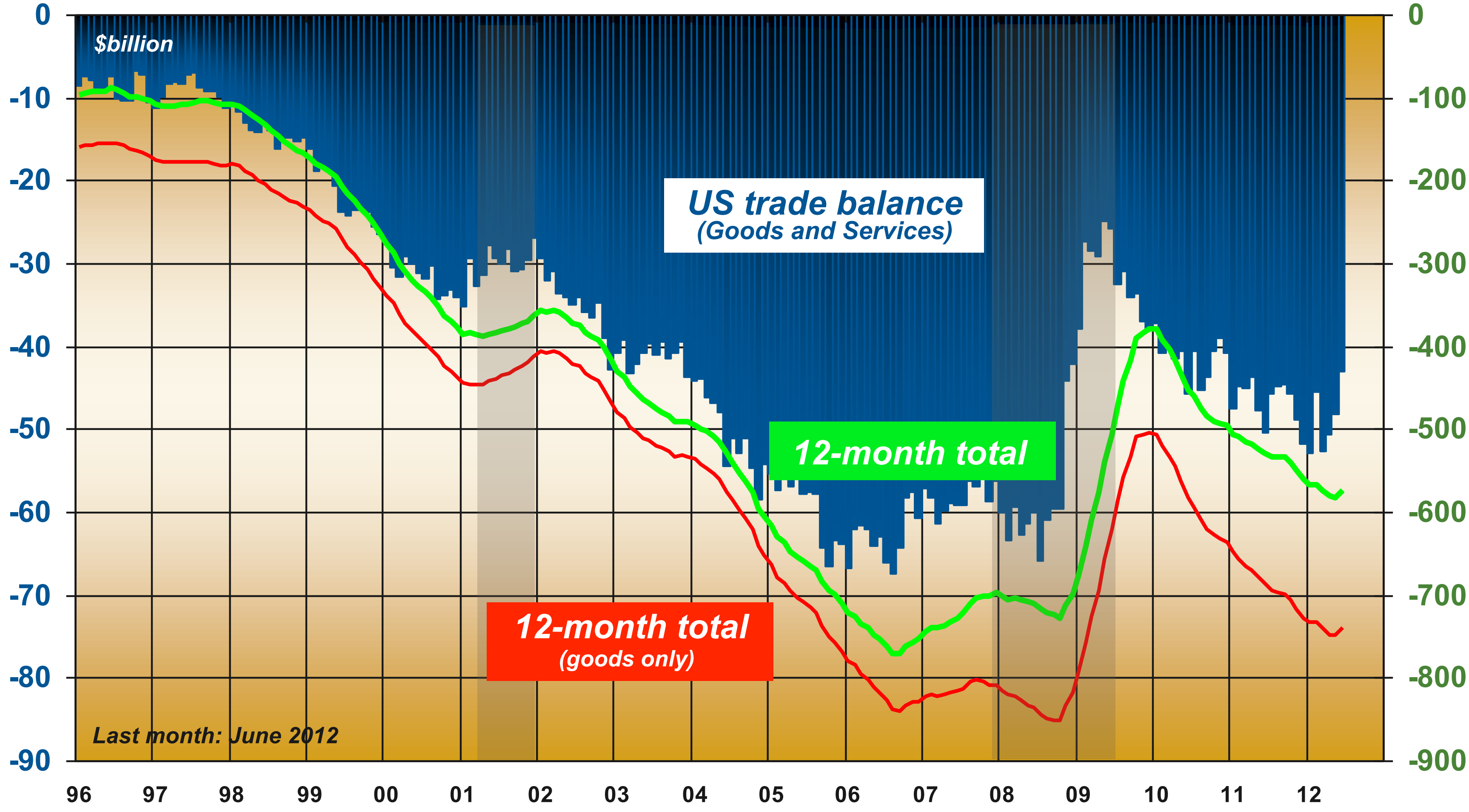
Bullish: (6) Global Imbalances

US trade balance remains in serious deficit



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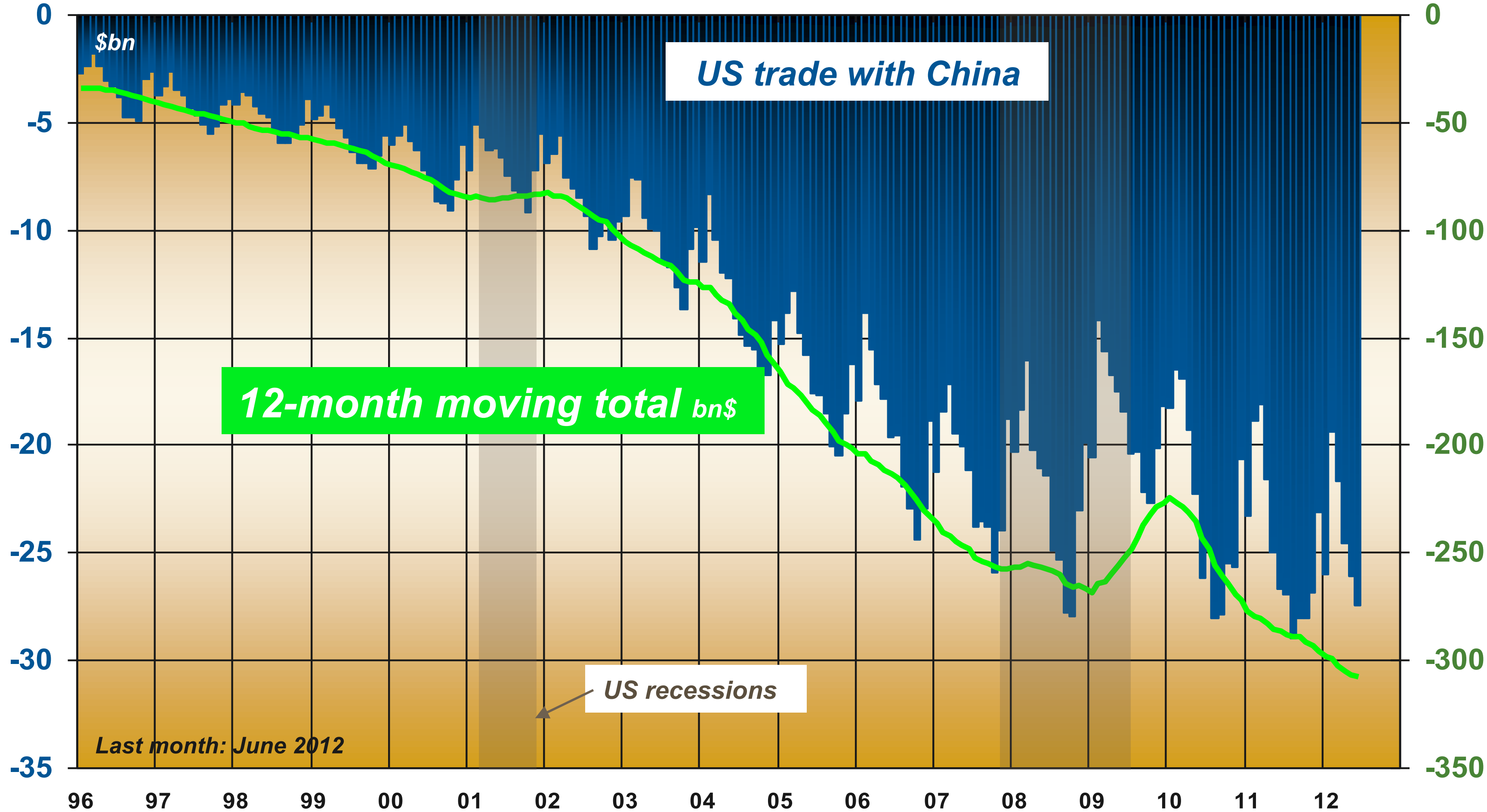
Bullish: (6) Global Imbalances

The US trade deficit with China is unsustainable



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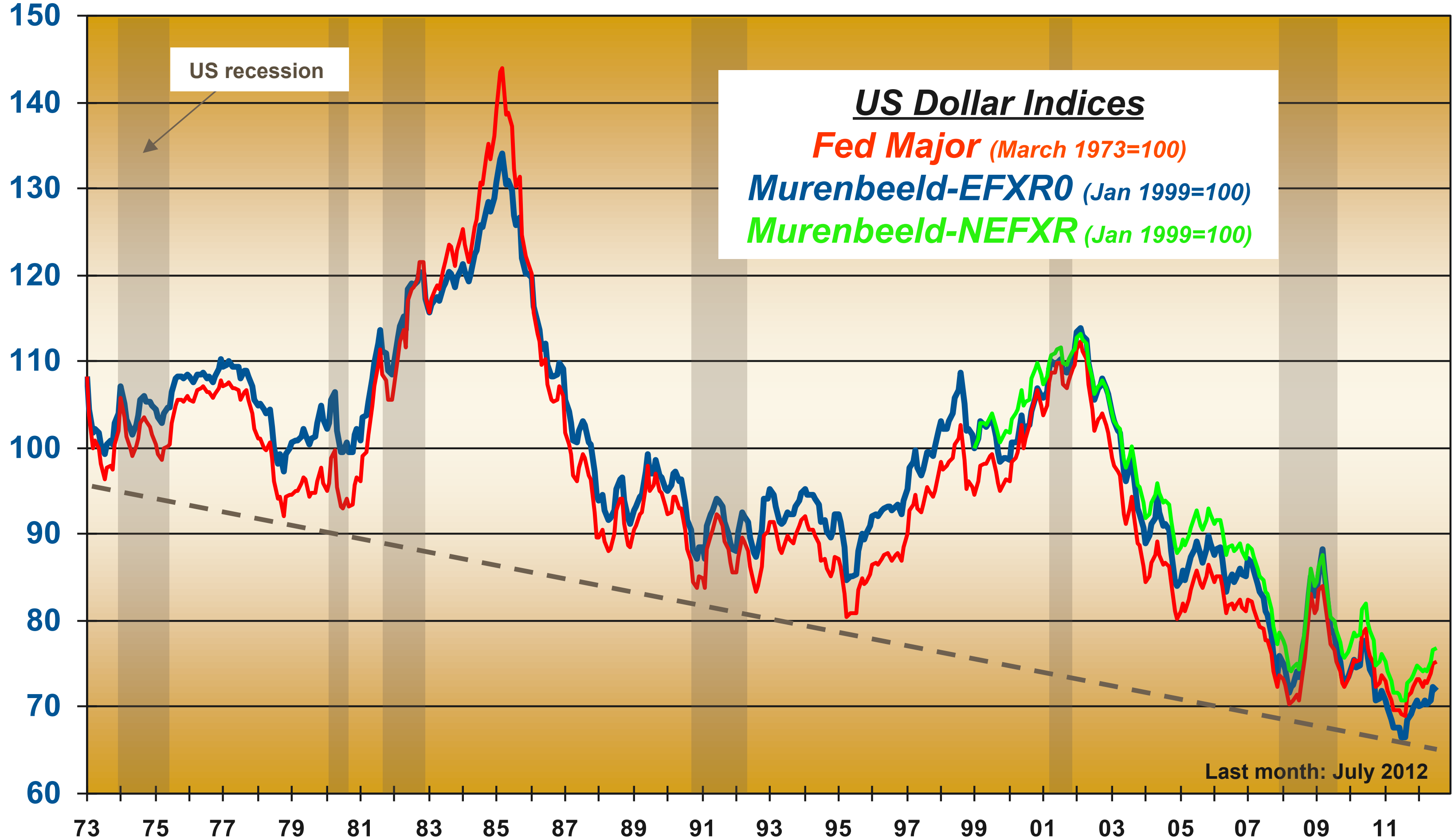
Bullish: (6) Global Imbalances

US dollar overvaluation being corrected …but slowly



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Bullish: (6) Global Imbalances

Currencies are generally misaligned

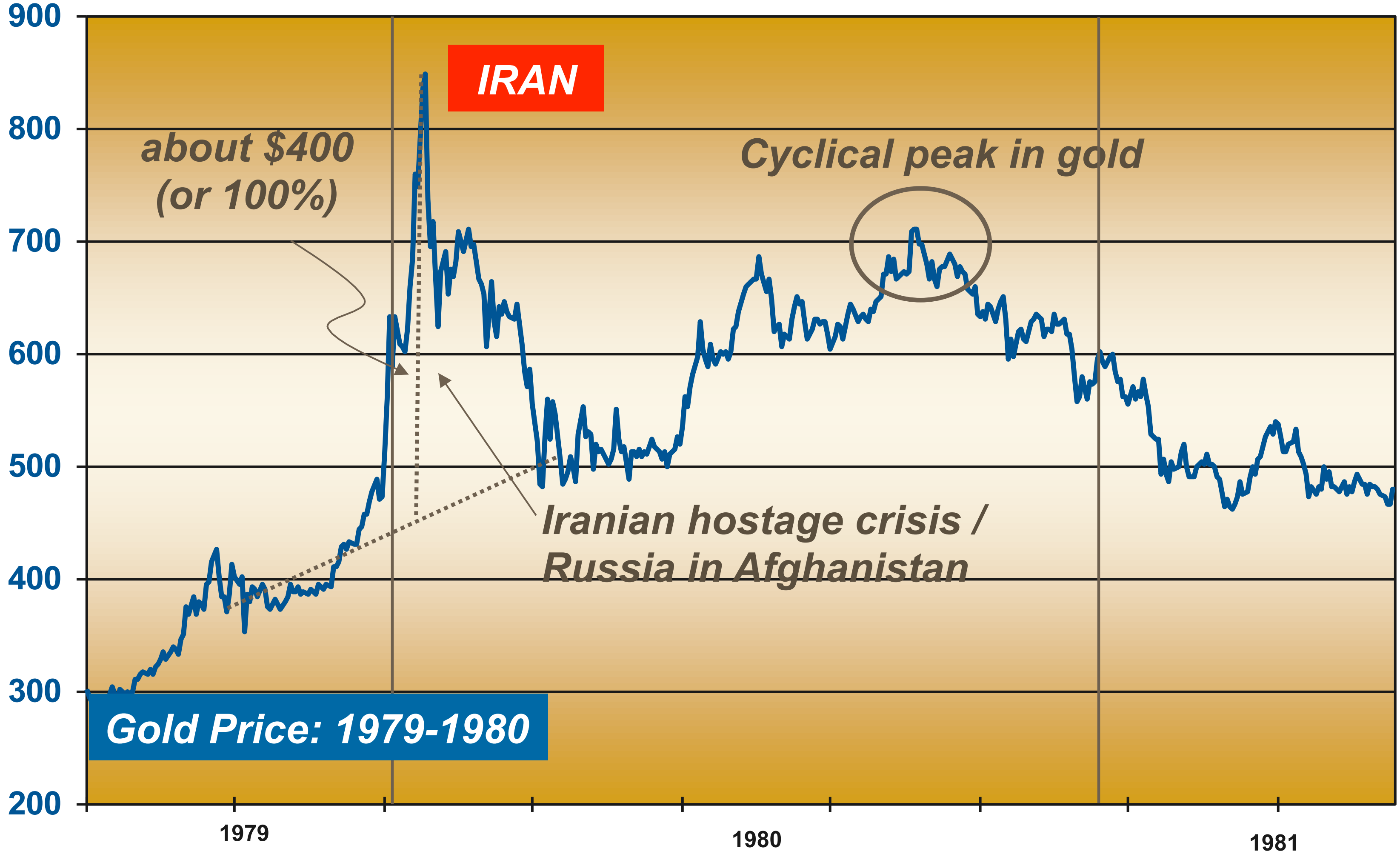
Estimated overvaluations as of late October 201

Country	Effective overvaluation	Overvaluation against the dollar[b]	Country	Effective overvaluation	Overvaluation against the dollar[b]
Argentina	5.4	-1.7	Korea	0.0	-12.5
Australia	15.5	4.8	Malaysia	-14.7	-31.0
Brazil	5.2	-1.5	Mexico	-12.9	-13.5
Canada	-3.5	-5.5	New Zealand	21.0	14.9
Chile	-0.2	-8.0	Philippines	2.5	-10.9
China	-10.6	-23.5	Poland	-4.1	-11.1
Columbia	0.3	-4.4	Singapore	-21.5	-37.4
Czech Repubic	-0.4	-8.6	South Africa	5.5	-3.8
Euro area	1.6	-6.9	Sweden	-8.0	-15.0
Hong Kong	-15.4	-29.7	Switzerland	-6.1	-11.8
Hungay	-8.0	-15.6	Taiwan	-17.7	-32.2
India	-2.4	-15.3	Thailand	-0.6	-13.1
Indonesia	1.0	-15.5	Turkey	21.7	12.7
Israel	-2.7	-9.3	United Kingdom	2.8	-5.1
Japan	9.0	-2.7	United States	9.3	0.0

Source: ***Peterson Institute for International Economics, Nov 2011***

Bullish: (7) Geopolitical

The biggest geopolitical crisis to date …



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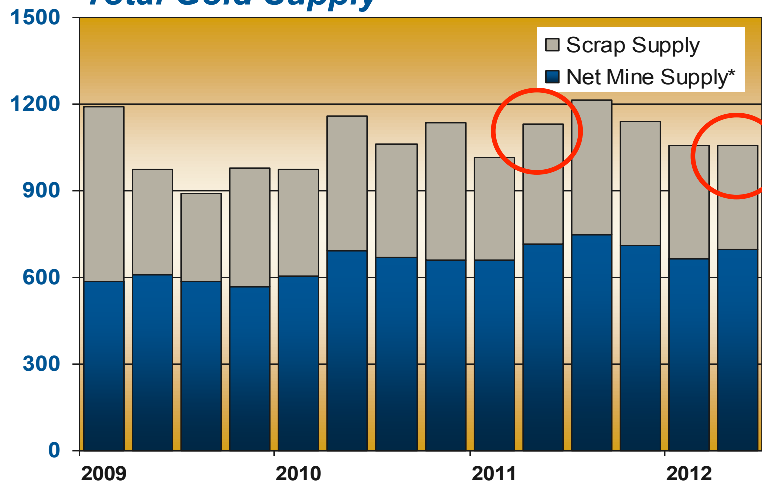
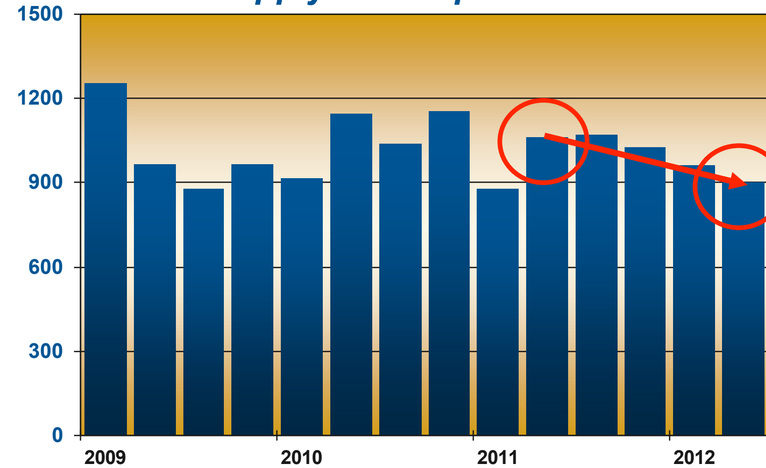
Bullish: (8) Gold Supply

Declines in supply limit demand and raise prices

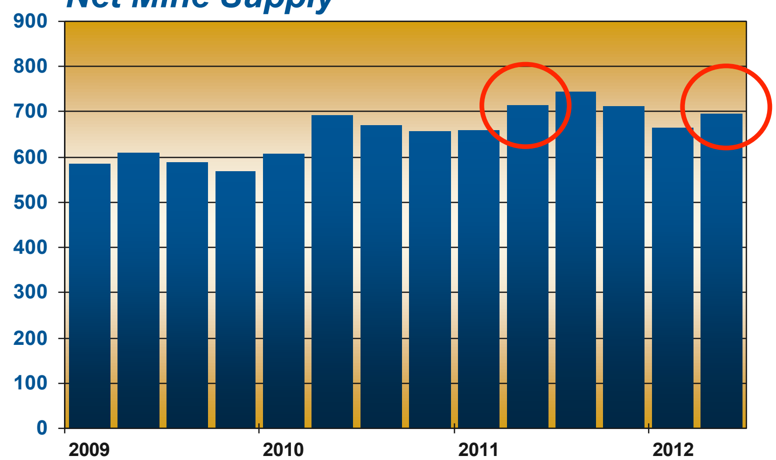
Total Gold Supply



Net Mine Supply + Scrap – CB Purchases*



*Net Mine Supply**



REMEMBER: demand cannot rise when supply does not rise … and prices must rise to ration demand to the available supply!!

***Net mine supply = mine supply less dehedging**
Source: ***World Gold Council, DundeeWealth Economics***

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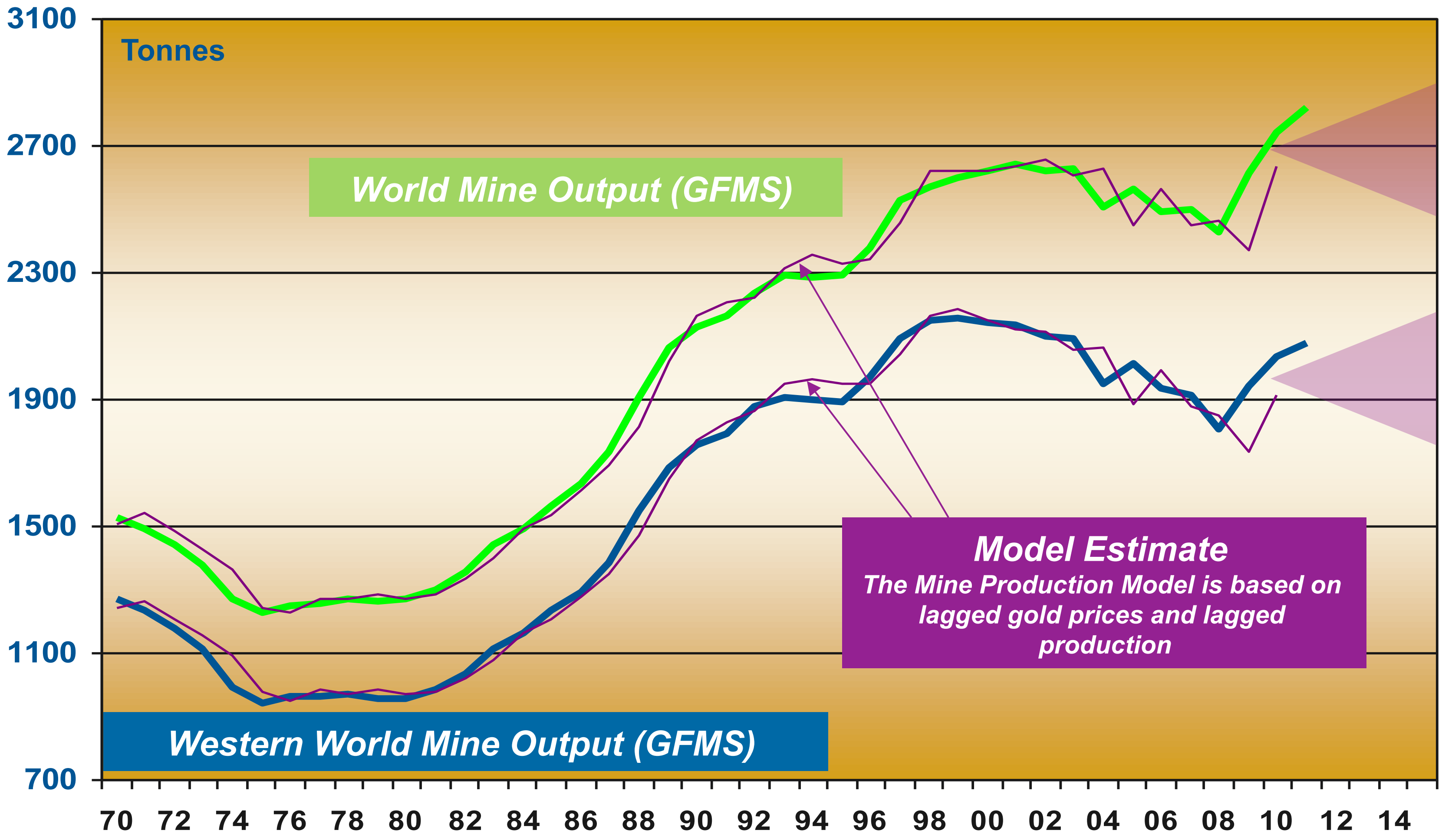
Bullish: (8) Gold Supply

Models suggests mine output constrained



Source: *Reuters GFMS, Murenbeeld*

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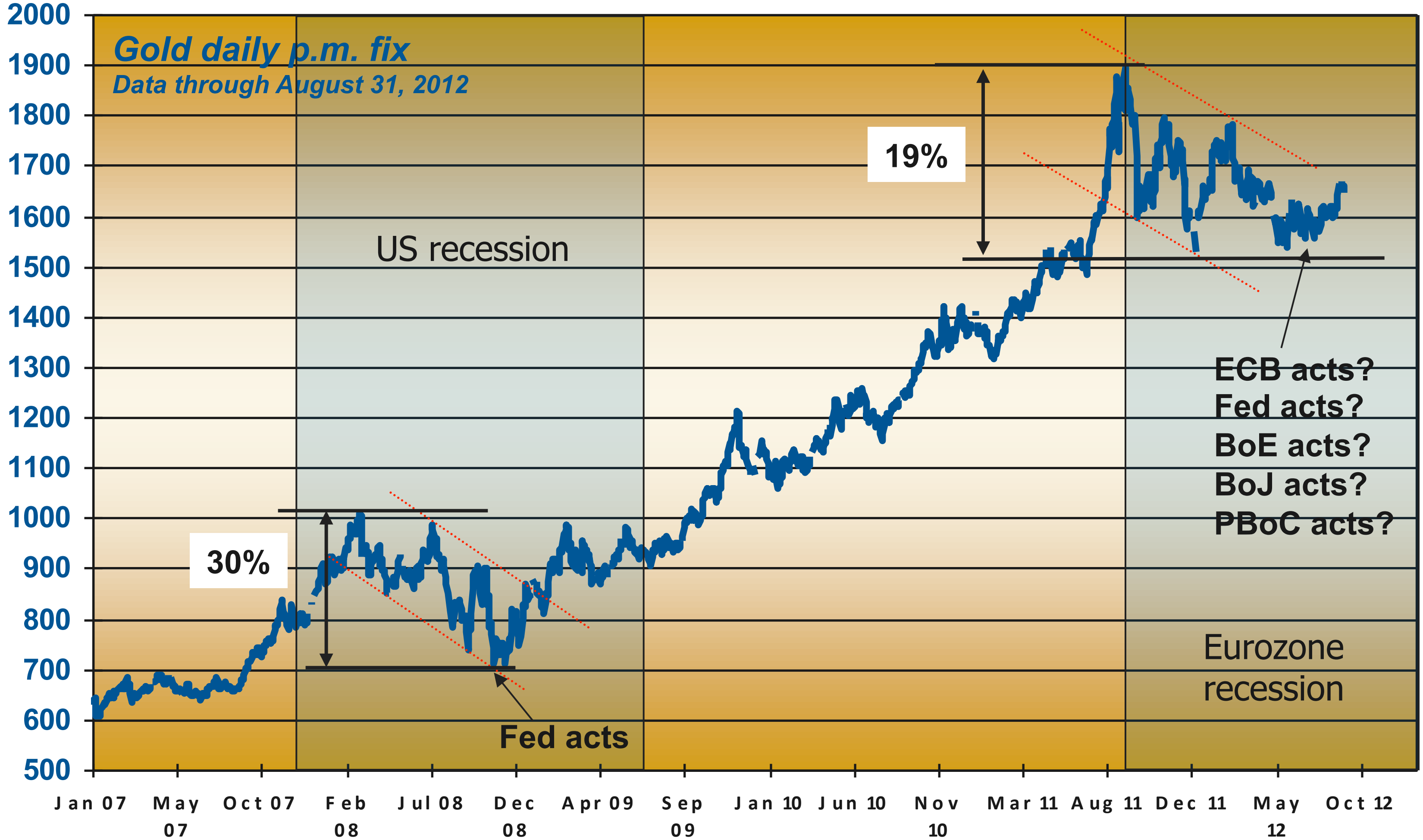
Seven Bearish Factors for Gold

1. ***EU Recession:** fiscal retrenchment, deflation*
2. ***Asia slowdown:** commodity demand weakens*
3. ***Strong dollar:** against the euro … flight to safety*
4. ***Liquidity of last resort:** for Greece, Italy … investors*
5. ***Equity market confidence improves:** investment interest in gold wanes*
6. ***Dehedging finished:** hedging recommences*
7. ***Policy "exit strategies":** rising real interest rates*

Bearish: (1) EU Recession

Gold declines in recessions - before stimulus



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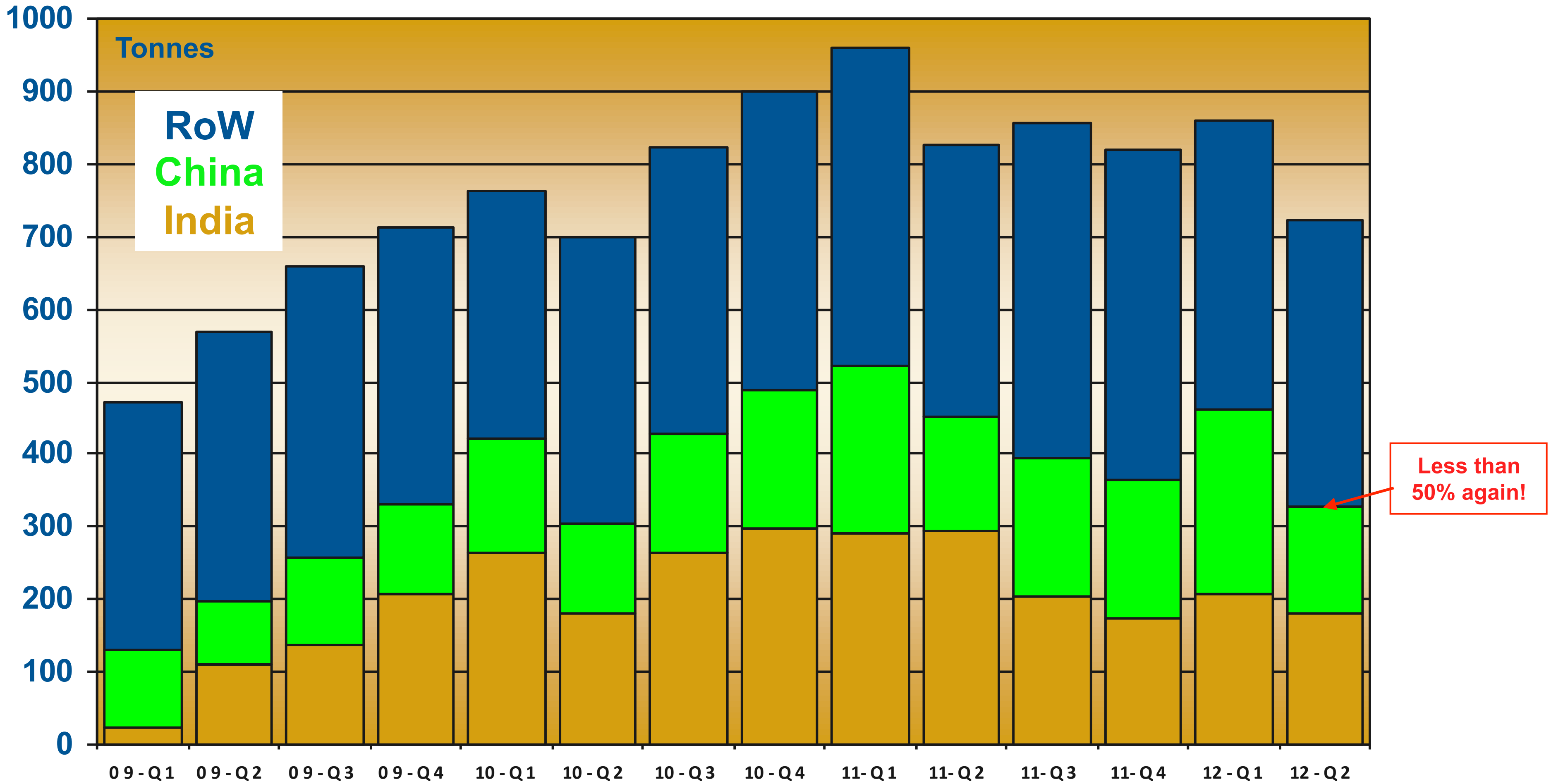
Bearish: (2) Asia Slowdown

Weaker growth in India/China not demand positive



Source: *World Gold Council "Gold Demand Trends 2012-Q2" data tabulated by Thompson Reuters GFMS*

Bullish: (2) Asia Slowdown
Lower income growth not positive for gold demand

If China has a "hard landing" …

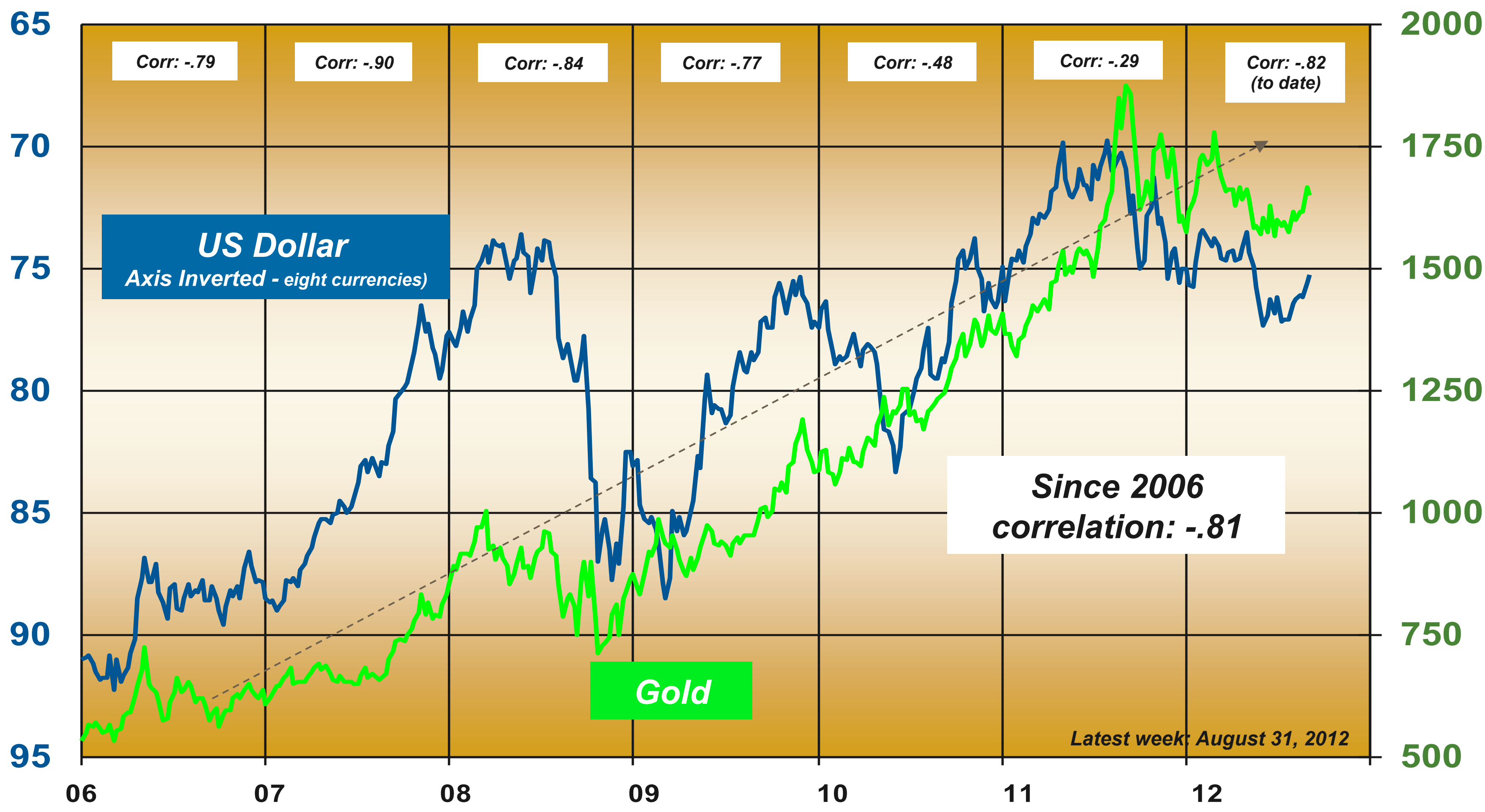
- *China's growth rate will drop below 6%*
- *Investment will cool - money will leave China*
- *World equity markets will sell off – some very sharply*
- *A flight to safety will almost certainly favor US Treasuries*
- *Chinese gold demand will suffer*

But policy will respond …

- *The PBoC will "print money" and fiscal policy will turn aggressively expansionary (China, too, will learn about non-performing loans)*
- *Other Asian central banks will want to insulate their economies, and print/devalue*
- *Which could eventually see gold demand rise to new highs*

Bearish: (3) Dollar Strengthens

A firm dollar is not usually good for gold …



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Bearish: (3) Dollar Strengthens

But the positive correlation with euro is overrated

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Bearish: (4) Liquidity of Last Resort
Europe needs liquidity ….

- *The PIIGS hold over 3000 tonnes of gold*
- *We have been concerned about Italy for years*
- *Europe collectively has more gold than the US*
- *There are reports of "hardship" gold sales throughout Europe*

("Italy's hottest retail slogan: 'I buy gold'", G&M 08/21.)

Gold Reserves	tonnes
Portugal	382
Ireland	6
Italy	2452
Greece	111
Spain	282
Total	3233
Europe	11260
US	8133

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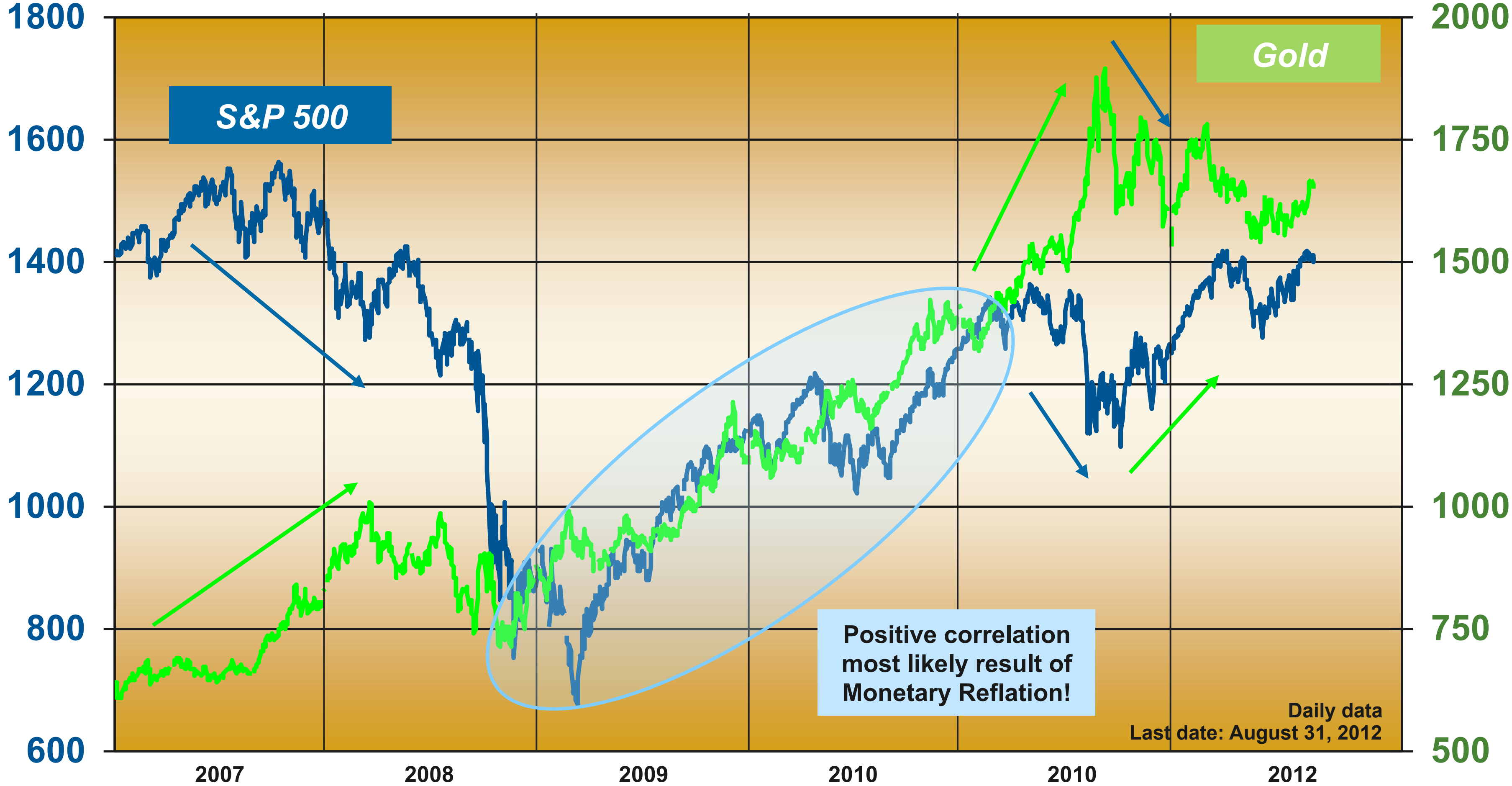
Bearish: (5) Equity Market Improves

Gold-equity correlation is most often zero-negative



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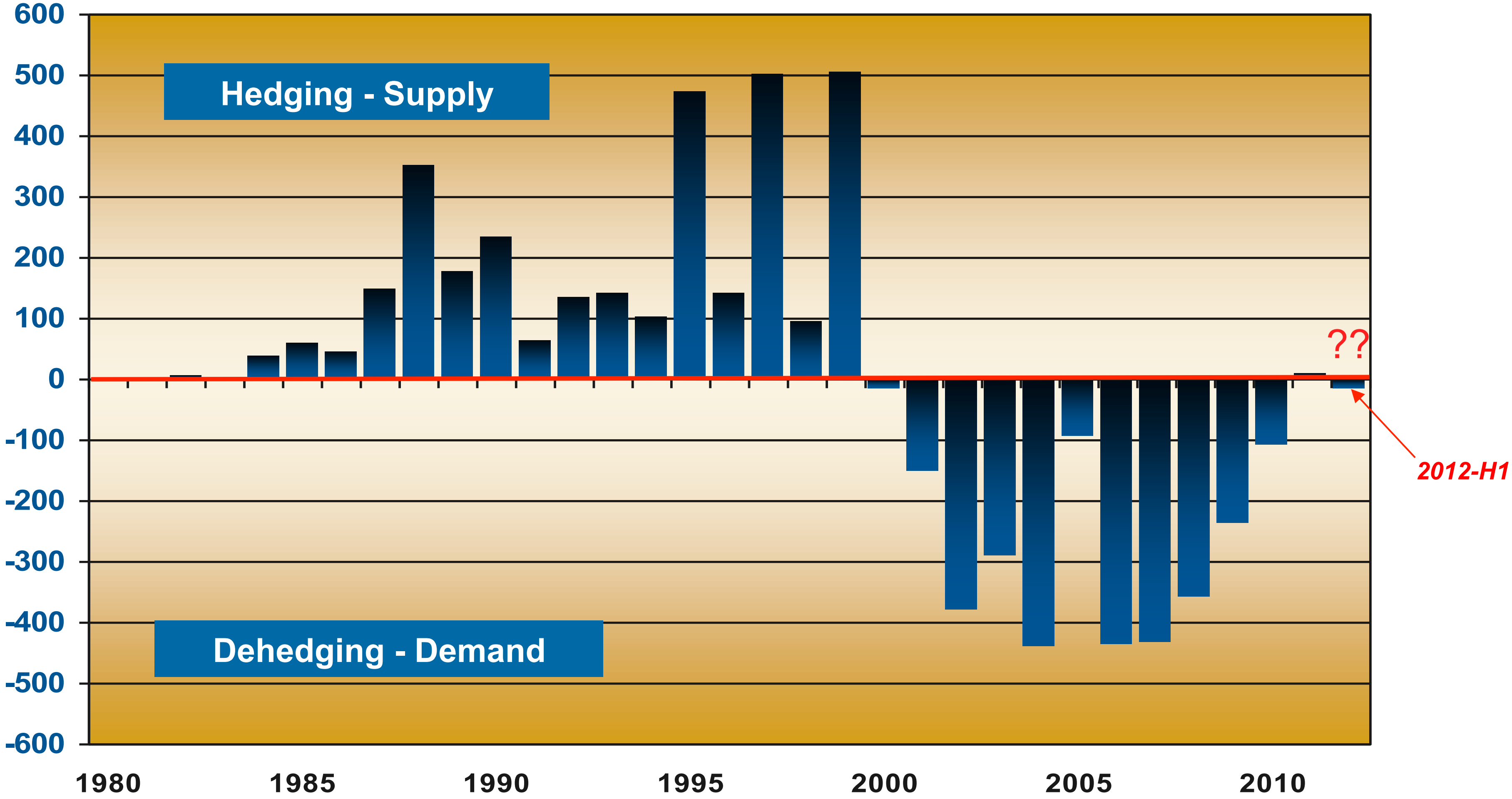
Bullish: (6) Dehedging Finished

Hedging to recommence …?



Source: *Thompson Reuters GFMS, WGC "Demand Trends 2012-Q2"*

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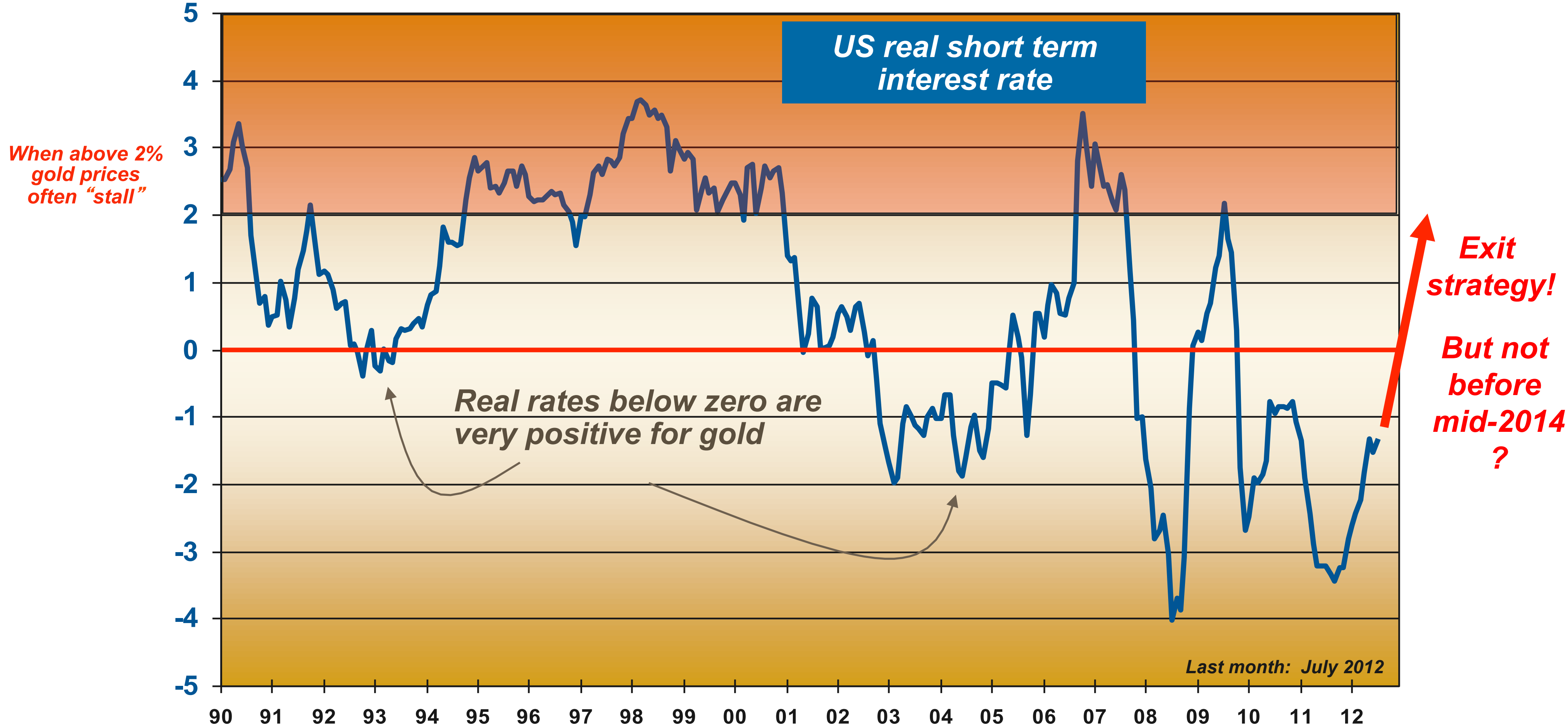
Bearish: (7) Exit Strategies

US real rates will rise … eventually



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Bearish: (7) Exit Strategies

With restrictive fiscal and monetary policies:

1. *Will be a drag on economic growth*
2. *Will keep a lid on inflation*
3. *Will cause the threat of deflation to linger*
4. *Will improve confidence in monetary policy*
5. *Which will weigh heavily on the gold price*

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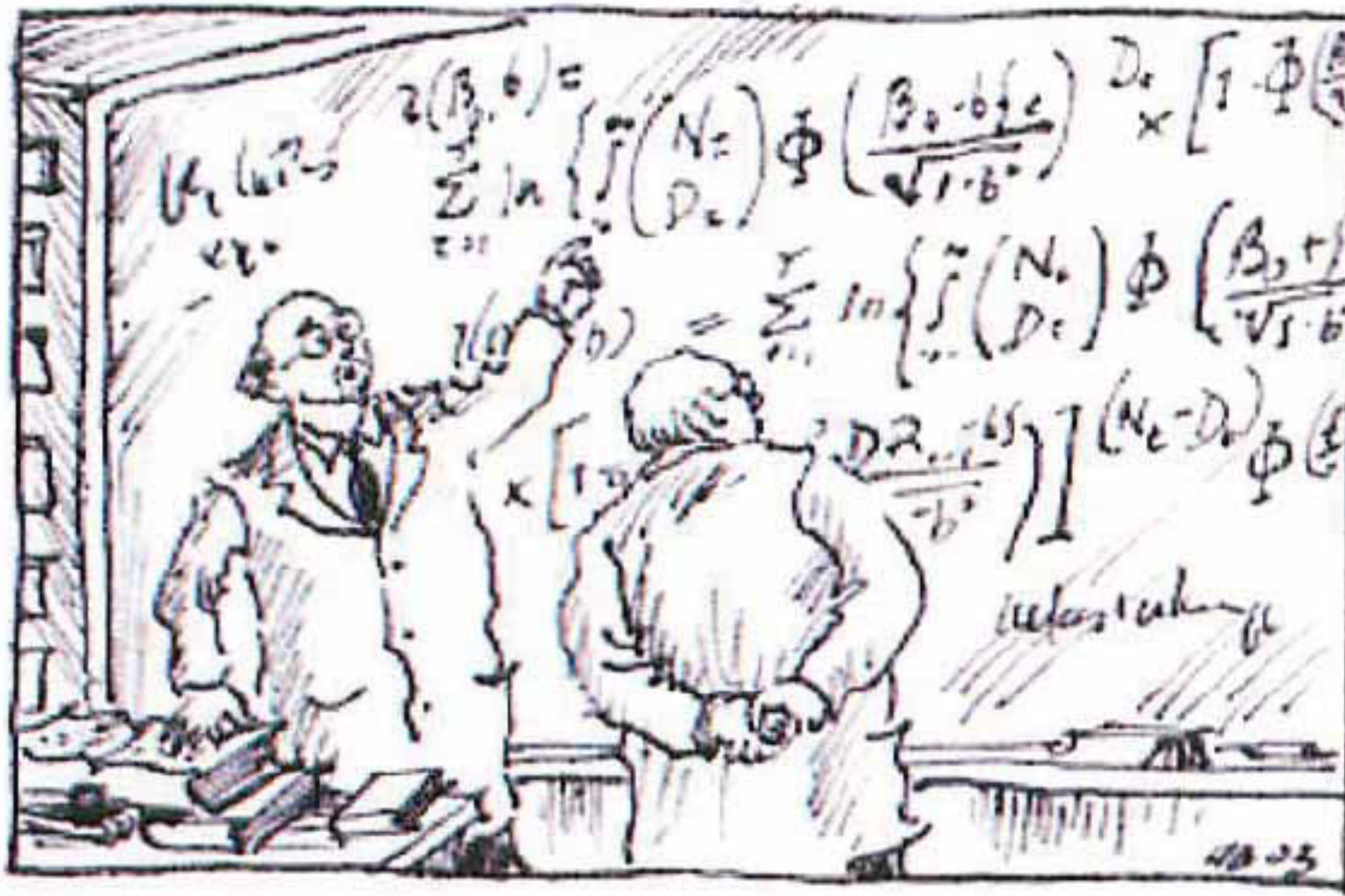
The Latest Forecast

The scenarios make no allowance for geopolitics!!

Gold Price Scenarios

	2012-avg	2012-end	2013-avg
Scenario A: p = 15-20%	**$1582**	**$1465**	**$1417**
Scenario B: p = 40-50%	**$1677**	**$1710**	**$1786**
Scenario C: p = 35%	**$1748**	**$1900**	**$2158**
Weighted:	**$1681**	**$1728**	**$1928**

- *Based on July 6, 2012 projections*
- *Next update September-end*



"Agreed, then—buy gold."

Thank you for your attention!

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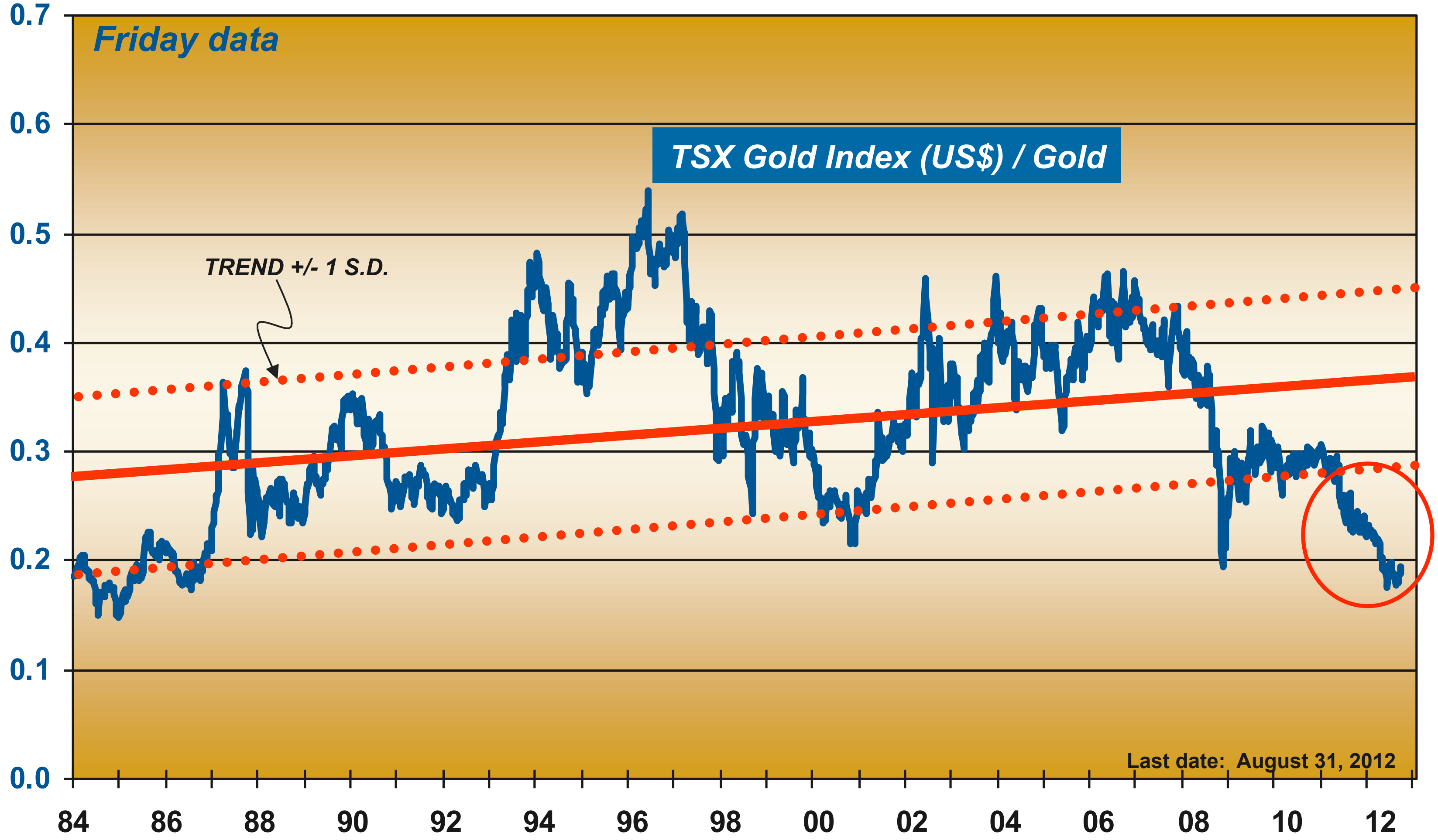
Appendix: TSX Gold/Gold *(in US$)*

TSX Gold Index depressed relative to bullion …



TREND: Based on calculation from January 6, 1984 through August 31, 2012

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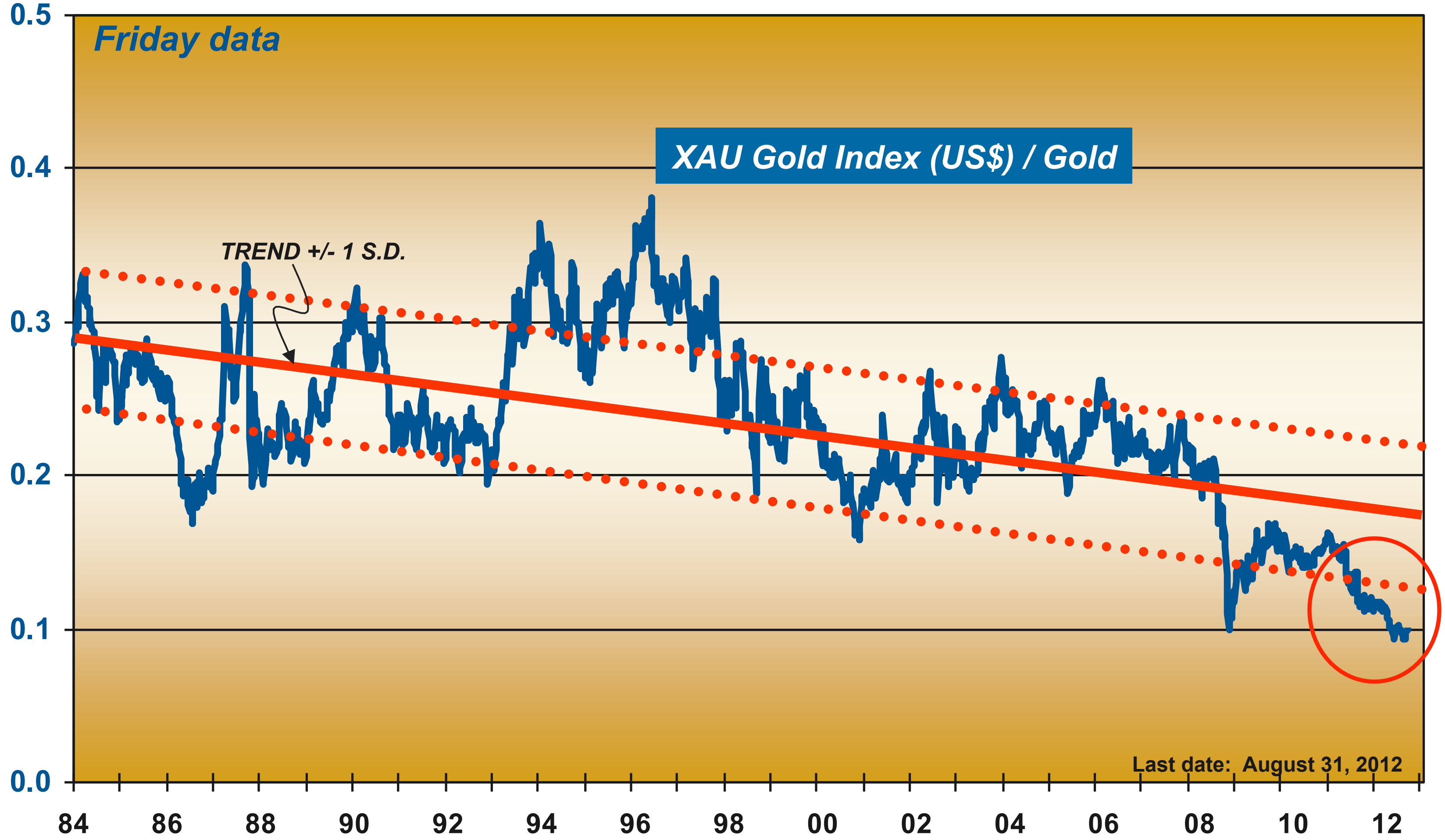
Appendix: XAU/Gold

… As is the XAU Gold Index …



TREND: Based on calculation from January 6, 1984 through August 31, 2012

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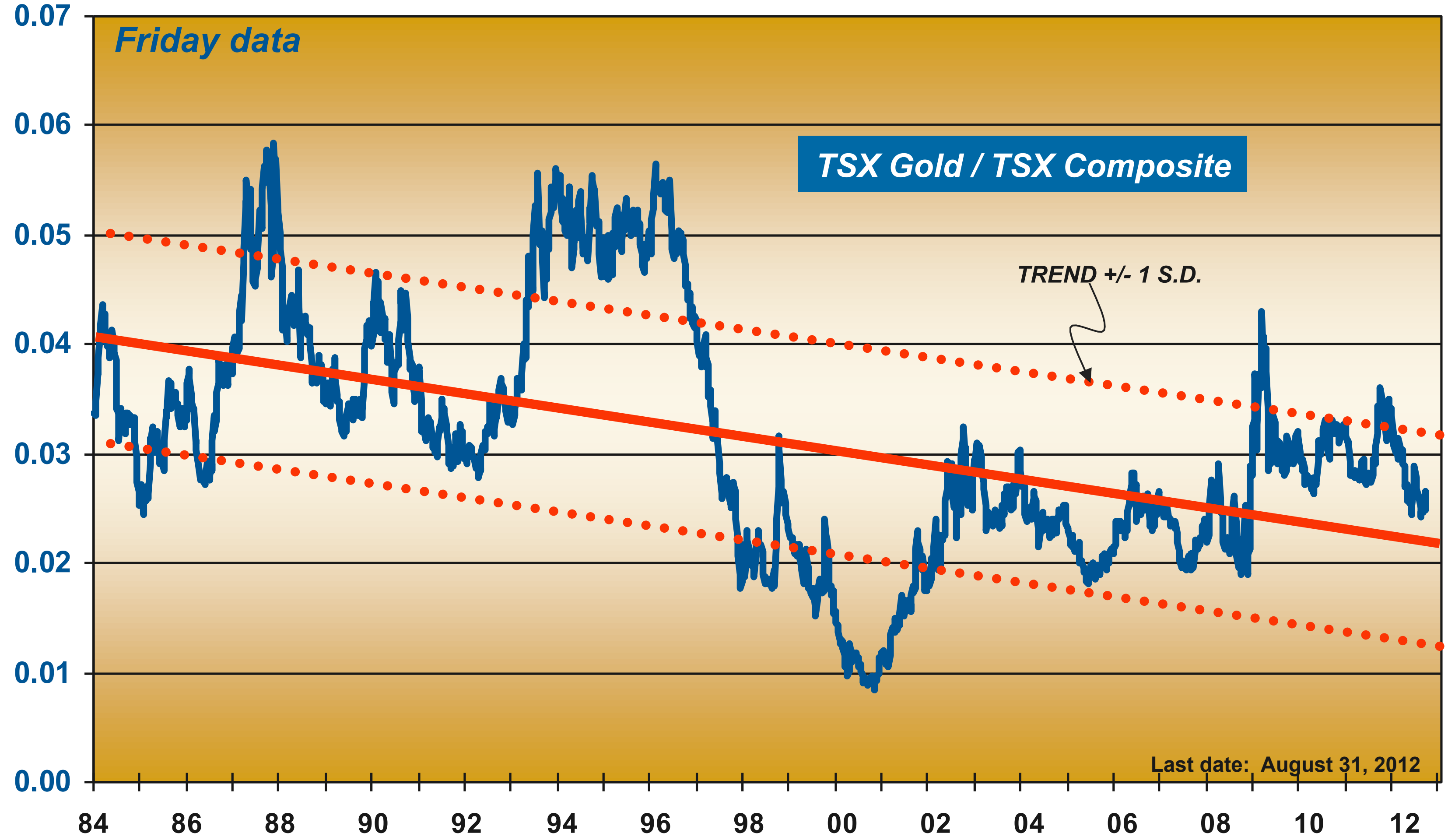
Appendix: TSX Gold/TSX

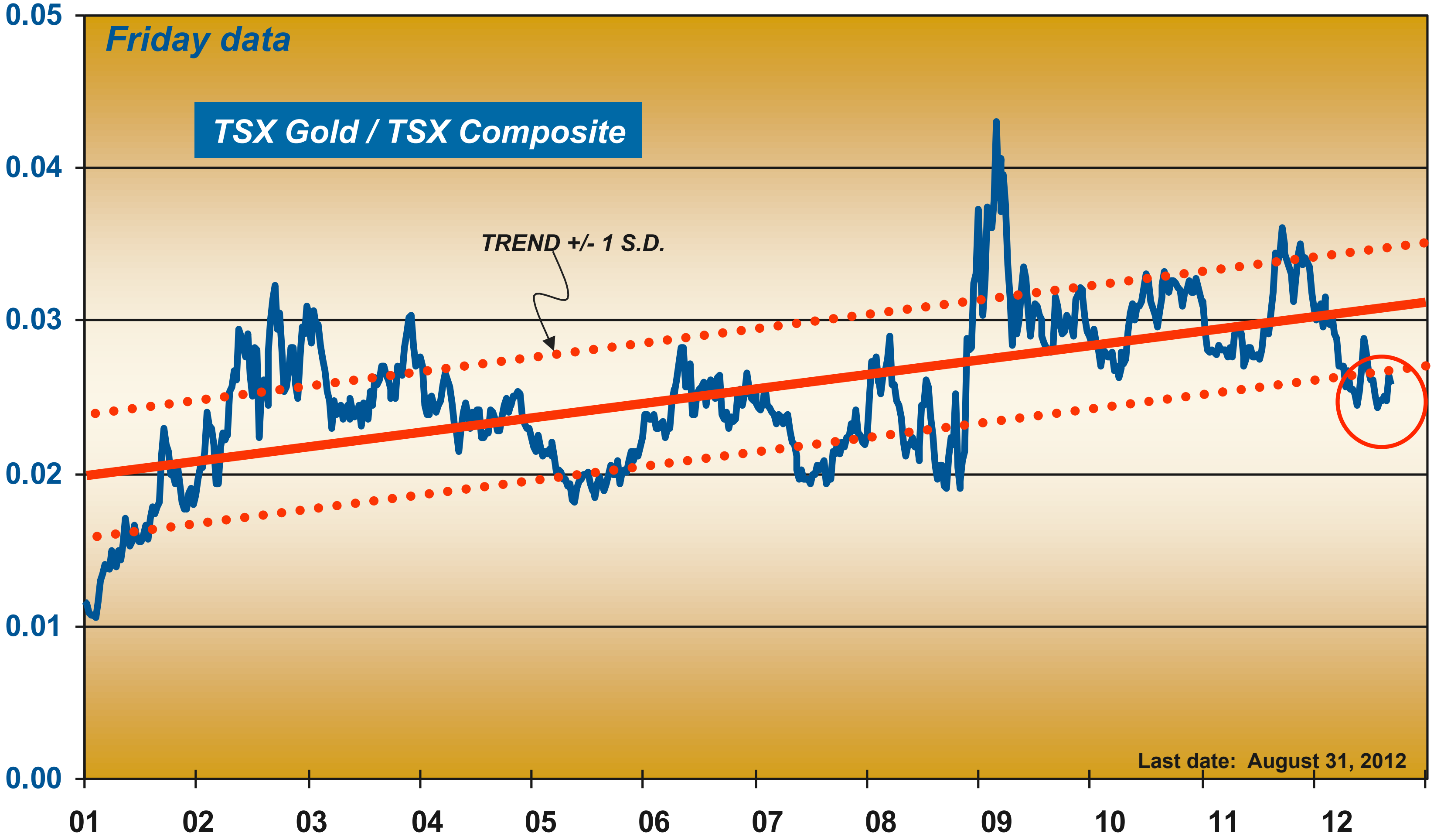
Gold Index "high-normal" relative S&P/TSX Index …



TREND: Based on calculation from January 6, 1984 through August 31, 2012

Appendix: TSX Gold/TSX

… But down when trend shortened to 2000



TREND: Based on calculation from January 6, 1984 through August 31, 2012

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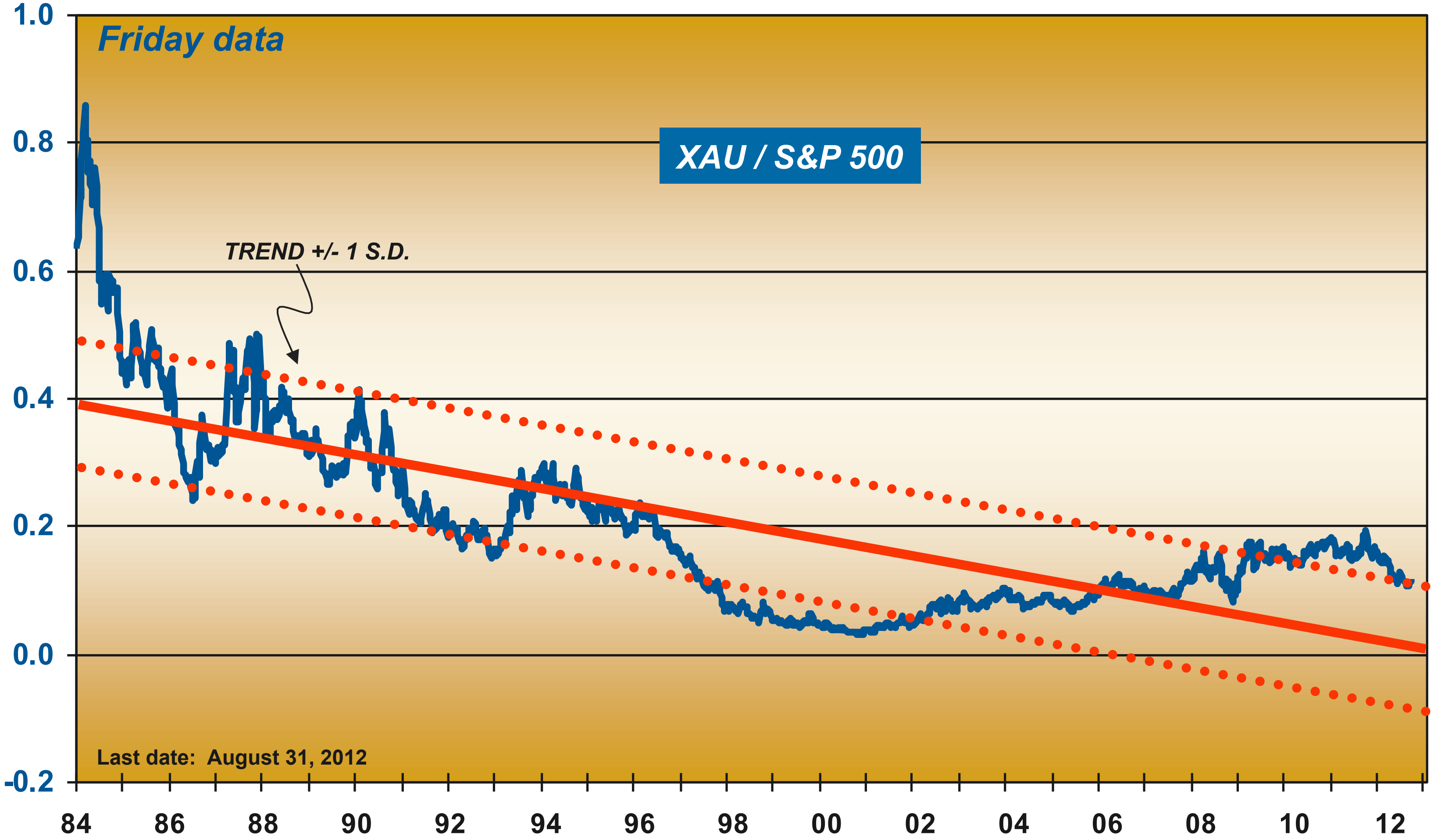
Appendix: XAU/S&P500

XAU "high-normal" relative to S&P500 …



TREND: Based on calculation from January 6, 1984 through August 31, 2012

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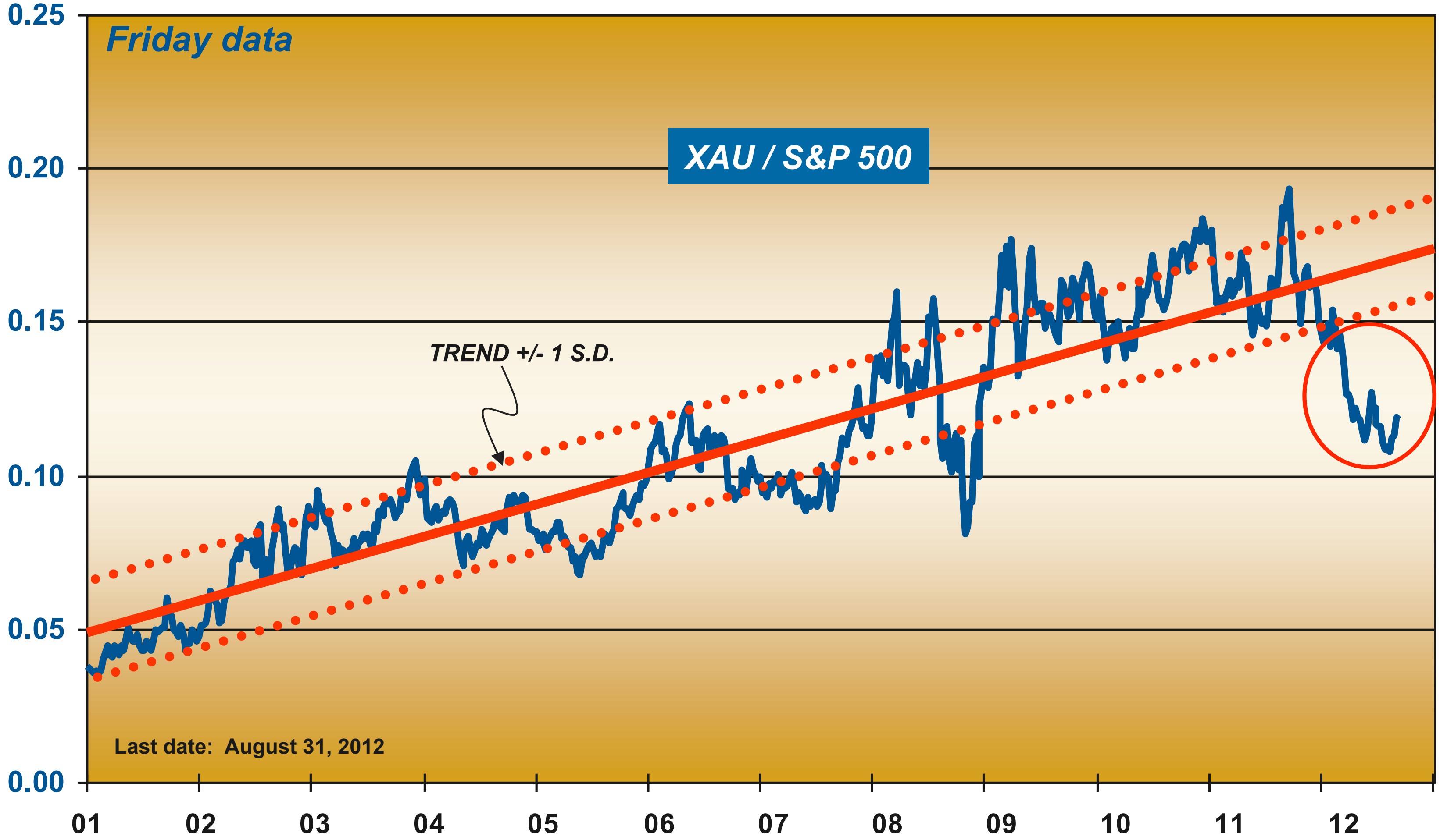
Appendix: XAU/S&P500

… But also down when trend shortened to 2000



TREND: Based on calculation from January 6, 1984 through August 17, 2012

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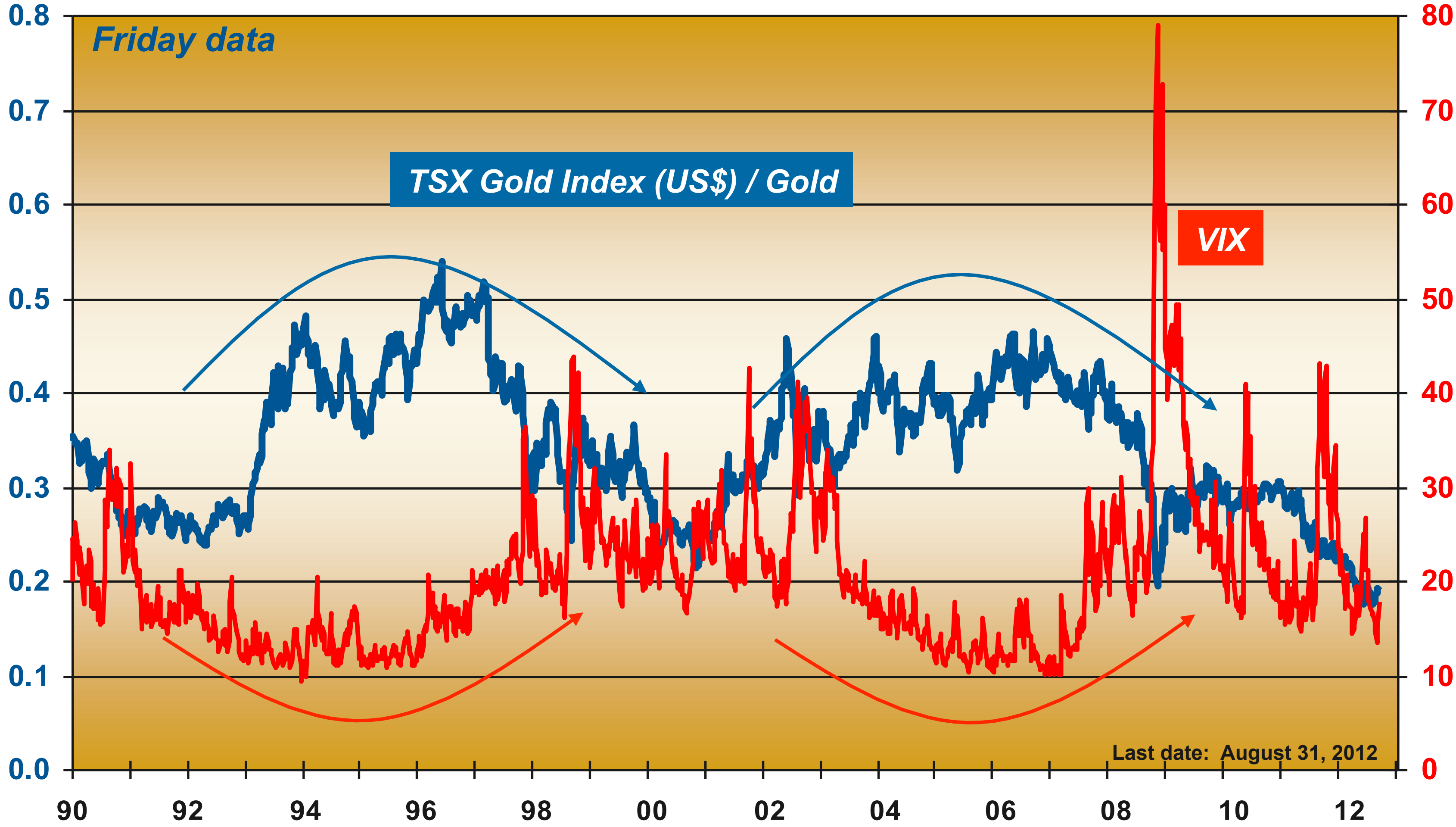
Appendix: TSX Gold/Gold (in US$)

High VIX* often equates with weak gold equities!



*VIX is a trademark symbol for the CBOE Market Volatility Index: a popular measure of implied volatility of the S&P500. It represents one measure of the market's expectation of stock market volatility over the next 30 day period.

Source: Chicago Board Options Exchange, Wikipedia

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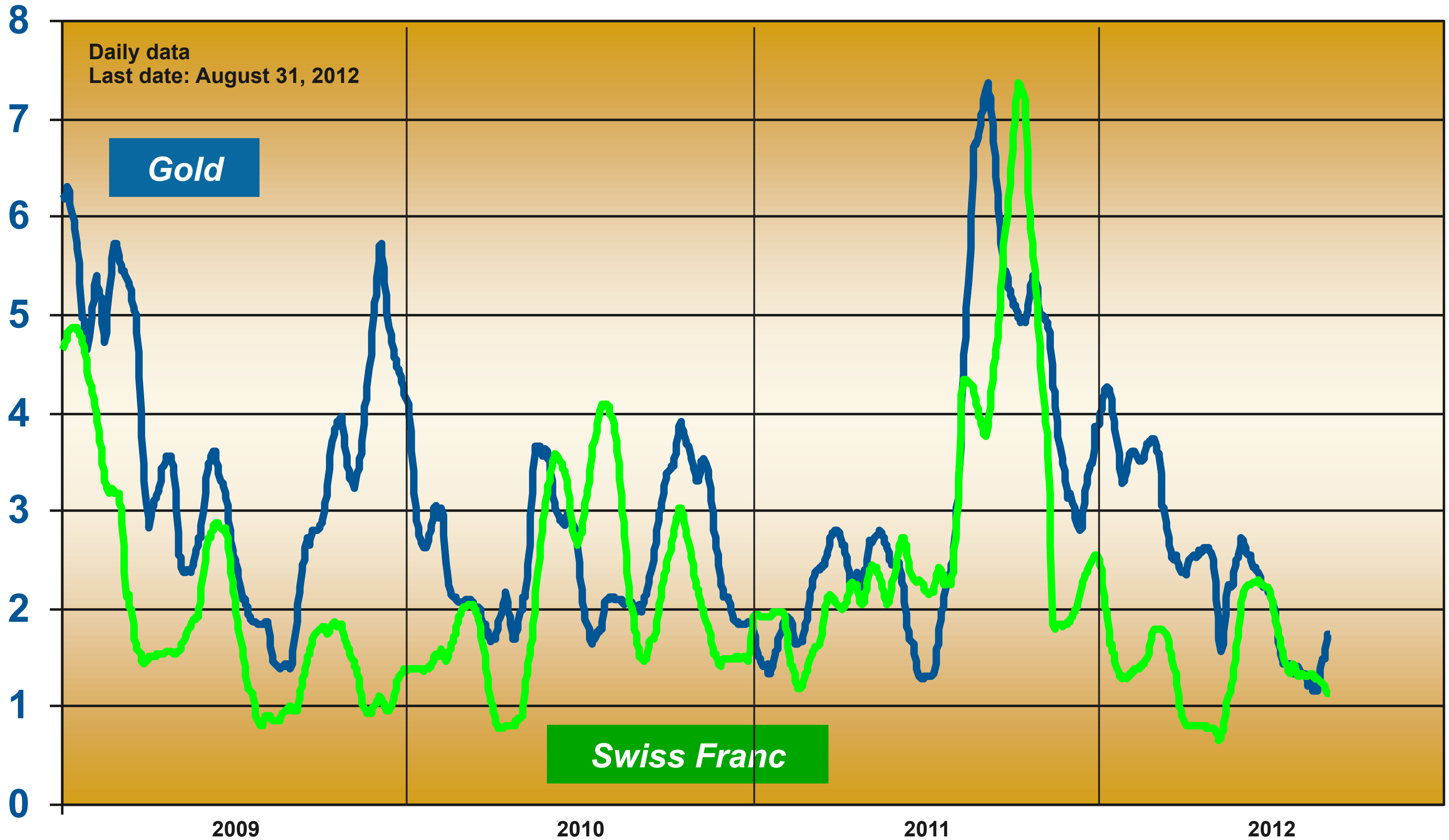
Appendix: Gold Volatility

Gold is no more volatile than some key currencies!



Volatility = S.D. as % of 50-day MA

Appendix: Commitments of Traders

The "specs" could return to gold …