CapitalStars Financial Research Pvt., Ltd.,

Special Report

Gold Special Report

WORLD
GOLD
COUNCIL

Outlook 2017- Global economic trends & their impact on gold.

The gold market in 2017

In 2016, investors around the world returned in large numbers to the gold market, as a combination of macroeconomic drivers. As we start the new year, there are some concerns that US dollar strength may limit gold's appeal. We believe that, on the contrary, not only will gold remain highly relevant as a strategic portfolio component, but also six major trends will support demand for gold throughout 2017.

Heightened political and geopolitical risks

Political risk is rising. Europe will hold key elections in the Netherlands, France and Germany in 2017. As John Nugée says, the election cycle will happen "against a backdrop of continued citizen unrest, fuelled by the ongoing uneven distribution of economic welfare." In addition, Britain must negotiate its exit from the European Union.

While the UK economy is still expanding, the pound fell sharply following the referendum decision and continues to weaken every time the markets sense that there is an increased chance of a 'hard' Brexit.

> "Confidence […] could be affected by geopolitical tensions triggered by the new [US] administration"
>
> *Jim O'Sullivan, Chief US Economist*
> *High Frequency Economics*

In the US, there are positive expectations about the economic proposals of President-elect Donald Trump and his team, but there are also concerns. The US dollar has gained ground since Trump swept to victory last November, but uncertainty is rife. Jim O'Sullivan sees "a meaningful risk that negotiations on trade will turn belligerent" and suggests that "confidence in markets could be affected by geopolitical tensions triggered by the new administration". As a high-quality, liquid asset, gold benefits from safe-haven inflows.

Currency

President Trump's Budget: The president is expected to release his fiscal 2018 budget outline this week. Will deficit-hawks push back against proposals that increase the deficit? Rising deficits are bullish for gold.

Fed: The Fed in March meeting increases rates by 25 Basis Points. This will raise the benchmark rate for Fed funds from .75 % to 1 %. This is the first interest rate hike in 2017 and the second rate hike in four months. However, when you look at the big picture, this is only the third interest rate hike since the beginning of the 2008 economic meltdown and the initiation of the quantitative easing program by the Federal Reserve.

Further 2017 FOMC Meetings

May	2-3
June	13-14
July	25-26
September	19-20
Oct/Nov	31-1
December	12-13

Monetary policy is likely to diverge between the US and other parts of the world. The Fed is widely expected to tighten monetary policy, but it is far from certain that other central banks may be willing and/or able to do so.

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Continued signs of strength in the U.S. economy prompted the Fed overnight to raise rates for the third time since the global financial crisis. But Tokyo remains more cautious about ending stimulus, preferring to stay behind the curve rather than ahead of it, after spending much longer fighting prices than its global peers.

"Exchange rates have historically been the key channel through which Asian economies have adjusted to higher US interest rates"

David Mann, Chief Economist, Asia Standard Chartered Bank

Bank of Japan: The Bank of Japan left policy unchanged Thursday, sticking with its expansionary measures even though other major central banks, including the Federal Reserve, are shifting away from years of unusually aggressive stimulus.

Japan's economy is recovering with the help of a weaker yen and other unexpected tailwinds stemming from Donald Trump's rise to the U.S. presidency. But economic growth and stable inflation still remain far from the levels promised by Prime Minister Shinzo Abe and the Bank of Japan.

Rising inflation expectations

Nominal interest rates are widely expected to increase in the US this year, but all the economists we spoke to forecast that inflation will rise as well.

"[Inflation] momentum remains upward"

Jim O'Sullivan, Chief US Economist High Frequency Economics

An upward inflationary trend is likely to support demand for gold for three reasons. First, gold is historically seen as an inflation hedge. Second, higher inflation will keep real interest rates low, which in turn makes gold more attractive. And third, inflation makes bonds and other fixed income assets less appealing to long-term investors.

Inflated stock market valuations

"Portfolio resilience and diversification in the face of shocks will be key"

former Reserves Chief Manager Bank of England

Stock markets had a significant rebound in the last stretch of 2016. And while some stock markets are just recovering from lacklustre multi-year performance, stocks in the US have reached historical highs. In many cases, valuations have been elevated, as investors increase their risk exposure in search of returns in a very low yield environment.

Until now, investors have used bonds to protect their capital in the event of a stock market correction. As rates rise, this is a less viable option – and in the meantime, the risk of a correction may be increasing. The interconnectedness of global financial markets has resulted in a higher frequency and larger magnitude of systemic risks. And as Jim O'Sullivan puts it: "The [US economic] expansion will not last forever."

In such an environment, gold's role as a portfolio diversifier and tail risk hedge is particularly relevant.

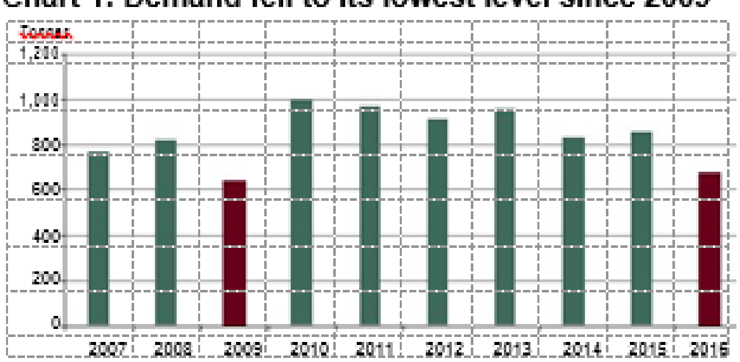
Long-term Asian growth

Macroeconomic trends in Asia will support economic growth over the coming years and, in our view, this will drive gold demand. In Asian economies, gold demand is generally closely correlated to increasing wealth. And as Asian countries have become richer, their demand for gold has increased. The combined share of world gold demand for India and China grew from 25% in the early 1990s to more than 50% by 2016. And other markets such as Vietnam, Thailand and South Korea have vibrant gold markets too.

> "Asia will account for around 60% of global growth in 2017"
>
> *David Mann, Chief Economist, Asia*
> *Standard Chartered Bank*

India Gold demand fell in 2016

Chart 1: Demand fell to its lowest level since 2009



India's gold industry suffered last year. In H1, the 1% excise duty on jewellery manufacturing prompted a 42-day strike. The income disclosure scheme disrupted the black market – fearing a backlash from tax officials, some consumers postponed buying gold. And in Q4, the shock demonetisation initiative caused a liquidity squeeze that affected the entire economy. These policies, combined with fragile rural sentiment and a soaring gold price, pushed gold demand to its lowest level since 2009.

Transparency

Transparency is at the heart of many initiatives undertaken by India's government. The government wants to streamline its bureaucracy, clamp down on tax evasion, and move India's cash-based economy into the digital age. While this has the potential to bring many benefits, it will doubtless cause short-term disruption.

Demonetisation:

On 8th November 2016, the government announced the abolition of Rs500 and Rs1,000 notes, ordering them to be tendered into local banks or the Reserve Bank of India by 30th December. This scheme has become colloquially known in the market as demonetisation. Rs1,000 notes were scrapped entirely, but new Rs500 notes and Rs2,000 notes have since been introduced. The government also capped the value of old bills exchanged at bank counters, as well as withdrawals from bank accounts and ATMs.

There was some flexibility. Certain payments using the old notes were allowed for a limited period: for example, purchases of petrol and airline tickets. And subsequent measures freed up cash-flow for pensioners, armed forces personnel and farmers seeking to plant crops.

The government's objective of bringing black money into the official economy is praiseworthy, but it dented economic growth. A total of Rs15.44 trillion – or 86% of the currency in circulation – was withdrawn from the economy by the demonetisation ruling. And these notes were not replaced quickly. According to the Reserve Bank of India only Rs11.07 trillion of currency had been issued by 17th February 2017 – equivalent to just 70% of the withdrawn currency. 2

A Whole New World of Gold Demand Is Opening Up... Muslims

Most analysis of gold and silver markets tends to be U.S.-centric. However, the next secular trend in precious metals markets may have less to do with U.S. debt, U.S. politics, the U.S. central bank, and the U.S. dollar and more to do with a gigantic new source of demand.

It's not the 1970s anymore. Back then, big moves in the metals markets were centered on United States. The great gold and silver mania of the late 1970s was driven by inflation fears and a rush of speculative demand. Although coin dealers struggled to keep up, there was no actual global shortage of physical metal, and spot prices crashed after manic buying peaked in January 1980.

Today, it's a whole new world when it comes to sources of gold demand. Gold prices are still quoted in dollars, but international buying and selling now figures much more prominently in determining those prices.

Over the past four decades, the populations and buying power of Asian countries have soared. As they have become wealthier, they have bought more gold. **India is now the world's number one consumer of gold. India and China together now make up more than half of all world gold demand, according to the World Gold Council.**

The recently launched Shanghai Gold Exchange will make China one of the leading players in physically settled gold contracts. No longer does the global gold trade have to go through the New York or London paper markets.

Fast-Growing Muslim World Can Now Turn to Gold as an Investment

Going forward, the fastest growing source of gold demand could come from the Islamic world. Iron-fisted **Islamic law imposes strict rules on the types of financial instruments that can be held in compliant accounts. Among the assets that are now permitted are physical precious metals.**

The Accounting and Auditing Organization for Islamic Financial Institutions recently approved a new Shariah Standard on Gold. This new standard is expected to be widely adopted this year by Islamic banks, brokerages, and other financial institutions. It will enable gold to be held as an investment asset within Shariah-compliant accounts.

The upshot is that investment demand for gold among Muslims could surge by several hundred tons amounting to tens of billions of dollars.

Total Shariah-compliant assets under management are estimated by the Islamic Finance Stability Board to grow to $6.5 trillion by 2020.

If clients opted for just a 1% allocation to gold, that would translate into $65 billion – or more than half of annual worldwide gold production.

While the fertility rate of most Western cultures has been declining at an alarming rate, the **Muslim population itself is rapidly growing worldwide.** According to a report by the Pew Research Center, **"if current demographic trends continue, the number of Muslims is expected to exceed the number of Christians by the end of this century."** That would make **Islam the world's biggest religion.**

Higher numbers of Muslims, plus rising standards of living in Asia, means non-Western demand for gold and silver can be expected to go up for the foreseeable future.

Supply Will Struggle to Keep Up with Rising Global Gold Demand

Supply, meanwhile, will be difficult to expand. Higher prices could cause new mines and new mining technologies to come online down the road. But for now, the tough economics of the mining industry point toward the likelihood of reduced output over the next few years.

All the gold dug out of all of the mines around the world in a year would amount to an 18-foot cube.

That would be enough gold to make one person insanely wealthy! But it wouldn't be anywhere near enough for each of the world's 7.4 billion people to have so much as an ounce of gold... or even half an ounce... or even a tenth of an ounce. In fact, total world gold production amounts to less than 1/70th of an ounce per person.

Technical Chart:

MCX Gold Apr., as seen in the monthly chart has good resistance near 30400 and support 27400 - 27300. As we seen it is trading in the downtrend. RSI is between overbought and over sold.

Trading Strategy: **Buy Gold Apr., near 28000 TG 29000/29500 SL 27000**

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