

Russian Bullion Seminar

Moscow, 24 of November 2011

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Москва, 24 ноября 2011

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Gold Outlook

Edel Tully

Precious Metals Strategist

This document has been prepared by UBS LTD

November, 2011

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON SLIDE 70



UBS 2012 Macro Themes

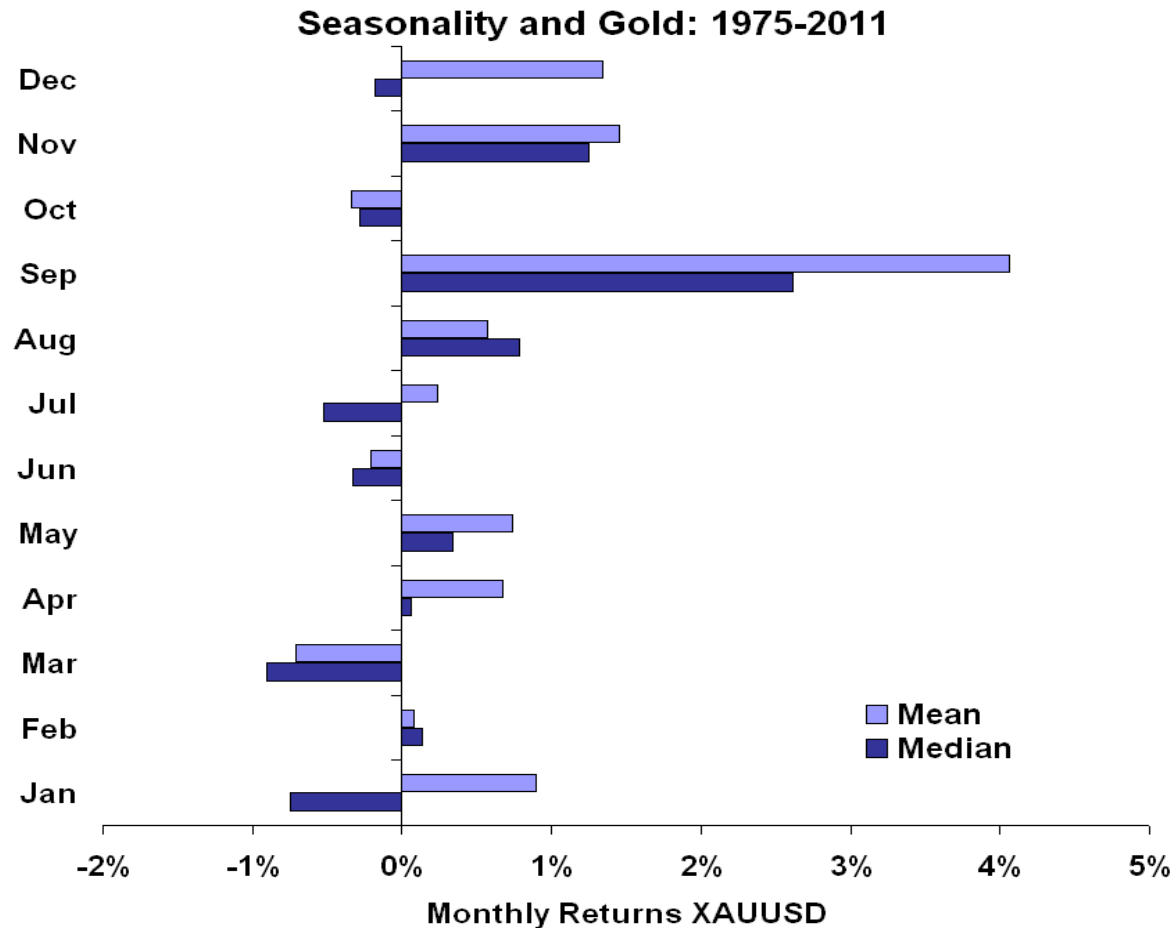
- More of the same drivers in 2012: high volatility and elevated cross-asset correlations, continued uncertainty on sovereign stress, and doubts about sustainability of global recovery
- Eurozone sovereign crisis to get worse, before it gets better
 - Situation to intensify, potentially resulting in a ‘big bang’ that will eventually result to Eurobonds
- High political risk on both sides of the Atlantic: regime changes
- Low interest rate environment: most major central banks to maintain low policy rates for longer, and easing inflation in EM economies allowing for policy easing
- Our economists expect global growth to slow to 3.1% in 2012 from estimated 3.2% in 2011
 - Reflects divergence: Eurozone to dip into recession in H1 2012, bringing down full-year forecast to 0.2% from 1.0%; US growth expected to hold at 2.3% from estimate of 1.8% in 2011

Gold – Core View

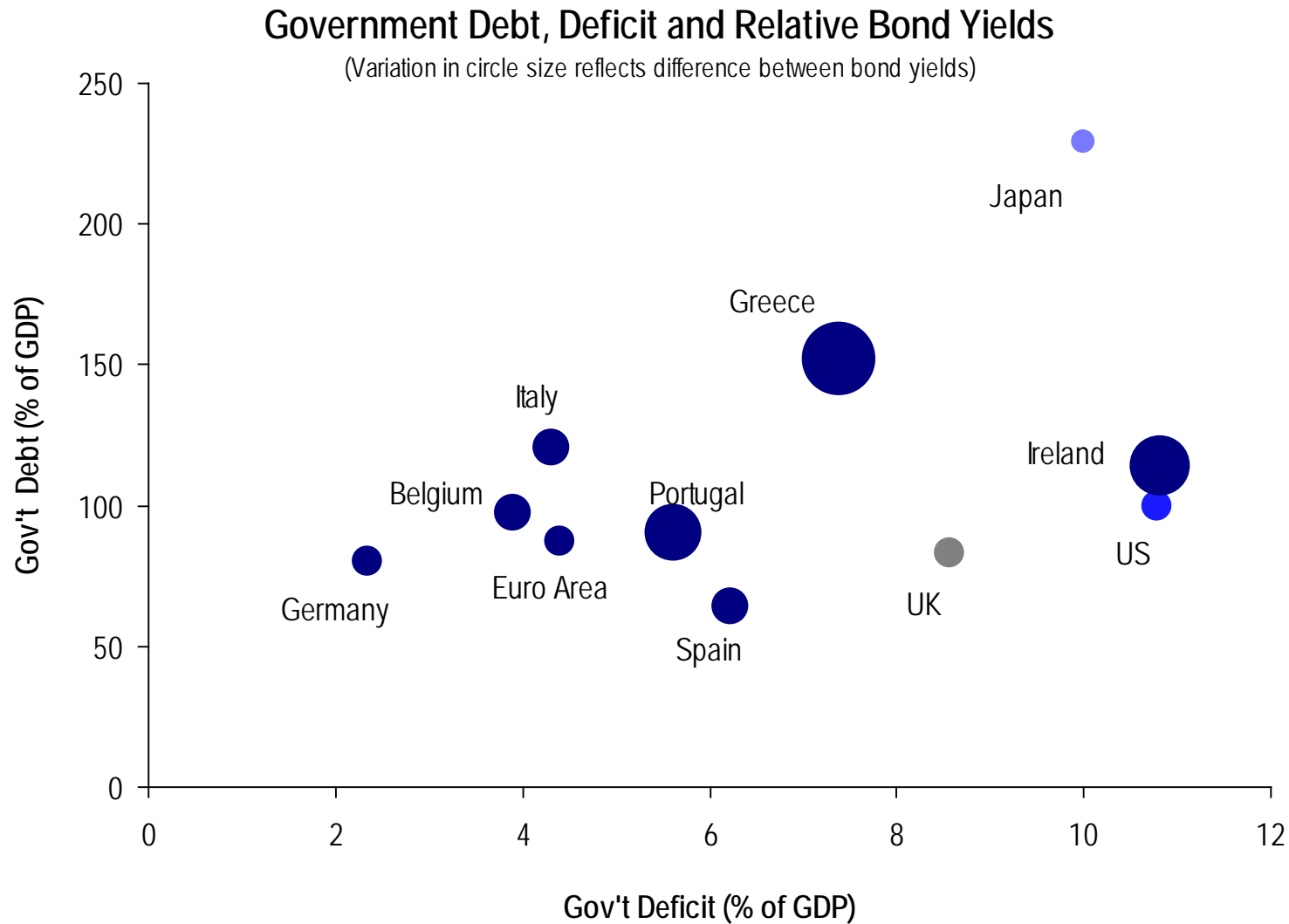
- Our core view is that ongoing global macroeconomic disappointments; the inevitability of further negative turns in the European sovereign debt crisis, alongside low business, consumer and investor confidence will lead to gold being used as the line of defence against further negative outcomes.
- With the pool of competing asset alternatives sparse, 'new' money will flow into the gold market over the months ahead and into 2012, and this will have significant price implications. Much rests on policy makers actions, in particular whether will act proactively and whether action will have a positive impact on growth.
- Forecasts:
 - 1m: \$1775; 3m: \$1950
 - Annual average forecasts: 2011: \$1675; 2012: \$2075

Seasonality – mixed prediction power

- Past guide didn't suggest a summer rally or a severe Sept pullback

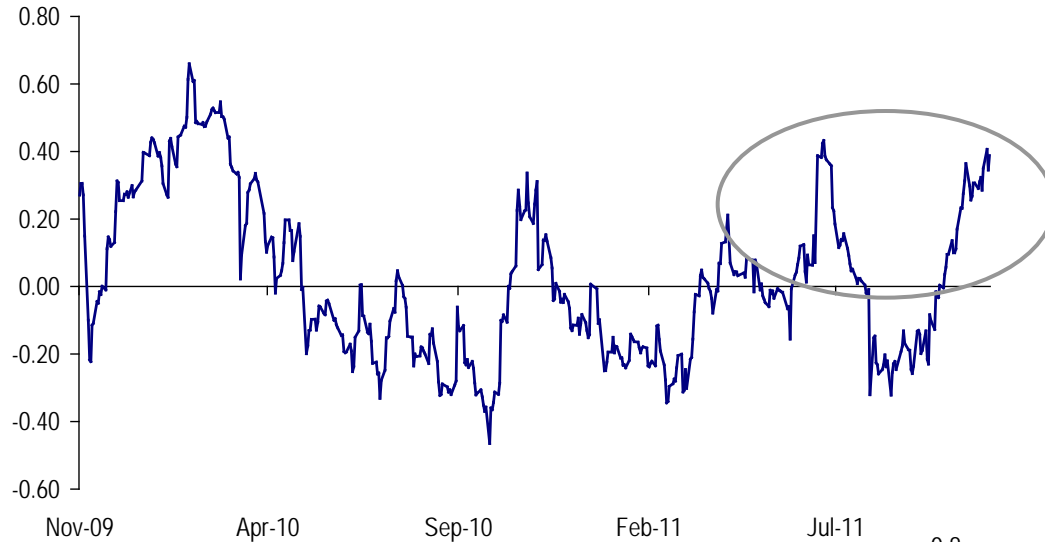


Sovereign debt woes - benefitting gold and will do for some time



Gold and Europe CDS indices - positive correlation

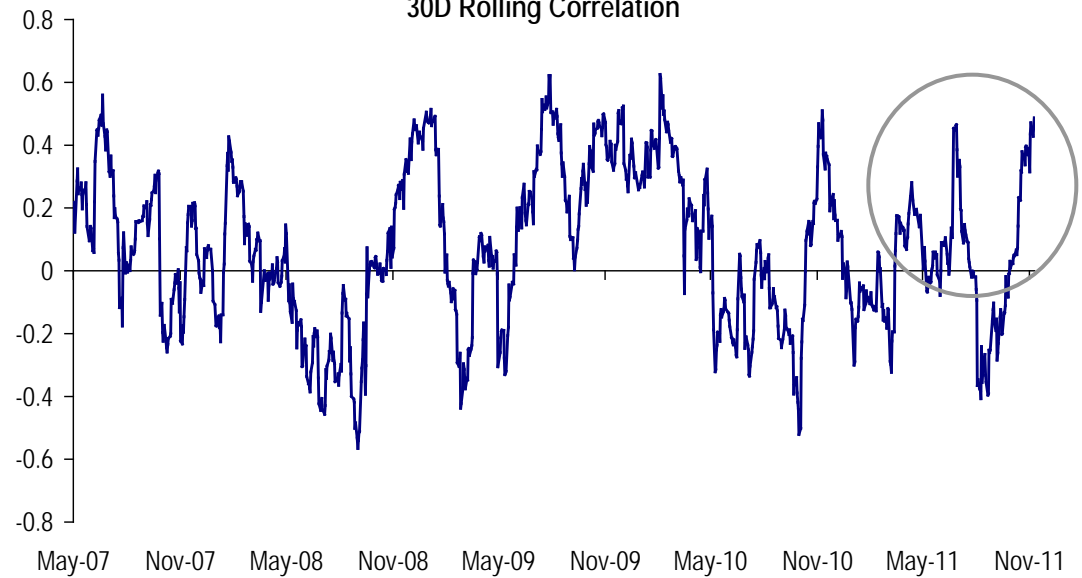
Gold and Markit Itraxx SovX Western Europe 5Y Index
30D Rolling Correlation



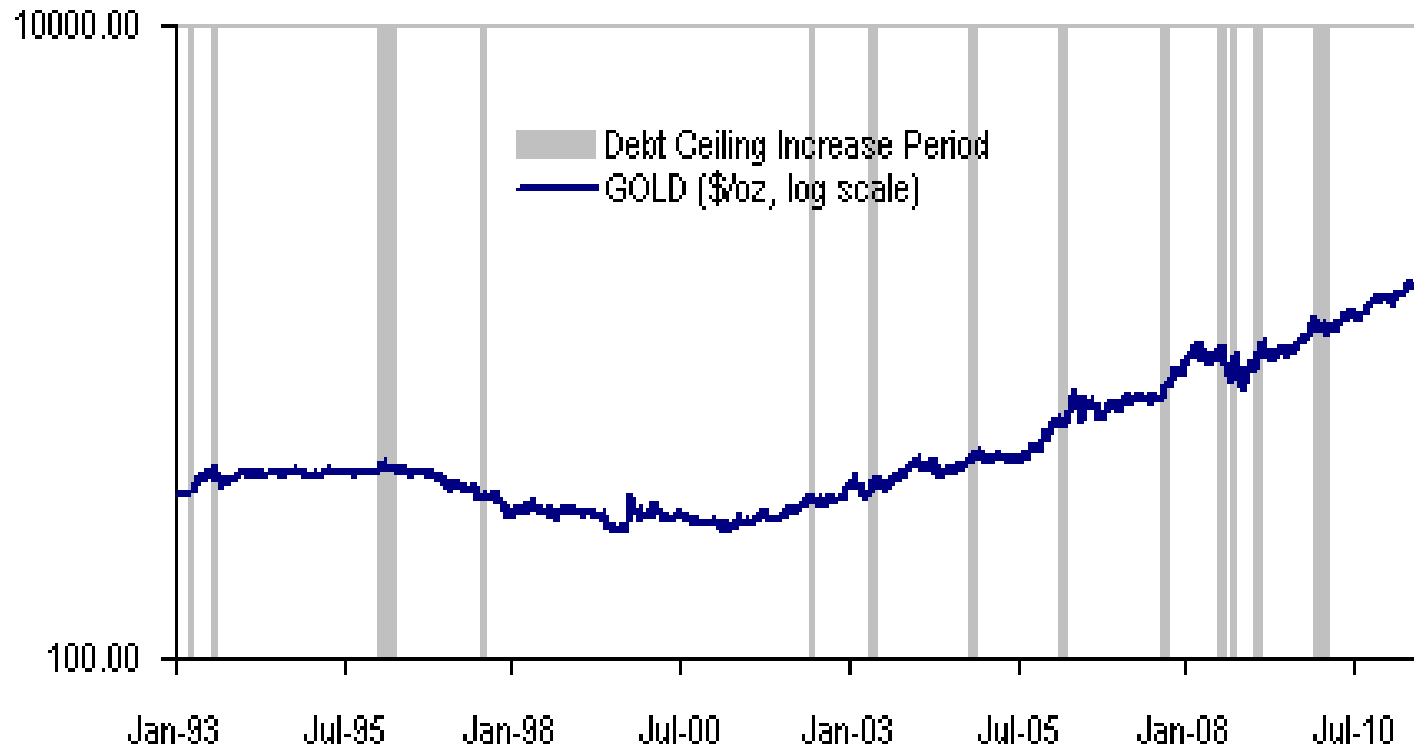
Sovereign CDS (15 Eurozone names, plus Denmark, Norway, Sweden and UK)

CDS of 125 equally-weighted corporates

Gold and Markit Itraxx Europe 5Y Main Index
30D Rolling Correlation



US Debt Downgrade triggered the \$250 move above \$1900

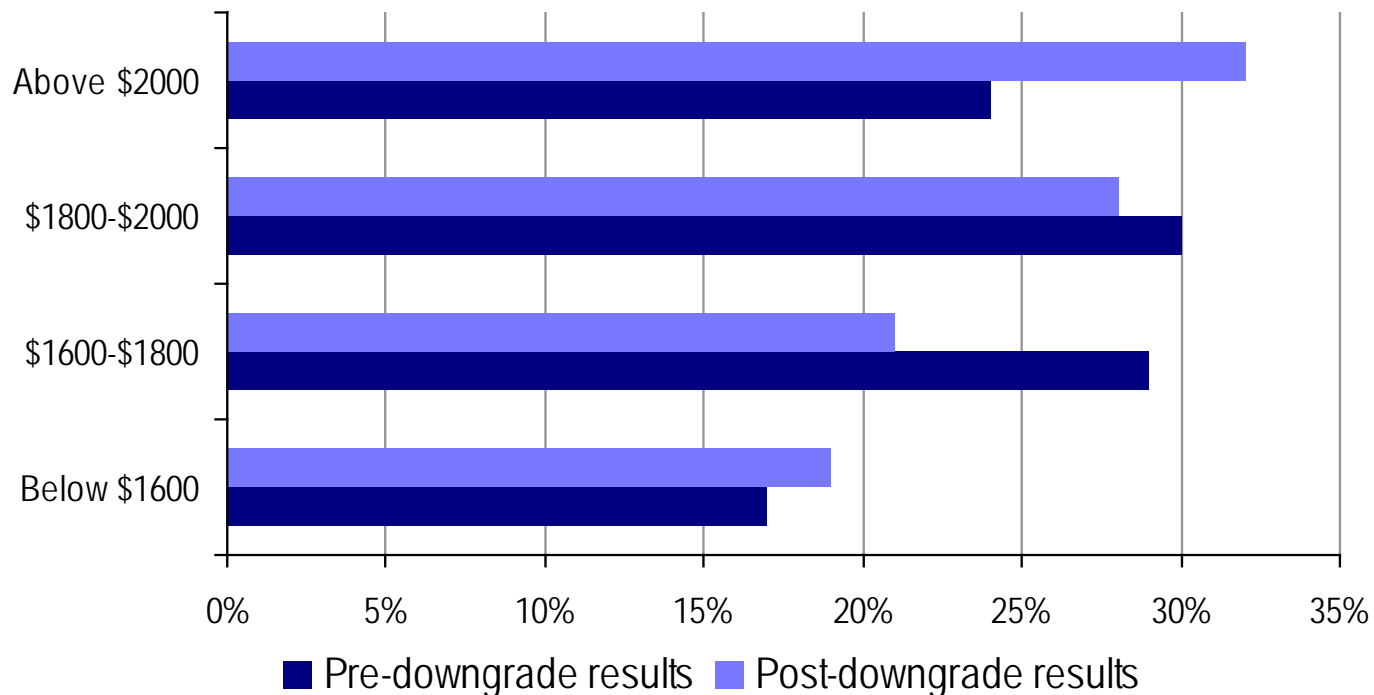


- Gold posted gains over the 30 days leading up to a debt ceiling decision in 10 out of the 16 times it had been raised since 1993
- Poses potential year-end upside risk as the US once again approaches its \$15 tn debt limit – US Congress ‘super committee’ has a Nov 23 deadline to come up with fiscal cuts, which needs to be approved by Dec 23

US Debt Downgrade – impact on year-end price expectations

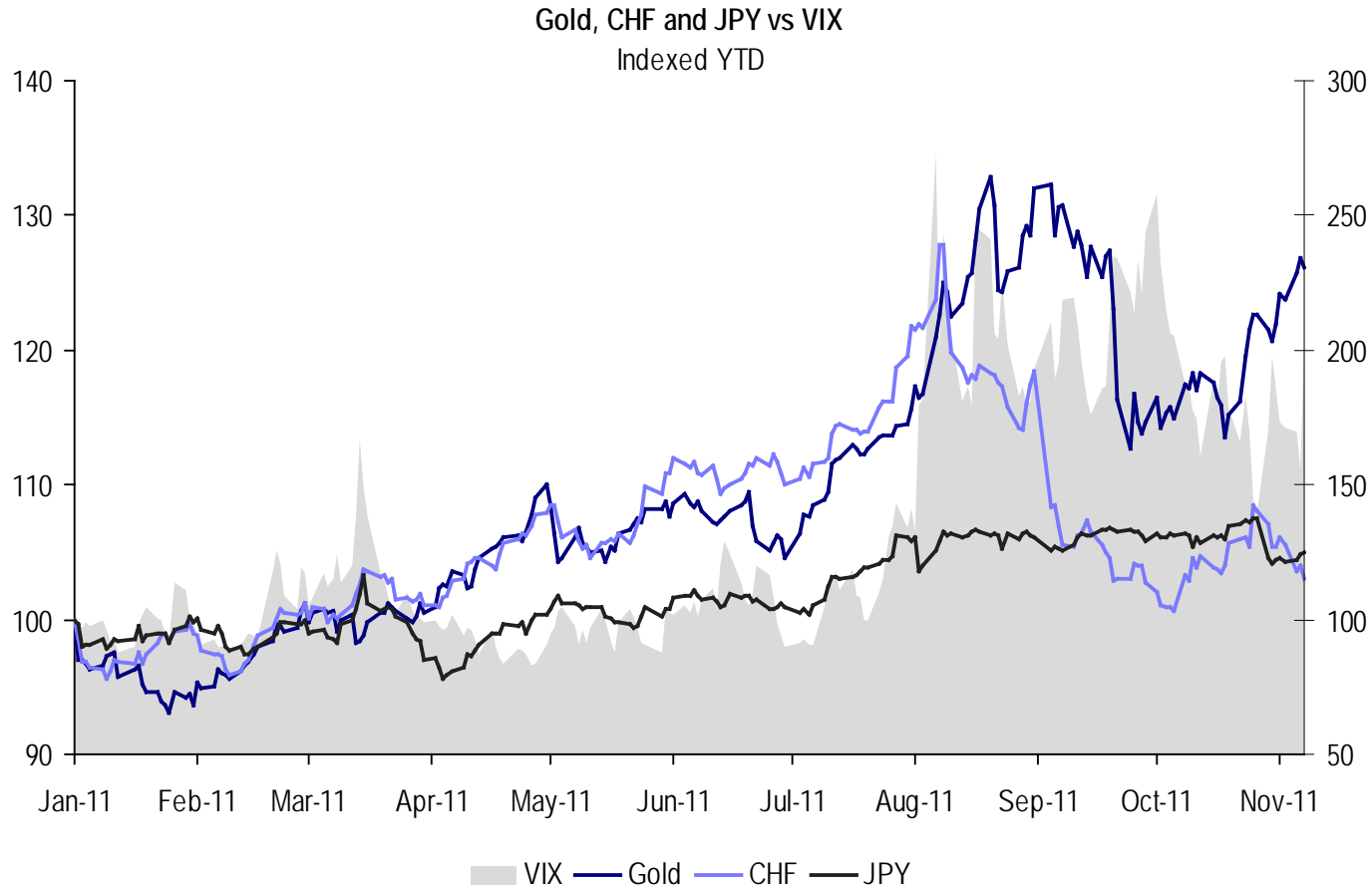
UBS Client Poll launched on August 1 ran for two weeks asking:

Where will gold end 2011?



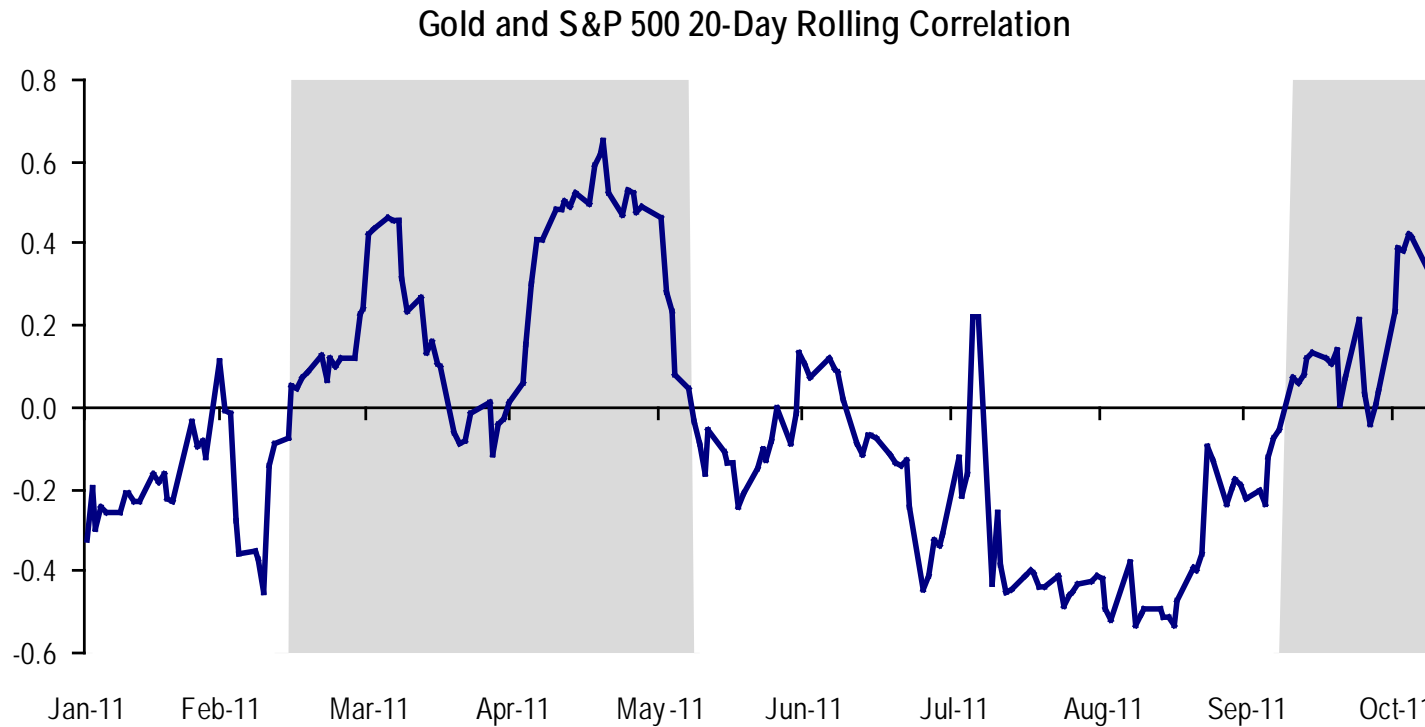
- Results show that responses logged in the week after the S&P downgrade of the US skewed final results higher

Currency interventions & the search for safe haven alternatives



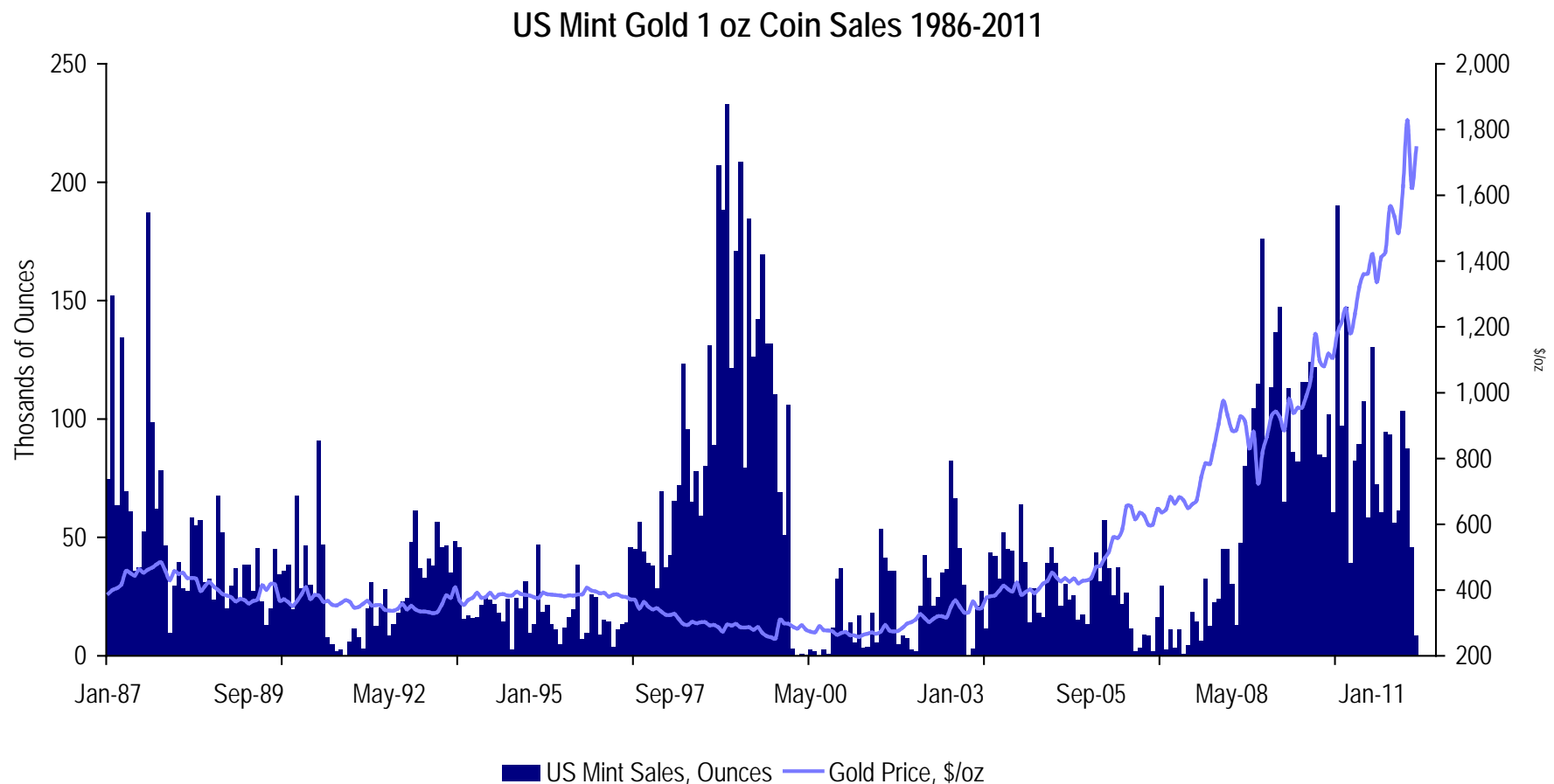
- Intervention in CHF and JPY limits upside potential, prompting investors to look for alternative safe havens – positive for gold – particular see this coming thru in coin sales
- The challenge for gold is USD strength which is seeing significant safe haven buying – UBS expects modest dollar appreciation: EURUSD at 1.25 by end-2012

But gold is currently acting like a hybrid of safe-haven and risk



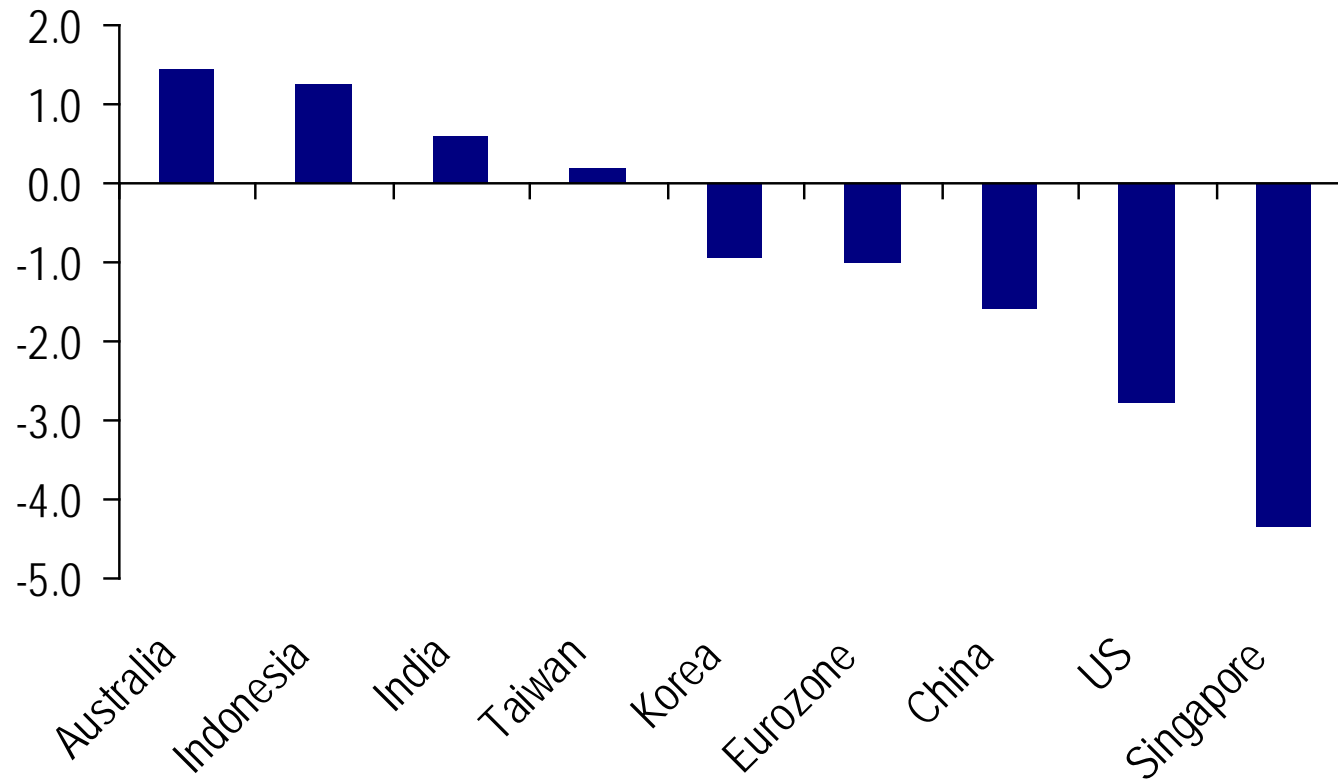
- Gold has been trading with risk assets for some time and the correlation remains positive
- But the re-emergence of the fear trade in Europe and recent sizeable additions to ETFs suggest that gold is beginning to break off ties with risk

The fear trade – coin demand eases in the US, re-emerges in Europe



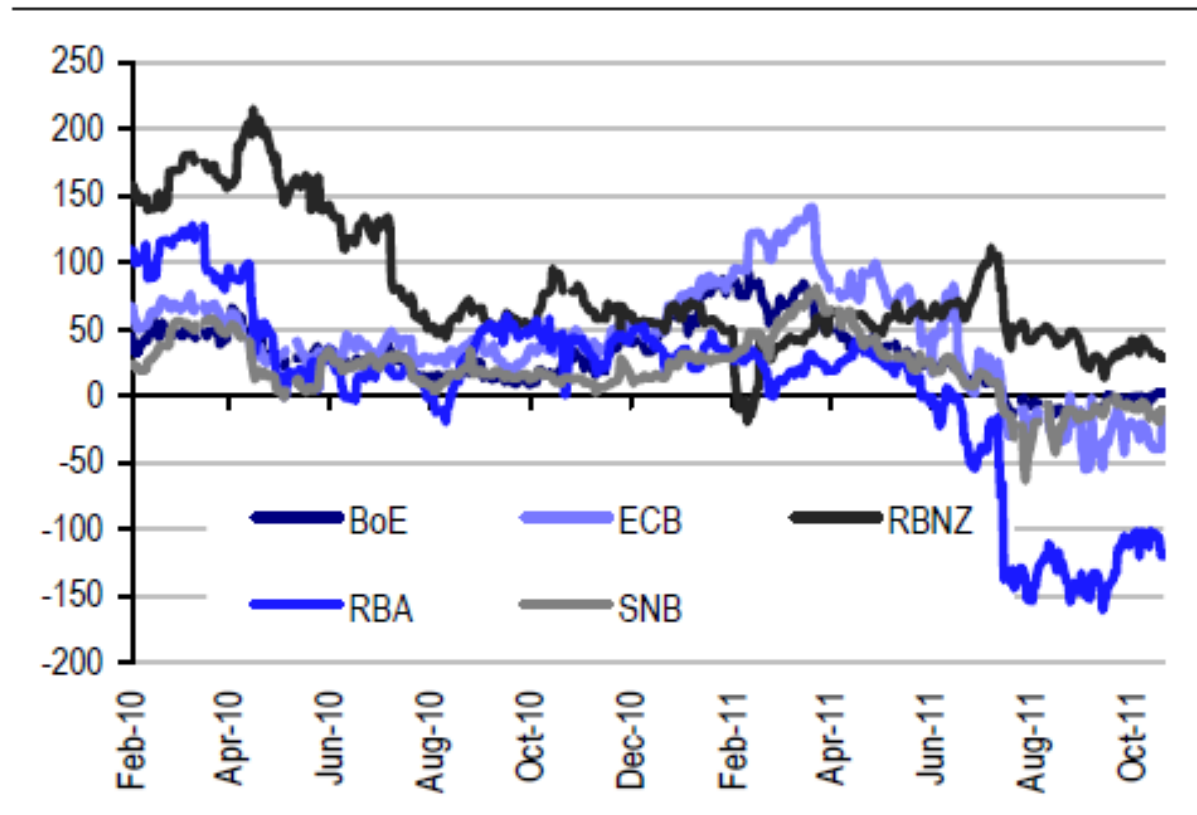
- After considerably above-average European demand for coins and small bars in July - Sept (strongest since summer last year), buying tapered off but re-emerged in early November
- US Mint gold coin sales increased 74% m/m in August, the largest volume since January, but has been dwindling to date

Negative real interest rates



- Accommodative policies to keep real interest rates in negative territory – EM central banks also likely to adopt loose monetary policies, with inflation prints expected to ease

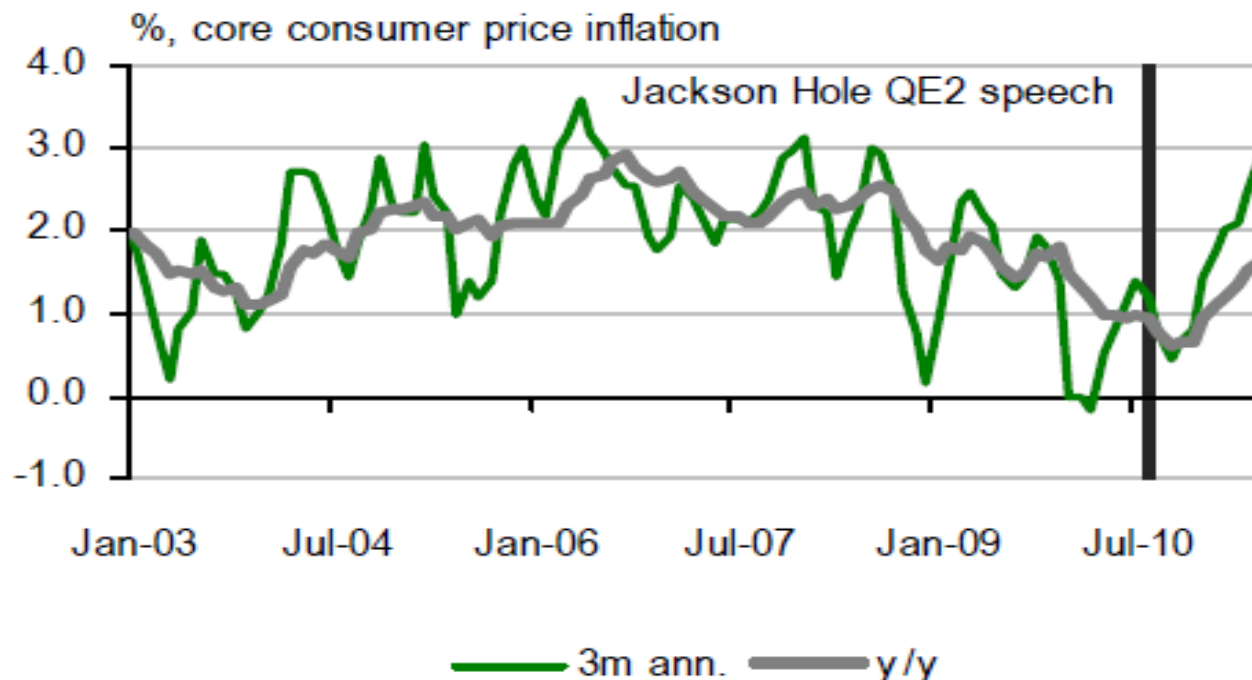
Falling rate expectations



Source: Bloomberg, UBS Calculations

- US Fed to keep interest rates on hold to 2013
- Rate expectations also falling elsewhere – ECB room for further cuts; BOE to extend quantitative easing

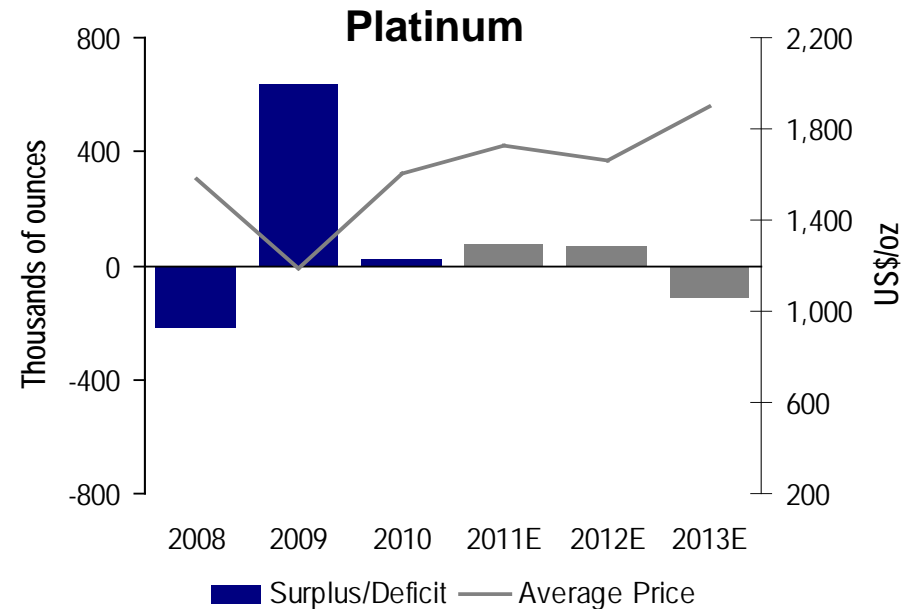
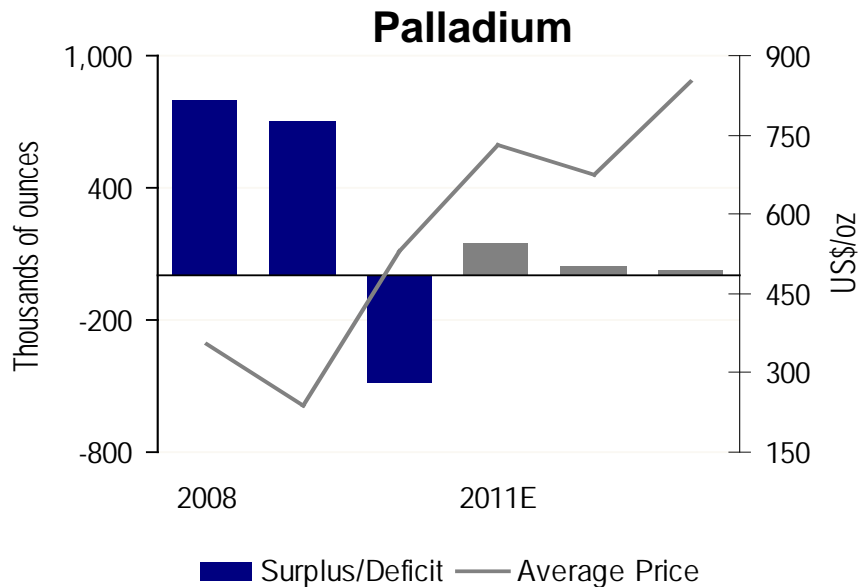
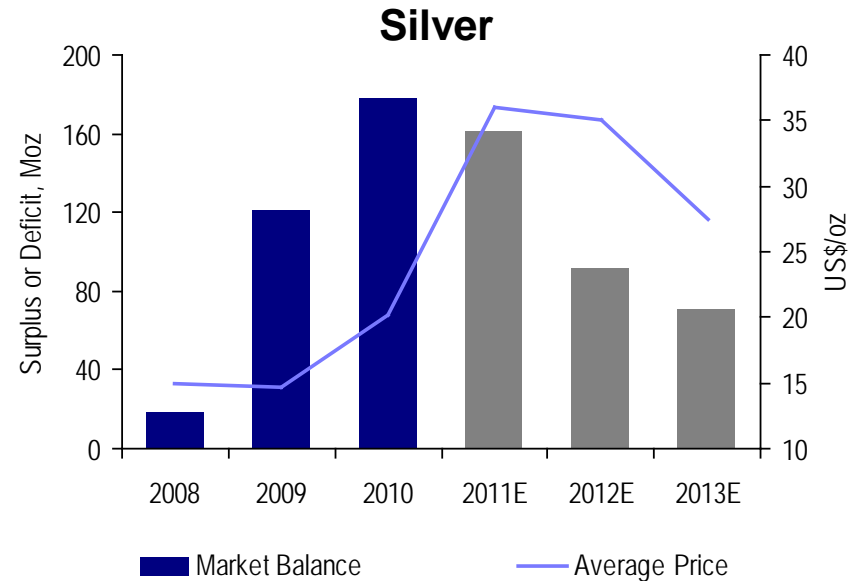
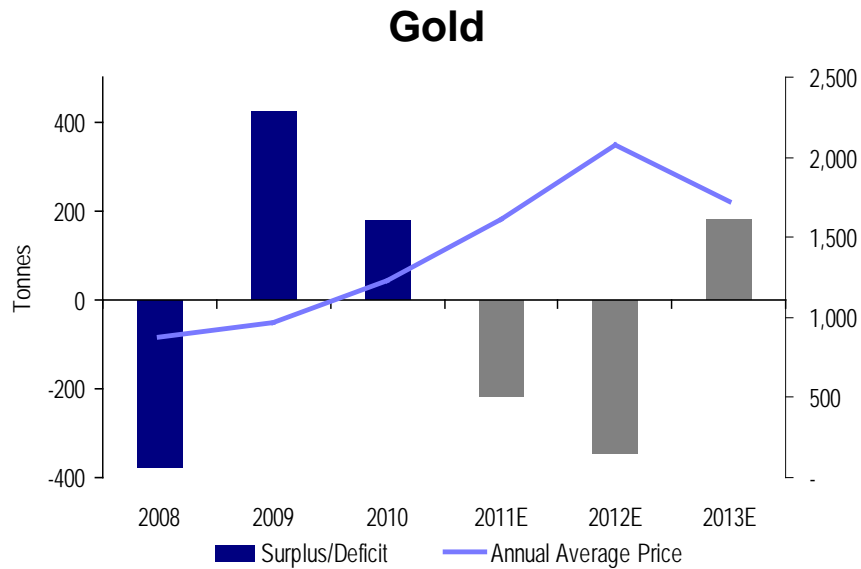
To QE3 or not? The bar is high – but markets are panic-prone



Source: Bureau of Labor Statistics and UBS

- If round 1 and 2 didn't work, why should QE3 be the solution?
- Monetary easing may not elicit the same response from risky assets
- Risk assets and precious metals didn't react positively to "Operation Twist"
- Better US data prints of late keep the QE3 bar high and further easing unlikely in the near-term

Gold is likely the only precious metal in a deficit this year

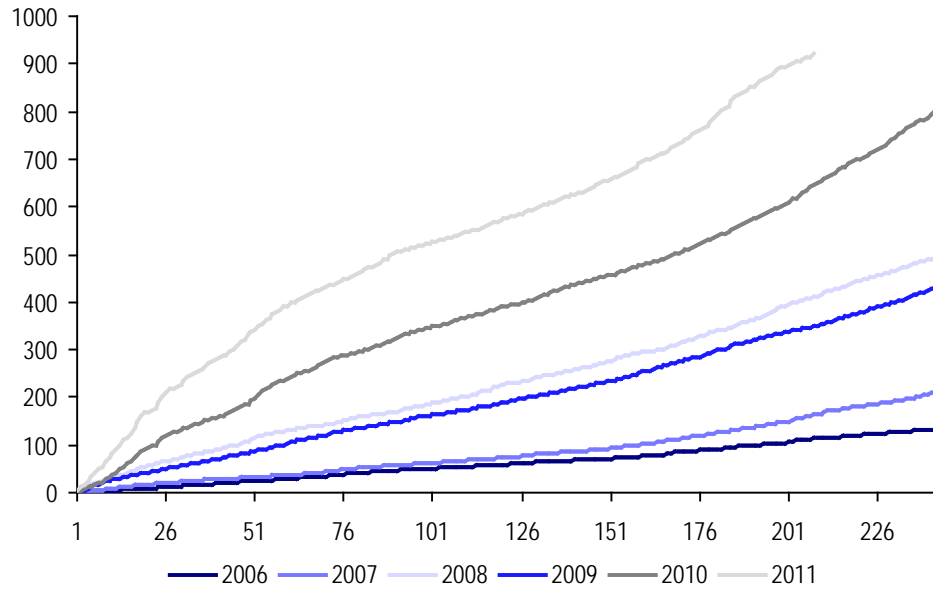


Jewellery demand is resilient despite high prices



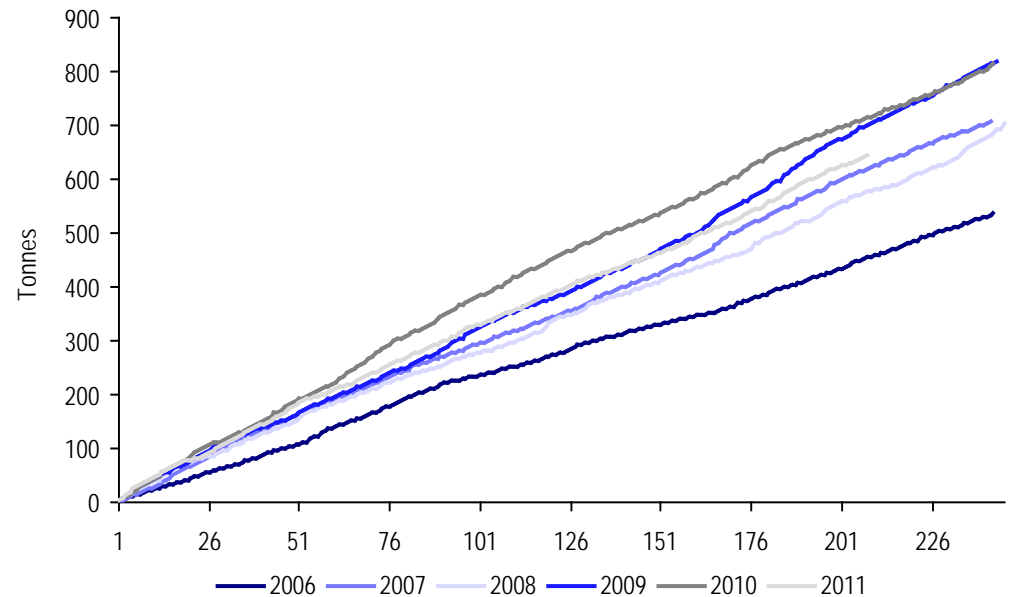
Physical demand is an embedded put – gold turnover on SGE

Progressive - Au9999



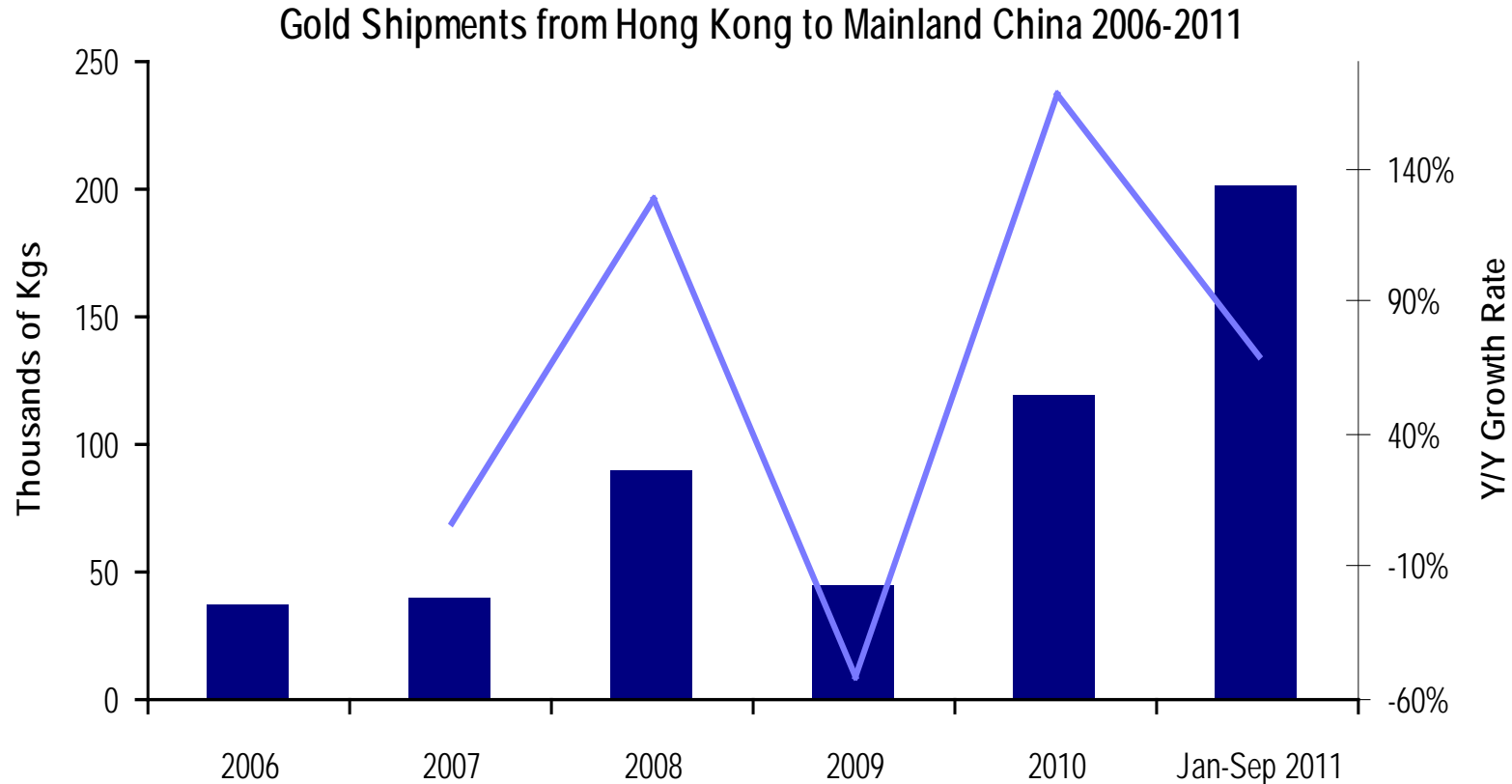
Au9999 Contract

Progressive - Au9995



Au9995 Contract

Gold shipments from HK to Mainland China jump in Sept

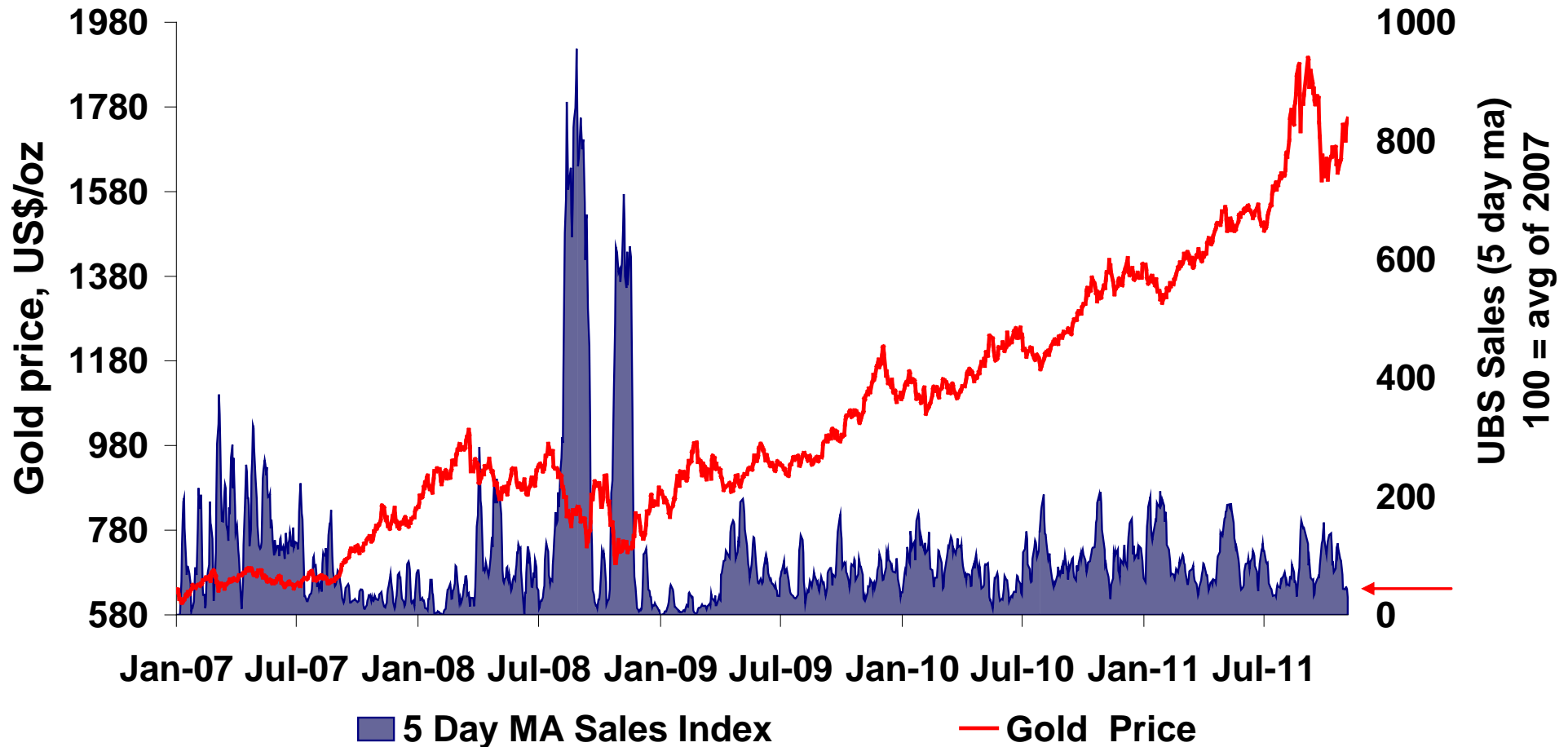


Source: Hong Kong Census and Statistics Department, UBS

- The surge in Chinese gold imports from Hong Kong in Sept ties in with the substantial increase in SGE gold turnover
- Combined turnover for both Au9999 and Au9995 contracts was the highest since March

Indian demand reacted strongly to late Sept price pull back, but has been quiet of late

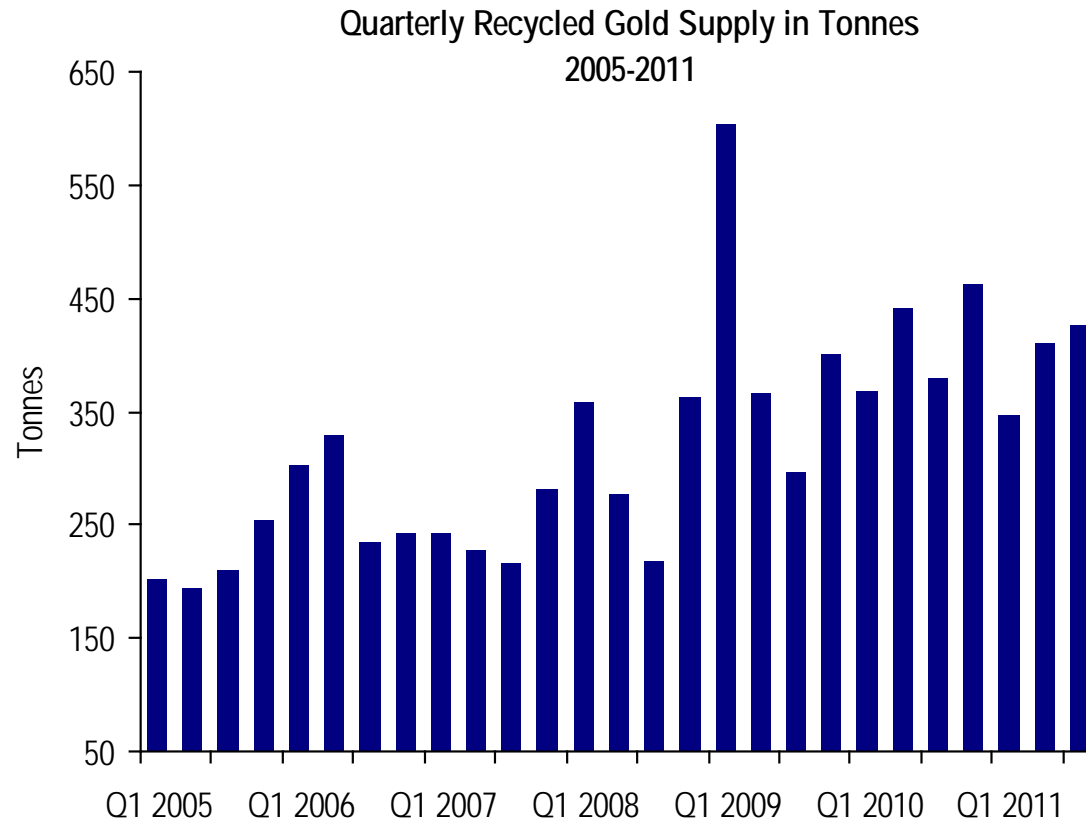
UBS Sales Index and Gold Price



Will seasonality in India and China play out?

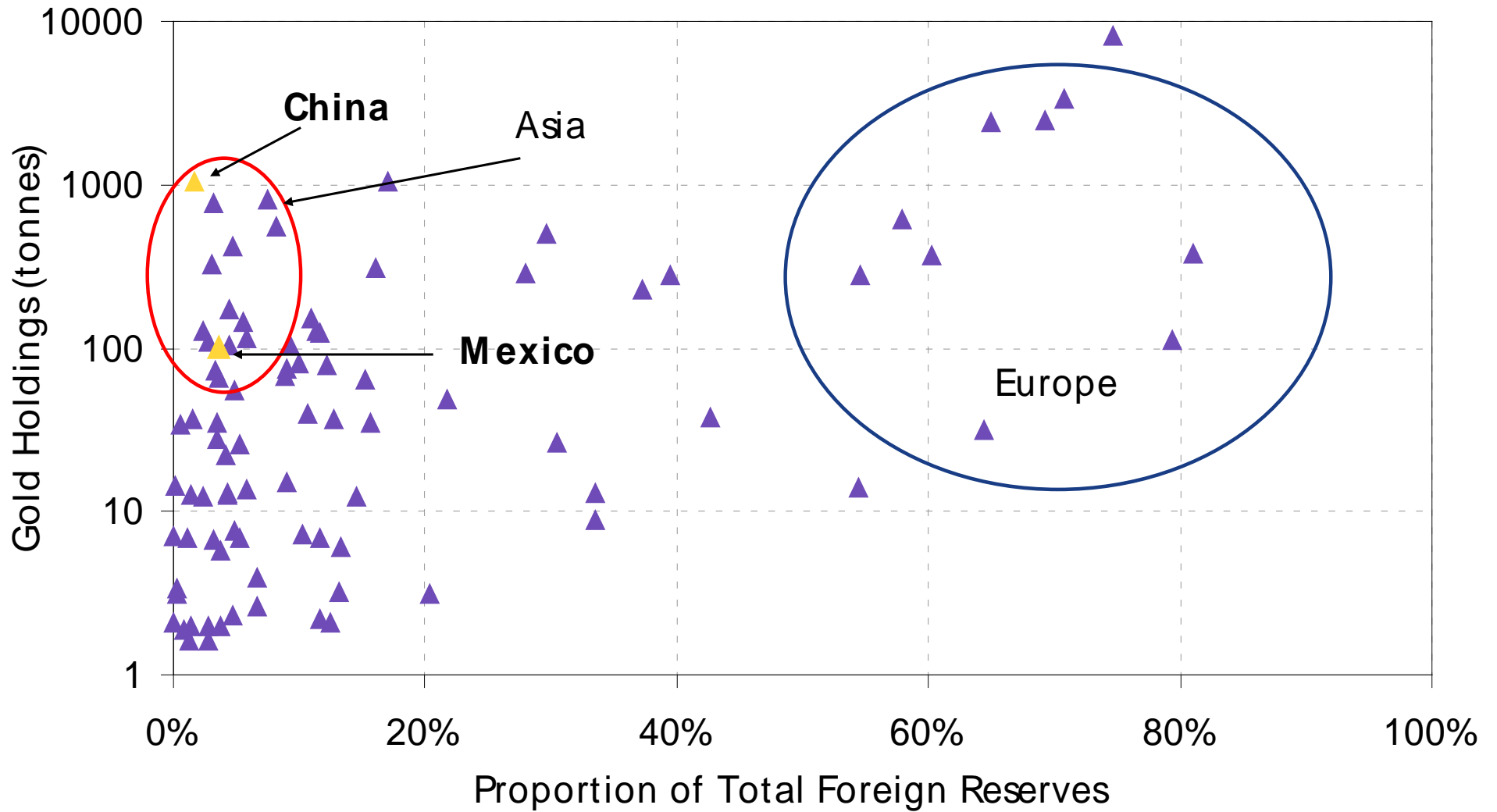
- Chinese participation on the SGE set to pick up for the remainder of the year through to early Q1 2012 in the run up to Chinese New Year festivities
- Physical demand from India tends to pick up in the last 4/5 months of the year
- 2009-2010 cumulative data shows Q4 volumes 45% higher than Q1 and 25% higher than Q2

Scrap supply around, but not a threat



- Scrap supply accelerated in the summer, with refiners reporting volumes as much as 60%-70% of Q1 2009 record levels
- Risk that scrap increases significantly above \$1800; inflows into Switzerland comfortably absorbed by production and loco swap rates have been stable
- WGC reported a 13% increase in Q3 y/y

Central Banks remain net buyers



Changes in central bank gold reserves YTD

Country	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	YTD Change	Current Balance
Others*									128.20	128.20	
Mexico	- 0.18	14.80	78.50	5.90	- 0.20	- 0.10	- 0.18	- 0.20	- 0.13	98.22	105.28
Russia	0.59	3.10	18.80	13.72	6.00	5.85	4.40	3.60	6.70	62.75	851.38
Thailand			9.30			18.66		9.33	15.60	52.89	152.42
Korea						25.00				25.00	39.44
Bolivia								7.00	7.00	14.00	14.00
Belarus	- 0.10	0.30	2.30	1.10						3.60	38.88
Tajikistan	2.00	- 1.20	0.30		0.40	0.04	- 1.19	1.87	1.00	3.22	3.22
Kazakhstan	1.56		- 1.60			3.10	- 3.11		3.10	3.05	70.37
Colombia							2.30			2.30	9.16
Serbia					0.50		0.30			0.80	13.92
Ukraine			0.10			0.30			0.06	0.46	27.99
Greece	- 0.09					0.30			0.03	0.24	111.84
Mongolia							0.90	- 0.68		0.22	2.23
Malta			0.10							0.10	0.20
Czech Republic	0.06		- 0.10					- 0.10		- 0.14	12.56
Sri Lanka	7.70	- 5.40	- 1.20		1.10	0.50	- 8.00			- 5.30	-5.30
Philippines	- 0.50			- 1.50	1.60	4.20	-10.30	-19.10		- 25.60	128.50
Libya				-29.00						- 29.00	-29.00
NET PURCHASES										335 tonnes	

*WGC reports net purchases by unidentified CBs in Q3

UBS NOTES: Based on WGC data to September, we have added new data from the IMF plus updates announced through news reports

European gold sales: FOUR reasons why we think the risk is low

- **The Central Bank Gold Agreement (CBGA3)**

- Limits combined sales of 19 European central bank signatories to 400 tonnes annually
- Sales over the last 2 years have been IMF dominated and for the current year, which ends on September 26, Eurozone CBs have sold only 1.1 tonnes

- **Central Bank Independence** – gold belongs to national central banks, not their governments

- **Article 130** of the **Treaty on the Functioning of the European Union** and **Article 7** of the **Protocol on the Statute of the European System of Central Banks and of the European Central Bank** clearly establishes the independence of national central banks
- The decision to sell gold lies exclusively with NCBs – cannot be instructed nor influenced by their governments
- An ECB opinion on the draft amendment regarding taxation on unrealised gains of Italy's gold reserves issued in 2009 highlights the importance of central bank independence: the ECB raised the issue that the proposed tax would compromise the central bank's financial independence and would influence the management of its gold reserves

European gold sales: FOUR reasons why we think the risk is low

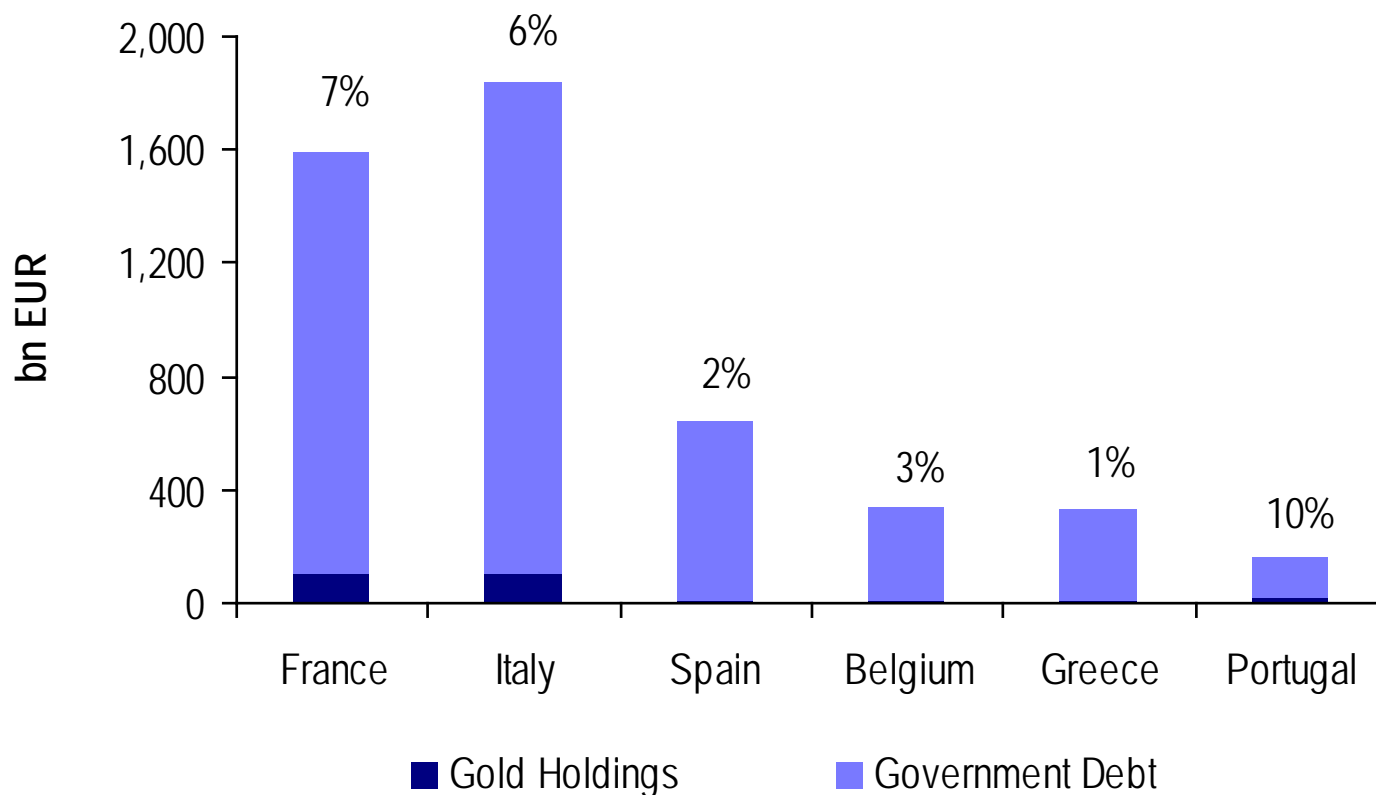
- **Prohibition on monetary financing of public entities**
 - **Article 123** of the Treaty and **Article 21** of the Statute explicitly prohibits monetary financing of the government or any public institution
 - This makes the direct distribution of proceeds from CB gold sales to the government inconsistent with legislation
 - The ECB opinion on the taxation of Italy's gold reserves in 2009 also cites this prohibition, highlighting that any agreement between the government and the CB does not rectify the inconsistency
- **ECB approval required** – implications for the euro makes ECB consent unlikely
 - Should a NCB decide to sell its gold, it can distribute a percentage of the profits booked to its shareholders, mainly the government
 - BUT, **Article 31** of the Statute implies that gold sales by any NCB would require ECB approval
 - The negative impact on market sentiment and confidence on the euro makes it unlikely for the ECB to favour such a move

Overall, the current institutional framework makes it very difficult for European CBs to sell gold, particularly for political reasons.

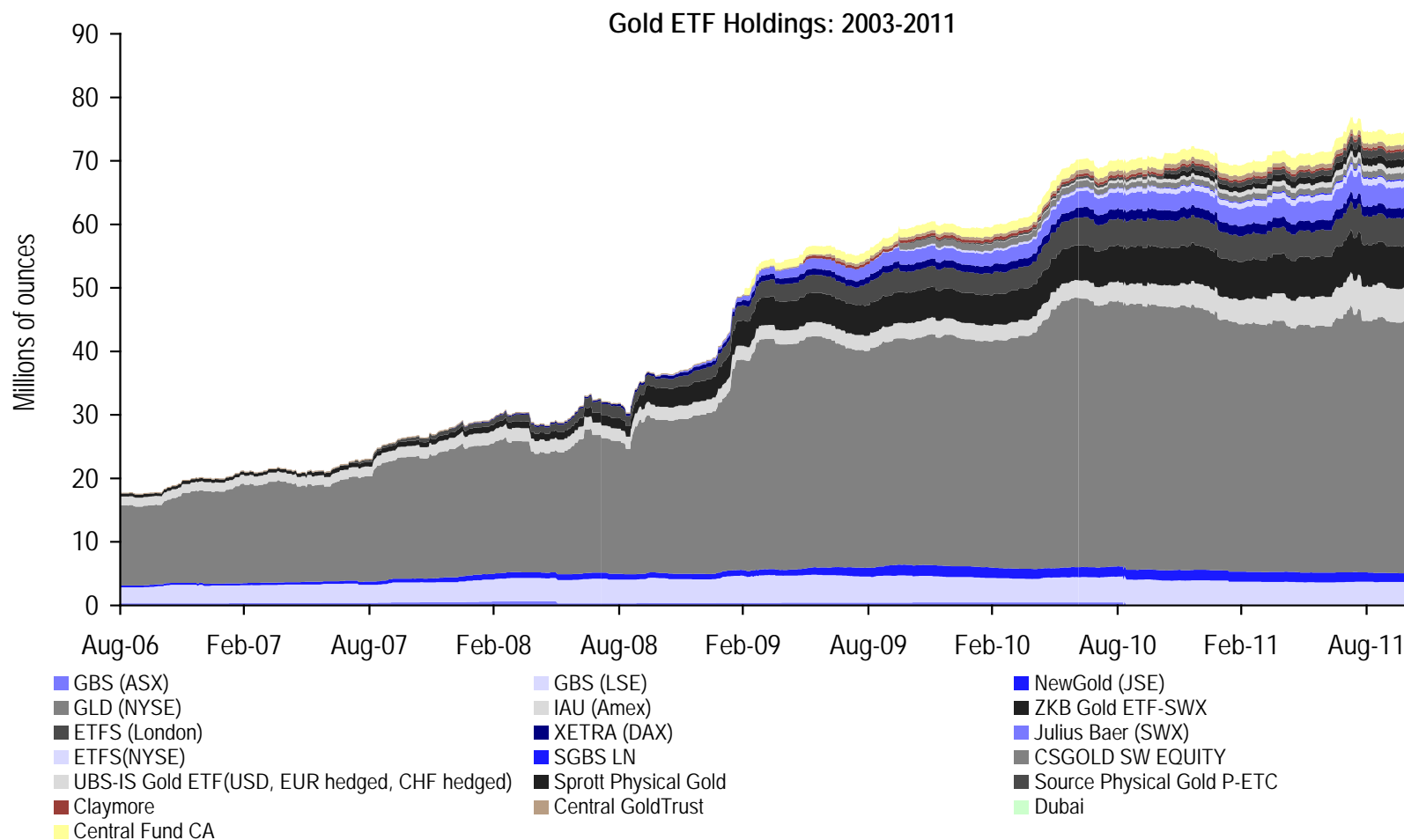
European gold holdings vs government debt

- The value of European central banks' gold holdings is tiny compared to the level of government borrowing – 10% or less

European CB Gold Holdings vs Government Debt



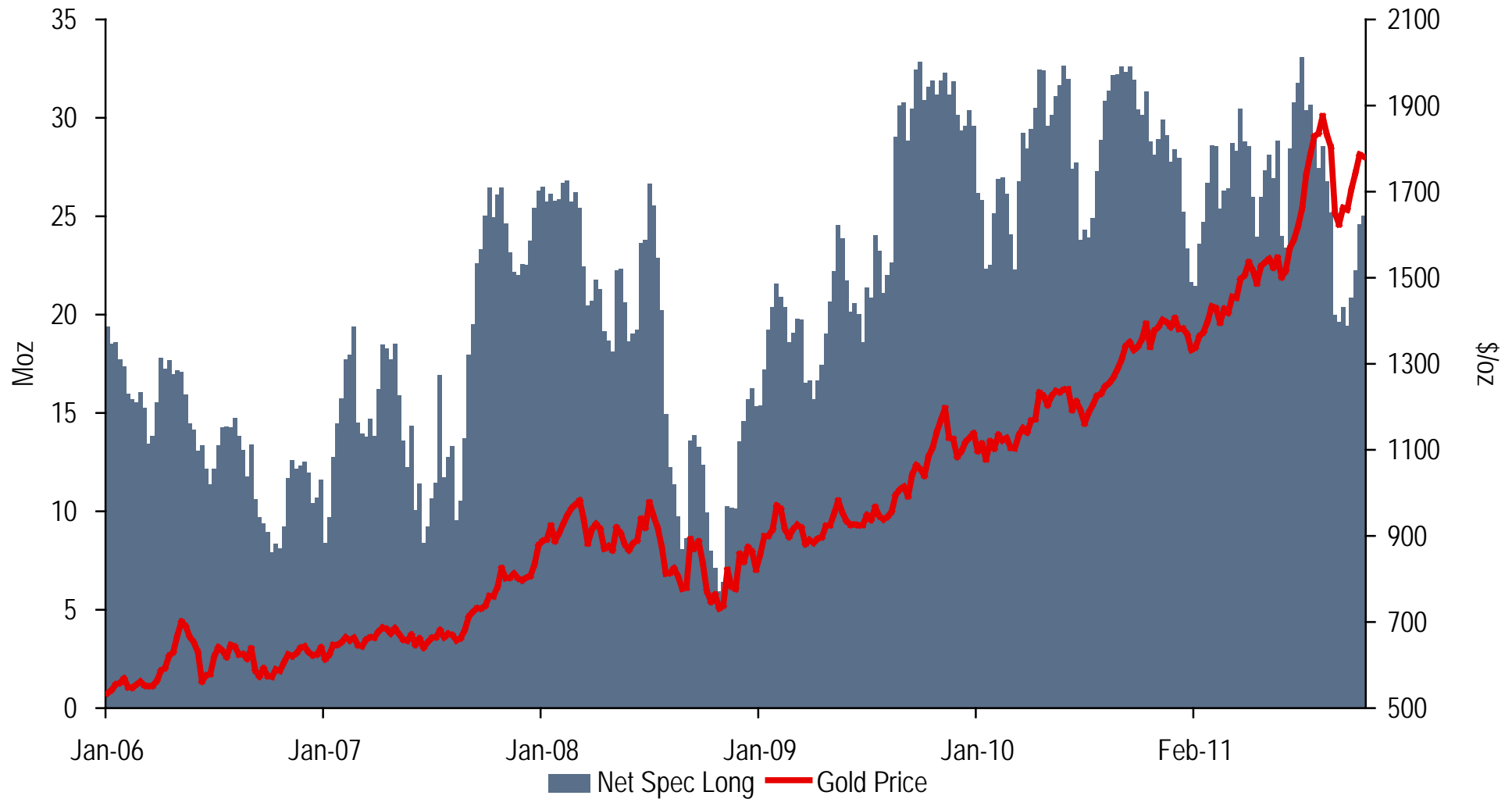
ETF flows pick up in Nov; YTD* inflow now at 4.44moz



- H1 – ETFs saw net selling; H2 – ETFs saw net buying so far
- From a net outflow of 645koz in Sept, ETF investors have been adding to holdings since

Comex Net Longs – rebuilding positions

COTR for Comex Gold since 2006



The Gold Train Continues...extreme times

- Stronger dollar is a short-term obstacle
- Expect volatile moves, particularly with gold lingering in hybrid space
- One of gold's biggest positive right now is the dearth of spec longs
- Concerns over a protracted economic slowdown should benefit gold, as will on-going European debt sagas
- QE3: the bar remains high
- Intervention in the CHF and JPY benefits gold...but also the dollar
- Move to physical gold
- Low interest rate environment helps
- Fed funds rate staying on hold until 2013 – large positive implications for gold
- That gold is facing a structural deficit adds to the mix of supportive factors
- Gold to average \$1615 in 2011; \$2075 in 2012; 1m \$1775; 3m \$1950

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