

GOLDEN PROSPECTS

Scotia Capital's Barry Wainstein in conversation with *Global Finance*.

Global Finance: One of the major themes in the gold market this year has been the metal's role as an alternative to fiat currencies. Can you elaborate on this?

Barry Wainstein: Gold's ability to rally in 2010, during periods of both USD strength and weakness, suggests that the metal's historical correlations have broken down. A below-trend recovery in the advanced economies has led to alternative macroeconomic strategies being considered. These include direct currency intervention and quantitative easing (QE) in Japan as well as potential QE in the US and the UK, which are fueling fears of currency debasement and competitive devaluations. Accordingly, the attractiveness of gold over fiat money has increased as the metal is viewed as a hard asset currency.

GF: How have the other drivers of gold fared in recent years?

BW: As gold prices have climbed, many of its traditional drivers have deteriorated. On the demand side, investment is the only growth segment and, in the first half of 2010, accounted for almost 50% of total gold demand. ETFs are an important component of investment demand. According to the World Gold Council (WGC), they hold a total of 2,042 tonnes (about \$82 billion). Industrial and dental use (approximately 10% of total demand) have been relatively constant, while GFMS estimates that jewelry demand fell to a 21-year low in 2009 and accounted for close to 40% of total demand. In addition, with de-hedging by producers almost complete, an important use of gold has essentially disappeared. Traditional supply is also shifting. Mine production and gold scrap sales have increased, but at a slower rate than historically, and, for the first time in over a decade,

the official sector is expected to be a net buyer of gold.

GF: What is gold's role in global reserves?

BW: Global reserves are climbing towards \$10 trillion, of which gold constitutes approximately 10%. Since 2009, the percentage of reserves allocated to gold has been rising, mainly by emerging markets central banks. However, current levels are still below those held 10 years ago, in both percentage and volume terms.

GF: China is a dominant market theme in the global financial system. Do the Chinese have influence in the gold market too?

BW: China has been the largest gold miner since 2007 and accordingly is a major player in world supply. In terms of global demand, China has a growing appetite and is the second largest consumer in the world, only outpaced by India. It is also the world's largest holder of FX and gold reserves, having accumulated \$2.5 trillion, of which approximately 1.5% is held in gold. Some market participants believe that if China diversified even a small percentage of its FX reserves into gold, this would have a large positive impact on gold prices. However, China has stated that any additional gold reserves will come from local production, so aggressive buying in the markets seems unlikely.

GF: What is your outlook for the price of gold from here?

BW: The rally in gold has also been a commodity story with silver, nickel, copper, etc. recording significant returns in the first 10-months of 2010. Nevertheless, the gold price has moved ahead of its traditional fundamentals. This has been driven by a weak USD, real (in Asia) and anticipated inflationary pressures in the US and Europe and gold's attractiveness as an alternative to fiat currencies. As long as the market fears currency debasement, the outlook for gold should remain strong. Given the small size of the market, it could potentially spike to \$1,500/oz. However, once the global economic recovery finds itself on a firmer footing, the more traditional drivers should reassert themselves, potentially rubbing some of the shine off the price of gold.



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