WORLD GOLD COUNCIL

Market Update
Germany's golden decade

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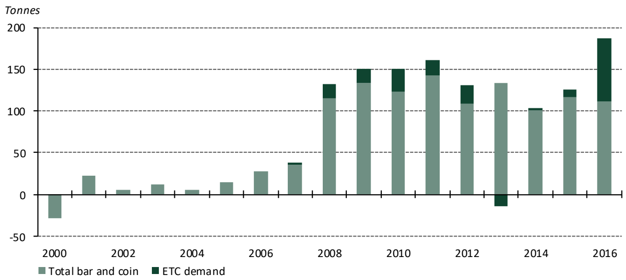
Germany's gold investment market has boomed in the past 10 years. In the face of successive financial crises and loose monetary policy, German investors turned to gold to protect their wealth. In response, new product providers entered the market making it easier for people to invest. Last year, more than €6bn was ploughed into gold investment products in Germany and, encouragingly, there is room for further growth: consumer research indicates there is latent retail demand which the industry can tap into.

A market transformed

The German investment market has undergone a radical transformation in the past 10 years. Before 2008 it was small. Bar and coin demand languished at low levels: average demand between 1995 and 2007 was a modest 17 tonnes (t) and, in some years, there were more sellers than buyers. In the early 2000s, some banks pulled out of the precious metals business altogether. The gold-backed exchange-traded commodities (ETC) market wasn't much to shout about either: before 2007, no gold-backed ETCs were listed in Germany.

Investment demand peaked in 2016



Source: Metals Focus; GFMS Thomson Reuters; World Gold Council

By 2009, Germany's gold investment market had become one of the world's largest. Annual bar and coin demand quadrupled, shooting up from 36t in 2007 to 134t in 2009. The gold-backed ETC market registered impressive growth too. Assets under management (AUM) jumped from zero at the start of 2007 to around 36t two years later and, in the years that followed, more gold-backed ETC products entered the market.

Since then, the German gold investment market has flourished. In 2016, €6.8bn was ploughed into German gold investment products. Germany has established itself as a 100t-plus per year market for bars and coins, and a vibrant domestic ETC market has developed: during Q3 2017, German-listed ETC AUM hit an all-time high of 252.1t, equivalent to €9.8bn.

Such a stunning improvement prompts two questions: why has the market boomed, and what does the future hold?

Crisis after crisis…

The global financial crisis in 2008 brought gold to the attention of German investors at large. While the world fretted about Lehman Brothers, German investors worried about the state of their own banking system. Landesbanks, the previously stable banking partners of corporate Germany, looked wobbly. People feared for their savings. To prevent a run on the banks and a collapse of its banking system, on 5 October 2008, the government guaranteed all private bank accounts.[1] This was part of a wider problem: banks across Europe were being bailed out by taxpayers.

The bailouts proved to be nothing but a sticking plaster. While banks stayed afloat, the countries that propped them up struggled. The European sovereign debt crisis highlighted the fact that government bonds, which had been perceived to be risk free, were anything but. In some instances, investors faced losses. Supranational bodies – the European Central Bank (ECB), the European Commission and the International Monetary Fund – formed a troika to rescue Greece, Ireland, Portugal, Spain and Cyprus. These countries have since suffered years of austerity trying to rebalance their economies.

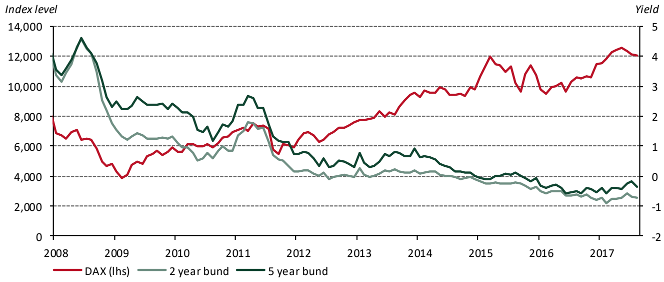
In response, European monetary policy became looser. In 2012, with the European project and its currency under pressure, Mario Draghi pledged to do "whatever it takes to preserve the euro". Faced with low inflation and anaemic economic growth, the ECB launched an aggressive quantitative easing programme

[1] OECD, The German Banking System: Lessons from the financial crisis, 2010

and slashed deposit rates into negative territory. Several banks started charging their corporate clients to leave cash with them.

The cut in deposit rates affected financial markets. Yields on German bunds were pushed lower and lower; two- and five-year government bonds have traded at negative yields since 2015. During the same period, the Deutsche Boerse AG German Stock Index (DAX) has hit record highs.

Yields fall, DAX soars



Source: Bloomberg, World Gold Council

German investors have an acute awareness of the wealth-eroding effects of financial instability. Hyper-inflation in the 1920s lingers on in the collective memory but, perhaps more importantly, German investors have seen fiat currencies come and go: in the past 100 years, Germany has had eight different currencies. It should come as no surprise that, when faced with such an unsettling economic backdrop, German investors turned to gold – which during our field research one investor described as an *enduring currency* – to protect their wealth.

More ways to buy gold

Retail investors have found it easier to buy gold in recent years. Banks have been a long-standing presence in Germany's gold market, acting both as wholesalers and retailers. But the market has evolved. As some banks pulled out of precious metals in the early 2000s, entrepreneurs stepped in to fill the void. Bullion dealer Pro Aurum, for example, launched in 2003 with a mission to make it easier for retail investors to buy and store gold bars and coins. Over the years, its suite of products has grown to include regular gold savings plans and gold loans.

Industry contacts estimate there are now 100-150 non-bank bullion dealers nationwide. Perhaps the biggest splash in recent years came from Degussa. Degussa is a name with a long history in Germany's gold business and, in 2012, new life was breathed into the brand through a series of high-profile marketing campaigns, which also promoted gold in general to German investors.

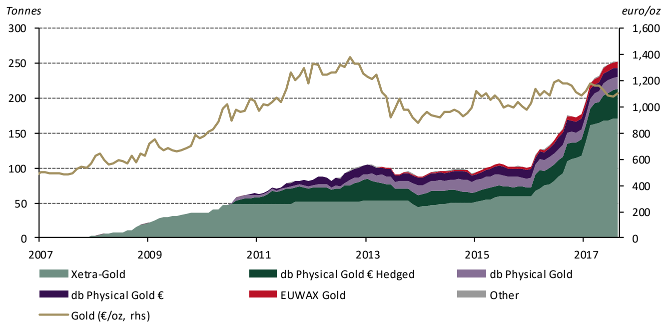
These gold dealers have embraced the digital revolution. Most of the high-profile retailers have an online presence, but there are also many online-only platforms; some contacts estimate that investors can choose from over 200 online platforms to buy gold. And investors are now as likely to use online channels to buy gold as they are to make any other investment.[2]

While gold-backed exchange-traded products emerged in 2003, it was several years later that they were introduced in Germany.[3] Xetra-Gold, launched in late 2007, was the first offering from Deutsche Bank and was soon followed by Boerse Stuttgart Securities. Available through both traditional banking channels and online brokerage platforms, gold-backed ETCs increased the accessibility to gold for institutional and retail investors alike.[4]

A key feature of some gold ETCs is that investors can take physical delivery of the gold when they redeem their investment. Such optionality gives investors the confidence that they can convert their holding into physical gold should they wish to. This is especially appealing to retail investors. Xetra-Gold, one of the providers that offers this service, has reported that this optionality has been used over 900 times since the product first launched, with a total of 4.6t delivered to investors. [5]

In recent years, these investment vehicles have benefited from the negative yields generated by government bonds and other similar assets. Since the start of 2016, investment in German-listed gold ETCs has skyrocketed. AUM have more than doubled, growing by 150t. At the end of September, 2017 total gold holdings were just shy of 250t.

Gold-backed ETCs AUM have grown rapidly



Source: Bloomberg, World Gold Council

But with popularity comes competition. In recent years, the competitive landscape has led to aggressive fee-cutting by some.

[2] Kantar TNS consumer research on behalf of World Gold Council, 2016

[3] Exchange traded products is an umbrella terms that includes exchange traded funds and exchange traded commodities.

[4] German investors have access to a wider range of gold-backed products than ETCs listed in Germany. They can also invest in cross-listed gold-backed ETFs, such as those offered by ETF Securities

[5] https://www.xetra-gold.com/en/news/news/xetra-gold-erzielt-zum-jahresende-neuen-rekord-beim-goldbestand/

ETC providers charge investors in different ways. Some, such as Xetra-Gold and EUWAX Gold, do not deduct management fees from the underlying AUM, as is the case with most other gold-backed ETPs around the world. In the case of Xetra-Gold, investors pay a safe custody fee to it for holding the gold on their behalf. And rather than levy a management fee, EUWAX Gold makes its money through the spreads investors pay when buying and selling its product.

There are also interesting differences in how these products are taxed. In September 2015, the tax authorities confirmed that an investment in Xetra-Gold would become capital-gains tax exempt after being held for 12 months. This puts an investment in Xetra-Gold on a par with an investment in a gold bar. The required criteria were that the product is physically-backed and that investors can withdraw gold when they redeem their investment. At the time of writing, no other gold-backed ETC provider has received the same confirmation.

Focus box: German ETCs

While gold-backed exchange-traded funds (ETFs) are more prominent globally, in Germany, gold-backed products must be structured as exchange-traded commodities (ETCs). ETCs are legally considered a bearer bond, representing the right for delivery of the gold underlying that bond. This differs from a gold-backed ETF which, while similarly backed by physical gold, does not automatically entitle the investor to take delivery of physical gold upon redemption.

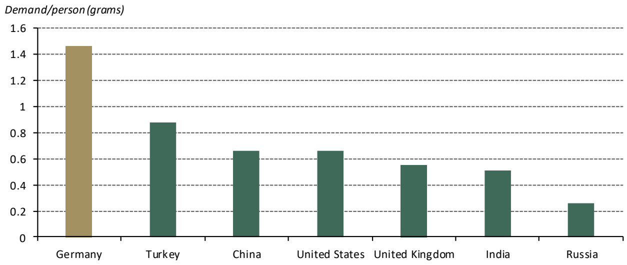
Investor insights

With its long history as a store of value independent of the financial system, gold is a natural investment for many German investors. In 2016, Kantar TNS surveyed more than 2,000 German investors on our behalf, revealing that:

- 59% of respondents agreed with the statement that *gold will never lose its value in the long-term*
- 48% agreed with the statement that *owning gold makes me feel secure for the long-term*
- 42% agreed with the statement *I trust gold more than the currencies of countries*

When asked why they invested in gold, 57% of bar and coin investors said it was to protect their wealth and 28% said it was to make good returns in the long-term. It is clear gold fulfils an important long-term, wealth preservation role in German investors' portfolios. So much so that the amount of gold bought by Germans per person in 2016 was greater than in either of the two gold powerhouses: India and China.

Gold demand per person in 2016



This includes bar and coin and jewellery demand. It excludes exchange traded product inflows.

Source: Bloomberg, World Gold Council

The type of retail gold investor has changed over time. People in the industry report that 15 years ago, when the market was much smaller, investors were relatively well-off and middle aged. The investor base now is far broader. Results from our consumer research reveal that the age distribution of gold investors broadly matches that of investors in general. And although higher earners are more likely to buy gold, it is still an important asset for those on lower incomes: gold was the third most popular investment choice for lower income earners in our consumer research.

Gold is a popular investment for retail investors

Q: Which of the following investments have you made in the past 12 months?

	Low income	Medium income	High income	Average
Saving accounts	69	70	61	**68**
Insurance	30	33	32	**32**
Gold	16	23	27	**22**
Shares	15	27	47	**29**
Collective investment plans	11	23	28	**22**
Real estate	7	11	21	**13**
Corporate bonds	7	11	21	**13**
Government securities	3	3	8	**5**

Source: Kantar TNS; World Gold Council

Interestingly, people in the market sense a regional skew. Contacts report that demand for gold in southern Germany is higher than elsewhere, partly because of its higher than average income levels. There is also a gender bias: 70% of German gold investors in our survey were male, significantly more than the gender bias amongst the overall investor population. [6]

Investors buying gold-backed ETCs differ from those buying bars and coins in a few aspects. While bars and coins are dominated by the retail sector, institutional investors dominate the ETC landscape. It is tricky getting hard numbers for the German market, but people in the industry estimate that around two-thirds of AUM in gold-backed ETCs originate from institutional investors, with the remainder coming from retail investors.

[6] For more information on this consumer research, please see https://www.gold.org/research/global-investment-market-new-perspectives-consumer-behaviour

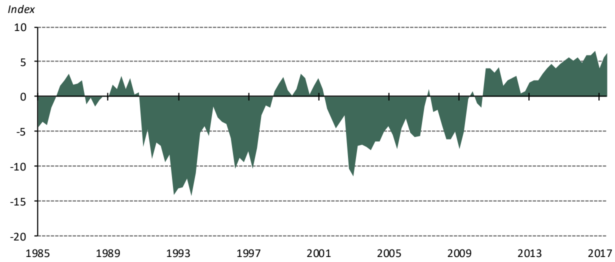
The behaviour of these two investor groups is subtly different. By and large, bar and coin investors have a 'buy and hold' mentality. One industry contact told us the ratio of investors buying gold compared to those selling is around 10:1. Institutional investors in gold-backed ETCs are more likely to trade actively, responding to changing macroeconomic and financial market conditions. This is partly due to the nature of the products. ETCs are designed to be liquid investments that are easy to buy and sell – a feature that is vitally important for major money managers.

Outlook

Revisiting our original questions, it is clear why the market boomed. Financial and economic crises brought gold to the attention of investors, and the resulting interest triggered a wave of product innovation and market development. It is now easier to buy gold than it has ever been in the past.

But it is important to highlight that Germany's gold market is not dependent on financial and economic crises. In recent years, Germany's economy has performed well. In August 2017 unemployment fell to 5.6%, its lowest level since reunification in 1990. Wage growth in 2017 has averaged around 4.4%, comfortably above the long-run-average of 2.6%. And people have positive expectations for the future: the European Commission's measure of German households' confidence in their financial situation for the next 12 months recently hit its highest level on record.

Households are optimistic about their future



Source: European Commission

Today, gold is increasingly viewed by German investors as a regular form of saving: 25% of those surveyed in 2016 said their gold purchase had been part of a regular review of their investments, while 23% said it was part of their retirement planning.

But what about the outlook for the market? Despite the dramatic growth in the past 10 years, we believe there is room for further growth. The consumer research conducted by Kantar TNS indicated that there is latent demand for gold amongst retail investors. This suggests potential for further growth in demand for gold bars, coins and ETCs in Germany.[7]

[7] For more information on this consumer research, please see https://www.gold.org/research/global-investment-market-new-perspectives-consumer-behaviour

People in the industry are confident that the German bar and coin market is in good health too. Having made it easy for investors to buy bars and coins, retailers are also marketing them effectively.

There is more uncertainty when considering institutional investors. It's likely that a significant proportion of ETC AUM is from long-term, strategic investors using gold as a hedge against unforeseen events. But we believe it is probable that some of the recent growth in these products has been driven by tactical investments in response to negative yields. Should yields edge higher – and in the case of the two- and five-year bunds, move into positive territory – some investors may be tempted to shift back into higher-yielding, liquid credit instruments.

Institutional investor behaviour, however, is far from clear cut: investors face risks on several fronts. Recent Bank of America Merrill Lynch Fund Manager Surveys, for example, highlight that European investors see FED/ECB policy mistakes as the most likely tail-risk event in the coming months, and around 30% of those surveyed believe Fed balance sheet reduction will be a risk-off event, causing a fall in both global bond and stock prices. It is easy to see why investors would like to remain invested in gold in such a scenario.

WORLD GOLD COUNCIL

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors. We provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

Based in the UK, with operations in India, the Far East and the US, the World Gold Council is an association whose members comprise the world's leading gold mining companies.

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