NEVADA MINING RESOURCES

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Gold paving the way v1

The calm after the storm: gold is forecast to average $1,270/oz this year, 10% lower than the 2013 average of $1.411.23. After its wild gyrations in 2013, with a range of 42% (basis the pm fix), gold price movements have been much more circumspect in the first part of 2014, with a range of 13%.

Thomson Reuters released "Update 1" last week, the first of the two interim updates to the 2014 edition of the GFMS Gold Survey. The update found that after last year's turbulent ride, gold is essentially in a period of recuperation.

Recuperation for gold in 2014

There was a substantial fall in physical gold demand in the first half of 2014 compared with the massive demand in the first half of 2013, which is persisting through the second half of the year to date. Last year was highly anomalous, however, driven by the dramatic price fall in the second quarter and the market has subsequently been gradually regaining its sense of composure.

From the grass roots standpoint, much of the Asian market over-bought gold in the price falls of 2013, effectively bringing forward purchases that would otherwise have been made in 2014. It is also arguable that market stakeholders in the middle of the value chain over-built their inventories and it has taken time for these to be worked off. Consequently there has been little pull on the international market from this part of the world. As these two sets of conditions work their way through to a conclusion then the market should see more of a dynamic flow which will help to put a floor under the price.

This is backed up by pent-up demand in the Indian market, traditionally the world's largest consumer of jewellery and physical investment products combined, but which was edged into second place by China in 2013. While the changed import rules have quelled a degree of demand for logistical reasons, the underlying market has also been stifled to a degree by lower price expectations against higher premia, which deterred any large-scale buying in the first half of this year.

Bar and coin purchase dropped by 50% in tonnage terms the first half of 2014 against the equivalent period of 2013 and by 13% against H1 2012, in dollar terms, however, the falls were 57% and 31% respectively. To put this into a wider historical context, global jewellery demand in the first half of the year, at 1,046 tonnes, was 16% higher than in the first half of 2012 (although very approximate expenditure, based on the average prices for the periods) was down 12%. Retail bar investment, meanwhile, was 10% down in tonnage terms and 30% in approximate dollar terms.

GOLD PAVING THE WAY v1

A floor at $1,200?

Rhona O'Connell, Metals Research & Forecasts, GFMS, Thomson Reuters noted that "any price fall towards $1,200 is expected to see a strong resurgence in physical interest in the highly price responsive regions of Asia and the Middle East (although the latter has its own local problems that are partially stifling demand). The lack of a clear price direction, and the expectation of lower prices, have been key drivers in deterring purchases among private buyers and a similar mentality has prevailed in the professional sector".

The only country to post any notable gain in physical demand in the first half of this year was the United States, where an 8% increase in jewellery fabrication was driven by weaker gold prices and improving consumer sentiment. Europe remains under pressure, but when the European economy finally turns, gold fabrication should improve accordingly.

Mine output plateauing

The supply side is posting a flat profile for the medium term. The mining sector is increasing production this year, with a number of important projects coming into production and / or ramping up to full capacity, having benefited from investment flows in earlier years when prices were much higher. The mining sector is now though concentrating on good husbandry and managed to reduce total global cash costs by 6% in the first half of the year, while the average grade of ore processed in the period posted an increase for the first time in more than ten years. Margins remain under pressure, however.

For the longer term, the production profile is likely to come under pressure and Thomson Reuters believes that 2014 will be a cyclical top for mine production.

Future outlook; Europe is key

A European recovery is likely to be pivotal in helping to change professional sentiment in the gold market. Once a global economic recovery starts to get underway (by which stage the market is likely fully to have discounted a rising interest rate cycle in the United States), attention is likely to turn to the longer-term inflationary pressures that should accrue following the massive injections of liquidity into the financial system in many of the likely economic regions in an effort to bolster economic activity.

There has been a whiff of professional investor interest this year, but this is still very tentative as perceived economic and financial risks are skewed, in the United States at least, towards continued tapering followed by a swing to rising interest rates. At present these features are the prevailing drivers of sentiment and, combined with the perceived lack of price response to the tensions in the Middle East has not only deterred investment, but resulted in an expansion of short positions in the market (which, while pointing to negative sentiment in the near term, could easily lead to a short covering rally in the future).

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Tightening fundamentals and inflationary pressures point to a longer term bull market

The GFMS team at Thomson Reuters expects the gold market (prior to any ETF or Over-the-Counter activity) to be in a small surplus this year, but that the fundamental position will start to tighten during 2015 as underlying demand strengthens, taking the market into a deficit.

With a growing demand profile and a flat to declining supply outlook (partly offset by a projected decline in official sector purchases) the market balance is expected to continue to tighten over the next few years. This is likely to attract the attention of professional investors, especially when coupled with the likelihood of increased inflationary expectation developing from the latter part of 2015 and beyond. The price is therefore expected to bottom out during 2015 before embarking on a gradual secular bull market.