Alchemist

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LBMA

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The Deisis mosaic in Istanbul's Haghia Sofia museum dates from the second half of the thirteenth century. See article on page 14.

Swiss Role

By Tony Warwick-Ching, Virtual Metals Research & Consulting

The Swiss marked the millennium with their own May Day revolution. In a low-key funeral, they finally laid to rest the Gold Standard. Barely were the rites concluded and the will read, however, than they began to sell off their golden legacy. How did they get to this point? And where next?

The Headlines

There are two stories – one the sensational, and the other the real. At times they overlap. Often they've been quite distinct.

For headline writers, the irresistible theme was Nazi gold. Charges that Switzerland had not only kept the gold of World War II refugees, but also bought bullion from the Axis powers were confirmed by US State Department archives in 1996. The consequent storm, Switzerland's worst foreign relations crisis in half a century, demanded dramatic measures. On 5 March 1997 the Swiss President announced a Foundation for Solidarity with the victims of humanitarian disasters, including the Holocaust. With a nice irony, finance would come from a Sfr7bn raid on the nation's mighty gold reserves.

That Switzerland of all countries should use its heritage for anything other than classic monetary purposes was, for the gold market, beyond fantasy. The price immediately plunged. It crashed again when the Finance Ministry suggested, a couple of days later, that the Solidarity Foundation was only one possible beneficiary.

Change gathered pace. Long-overdue constitutional overhaul was approved by popular referendum last year. Laws allowing the Swiss National Bank (SNB) to trade gold at market prices came into effect May 1. The Bank was free to sell for the first time in nearly 30 years, and promptly did so. But in sharp contrast to the damage of three years ago, prices have shown only the tiniest after-shocks. Was it all a passing storm? Small avalanche in the Alps, not many hurt?

The Reality

Let's look at the reality. Fate struck its first blow in August 1971, when the Americans pulled up the drawbridge at Fort Knox and suspended dollar convertibility. The IMF shepherded in a brave new world in which gold was formally demonetised – except in Switzerland, which remained a happy haven of tradition. Its active neutrality kept Switzerland out of many international institutions, not least the IMF, so it retained strong links between gold and currency.

The End of History pointed, however, to an end to glorious isolation. In 1992 Switzerland signed up for the Fund, implicitly accepting its austere views on gold. Ironically, with almost 2,600 tonnes of gold, the world's fourth largest central bank stock, Switzerland was marching into the new world order extraordinarily well endowed.

The Formula

But just how well endowed should it be? In 1997 an Expert Group of advisors devised an arcane formula based on the short-term external liabilities of Switzerland's commercial banks. To guarantee these, the Group reckoned the SNB needed gold reserves of just Sfr10.7bn. The key proposal was a revaluation of the gold from its historic worth of just under Sfr5,000/kilo ($87/oz today) to Sfr9,000/kilo ($170/oz), raising its book value to Sfr23.3bn.

Switzerland's worst foreign relations crisis in half a century demanded dramatic measures.

This clearly left a surplus of Sfr12.6bn, equivalent to 1,400 tonnes of gold. This would, in the prosaic but terrifying words of the Group, be declared excess and "available for other purposes, such as the budgetary requirements of federal and regional governments". Since then official statements have sugared their candour. Speaking in December 1997 the Finance Minister promised "We will sell gold in homeopathic doses", claiming that "Switzerland would never do anything without co-ordinating with other central banks". Was this the real moment of conception for the European central bank agreement?

Was it all a passing storm? Small avalanche in the Alps, not many hurt?

Selling the Policy

How was Switzerland's policy sold at home? Despite disquiet over using proceeds of central bank gold for a charitable foundation, the overall policy has never triggered a popular storm. One by one, through painstaking consultation, the main constituencies in politics, institutions and the public were brought on board.

The moment of truth was last year's referendum. Cleverly, voters were offered a comprehensive package, of which proposals for the central bank were just one small feature. Opponents of gold sales set great store by the conservative Swiss People's Party (SVP), now a member of the coalition government. While the SVP has been hostile to funding the Solidarity Foundation from SNB gold, however, it has not opposed sales, which benefit its pet causes, such as the war generation of pensioners.

An important government ally has been the SNB itself. Here the Swiss story offers a salutary contrast to the fiasco in Germany three years ago. A scheme to revalue the Bundesbank reserves and pay a special dividend to the Finance

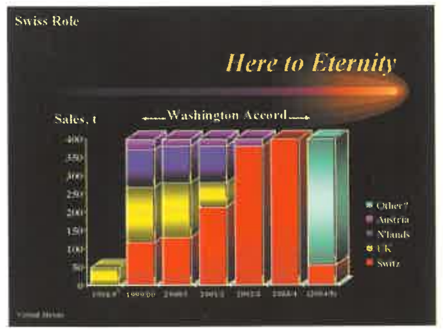
Ministry, thereby putting Germany's debt position in good shape for EMU membership, was seen off in short order by the bank's redoubtable president, Hans Tietmeyer.

More recently, we've seen echoes of the German story in a French government plot to raid the gold reserves for pensions funding. That the gold may not actually belong to it didn't inhibit a stern denial from the great and glorious Banque de France.

Selling the Gold

The gold business has not quite been flooded by central bank sales. But adding 40% to the 3,500 tonnes sold over the past decade was always going to be a challenge for the Swiss. There is now, of course, a broad dimensional framework. It's the European central bank agreement to bring order to central bank sales. How do the Swiss fit in?

The British got 50 tonnes out ahead of the pack, but have to fit another 365t into the frame. The Dutch have a 300t quota, with 100t already sold and probably another 100t in each of the next two years. The Austrians are throwing 90t into the pool, 30t in the first year and perhaps another 20t/year over the next three years. That leaves room for



1,245 tonnes from anyone else. So Switzerland's programme will have to roll on beyond the agreement's end.

When does the Swiss gold come to market? The Eurogold sales season runs October-September. The Swiss have confirmed we'll see 120 tonnes this season – an average six tonnes a week, though they'll no doubt sell into strength and step back from weakness. Next season the rate has to drop as there's room for only 130 tonnes over 12 months. The following year there should be room for 215 tonnes, and the year after that 380 tonnes. The final year of the agreement could allow the full 400 tonnes from Switzerland. And the three months following the agreement have to take care of the last 55 tonnes.

Many Roads, One Destination

What kind of sales routes are available?

- Direct sales to other central banks? This hasn't happened on any scale since Belgium's first went partly to Spain a decade ago.

- Sales via friendly central banks already active in the gold market? This route has also closed off in recent years.

- Auctions? Even the Bank of England's best friends would concede they've been controversial.

- Spot sales to dealers, like the Canadians? Excellent discretion and minimal price disturbance, but it's taken forever.

- The London fixing? Simple, cheap and reliable, and freshly endorsed by CSFB buying the vacant Republic seat.

- An options package, as the Argentines are said to have used in 1997. Or structured forwards, used by the Dutch and the Australians in 1997.

- Any of these (probably) could use as intermediary the Bank for International Settlements, the Swiss choice for this year. The BIS had a very successful campaign with the Dutch, placing 100t in 12 weeks flat.

- Swaps, and coins. While everyone's been looking the other way the Austrian National Bank has shed 260t in recent years, mainly through coins and unredeemed swaps. Its coin programme didn't start out as a deliberate way of offloading gold. But it's been a very neat approach, locking the gold away in a premium product and leaving sentiment intact. Snag is you'd now need an improbably buoyant coin market to lay off serious tonnages.

Still a Heavyweight

What lies beyond Switzerland's current programme? A National Bank official has said that the reserves remaining after the forthcoming sales would naturally be retained, but he added, "I have to concede it is difficult to operate rational portfolio arguments with gold". It's inescapable that even after the sale of 1,300 tonnes the Swiss will remain a gold heavyweight, with as much as the Belgians before they began their sales in 1989. There could, surely, one day be more.

This is not just a matter of citing Belgium. Go back to the blueprint devised by that studious Expert Group in 1997. Their formula gave the National Bank a gold requirement of Sfr10.7bn. Even revaluing the gold way below market price (at $170/oz) still threw up a large excess. At today's values Sfr10.7bn translates into a reserve requirement of less than 750 tonnes, and the excess becomes more than 1,800 tonnes.

Paying the Price

What's the market's verdict so far? In theory it should all be in the price – a price that inevitably bears scars. Tallying up the moves prompted by developments since the story broke – yes, even those judicious statements that were such a nice blend of candour and reassurance – we reckon the announcements from Switzerland have exacted a total penalty of $50/oz.

Reaction to actual sales has been a different story, and provided the European central bank agreement holds they seem set fair to remain low-key events. As significant as immediate price developments, however, is the demonstration effect of what the Swiss are doing. That stands every chance of being seen as a rational, well-planned and very well managed response to inexorable long-term change in the international financial system. Other countries will certainly be watching closely.

Whether there is room for another gradualist approach like that of Switzerland among the retired heavyweights of the Gold Standard is, however, very much a matter of conjecture. ■

Tony Warwick-Ching

Tony Warwick-Ching's career in the mining business goes back to central Africa in the 70s, when he was involved with base and precious metals in Zambia and elsewhere. He then had extensive research experience with CRU, Mining Journal and other consultancy and publishing organizations. After a spell with a merchant bank he joined Virtual Metals Research & Consulting at the beginning of 1999. The author of a variety of articles and conference papers on precious and base metals, his book, The International Gold Trade *was published by Woodhead Publishing in 1992/1993.*

Images from the Gold Virtuosi Collection's Paris debut on 25 June, coinciding with the FT Gold Conference in Paris. The collection totals over 20 kilos of gold.

Dressed to Thrill *The Art of Selling Gold*

Take a look, feel the heft, of over a kilo of elemental gold – mined and refined, poured and cast, hammered and teased into a glinting fantasy of sparkle and light – as it graces the neck of Nombulelo, one of the world's top fashion models.

Sparked by the soundtrack, she and her companions glided down a summery sunset runway in the garden of a Paris museum. Given the setting, what would Rodin have thought? His cast-bronzed presence, The Thinker, contemplated the graceful comings and glittering goings.

"Wow!" and much more said the guests, who numbered over 150 – miners and marketers, traders and dealers, investors and manufacturers.

Co-hosts AngloGold and Credit Suisse First Boston mounted a show that announced to the fashion world and the world at large that the market formerly known as the market that had not marketed itself was changing its mind. ■

Annual General Meeting

By Susanne M Capano, Editor

At the Association's AGM, held on 21 June 2000 at the City of London Club, Martin Stokes was re-appointed Chairman for a second year, and Simon Weeks of The Bank of Nova Scotia-ScotiaMocatta was re-appointed as Vice-Chairman, also for a second year. The other members of the Management Committee elected were:

John Coley, *Brink's Ltd*
Kevin Crisp, *Credit Suisse First Boston / Credit Suisse First Boston International*
Nick Frappell, *Sumitomo Corp (Europe) Plc*
Colin Griffith, *Standard Bank London Limited*
Rick McIntire, *Deutsche Bank AG*
Clive Turner, *N M Rothschild & Sons Ltd*

In his report to the members, Martin Stokes reviewed some of the year's achievements and outlined initiatives currently underway:

- the conclusion of a successful conference in Dubai and the promise of another one next year in Istanbul
- several new admissions to the Good Delivery lists and continued processing of other applications
- improved arrangements for weighing gold and silver
- admission of the first International Associates
- establishment of an Electronic Trading Committee to determine whether a market-wide electronic trading platform would be appropriate
- standard documentation for Interest Rate Swaps and Forward Rate Agreements, currently in process with ISDA
- consultations with the FSA and Bank of England for the forthcoming Inter-Professional and Non-Investment Products Codes
- development of a short Users' Guide to the OTC Bullion Market.

He took a look at what lies ahead for the market:

"It is easy to describe the current landscape as changeable – and I am somewhat concerned about the dangers of fragmentation of the market - especially on the spot side. There are several initiatives out there, though in general they are primarily aimed at and have been developed for other markets. However, it is most important that we stay ahead of the curve.

We can only do this by being open to new ideas and pro-active in pursuing the best interests of the market as a whole. This is what we have been attempting to do with the various initiatives that I have mentioned. I hope that the members as a whole will support their implementation in the coming year." ■

A Global Fixation

By Susanne M Capano, Editor

The possibilities were endless – a limousine, a motorcycle weaving in and out of traffic, a high-speed boat, a helicopter (although landing it in the City of London might prove difficult). But Credit Suisse First Boston 's choice of transport to their newly purchased seat on the London Gold Fix is the same choice as that of millions of commuters shuttling between the City and Canary Wharf every day – the Docklands Light Railway.

Not a very flashy method of transport to use to join the other four fixing members – NM Rothschild and Sons (the chairman), the Bank of Nova Scotia–ScotiaMocatta, Deutsche Bank AG and HSBC Bank USA – in a discreet room located on the premises of NM Rothschild.

But then, the fix is not a very flashy process. No screaming and yelling. No jumping up and down or waving of hands. Each member does have his own flag, but it simply stands on the desk, indicating – as long as it is upright – that someone somewhere is still deciding about whether to place or change an order. Once the orders are all settled the member lays the flag down. Until all five flags are lying down, the price cannot be fixed.

The process of leaving orders is entirely flexible according to the customers' needs. They can decide to leave a standing order to sell or buy a given number of ounces, either once or over a fixed period of time that can extend to years if desired. Or they may change their order during the fixing process as the price fluctuates. A buyer can decrease or cancel his order if the price moves up, likewise a seller if the price falls.

"Markets can change, but customers will continue to require an impartial, trusted and open method of transacting and pricing their business," says Clive Turner of NM Rothschild & Sons. "The London Gold fixing provides such a platform – as it has done for the past 80 years."

What is produced every day, twice a day, without bells and whistles, is a remarkably efficient and useful benchmark. It is arguably gold's most universal benchmark, one that proves equally valuable to those customers needing to transact thousands of ounces or others with a few kilos to price. From central bankers to miners to refiners to wholesale jewellers, the London Gold Fix is the price that is awaited across the market and around the world. ■

Following are comments from users of the London Gold Fix around the world.

The London Gold Fix is the most reliable equation of daily global gold supply and demand reflecting the prevailing interest from world official and unofficial sources. Both our customers in Asia and we ourselves have been utilising the fixing facilities for many years.

Robert Sitt
RNA Holdings Ltd, Hong Kong

The fact that significant volumes of business are transacted at the London morning and afternoon fixes means that the price is seen as transparent. The Fix accordingly provides an appropriate pricing benchmark for producers, especially in volatile markets and at times when spreads are wide. Any agreement which needs a price reference point will usually use the fix, as it is seen as the price at which gold trades in significant volume.

Martin Cross Managing Director, Standard Risk and Treasury Management Services (Pty) Limited Johannesburg, South Africa

The prices for a substantial part of the gold and silver that we export and sell on behalf of our customers are determined on the basis of the London Fixing. The Fixing prices are commonly used in Russian market by banks, producers and consumers of precious metals as a credible benchmark.

Alexander Popov,
Deputy Chairman of the Board
ROSBANK Joint-stock commercial bank,
Moscow

The London Gold Fixing is the major transparent pricing mechanism permanently used by our bank in its collaboration with the gold mining companies.

Sergey Filippov
Vice President, Lanta-Bank, Moscow

In the US, many of our customers, especially the jewellery manufacturers, like to use the second London fixing to price the gold portion of their product. Since this price is established at a time when most of the U.S. is open for business, and most importantly is very much publicised throughout the world, it allows our customers the flexibility of being able to hedge their sales or purchases that morning while using a pricing mechanism that all their customers accept as a fair benchmark price.

Robert G Arcand
Fleet National Bank Providence, RI, USA

...[The London Gold Fix] is useful for Central Banks to have an official rate to use in revaluing their reserves.

Mr Fazliddin Urunbaev
Executive Director-Treasury
National Bank for Foreign Economic Activity of the Republic of Uzbekistan

The London Fixing is integral to the price we receive from our smelters for our gold/copper concentrate.

Gary Scanlan
General Manager Finance
Newcrest Mining Limited

I find the Fixing extremely useful as I believe in it as the only real reference price for gold on which everybody can conclude transactions.

Mr. Ramesh Ganesan (Head Trade & Commodity Finance), ABN/Amro, Mumbai

I welcome the Fixing in the provision of a daily 'official' rate.

Giacomo Panizzutti
Head of Foreign Exchange and Gold Section
Bank for International Settlements, Basle

The London Fix is important for the Italian jewellery business. Many trades use the fixing price as the reference price even if the trades are not actually executed through the fixing process.

Emilio Camponovo Aurofin SA, Chiasso, Switzerland

The London Fixing is very useful for our manufacturing business. We use the fixing price as a reference rate for our final product pricing because it is a transparent price over which there can be no dispute.

Nayan Pansare Inter Gold (India) Limited, Mumbai

Virtually the only open window between jewellers and the gold market.

Vittorio Gori Unoaerre Italia SPA, Arezzo, Italy

The London Fixing is central to the core of Damas' business, since the majority of our supply and physical delivery contracts are settled against the London PM Fix on the delivery date. The use of the fixing price facilitates the automation of administration and simplifies settlements.

Tawfique Abdullah Damas Jewellery, Dubai

The London Fixing is an extremely useful process which provides a single universally accepted yard-stick against which all price and performance can be measured. The market penetration of the fix price will not, in my view, be easily replaced even with the freer availability of cheap information.

Professor Adriaan Steyn
Group Treasurer
Gold Fields Limited, Houghton, South Africa

We view the Fixing as the definitive indicator of the gold price during the London trading day. The Fix has a historical significance and, going forward, we would expect it to remain a key barometer of the gold market.

Jamie Sokalsky
Senior Vice-President and Chief Financial Officer, Barrick Gold Corporation

The London gold fixing price is widely recognised as the benchmark – not just for London, but for the spot market globally. Few other benchmarks have had such an illustrious history.

Clifford Smout
Head of Foreign Exchange Division
Bank of England, London

The London Fix is so transparent that there is no dispute on the transacted price, even during audits.

Mahendra Poladia
Bin Sabt Jewellers, Dubai

Surprisingly, in this day and age, the London Gold fix is the only place where buyers and sellers, large or small, meet twice a day to transact large quantities of bullion at a singly price without wide bid/ask spreads, even during volatile market conditions.

Harish Pawani
Peekay Intermark Ltd, Dubai

We find the fixing very useful as especially the exporters of gold jewellery can purchase their sold gold at the Fixing...[it is] the best reference price for gold.

Mr. C. Joy – Manager, MMTC Mumbai

The London Fix, with its long history, provides a respected reference price benchmark for the industry and offers a transparent and liquid trading mechanism at fixed cost.

Mark Lynam
Anglogold Limited

We use London gold fixing for many of our customer orders. My wild guess is that here in Istanbul roughly about 10 tons/year of gold (which is 5% of the total trade) are priced on the London fixing. Our customers think it's a price they can trust – they may not always trust all prices in the market, but when it comes to the fix, they know it's the right price.

Ismail Yanik – *AGM, TEB - Turk Ekonomi Bankasi Istanbul*

The Platinum Age

China's Growing Fascination with Platinum Jewellery

By Susanne M Capano, Editor

Platinum chain styles becoming very popular in China

All that glisters is not gold. Especially in Chinese jewellery shops these days. It's increasingly likely to be platinum.

Chinese demand for the white metal has soared over the past few years to levels no one could have predicted a few years ago. In 1993, China consumed 15,000 ounces of platinum, only 1% of the world's total demand, far behind Japan, the US and Europe. By last year, they had become the second-largest consumer, accounting for some 950,000 ounces.

But Platinum is a Diamond's Best Friend

The modern day origins of China's fascination with platinum jewellery began in the early 1990s as the popularity of diamonds began to increase.

Most of the diamonds being sold at the time tended to be fairly small and would have been swamped if high-carat yellow gold were used in the settings. Jewellers decided it would be better to set the stones in a more delicate setting using a white metal that wouldn't taint the colour of the diamond.

But which white metal? Silver had never been very popular in China. There was white gold, but the alloy used in making gold 'white' actually resulted in a pale straw-coloured metal. Usually it was then plated with rhodium to give it a white appearance, but eventually, the plating will wear off, which goes against the Chinese preference for pure metal.

Another possibility was platinum, for which the Chinese characters used by consumers – bai jin – actually mean 'white gold'. In 1994, Johnson Matthey began to investigate the potential of promoting platinum jewellery in China by taking advantage of the popularity of diamonds. The campaign began in Shanghai – the 'Paris of the East' – often the launching point for new fashions, from where it spread to Beijing. Leaflets were produced describing the benefits of platinum, the pure white metal: rarer, stronger, more expensive and therefore more precious than gold.

Quantity Rises...

The rest of the platinum industry soon took up Johnson Matthey's lead. "Often when a market takes off, it's driven by more and more consumers wanting a certain item. In China, though, it wasn't only the consumers who helped move the market forward. The trade was happy to help promote platinum," notes James Courage, Chief Executive Officer for the Platinum Guild International (PGI), a marketing organisation sponsored by the main South African platinum producers.

The reason? Platinum jewellery had a key advantage over plain gold jewellery for them: the government did not fix its price. There were also fewer restrictions on importing it and selling it at retail. That meant fewer barriers for the manufacturing and retail trades and potentially wider profit margins. Some of those profit margins were ploughed back into upgrading equipment, and the quality of pieces produced began to improve, thus further increasing consumer interest.

If the market was to continue to develop, a dedicated and focused marketing campaign was needed. PGI launched a consumer advertising campaign on television in the autumn of 1997 in the key cities of Shanghai and Beijing. Aimed at the 20-40 year-old generation, the theme linked platinum with elegance. The idea caught on with the younger generation, which began to see yellow gold as old-fashioned, the metal their parents and grandparents had bought. Platinum became 'their' metal.

Tourists from other parts of China visiting Shanghai and Beijing were attracted to the new white metal on sale in the local jewellery shops. They took their purchases back home, attracting the attention of their friends and relatives. The trend began to spread to some of the secondary cities. PGI's marketing campaign was extended to four additional cities – Hangzhou, Shenyang, Nanjing and Dalian – with print and television advertisements, as well as trade education and point-of-sale material, all designed to give the consumer a better understanding of the metal.

While the level of personal wealth in China is growing, it's still lower than in many of the other platinum markets. Not everyone can afford a diamond, even a small one. More and more non-gem pieces have been produced, some with diamond-cut facetted surfaces that add low-cost sparkle. Today 80% of the market is in metal-only pieces, with many items comparable in price to a pair of imported top-brand sunglasses – still an important purchase for a young Chinese consumer.

No one could have predicted just how explosive the growth in demand would become. In 1998, the Chinese consumed 620,000 ounces. And last year, according to Johnson Matthey's recently published Platinum 2000, China was the second largest consumer behind only Japan, and consumed a total of 950,000 ounces – an increase of 53% over the previous year.

A large-scale manufacturing centre became established in the area of Shenzhen, providing a well-priced source of products for smaller wholesale jewellers. There are now ten very large manufacturers in the region. Jewellers make periodic excursions there to make their selections, armed with plenty of cash and content to stay in the region for a few days while their jewellery is finished.

A still from PGI's first television commercial.

...And so does Quality

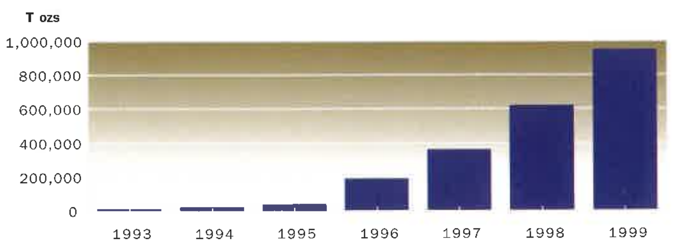
The consumer is well protected in China. Each piece of jewellery has a label attached containing a total of 9 pieces of information – including the price, the type of jewellery, the labour charge and the manufacturer. The platinum jewellery sold is mostly 90% pure, with the other 10% traditionally consisting of palladium. As the palladium price has risen recently the metal has been thrifted and other metals, such as copper and cobalt have been added to the mix. From the summer, the government is expected to pass a standard for alloys that will set a minimum content of platinum and palladium combined at 95% and will limit the use of some base metals to ensure better quality.

PGI together with Johnson Matthey established the Pt mark, which is stamped into every piece of jewellery sold. The consumer tends to view the 'Pt 900' stamp as a brand mark – not so much an indication of the percentage of platinum in the piece as an indication that the piece is 'pure' platinum.

What Goes Up – Must Be Prices

"The retailers' mentality leans towards fixed prices," notes Neill Swan, sales and marketing manager for Johnson Matthey. "They don't like wide fluctuations. Even if the wholesale price rises, they are reluctant to change their retail prices – their first reaction is to hold out for a price correction." Generally, the price has fallen back from time to time, but the recent rally has left little respite for the buyers.

Platinum Jewellery Manufacture in China



In fact, the base price for platinum varies from one location to another. In Shanghai, the price is set by a Price Adjustment Committee, which has prominent retailers and manufacturers among its members. As platinum sales have become more and more important to them, and as the price has risen, they have pushed for price increases. While the price had remained unchanged for the past ten years, it has had to rise twice in the past three months. It now stands at 198 renminbi (RMB) per gram, equivalent to about $23.50/gram or $730 per ounce. In Beijing, however, there is more of a free market and more competition – and the price is considerably lower, about 158 RMB/gram.


Designs for the Year of the Dragon

Will higher prices dampen the consumer's enthusiasm? "What isn't fully tested is whether there is a ceiling to the price," says James Courage. "We don't really know how the market will react to a sustained period of high prices."

High prices may not be a deterrent to all buyers, though. While for some, it may push platinum out of reach, for wealthier consumers it may actually increase the metal's appeal. "The fact that it is a more expensive metal might make it that much more attractive to wear. Platinum's relative scarcity and still small market size – compared to gold – add to the metal's allure, because it allows platinum jewellery to be marketed as something that not everyone else has. It plays perhaps to the consumer's sense of one-upmanship," says Kevin Crisp, precious metals strategist with Credit Suisse First Boston.

Ageless Beauty?

Is the Chinese consumer's apparent fascination with platinum a brief fling or a lasting relationship? "The platinum jewellery market in China is a very young one and continued growth is dependent on several factors" says Neill Swan. "It needs the Chinese economy to continue to grow and with it consumer wealth. The trend for more and more consumers preferring white metal has to continue – something which the platinum industry are working hard to ensure. And it needs jewellery manufacturers and retailers to continue making profits on platinum – something that depends heavily on the international metal price and consumers' willingness to pay. The market has made excellent progress in recent years, however, and if these factors do continue, China may well overtake Japan as the number one market within the next few years." ■

Welcome *First International Associates Join the Fold*

By Susanne M Capano Editor

The LBMA has extended its boundaries well beyond 6 Frederick's Place. Four companies – from Dubai, Poland, Japan, and South Africa – have joined as the first International Associates from 9 June 2000.

ARY Traders

A bullion dealer and jewellery manufacturer, ARY has been dealing in precious metals since 1979. They specialize in the production of innovative jewellery and small bars. They were chosen by the World Gold Council and the Economic Department of the Government of Dubai to be the primary collaborator for their Dubai – City of Gold promotion during the Dubai Shopping Festival.

KGHM Polska Miedz SA

One of Poland's largest enterprises, they are the sixth largest copper producer, with about 4 percent of world copper output and the second largest silver producer, with about 7 percent of world silver production. The company's products include electrolytic copper in the form of cathodes registered as grade A on the London Metal Exchange, as well as billets, wire rod and granulated copper. Its silver bars have been listed on the London Good Delivery List since 1995.

Tanaka Kikinzoku Kogyo KK

One of the leading precious metals refiners and manufacturers in the Far East. They are well known for their high specification industrial products, used in a variety of applications ranging from semiconductors to communications and are a producer and trader of a wide range of gold and silver bullion, platinum group metals equipment, and gold and platinum coins. Their gold refinery has been accredited to the Good Delivery List since 1978 and their silver refinery since 1934.

Standard Risk and Treasury Management (Pty) Limited (SRTMS)

SRTMS has been growing rapidly since its launch two years ago as an independently managed company within the Standard Bank Group of South Africa. It provides a complete treasury and risk management outsourcing service to corporate clients. For companies that have their own in-house treasuries, SRTMS provides risk management support services with the ability to independently value complex hedge products and structures. ■

Obituary

Keith Smith

20 Jan 1934 – 30 May 2000

Remembrances

by Henry G Jarecki

I am grateful to Keith's family for letting me say a few words about this gentle man who was my friend for 34 years, half of his life and half of mine.

I am proud that he chose to be my mentor and friend from the day I first called him in 1967 and told him I was a psychiatrist from New Haven, Connecticut and had an arbitrage idea I wanted to talk about. Close friends though we were as different - as he liked to say - as chalk and cheese. I was driven and sometimes got frustrated by his laid-back style. He was idle and proud of it he said that that was what forced him to be clear thinking and intuitive, and to find always the safe and easy way.

He was not all that comfortable to be around because he had an uncanny ear for the pompous, the phoney, and the crook. He seemed almost surprised by his rise from junior accountant to leader of the world's gold market for he took the job, as he never tired of telling us, because the ad that Pat Brenan put in the newspaper said that the job started at 9.45 in the morning not 9.00 or 9.15 like all the other jobs. The press worshiped him. They called him "lean and debonair" and hung on his views about gold prices:

"What will the gold price be one year from now?" The Time magazine reporter asked:
"I don't know," said Keith, modest as always.
"Well just make a guess, then."
"All right then," said Keith, "148 dollars and forty cents." "As exact as that?" gushed the reporter.
"If you're making a guess," said Keith "it might as well be exact."

His modesty and gentleness were mixed, strangely enough, with clear principles and a firm will. Once he had made his mind up, he didn't like to re-think and re-work the issue. Those clear principles governed Mocatta for the 34 years he was there, and were greatly appreciated by the many friends he made in the London Gold Market - and in the markets in Zurich, Frankfurt and the Middle East.

Shattered though I was by the news first of his illness and then of his death, I was comforted by the way he died, surrounded by Phil, Graham, Salena and Fiona, without pain or discomfort, just falling asleep like the gentle child he was. He left us as Alfred, Lord Tennyson described it, "God's finger touched him, and he slept."

Goodbye Keith. You were my partner, my teacher, and best of all, my friend. I shall not see your like again.

Looking Forward

Three days in the city where all that glisters is gold

By Susanne M Capano, Editor

Interior of the Haghia Sofia museum

If you want to wake up in the city that doesn't sleep, spend the night in Istanbul.

By day or by night, the city hums with activity. "Does it ever slow down?" I ask a local. "Well, maybe for about two hours – say between 3 and 5 in the morning. Then it starts up again."

My first glimpse of the city is shortly before midnight, having arrived on the last flight from London. Istanbul is striking by night, with palace and mosque silhouetted against the stars, birds flitting in and out of floodlights, diners spilling out of the glow of restaurants and clubs. The following midnight, as one day gives way to the next, there's an intercontinental fireworks display on the Bosphorus. A state holiday? No – it's opening night for a new club. Hundreds of people have turned out. Another midnight, another show.

Now that the LBMA has chosen Istanbul as the venue for next year's conference, I've come to make some contacts in the local market and get a taste of the sights, not something you can easily accomplish in three days. It means spending a fair amount of time criss-crossing the city in one of the innumerable taxis.

"Europe . . . Asia." The taxi driver indicates the two sides of the Bosphorus with a sweep of his hand. This fascinates me – where I grew up, you took a bridge from New York to New Jersey, a ferry to Staten Island. Here you could hold your breath as you cross two continents.

Shopping is quite a different experience, too. Istanbul's Kapali Carsi – the Covered or Grand Bazaar – is an experience in itself. It began life in the 1400s as two warehouses. Merchants began to set up stores and workshops in the area, which was covered by canvas to protect customers from the summer sun. Eventually gates were installed that could be locked at night. Today the area is an immense labyrinth of roughly 4,000 shops selling a kaleidoscope of goods, each with its own section – gold and silver, leather, rugs, food and trinkets.

Inside the Grand Bazaar

The subject of gold doesn't only come up with my contacts in the market. When anyone and everyone finds out where I work, it seems they all want to talk gold.

"What do you think of this bracelet?" the taxi driver asks as I leave the bazaar. He tells me its weight in grams and how much it cost him. "Do you think I got a good price?" he asks anxiously. Much better than he'd pay almost anywhere else in Europe, I reassure him. Another merchant in the bazaar selling leather handbags asks what the gold market in London is like. I tell him about good delivery bars – that each one weighs 12.5 kilos – and his eyes widen. "How can you lift such a gold bar?" he asks. I assure him that bar lifting is not part of my job description.

During my stay, I see a variety of the players in the local gold market – bankers, dealers, jewellery manufacturers, the government mint, refiners, taxi drivers. This is a market with a very long history, but it isn't spending time looking backwards – it's looking ahead. Seated in the plane going back, I review my notes, then pull out my guidebook. It's time to plan our next trip back. May looks good. ■

Treasures of the Topkapi Palace: above, a ceremonial golden throne studded with topazes, right, sixteenth-century pitcher, left, dagger encrusted with emeralds and diamonds.

Quick Study...

Barrier Options For Producers

By Xavier Lannegrace, Managing Director Marketing Metals, SG

For the last ten years, producers have considerably modified their hedging strategies. Traditional forward sales have lost ground to options. Where forward sales lock the price of physical sales regardless of the gold price at maturity, European put options allow producers to participate in an upside movement at maturity while still being fully protected against the downside. This upside participation is an important feature both for producers increasing their cash flows alongside with the gold price and for some shareholders expecting a good level of correlation between their shares and the gold price.

However, there is no free lunch: a premium has to be paid when purchasing such insurance. The premium for puts is traditionally paid in cash at the time of the transaction, but can also be paid in several instalments (synthetic puts) or financed by other instruments: additional sale of calls (collars), additional forward sales at a lower price than the market, gold interest rate swaps, etc. Another way of reducing this hedging cost is to use options with lower premiums, such as barrier options, part of the "path-dependent" option generation.

Barrier options

Classic European put options do not take into account possible spot movements during their lives. This is important since markets do not necessarily move progressively in one direction, but can also retrace their steps, resulting in a small net movement. A producer holding a European put option may not have the opportunity to benefit from a sudden peak in the market, as the gold price and the strike price are only compared at maturity date. In fact, for "static" hedgers protecting their physical sales at maturity, the life of a European option can be summarised as the conception at transaction date and the birth and death at maturity.

The life of a barrier option is significantly longer, since it starts at the transaction date and stops when the barrier is triggered or at maturity.

There are two types of barrier options, also called one-touch or option with limits.

Knock-out option –
has a cancellation limit. If the gold spot price trades at a predetermined level (the limit) at any time during the life of the option, the contract is automatically cancelled.

Knock-in option –
The mirror image of a knock-out option. If at any time during the life of the option the gold spot price trades at a predetermined level, a defined option appears.

The premium of a barrier option is always cheaper than a European option, as there is a probability that the barrier option disappears (a knock-out) or never appears (a knock-in). In fact, the higher this probability (measured by the barrier level vs market price), the lower the premium.

Case Study

Purchase of a knock-out put with a forward sale order.

This is the simplest and one of the most effective strategies in using barrier options. The producer is protected if the gold price slides, but still takes advantage of a price rise.

The producer purchases a knock-out put with a barrier over the strike price and simultaneously leaves an order to sell forward the same amount of gold when gold spot reaches the level of the barrier. If the barrier is triggered, the put is cancelled and the producer automatically sells forward at a higher level than the barrier. This forward sale order enables the producer to lock an attractive price, avoiding a possible forthcoming drop in the gold price.

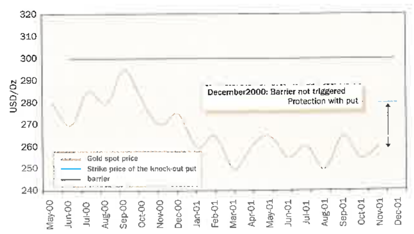
Transaction Details

Transaction date: June 2000
Purchaser: the producer
Seller: the bullion bank
Option type: knock-out put
Maturity: December 2001
Strike price: US\$ 280/oz
Barrier level: US\$ 300/oz
Premium: US\$ 5.35/oz

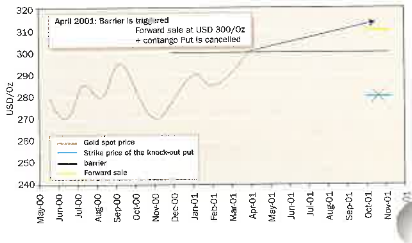
This up-and-out put has a 30% discount compared to a standard European US\$280/oz put.

From the time of the transaction onward, the gold spot price is closely monitored by the bullion bank.

If the barrier is not triggered, the producer is protected by the put at maturity.



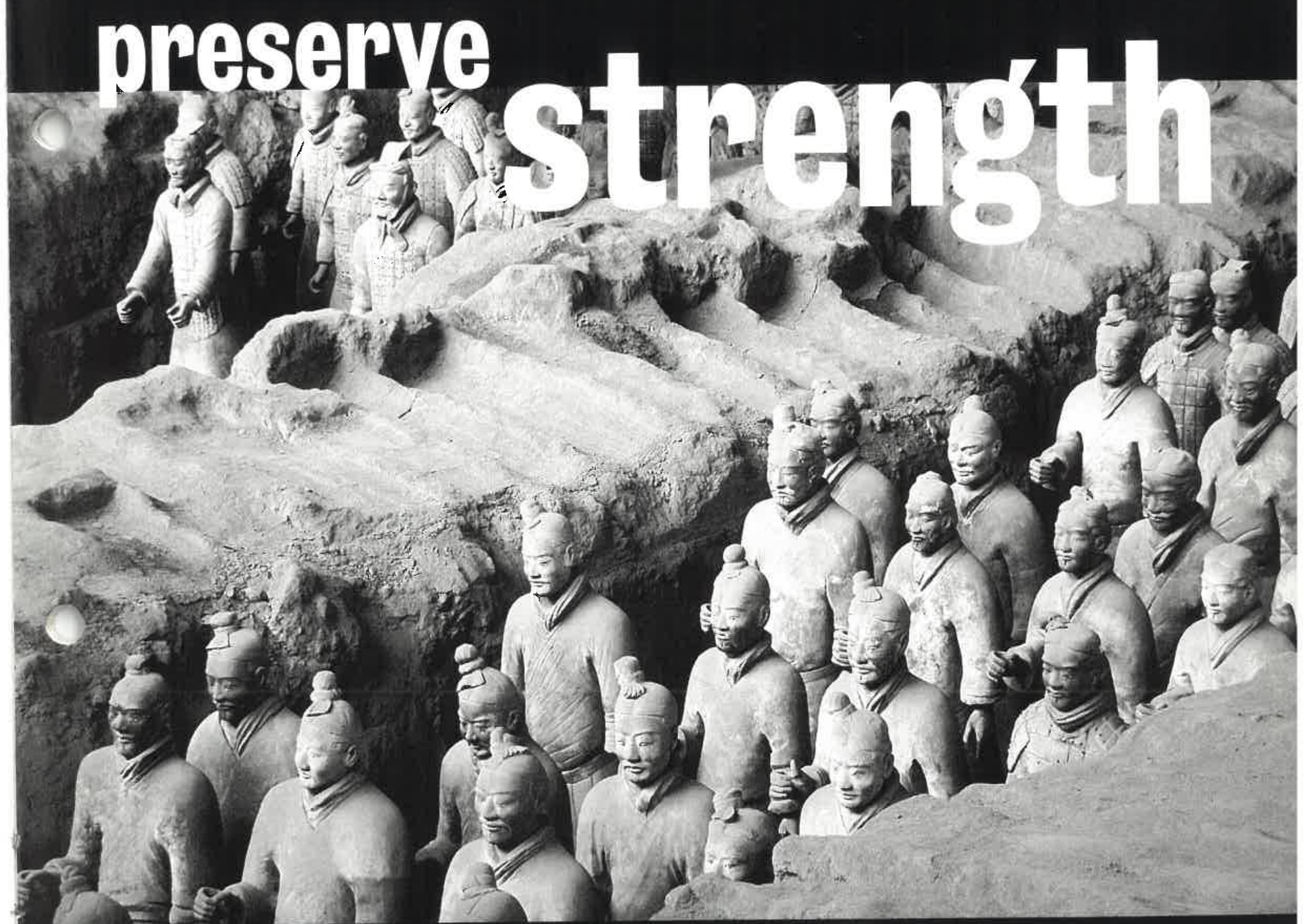
If the barrier is triggered by the gold spot price, the producer automatically sells forward for December 2001 at a higher price than the strike price of its put (barrier level + prevailing contango). At the same time, the put is cancelled (no overprotection). The producer has now fixed the sale price of his gold thanks to the forward sale.



No additional premium is paid if the barrier is triggered. The lower cost of this option and the opportunity to set the knock-out level at a high gold price make this an attractive strategy.

The juxtaposition of different knock-in and knock-out options can also create strategies such as the "reset option" which allows the producer to improve his strike price with the gold price. Used in combination with other hedging instruments, these options can offer many possibilities, and their wide usage on foreign exchange or interest rate markets proves this ability.

However, whichever such path-dependent strategy is chosen, the golden rule of hedging must not be broken: the producer must initially reconcile physical production and global hedge portfolio to avoid finding himself exposed to unwanted commitments. ■



Gold as a Hedge

by Michael Thomas, Senior Economist (International), NM Rothschild (Australia) Ltd

There is a lot of interest in the nature of relationships between commodity prices and financial variables. Indeed, there are many sophisticated techniques available to analyse the myriad factors at work in commodity markets. The following article aims to shed some light on the relationship between gold and a number of key financial and economic variables.

Stylised 'facts' about gold price relationships

Volatility on Wall Street has revived hopes of a recovery in the gold price in some quarters. This reflects a perception that the desire to hold gold increases during periods of heightened uncertainty – that gold is a store of wealth. Intuitively, therefore, the price of gold should respond positively to:

- Political uncertainty, such as the threat of war, and;
- Economic uncertainty, such as a stock market sell-off, rising inflation or periods of high volatility in financial markets.

Alternatively, the price of gold may be adversely affected by:

- Economic optimism, where other assets promise greater risk-adjusted returns, and particularly
- Conditions favouring US dollar appreciation, as this tends to depress the price of all USD-denominated assets.

While the motivation for holding gold is relatively clear cut, the increasing globalisation, sophistication and deregulation of financial markets has given rise to an array of alternative safe havens. This would tend to weaken the allure of gold over time, depending on the stage of development of individual markets.

It is said that gold thrives on uncertainty – especially in less developed markets.

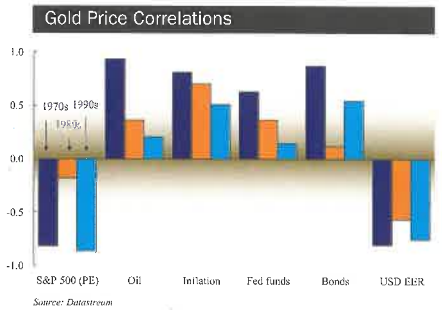
Nonetheless, in less-developed countries gold still plays an important role during times of stress. Developing countries account for two-thirds of new gold consumption. Indeed, anecdotal evidence suggests that large volumes of gold flowed back into Korea and Indonesia after the Asian financial crisis, despite the high local-currency price of the metal.

The Data Supports the 'Facts'

Correlation coefficients calculated from monthly levels of gold prices and a selection of variables over three decades lend support to these a priori assumptions. The results are presented in chart form below:

- The estimated coefficients have the right signs (+/-). The gold price is positively correlated with oil prices, inflationary pressures and interest rates (Fed funds and ten-year Treasuries). It is negatively correlated to episodes of US dollar strength (a rising USD effective exchange rate) and equity market optimism (proxied here by the average P/E ratio of S&P 500 stocks, to normalise the exponential rise of stock prices since the mid-1980s).
- The absolute size of the coefficients has diminished with time for the oil price, inflation and interest rates.
- The relationship with equity prices became more muted during the 1980s but strengthened again during the 1990s for reasons that remain unclear, given the range of alternative investments available. It is likely that the coincidental impact on the gold price of concerns about central bank sales exaggerated the measured relationship towards the end of the decade.

Gold Price Correlations



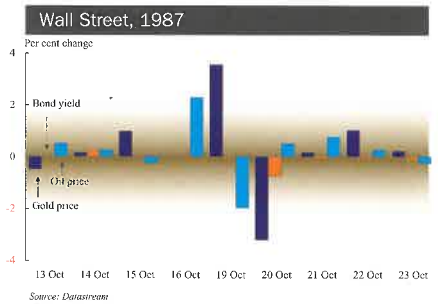
- The correlation between the gold price and the exchange rate remained strong. This is because the value of the USD directly effects the calculation of the USD gold price, irrespective of sentiment.

While the long-run coefficients highlight gold's theoretical relationships with other variables, the correlations have diminished on average. Of course, the relationship may still become pronounced during shorter periods of extreme volatility, but the evidence surveyed below provides only tenuous evidence of such links.

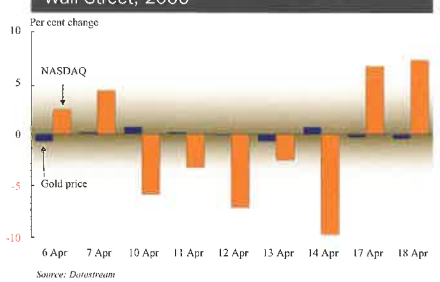
Gold Prices and Equity Markets

In October 1987, the Dow Jones plummeted from 2508 to 1739 in four trading sessions before bouncing and stabilising above 1900.

Wall Street, 1987



Wall Street, 2000



- On six of nine days the gold price and the stock index moved in different directions, with daily price levels registering a correlation coefficient of -0.84.

Gold may offer some protection over shorter periods when equity markets are troubled – but cannot totally guarantee peace of mind.

In April 2000, the NASDAQ also experienced a volatile nine-day period, trading between 4446 and 3321.

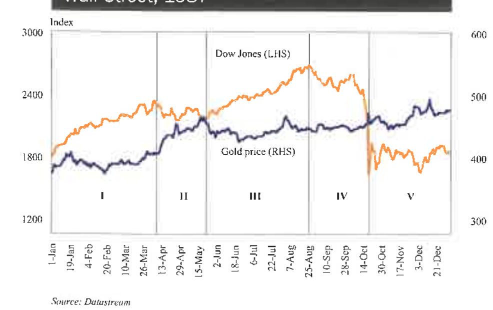
- Gold and equity prices again moved in opposite directions on six occasions (correlation = -0.50).

Six favourable outcomes out of nine represents only modest support for our stylised 'fact', diminishing the power of the strong correlation observed in 1987. Meanwhile, changes in the levels of the prices show that gold generally moves by only a small amount – and sometimes not at all – in response to even quite large changes in stock prices.

Thus, from one day to the next, it appears that gold may provide a modicum of protection against stock market jitters, rather than delivering large returns.

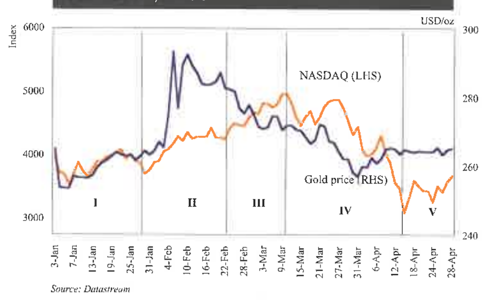
However, what would happen to the investor who was unwilling or unable to trade on a day-to-day basis? After dividing the year 1987 into five periods, corresponding roughly to turning points in the Dow Jones, it can be seen that when optimism was high, gold significantly underperformed the stock market. But, when sentiment turned bearish gold came into its own. A zero correlation for the year as a whole illustrates gold's potential as a hedging instrument.

Wall Street, 1987



Period	Dow Jones	Gold Price
	Per cent change	
I	26.9	7.9
II	-7.9	12.6
III	22.8	-3.6
IV	-36.1	5.1
V	11.5	1.0

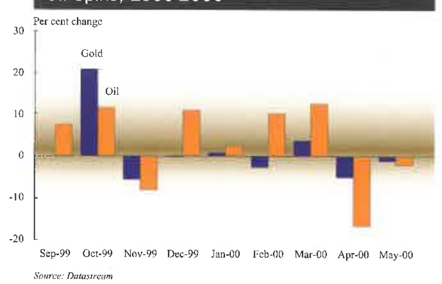
Wall Street, 2000



Period	NASDAQ	Gold Price
	Per cent change	
I	-5.9	-1.7
II	12.7	6.0
III	15.2	-4.3
IV	-34.2	-2.5
V	16.3	-2.7

However, similar treatment of year-to-date NASDAQ performance revealed a positive correlation between gold prices and stock prices over four months. For example, period IV shows the two price series falling together for a time, although gold rallied in late March as the NASDAQ came under increasing pressure.

Oil Spike, 1999-2000



Gold and Oil

The prospect of war in the Arabian Gulf caused a spike in oil prices during 1990. The oil price also rose precipitously when OPEC nations decided to limit supply last year. Oil price spikes in the 1970s caused quite severe and widespread economic problems. However, the impact of oil price spikes has greatly diminished during the 1990s.

In accordance with prior expectations:

- Gold and oil prices moved together in six of the nine months straddling the peak in oil prices in both 1990 and 1999-00, and;

The gold price has responded in kind to oil price rises, but in a muted way.

- Gold prices generally moved considerably less than oil prices, the only exception being in October 1999 when the gold price reacted to the European central banks' announcement about their gold holdings.

The medium-term investor who bought gold in mid July 1990, in response to the rising oil price, would have been about $US40/oz (10 per cent) richer at the end of the year – oil was 50 per cent higher. An early December 1999 gold purchase would have returned 1 per cent return by the time oil peaked in mid-March 2000 – oil rose 30 per cent. Thus, gold provided only limited protection from higher oil prices.

Conclusion

Historically, demand for gold has increased in times of crisis. The gold price has risen with the oil price, inflation and interest rates, on average, and against falling stock prices. However, the relationships have faded with time. Overall, the most enduring link is between the gold price and the USD. This suggests that gold may have useful risk characteristics in portfolios of assets. Gold is a hedge, if not always a strong one. ■

Michael Thomas has been Senior Economist (International) for NM Rothschild (Australia) Ltd since May 1997. He is part of the Economics team, responsible for providing analysis of, and advice on global economic issues, with particular emphasis on commodity, currency and interest rate markets. Prior to joining NMR(A), Michael worked as an Economist with CSFB and also taught Economics at James Cook University of North Queensland. He has a B. Econ (Hons) from JCUNQ and a M. Com from UNSW.

Vietnam

Taking a Big Step Towards Gold Market Liberalisation

by Albert Cheng, Regional Director, East Asia, World Gold Council

For the World Gold Council staff in Vietnam, 9 December 1999 was a day worth celebrating. Five years after the Council first opened its office in this then completely closed and regulated gold market, the State Bank of Vietnam (SBV), which manages the country's gold business, deregulated the gold jewellery market, taking a big step towards full gold market deregulation.

Under Decree 174 issued by the SBV, gold jewellery and gold art objects are now regarded as regular consumer products. All related gold jewellery trading activities, including import and export will therefore be subject to the laws governing the trading of other regular commodities.

While this may sound totally unremarkable to someone who is accustomed to a free market – where the only obstacle to trading is the depth of one's pocket – Decree 174 is great news for Mr. Pham Van Tam. As director of Kim Hao Gold Enterprise, the most prominent private gold jewellery wholesaler in Ho Chi Minh City, Mr. Tam knows that at least one of his major headaches will become history – the annual battle for gold jewellery import and export quota. "Our business is very much determined by whichever quotas we receive every year on both the buy and sell sides. Balancing these two uncertainties requires nothing less than skills, talent and connections. The removal of the quota system by the SBV makes our business a lot simpler", Mr. Tam said.

To fill the role left vacant by the SBV's withdrawal from the gold jewellery business, Decree 174 also authorises the founding of an official gold trade association to provide a legal basis for the creation of a gold trading centre in Ho Chi Minh City. The gold trading centre will serve as a channel for trading gold raw materials for the domestic gold jewellery market.

Now with Decree 174, people like Mr. Tam, who have seen Vietnam's gold market go from prosperity to desolation to revival over the past three decades, have reasons to believe that a flourishing gold market resembling or even exceeding that of pre-war Vietnam is not far away.

In the early 1970's, Vietnam's Saigon, now known as Ho Chi Minh City, was the Pearl of the Southeast Orient and a hub for Indochina's thriving gold industry. Saigon's gold jewellery shops were known for their stylish designs and quality craftsmanship. Jewellery lovers in nearby countries and cities used to come in droves to Saigon to seek out their favorite pieces. At the same time, gold bars like the wafer-thin "Kim Thanh" used to be the only reliable means of payment throughout South Vietnam, Cambodia and Laos.

"Those were the industry's golden times", Mr. Tam says. In those golden times, Mr. Tam was already a major gold jewellery trader in Saigon, with a distribution system covering the South of Vietnam.

After the war was over and the Communists took over Vietnam, all gold transactions were forbidden and Vietnam's gold market became virtually non-existent. Whatever gold business persisted turned completely underground. Gold jewellery, which was considered a luxury, was only sold by the government under a quota system.

In 1989, a gold market began to re-emerge with the founding of several state-owned gold companies like Saigon Jewellery Company and Phu Nhuan Jewellery Company. These companies were allowed to buy and sell gold jewellery and to produce their own branded gold tael bars to be used as means of payment in such high-value commercial transactions as real estate and motorcycles.

Private enterprises were permitted to participate in the gold business based on Decree 63, promulgated by the SBV in 1993. However, the SBV controlled all gold import & export activities with its licensing and quota systems. Nevertheless, a gold jewellery market started t o develop under the restrictions, but it accounted for only 16% of the country's total gold offtake, surrendering the rest of the market share to tael bars.

In January 1995, the World Gold Council established its presence in Vietnam, aiming to become the industry's influential spokesperson in market deregulation and in consumer marketing of gold jewellery. The Council has nurtured a very good relationship with the SBV, which subsequently accepted the Council as its official consultant on gold market deregulation. The Council's work has paid off on both fronts over the past five years. Gold jewellery offtake has seen a 175% increase from 8 tonnes in 1994 to 22 tonnes in 1999. The market share of gold jewellery in total gold offtake has soared from 22.86% (8 tonnes out of 35 tonnes) in 1994 to 41.5% (22 tonnes out of 53 tonnes) in 1999. Now, Decree 174 not only signifies the first real step towards gold market deregulation, it also means that Vietnam's gold market is ready for its biggest take-off.

For the Council, the task of deregulation is not over. The SBV still controls the gold bullion market as it is related to the country's monetary policy. Jewellery manufactured from imported gold raw materials still has to be exported. The gold trading center has yet to be established. All these present new challenges to the Council's staff in the field. However, with the promulgation of Decree 174, we believe the rest should follow in due course.

Deregulation of the gold jewellery market also means a more open and level playing field, therefore more competition. Under Decree 174, registration and licensing for gold jewellery manufacturing and trading no longer requires the approval of the SBV. It's now much easier to enter the business. However, Mr. Tam is undaunted by this prospect: "To us, the upside of Decree 174 is far greater. We have already had a head start in the business with the accumulation of a vast resource of human capital. That will make us a big competitive force in the market".

Mr. Tam, we like your spirit. ■

Albert LH Cheng

In his position as Regional Director, East Asia, Mr Cheng is in charge of the Council's activities in China, Hong Kong, Taiwan, Vietnam, Singapore, Malaysia, Indonesia and Thailand.

Mr Cheng joined the Council in 1993 as Regional Manager of Planning & Business Development, Far East, assisting the Council's Regional Chief Executive in strategic planning and development in the region. In 1997, Mr Cheng assumed the position of Area Manager for North Asia and New Markets in the Council, taking charge of China, Hong Kong, Taiwan, Vietnam and new markets such as Philippines and Myanmar.

Prior to the Council, Mr Cheng was Asia Pacific Regional Manager for the Royal Canadian Mint, with responsibilities in regional market development as well as sales and promotional activities for the mint's numismatic and bullion products.

Can Chinese Demand for Gold Save the World?

By John Adams, China Financial Services

The debates on the gold sector in China have turned on three very simple questions: What is the level of Chinese gold production? How much gold is there in China's official reserves? How and when will the gold market be liberalised? In the minds of many producers and dealers, this boils down to one very large question: how much gold can China's 1.2 billion people consume? This article attempts to answer these questions.

What is the Level of Chinese Gold Production?

Until recently, this was a real enigma. This is no longer the case, and a full run of historical data broken down by province and type of gold (placer or mine) is freely available (albeit in Chinese) for the period 1949-92, together with a commentary on the problems faced by China in that period, with frank comments on the lack of capital and the deleterious effects of political movements of the 1950s and 1960s. Further Chinese data for the period 1992-1999 can also easily be acquired, together with official comments on the government's plans for the gold mining sector in the next few years. The People's Bank domestic buying and selling prices over the period to date are also available.

What these data reveal is growth in Chinese gold production rising fairly steadily from a few tonnes immediately after the Communist Revolution in 1949, to reach 100 tonnes by the mid 1990s. By 1999 the level was 167 tonnes. Total production in the period 1949-1999 is unlikely to have exceeded 2000 tonnes overall. There are however a number of thorny statistical problems in the data: it is clear for example that the official price for gold purchase from the mines has at times massively favoured illegal export. Even after the domestic price began to mirror the international price, there have still been occasions for profitable arbitrage – in both directions – with gold being presented for official purchase that almost certainly had not originated in Chinese mines. At one point the flow of gold into China is estimated to have reached 250 tonnes in a single year – an awful lot of hot men in large overcoats, or else mind-boggling connivance.

How Much Gold is There in China's Official Reserves?

It is well known that China has published a figure of 12.7 mn ounces (395 tonnes) unchanged for the past few years. We also know that China sold gold in the aftermath of the disastrous Great Leap Forward (1958), as well as at the time of the Death of Chairman Mao (1976) and around Tiananmen (1989). Similarly we know that about 200-330 tonnes of gold has been going into the jewellery industry each year during the late 1990s. If we allow total domestic production to have been 2000 tonnes, then domestic official accumulation cannot have been much in excess of the 12.7 mn oz quoted. This does not of course allow for official purchases or smuggling into China.

The more intriguing question is whether China will decide to boost its official gold reserves from the current 2-3% (US$3.5bn) of total foreign exchange reserves of US$150bn, to a level of say 10-15%, implying a holding of some 1000 to 2000 tonnes. There are indeed siren voices within China suggesting such a move, though it is unclear whether domestic production could be directed to this end without drawing in vast quantities of legal or illegal imports for jewellery.

How and When Will the Gold Market Be Liberalised?

The liberalisation of access to data on China's gold production and frank comments on the state of the industry suggest that the Chinese authorities are serious about reforming the sector and avoiding the problems that the last decade has seen.

The World Gold Council has been influential in pushing this debate forward, and in 1999 commissioned a paper which contains a road map of the likely course of liberalisation of the gold market. The paper suggests inter alia that the authorities should:

- Open up the domestic market; abolish sales quotas for manufacturers to be but gold exports to remain banned. Individuals to be able to hold, buy and sell gold products including bullion for savings and investment.

- Establish a gold exchange to replace the People's Bank monopoly; the exchange to trade in Renminbi, for spot only. Exchange members to undertake futures through Chinese banks on international exchanges.

- Link up with the international markets. Interim Price Stabilisation Fund to be set up under the People's Bank to even out domestic and international price differences.

- On achieving full convertibility of the Renminbi, domestic and international gold price to merge, Stabilisation Fund to cease intervention.

There are of course a number of interested parties to placate with this road map. Perhaps most difficult are those in China who might be called "resource nationalists" and are best characterised as at the far end of the spectrum from those European central banks who are avidly selling off gold. China still recalls the difficulties of the economy immediately after 1949 and during the Korean War, when access to foreign exchange was very limited. It also remembers the difficult years after the Great Leap Forward (1958 onwards) when gold was sold abroad to alleviate famine. To these minds the "commoditisation" of gold, to be sold like pork bellies or orange juice is anathema. They point to the large gold reserves of, for example, the US. This group is not in the ascendancy, though untoward world economic events could propel it into the decision-making process.

Another group is the economic policy makers, who worry whether true liberalisation can be achieved without renminbi (RMB) convertibility, and what the effect of convertibility will be on domestic demand for gold. Here the schools are split, with some asserting that convertibility is not a prerequisite, and that a domestic RMB-denominated market is sufficient. This latter point of view might be fine, if China's exchange rate is not seen as ludicrously out of line, or in need of competitive devaluation. The RMB began to deviate a little from its core rate in April 2000, and this may mark a turning point prior to China's access to the WTO. If so, the authorities will need to watch the international and domestic RMB gold price carefully to ensure that they do not diverge too widely.

Finally there are those for whom a free market in China is irrelevant, because they wish to move gold in and out of the country with the minimum of attention, and possibly regardless of the price. This sector might include such diverse groups as arms of the state itself, gold jewellery manufacturers who need a secure and steady supply of gold, and those for whom smuggling is a way of life. They are unlikely to be attracted by liberalisation.

Where is China's Klondike?

This is a question which many of the best minds in foreign gold exploration set themselves in the 1990s, when the world gold price was high. A few dozen companies, mainly Canadian juniors, set up shop in Beijing and the outback, and began to look at China's rich geology. Some of the majors, such as BHP, looked at what appeared to be major deposits, but turned out to be less rich than expected. It was however a falling gold price and the Chinese bureaucracy and legal system which defeated many. Doubtless the gold is there, but the guarantees, tax and legal structures which would attract large-scale foreign investment, such as that seen in Indonesia, are still not fully in place.

At the same time China is experiencing a shortfall in budget revenues which for the gold industry has meant cutbacks in investment in smaller mines, in unproductive treatment processes and in prospecting. Some Chinese mines are already in the US$280/oz cost range, so that further falls in the gold price could hit hard. It will be interesting under these constraints to see if China's official production can leap the targeted 200 tonne level in the 2000s, or whether it will stagnate in the 175-tonne range. A new super ministry, the Ministry of Land and Natural Resources, has been tasked with a national resource audit, and may perhaps bring more focus to these issues.

Just how much gold can China's 1.2 billion people consume?

The Victorian dream was that if every Chinaman (a politically incorrect term today) would wear his shirt tails an inch longer, the looms of Lancashire would run for a thousand years. This is now patently a fantasy.

The modern dream is for every Chinese couple to buy a pair of matched gold wedding rings and boost gold consumption, and to this end Shanghai TV soaps have been sponsored by jewellery stores. This has grafted the alien St. Valentine's day onto Chinese New Year as a major jewellery buying period. The small problem is that youth is unpredictable and seems to prefer platinum – a metal that China does not even produce but which is not subject to the same official controls as gold. Taste is so fickle. ■

John Adams was previously Manager for China at the Bank of England, and Adviser for China in the Project and Export Finance Division of Westdeutsche Landesbank's West Merchant Bank. He is at present engaged by the British Council as Technical Director for the China Financial Sector Training Scheme (FIST), and is building its Chinese language website. He runs his own China consultancy, China Financial Services, and is also author of an 'English-Chinese Dictionary of Finance' and 'Financing China's Electricity.' This article was excerpted from The Deregulation of the Gold Market in China. *Comments are welcome through the publisher's website at: www.amcd.co.uk or fax +44 (0)161 434 5105.*

LBMA News

By Stewart Murray, Chief Executive, LBMA

Membership Changes

BankBoston resigned its membership with effect from 9th June, 2000 as a result of its merger with Fleet Bank.

The contact details for Fleet Bank have changed to:
Fleet National Bank
London Office
39 Victoria St.
London SW1H 0ED
Tel (020) 7799 3333

The address for WestLB has changed to:
33 Gracechurch St
London EC3V OAX
Tel (020) 7444 6401

The Bayerische Vereinsbank has changed its name to:
Bayerische Hypo- und Vereinsbank AG
and is now located at:
Vintners Place
68 Upper Thames St
London EC4V 3BJ
Tel (020) 7634 3701

The Credit Suisse Group's membership is now in the name of Credit Suisse First Boston/ Credit Suisse First Boston International.

The phone number for Phibro Bullion has changed to:
(020) 7721 4555

The phone number for Cookson Precious Metals Limited has changed to:
(0121) 212 6429

The phone number for UBS AG has changed to:
(020) 7567 8000

International Associates

The first applications to be accepted for International Associates were approved on 12 June (see special feature on page 13)

*"Usually only two t*ts wiggle about when I do this."*
The winning caption from last month's contest was submitted by Andy Smith of Mitsui & Co UK Plc
The runner-up: "Raucous activity on the Khartoum Gold Fixing" was submitted by Howard Levine of Bear Sterns Futures New York.
Our thanks to all those who participated.

Good Delivery List

Additions

Gold

Japan – Nippon Mining's Saganoseki refinery, from 3 May, 2000.

Silver

China – Neimenggu Precious Metals refinery, from 7 June, 2000.

Name Changes

Gold and Silver

Bars from the AGR Joint Venture between the Golden West Refining Corporation and the Western Australian Mint now have common bar markings consisting of Australian Gold Refineries AGR Perth in lozenge with outline of swan on the left and three stacked bars on the right.

Committees

Management Committee

In recent months the Management Committee has been discussing various possible technologies which might form the basis of an electronic trading system to be used in the London market. Following a consultation with all members, a new committee, the Electronic Trading Committee, has been established under the chairmanship of Paul Copsey of Rothschilds to investigate the associated issues for the LBMA. The Management Committee has overseen modifications to the GOFO pages on Reuters whereby members' contribution pages are wiped down at 10:30 each morning, thus ensuring that the 11:00 am mean is based on refreshed and topical data. Other subjects discussed include the new codes being prepared to replace the London Code of Conduct. The LBMA is working with the Financial Services Authority to produce a bullion appendix for its Inter-Professional Code and also with the Bank of England on a similar appendix to the Non-Investment Products code which it is drafting.

Public Affairs Committee

The main subjects considered by the Committee recently have been the LBMA Precious Metals Conference to be held in Istanbul on 21/22 May, 2001 and the Biennial Dinner, to be held in September this year. The guest speaker at the dinner will be the Right Hon. Michael Portillo; Sir Evelyn de Rothschild will respond to him. Invitations to the dinner have been sent to invited guests and members. Finally, the arrangements for the LBMA autumn Seminar have been provisionally agreed. The event will take place on the evening of 9 November and will focus on e-commerce.

Physical Committee

Apart from approving the above-mentioned applications from refineries for inclusion on the Good Delivery Lists, the Committee has also granted Approved Weigher Status for Silver to VIAMAT International with effect from 3 May. Members of the Committee are now working to update and combine the various agreements that govern interbank trading in bullion, such as the Market Practice Agreement and the Letter of Understanding. Four of the clearing companies are continuing to fund the development of an automated matching system to facilitate bullion clearing.

Golf

John Coley writes:

Despite some appalling weather conditions all through the morning, 39 competitors teed off in the LBMA annual golf day at The Drift GC. Perhaps the only happy man was the professional who did a roaring trade in waterproofs. In the very trying conditions, Peter Beaumont of UBS produced an excellent performance of 37 points to comfortably take The Jack Spall Trophy with Phil Barton of Tradition in 2nd place. Jurg Anghern of Premex won the guest prize. The conditions in the afternoon for the Tradition Team Trophy could not have been a greater contrast with warm sunshine and blue skies. The winning team in a keenly fought and close contest was Phil Barton, Doug Bull, Tony Casey and Alan Wallis.

Our thanks are due to Brambles, VIAMAT and Mitsui for their generous sponsorship of the event and to the companies who contributed to prize table.

Next year we shall return to Brickendon Grange in Herts and details will be published in due course. ■

Market Moves

Niel Taitt joined UBS Warburg as a Director on 16 May 2000.

Prior to joining UBS, Niel spent the past 15 years working in the Bullion Department at JP Morgan on both the trading and marketing sides. He covered the Middle East and Latin American sectors, concentrating on central banks and producers.

At UBS he has primary responsibility for marketing both gold and silver to the North and Latin American sectors.

Clare Ferguson joined Credit Suisse First Boston on 9 June to augment the central bank coverage team.

Clare completed her Masters of Engineering Science at Oxford University in 1992, shortly before joining the graduate training program at N M Rothschild & Sons Limited in the Treasury Division. She spend three years working in the Credit Risk department, progressing to lead a team. She then transferred to the dealing room, where she spent the next four years in a variety of sales and marketing roles covering currencies, interest rate products and precious metals. Her last two years were spent focussing on Central Banks particularly for precious metals transactions.

Clare will be based in the London office of CSFB.

DIARY OF EVENTS

24 - 26 July
The Diggers and Dealers Conference "Forum 2000",
Palace Hotel, Kalgoorlie, Australia.

31 August-1 September
3rd Annual RNA China Gold & Precious Metals Conference,
International Convention Centre, Wu Zhou Guest House, Shenzhen Special Economic Zone, PRC

6-7 September
Las Vegas Investment in Mining,
Las Vegas
International Investment Conferences,
6310 Sunset Drive. Miami, FL 33143-4823, USA.
Tel: (+1 305) 669 1963.
Fax: (+1 305) 669 7350.
iiconf@iiconf.com

13 September
GFMS Precious Metals Seminar in London

15 September
GFMS Precious Metals Seminar in New York

21 September 2000
LBMA Biennial Dinner, Gibson Hall, guest speaker, The Right Hon Michael Portillo, MP

9-12 October
MINExpo International 2000 and XVIIIth World Mining Congress, Las Vegas
National Mining Association
Contact Kim Boscia
Tel: (+1 202) 463 2611.
Fax: 463 9799.
kboscia@nma.org
www.MINExpo.com

17-20 October
IV Sonora Mining Seminar 2000,
Centro de las Artes, Universidad de Sonora
Hermosillo, Sonora, Mexico.
Organizer: AIMMGMAC Distrito Sonora,
Tel: +52 62 12-26-22
josetala@aimmgmac-son.org.mx

18-20 October
GME 2000 Goldfields Mining Expo,
Kalgoorlie, Western Australia.
Contact Clive Holt, marketing coordinator, GME 2000,
Tel: (+61 8) 9021 2466.
Fax: 9021 1402.
admin@gmexpo.com.au
www.gmexpo.com.au

29 October-1-November
2000 New Zealand Minerals & Mining Conference, New Zealand.
Vivienne Bull, New Zealand AusIMM.
Tel: (+64 9) 373 5917.
Fax: 308 9966.

1-3 November
African Mining – Exploration & Investment Opportunities, Perth, Western Australia.
Contact: Ms Diana Lauzi, AJM Conferences,
Tel: (+61 2) 8235 5313.
Fax: 9290 2577.
Diana.Lauzi@informa.com.au
www.ajmafricanmining.com

1-4 November The National Western Mining Conference, The Broadmoor, Colorado Springs, Colo.
Tel: (+1) 800/634-7711.

6-8 November Investing in Central and Eastern Europe & Central Asia, Berlin, Germany.
Contact: Evelio Garavito, International Investment Conferences
Tel: (+1 305) 669 1963.
Fax: 669 7350.
iiconf@iiconf.com

9 November
LBMA Autumn Precious Metals Seminar

13-15 November
Minerals Engineering 2000, Cape Town, South Africa.
Contact B.A. Wills, Minerals Engineering International
Fax: (+44 1326) 318 352.
bwills@min-eng.com

26-27 November
Western Investment in Mining, San Francisco
Contact: Martin Rothman,
International Investment Conferences,
Tel: (+1 305) 669 1963.
Fax: 669 7350.
iiconf@iiconf.com
www.iiconf.com

Blue Mosque, Golden Dreams

Editorial Comment by Stewart Murray

Selecting Istanbul as the venue for next year's LBMA Precious Metals Conference was in the end an easy choice. This is not just because of the city's historical role as a trading centre for precious metals and the tradition of investing in gold – both coin and jewellery – which still finds echoes in the Grand Bazaar today. More particularly, the past decade has seen the development of an increasingly well-organised and sophisticated precious metals business, including not only an efficiently run exchange but also a number of large and well-equipped jewellery manufacturers.

The technical prowess and the marketing strength of the jewellery sector are reflected in the export figures, particularly those to the United States. This success did not come about by accident: its foundations go back to the late 1980s and the decision to liberalise the economy in general and the gold market in particular. One of the first important reforms was to allow duty-free import of gold, initially by the central bank which, for the first half of the 1990s, acted as the first point of supply to the gold trade. Later – in mid-1995 – this role was assumed by the newly established Istanbul Gold Exchange, which immediately became the point of entry for virtually all of Turkey's gold bullion imports.

The effect of liberalising the bullion import regime was to stimulate the growth of the formal jewellery manufacturing sector. The 1990s saw the rapid growth of a number of old-established and in some cases newly formed companies and on the other hand the relative decline of the traditional atelier sector. At the same time, the industry steadily improved the styles, finish and range of jewellery designs which it produced, initially in the 14-carat sector, much favoured by younger urban buyers and many of the tourists who visit the resorts on the south coast each summer. But in recent years this trend was also seen in the 22-carat items that are traditionally favoured by the rural population in Anatolia. Istanbul's strategic position astride the Bosphorus has meant that its gold trade has often played an important role in the regional flow of gold bullion. This entrepôt function continues today, with significant quantities of the metal being re-exported unofficially to neighbouring countries where the bullion import regime is much less liberal.

But there is also a supply side to the precious metals business in Turkey. With its mountainous country like Turkey is, not surprisingly, a rich source of mineral resources, including base and precious metals. Silver is produced both as a by product of copper and zinc mining and as a primary metal at the old-established Hundredth Anniversary mine developed by Etibank. Gold resources also exist but the developers have faced problems in persuading the authorities that gold extraction is safe in the face of a well organised anti-mining campaign mounted by environmental lobbies. Personally, having spent a considerable amount of time analysing the Turkish market in a previous existence, I am delighted that the LBMA opted for Turkey for next year's Conference. I look forward to renewing my contacts with many of the wide range of companies that comprise this dynamic sector and who knows, I might at last even have time to see the Blue Mosque! ■

Correction

In the last issue of the *Alchemist*, the photo caption on the cover incorrectly stated the value of gold tola bars sold in Dubai as $10 million. The figure should have been $10 billion.

facing facts

By Paul Burton
Editor, World Gold

The shape of the gold mining industry continues to change, while there are some signs that size might be changing as well. Both changes are ultimately driven by the low gold price environment.

Consolidation, one of the most discernible trends within the industry in recent years, was given fresh impetus with the news in June that the world's fourth largest producer, South Africa's Gold Fields, was to merge with Canadian royalty company Franco-Nevada Mining. Although the immediate impact on production will be minimal, Gold Fields will simply gain another 230,000 oz/y to add to its 1999 production of 3.98 Moz, longer term this new cash-rich, Toronto-based giant will surely be in a strong position to capture other gold producing assets. It is known to covet certain Australian operations.

Also, in the future it will have the opportunity to develop on the extensive land positions that Franco-Nevada holds on Nevada's Carlin Trend, the largest goldfield outside of South Africa's Witwatersrand Basin. With Franco-Nevada's deal-making skills and Gold Fields' underground mining capabilities and vast gold reserves, a formidable international player is set to be formed when shareholders vote on the proposal in August.

Before this deal was announced, Gold Fields was able to secure certain assets of the mothballed Teberebie mine that lies adjacent to its Tarkwa mine, in Ghana. The acquisition will assist Tarkwa to expand production from its current level of 250,00 oz/y to the target 500,000 oz/y within a few years.

The deal for Teberebie was engineered after Ashanti Goldfields made a successful bid for Pioneer Goldfields, which owned 90% of the Teberebie mine. The deal will enable Ashanti to extend by eight years the life of its 80%-owned Iduapriem mine, which also lies adjacent to Teberebie. The estimated production rate will be 150,000 oz/y at a cash operating cost of around US$200/oz.

In April, another hungry and powerful South African predator, AngloGold, secured significant stakes in two of Africa's most promising development projects.

The first was the Geita project, in Tanzania, owned by Ashanti. AngloGold, is to pay US$205 million in cash to Ashanti for a 50% interest. AngloGold will also "procure or provide" project financing for Geita of US$130 million. Financially weak Ashanti will receive an immediate cash injection of US$335 million to pay down debts owed to its various lenders and hedging counterparties.

Geita is designed to produce 500,000 oz/y of gold at a cash operating cost of less than US$180/oz for the first five years. Commissioning is imminent and the first gold was poured in June.

The second of AngloGold's acquisitions concerned Morila, in Mali. AngloGold will acquire half of the 80% interest held by London-listed Randgold Resources in the high-grade Morila gold project for US$132 million in cash. AngloGold and Randgold will thus each hold 40% in the project, with the balance of 20% held by the Government of Mali. Construction of the US$85 million project is already 30% complete. The operation is expected to yield 420,000 oz/y at a cash operating cost of US$137/oz over a 14-year life.

In other consolidation activity Australia's Normandy Mining has restructured its operations giving it a greater focus on gold.

The main elements of the April restructuring are the raising of Normandy's interest in Great Central Mines, which owns the Bronzewing, Jundee and Wiluna gold mines in Western Australia, from 57.5% to 100%; the distribution to Normandy's shareholders of the group's effective 65% interest in a magnesium project in Queensland; and the disposal of Normandy's other industrial minerals assets. The move to take on full ownership of Great Central Mines has a intuitive logic to it that should allow for better exploitation of the Yandal belt deposits and have the effect of increasing Normandy's attributable gold production to an annualised 2.3 Moz.

During the March 2000 quarter Canadian mid-tier producer Meridian Gold made a significant impact on the production scene with the opening of its El Penon mine, in Chile. This high grade, silver-rich underground mine contributed 61,000 oz at a total cash cost of US$71/oz in its maiden quarter. Total production costs were US$112/oz.

Meridian Gold's production rose by 134% from a year earlier to 114,823 oz at an average total cash cost of US$111/oz (1999: US$200/oz) and a total production cost of US$175/oz (1999: US$293/oz). The company, whose other mines are Jerritt Canyon (30% owned) and Beartrack, is now one of the lowest cost producers in the industry.

Country of domicile	Production (Moz)	Total cash costs (US$/oz)	Total production costs (US$/oz)
South Africa	3.60 (-2%)	228 (+1%)	258 (+4%)
Canada	2.78 (-1%)	160 (-1%)	243 (-5%)
US	2.34 (-6%)	183 (-5%)	241 (-2%)
Australia	2.18 (+0)	203 (-5%)	262 (-2%)
Other	1.23 (-)	na	na
Total	**12.12 (-2%)**	**196 (-2%)**	**251 (-)**

Figures in parenthesis represent changes from March 1999 quarter.

One disturbing development in recent weeks has been the incidents of unrest around the globe that have affected gold production. There have been attempted coup d'etat in such seemingly idyllic locations as the South Pacific islands of Fiji and Solomon Islands, protests and violence in the more volatile Indonesian arena, and civil unrest in Zimbabwe. In each case gold mining activity has been threatened, if not suspended, and workers have been intimidated.

In Fiji, the unstable political situation following the May coup attempt temporarily disrupted production at Emperor Mines' Vatukoula mine.

Less than three weeks later, on 4 June, tensions rose in the Solomon Islands where a militia group calling itself the Malatian Eagles took the Prime Minister and the Governor General hostage in what appears to be an ethnic land dispute. On 8 June, Delta announced that the political violence and lawlessness around the mine had escalated to such an extent that it deemed it unsafe to continue operations. Work at the mine was suspended.

The same weekend, UK-based precious metals company Lonmin closed one of its gold mines east of the Zimbabwean capital Harare for two days after managers at the mine were threatened by supporters of the ruling Zanu PF party.

Throughout May, Rio Tinto experienced operational problems at its 90%-owned Kelian mine, in Indonesian. The interruptions were caused by protests from local residents, who are fighting for compensation for land used to build the mine's only access road.

Finally, and despite the positive project developments mentioned above, figures for the March quarter published in World Gold Analyst in June show that the low gold price might at last be beginning to bite into gold production. A year-on-year analysis of the March 2000 quarterly results shows that production has fallen by marginally. Overall, production from the fifty core companies fell by 2% from the levels of a year earlier. Although this fall in itself is not large, when put into the context of more recent quarterly results it does show a declining trend in production. In fact the figure is the lowest since World Gold Analyst starting compiling aggregate figures in mid-1998. ■

The *Alchemist* is published quarterly by the LBMA. For further information please call Susanne M. Capano, Editor, Stewart Murray or Stella Thompson
LBMA Executive
6 Frederick's Place
London EC2R 8BT
Telephone: 020 7796 3067
Fax: 020 7796 4345
www.lbma.org.uk
Email: alchemist@lbma.org.uk

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CHINA GOLD & PRECIOUS METALS CONFERENCE

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