Alchemist

LBMA

LONDON BULLION MARKET ASSOCIATION

ISSUE 3

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Spotlight on Gold

Editorial Comment by Jeffrey Rhodes

Welcome to the third issue of what, we believe, is rapidly becoming required reading by followers of precious metals around the globe. Certainly our last edition was truly international including contributions from Jesus Arvelo, Head of the Central Bank of Venezuela's Gold Department and Ted Arnold of Merrill Lynch.

The highlights for many though, were the thought provoking and controversial views expressed by Christopher Fildes, Financial Columnist for the Daily Telegraph and Spectator, on the role of central banks in today's gold market. We would be interested to hear the counter arguments from what is still the most important sector of the market and invite contributions from our friends in central banks.

Turning to this issue, the international perspective is maintained with contributions from South Africa in the form of Jessica Cross, who focuses on the implications of two of the largest hedging transactions in the history of the gold market. The USA is represented by Jeffrey Christian of the CPM Group, who considers the apparent gold production shortfall. Martin Stokes of JP Morgan flies the flag in London with an assessment of the gold lending market, while UBS's Andy Smith submits the Swiss view on gold lease rates in his own unique and entertaining style.

It certainly looks as though this could well be a vintage year for gold and the other precious metals, with the yellow metal having broken out of the shackles of the tight two year trading range of $370 - 395 to reach the holy grail of $400 dollars. The new year rally which had its origins in the spike in gold lease rates back in November, culminated in gold fixing at 416.25 on the 4th February, its highest level since 22nd February 1990. The price actually posted an intra-day trading high of 418.

Although the London market does not publish turnover data, dealers reported heavy volumes in often hectic trading. In New York, the Comex registered its highest ever monthly volume of 1,384,732 contracts or over 138 million ounces, breaking a record that had stood for 13 years.

Christopher Fildes' piece contrasts somewhat with one or two comments made in the press over recent months which have not been as accurate as perhaps they might. While the market should be pleased with gold's return from five years in the newsprint wilderness, some of the reporting may have done more harm than good. It is imperative, therefore, that we fill the information vacuum some journalists are writing in. Our task is to inform, to educate and to be accessible and responsive. As a market we must work with and embrace the media much more effectively and openly allow them to balance their reporting, while maintaining our own traditional integrity by ensuring that comments only emanate from experienced responsible representatives of each of our houses. As a result, comments that refer to the gold fixing on the Comex should become history.

As ever, we are always looking for new ideas, constructive suggestions and interesting contributions. Please contact me at Standard Bank on 0171 815 4210, or write to Chris Elston, Chief Executive, LBMA, 6 Frederick's Place, London EC2R 8BT.

Jeffrey Rhodes

South Africa

Why now ? *by Jessica Cross*

The past six months have seen the execution of the two largest hedging transactions in the history of the gold market. Ironically, this volume came from South Africa; a gold producing region not known for its propensity to enter into the price protection programmes of such magnitude or tenure. What then prompted Gengold, in August 1995, to hedge 2.9 million ounces of metal to finance its Beatrix developments; and JCI, during the last quarter of 1995, to hedge no less than 7.3 million ounces associated with the company's expansion at South Deeps, Western Areas? More importantly, do these developments imply thatother transactions of similar structure and volume could be forthcoming from that region, and what does it mean for the future gold market?

The most striking characteristic common to both these transactions is the fact that they were structured to finance developmental work, and hence those involved in their design were concerned mainly with capital requirements, future cash flow projections and debt management. Therefore, unlike so much of the producer hedging emanating from North America and Australia since the mid-1980s, there were factors other than primarily the international or local gold price, central to the decision-making. Thus, this decision to hedge almost, but not completely, divorced from the gold price, gives insights to the rationale behind the programmes and what could possibly be expected in the future.

Historically, the South African mining houses have been considered rather reluctant hedgers. Initially, activity was limited largely because the authorities curbed hedging and permission was required to enter into even the most basic of strategies. With time, however, the South African Reserve Bank recognised the growing operating and financial constraints facing the mining industry. In response, it gradually began to give the producers increasing latitude to implement more sophisticated hedging. But this was not the only factor that generated a change in hedging philosophy.

Throughout the 1980s and until the dual currency mechanism was abolished, the South African Rand depreciated against the currencies of its major trading partners. This implied that the mines enjoyed a natural priced hedge, since the vast majority of operating costs, including a massive wage bill which represented some 50% of all working costs were, and still are, paid out in Rand. Contrary to the expectations of many market commentators, once the Financial Rand was abolished during the first quarter of 1995, the Commercial Rand began to stabilise against the Dollar as the accompanying chart shows.

This has been due largely to massive inflows of capital into the country, but the net effect was that the mining houses found themselves no longer protected by currency-induced high local gold prices.

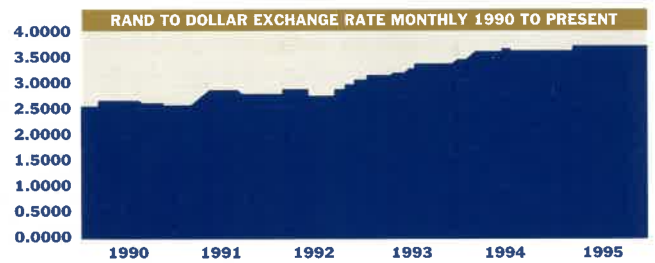
A second major factor concerns local interest rates which, compared to Europe, Japan and North America, remain high in both nominal and real terms.

Even with sharply higher lease rates, therefore, the South African producers could secure a contango that can only be described as the envy of their Australian, American and Canadian mining colleagues. Gengold elected to forgo some of this contango with which it bought a series of options associated with the Beatrix transaction. But even with the options paid for, the company recurred a contango of no less than 9%. JCI decided to secure the full contango of 10.6% for the 8.5 year transaction, which effectively pre-empted the company calling for a rights issue in order to finance the project.

A second striking characteristic is the length to which both Gengold and JCI have gone to allow the maximum participation in any upward movement in the gold price. Gengold achieved 70% while JCI settled for at least 55%. Both were achieved via a series currency and/or metal options, but demonstrate the companies' concerns relating to how shareholders perceive these strategies. Gone are the days when companies simply sold forward into a rising gold price and hence, left themselves open to criticism relating to capping a fledgling price rally or locking into a price at the expense of future appreciation.

Although considered a latecomer to the hedging market, as these two deals demonstrate, the mining industry has come a long way in terms of how it views hedging and how it ought to be done. The transactions are no longer knee jerk ones in response to a short term price movement; they have long term operational plans at the core of their structure. Furthermore, the mining community is acutely aware of the potential reactions of both the shareholder and the market in general, and hence their willingness, and indeed their wish, to share with the market the details of the strategies.

Beatrix and Western Areas are not the only mines undergoing long term development in South Africa. There are, and will be, others which will be subject to expansion or even merely the need to re-finance. To consider these transactions, therefore, as once-off project specific events, not to be repeated, would be to ignore the fact that the South African mining industry is essentially a long term survivor. Financial or operational limitations that they may be currently experiencing are not at all new to the industry in general. The recent fall in South African output, compounded by the announcement that Anglo American is planning to close shafts, generated press comment to the effect that the industry as a whole is on a steep decline. While we may indeed see some casualties in future months or years, are these conclusions perhaps a little too general and overstated? The counter argument is that there is simply too much in the way of infrastructure invested in that sector to discount its future, and the hedging developments of the past six months have demonstrated the industry's will not only to survive, but to do so profitably.



US$/ZAR	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1990	2.5562	2.5452	2.6130	2.6553	2.6448	2.6640	2.6295	2.5733	2.5700	2.5445	2.5240	2.5310
1991	2.5628	2.5387	2.6470	2.7405	2.7949	2.8640	2.8810	2.8711	2.8360	2.8305	2.7949	2.7670
1992	2.7793	2.8153	2.8810	2.8785	2.8474	2.8098	2.7533	2.7632	2.7980	2.8835	2.9878	3.0119
1993	3.0688	3.1226	3.1791	3.1674	3.1762	3.2330	3.3501	3.3646	3.4070	3.3951	3.3651	3.3760
1994	3.4097	3.4498	3.4540	3.5887	3.6329	3.6290	3.6683	3.5990	3.5570	3.5387	3.5350	3.5610
1995	3.5389	3.5590	3.5980	3.6013	3.6596	3.6630	3.6519	3.6472	3.6630	3.6519	3.6472	3.6630
Bank Rate	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
1990	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
1991	18.0%	18.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
1992	17.0%	17.0%	16.0%	16.0%	16.0%	15.0%	15.0%	15.0%	15.0%	15.0%	14.0%	14.0%
1993	14.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	12.0%	12.0%	12.0%
1994	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	13.0%	13.0%	13.0%	13.0%
1995	13.0%	14.0%	14.0%	14.0%	14.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%

Jessica Cross *gained a science degree from the University of the Witwatersrand before joining the Anglo American Corporation in Johannesburg in 1980. There she was trained as a commodity analyst covering the base and precious metals. In 1987, she joined Consolidated Gold Fields in London to work primarily on the authoritative Annual Gold Survey, but also to complete platinum research. She co-edited the 1989 Gold Survey before joining the economics department at The RTZ Corporation plc as their gold analyst.*

After completing an honours degree, she went on to complete a doctorate at the University of Nottingham, evaluating the financial derivative products of gold and their influence on the gold price. In 1994, she launched Crosswords Research and Consulting, her own consultancy, and is continuing with her research in base and precious metals derivatives and commodity market analysis in general. As part of Crosswords, she has recently published her first book: New Frontiers in Gold – The Derivatives Revolution, Rosendale Press, London.

LONDON BULLION MARKET ASSOCIATION

"Why golden futures suddenly turned sour" *by Martin Stokes*

"Why golden futures suddenly turned sour" was an inflammatory headline above a somewhat inaccurate article on the topic of gold lending in one of the London newspapers on 30th November 1995 after the market moved into backwardation for the first time in over 20 years. The ensuing press coverage given to the subject arguably afforded the Bullion market the greatest "publicity" since the story of the Johnson Matthey affair, with journalists desperately seeking evidence of disaster in the marketplace. Perhaps the attention given to the gold lending business was so intense because it is so little understood by the general public, who may not even be aware of its existence.

BACKGROUND The gold lending market is the very cornerstone of the Bullion business, being the vehicle which supports not only the greater part of the global jewellery trade but also the widely discussed hedging programmes of producers. Its existence stems from the basic historical imbalance of activity in the forward market – jewellers are under no pressure to hedge their future requirements, having a price elastic end-consumer in the general public, while producers are generally more price sensitive. Moreover, the contango which makes forward selling so attractive to producers, makes forward buying generally unattractive. Thus dealers having few forward buyers on their books must hedge their forward purchases by borrowing gold and selling it in the spot market. Estimates of the size of the gold lending market today oscillate around a figure of 2,500 tons ($32 billion approx), most of which is traded on a physical loco London basis across the accounts of LBMA members. The Bank of England, in its supportive role in the London market, provides the major conduit through which central banks can access the commercial market confidentially and efficiently.

As with every market, there have to be benefits to both sides. For the lenders, yield for an otherwise dormant asset is the obvious attraction. However, this yield must be balanced against limits of both credit and tenor. These limits are of particular concern to central bank lenders who, after all, are lending reserves which arguably are their country's last line of defence. Thus their required counterparties are first class names and the preferred term is comparatively short, certainly within one year. Moreover, for obvious reasons, relatively small percentages of official reserves are committed to the market irrespective of yield. This is truly a market of demand and supply, untroubled by governmental fiscal policy!

USES FOR GOLD LIQUIDITY The commercial banks put this gold liquidity to use in a panoply of products. The simplest structure is a gold loan – the bank passes on the gold on a lease basis to clients with a credit spread. Such customers could be jewellery fabricators who, being unwilling to take price exposure, borrow gold for the period of manufacture before sales. Gold liquidity is also used to support consignment stocks, traditionally lodged with Middle East or Japanese wholesale consumers.

However, the most important activity supported by gold loans is that of dealers buying forward, usually from producers. These clients seek to lock in current prices plus a contango for the future delivery of their as yet unmined gold. Essentially the contango is calculated by deducting the gold deposit rate from the currency (usually US$) deposit rate. This activity hedges the miner against falling prices, but leaves him exposed to opportunity loss should prices rise. Therefore miners rarely lock in more than a carefully calculated percentage of their future production.

Another hedging method utilized by miners involves their taking a gold loan instead of a currency loan to develop their prospect. The gold is sold immediately for cash and the loan is repaid out of future production. The economics are essentially the same as a forward sale, but the bank has a greater credit exposure to the miner and the rate charge will reflect the increased risk.

Options and more complex derivatives are other risk management products that also rely upon gold liquidity. For example, should producers wish to sell calls or buy puts, then the options dealer will generally sell out the underlying hedge for a forward value to his own in-house forward book which will require liquidity cover as a result.

THE NOVEMBER SQUEEZE The structure of the deposit market has been evolving over the last 20 years as more producers feel the need to hedge in a stagnant market and more long term holders are attracted to the yield for their otherwise non-performing asset. However, there is a limit to the availability of central bank's gold; many of the largest holders have policies not to lend, and if their reserves are deducted from the approximately 35,000 tons of total official holding then the estimated 2,500 tons of loaned gold becomes a significant percentage. Moreover, ongoing sales programmes are slowly reducing the available material.

Late last year, a confluence of factors contributed to the extreme tightness in the gold lending market. Historically there is a "seasonality" about rates over the turn of the year. This is partly explained by the Christmas bulge in the jewellery business and the concern that some central banks take back gold for reporting purposes over year-end. Additional factors in late 1995 were significant hedging programmes from South African miners (on top of ongoing activities from US and Australian producers) and relatively low prices, encouraging the dealers to place out larger consignment stocks with physical consumers. Finally, some bearishness in the Comex market had afforded dealers the opportunity to buy gold futures (and sell spot) at initially attractive arbitrage levels.

Moreover, the wish by the borrowers to match their maturities to those of the lenders had been taken to an extreme. Over the years some hedgers, not wanting to pay the premiums charged by the bullion banks for longer-dated (particularly more than one year) transactions, have decided to fix the currency interest rate component of a forward deal and leave the gold portion on a floating basis, charged as a lease rate. Thus the central bank's preferred term would be matched by the borrower's, though of course this does not give a locked-in term cost structure for the latter, who sacrifices certainty for economy.

On account of one of the anomalies created by the physical nature of the gold market, overnight gold has no deposit value and all positions must be covered on a tom/next basis, generally the cheapest point of the curve. The apparent logic of running a short position down to the very shortest time horizon therefore seemed attractive to an increasing number of market participants late last year. Such a strategy is of course dangerous, as there is no time for manoeuvre should liquidity dry up. The discomfort of these squeezed shorts was clearly one of the forces which pushed the market to extremes. More recently, many of these clients seem to have repositioned their interest further along the curve!!

A large part of gold liquidity demand springs from the fact that gold borrowing is undertaken because it is cheaper than US$ funding. Therefore, there is theoretically a natural cap – at least over the medium term – at $ LIBOR. However, this will not prevent short term shocks as seen in November, as decisions to unwind positions cannot be taken swiftly. This is also the problem with central bank liquidity – generally those lenders are fully lent out to their conservative limits, and given that their alternative yield is zero, maturities tend to be rolled over, making supply somewhat inelastic. Decisions to increase lending activity must be taken at very high levels and this takes time. With gold deposit rates approaching those for the DM, however, some central bankers who view gold as just another part of the reserve management equation, are doubtless making their voices heard.

Other evidence of the self-balancing nature of the market comes from the demand side. For example, higher gold lease rates have been a factor in recent decisions to repurchase short positions. Indeed, hedging to enhance yield is beginning to look uneconomic as currency rates ease and gold rates rally. A forward premium of only $10 for a year is beginning to look rather skimpy.

THE PRODUCER IMPERATIVE However, some producers do not have the luxury of viewing hedging as a yield enhancement. Miners with rising costs, particularly those in South Africa and Australia, are being forced to hedge, or at least to buy put options out over a number of years duration in order to protect their margins and to facilitate the raising of capital for expansion. This capital must come either by way of rights issues or by banks lending, and such funding requires the comfort of gold price protection. As the forward sales are undertaken in a high yielding local currency, the benefit is much more attractive. However, these forward sales and the large option deltas will require fixed long term gold liquidity and will contribute to the pressure on this area of the curve.

Logically, rising costs for the mining companies who produce over 35% of the Western world's annual production should create a fundamentally constructive outlook for gold prices. However, the reality of declining grades and, in South Africa, a more stable currency and a workforce with greater expectations, is creating a harsh environment where hedging is becoming a more necessary tool for ensuring the economic viability of increasingly marginal mines.

With these scenarios in place it is hardly surprising that the gold market generally has entered a more interesting time and the curve of forward deposit rates has assumed a more conventional shape as the demand for liquidity is now more focussed at the long end. The short end of the deposit market has eased particularly in response to speculative buying in the April Comex contract which has allowed dealers to buy spot and sell the futures at attractive yields. Moreover, as we move further into the New Year almost all of the seasonal factors mentioned earlier are turning around.

GOLD INVESTMENT FOR YIELD Another potentially bullish factor for price is that gold rates in excess of 2.5% should encourage buyers who are prepared to invest for yield, particularly in times of declining currency rates. There has certainly been some buying from Japan where currency yields have fallen to virtually zero, and with Swiss Franc rates around 1.5% and DM rates around 3.25%, this argument becomes more compelling for Europeans. Should such investors come to the market in any size, gold deposit rates will ease even further at the short end – one presumes that these participants are not prepared to invest in and therefore to lend gold for the longer term.

CONCLUSION – THE FUTURE Therefore, the challenge for the Bullion banking community remains that of bridging the gap of tenor between the lenders, who for reasons of flexibility or conservatism are only prepared to place deposits of around three months duration, and the borrowers, in some cases dealers' in-house options books, whose preferred term is probably three years!

As the market becomes more mature it is probable that some central banks will be attracted by the significantly improved yield available for longer term commitment, perhaps on a collateralised basis. Moreover, the market has been inventive in offering longer term fixed for floating, cash settled swaps settled on the benchmarks of LIBOR and GOFO. The use of these by lenders may well increase. Bullion banks have limits as to how much of a mismatch of tenor they can run on their books and they will pay well to reduce their risk. Yield opportunity beckons for providers of longer term liquidity!

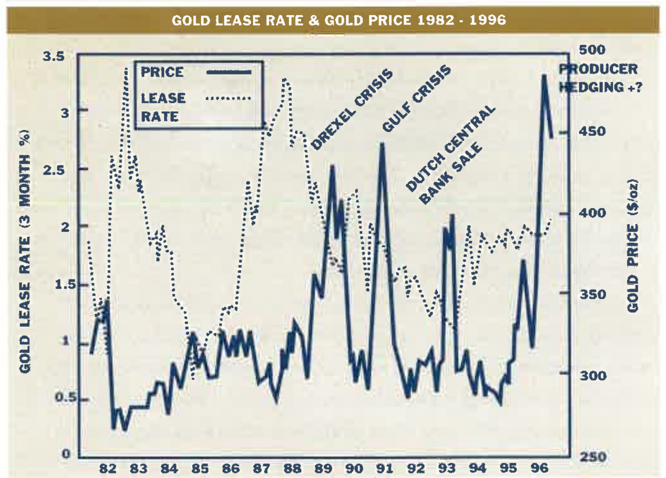
If one considers the longer term horizon, projected gold production numbers, particularly from Australia, Central South East Asia and South America, look set to escalate dramatically. If the mining companies concerned are obliged or wish to hedge for whatever reason, then it is clear that the market will need to unlock fresh areas of liquidity to cover this potential demand. It is unlikely that the demand for long-dated fixed material will ever be fully met, but at the shorter end and on a floating basis it is probable that supply will be teased out eventually by yield.

What is sure is that a return to the days of gold at 3/8 per cent for a three month deposit have passed, and that the gold lending market will continue to be volatile at higher levels, almost certainly giving the central banks a better return than they ever expected for their barbarous relic.

Martin Stokes - *Vice President, Bullion/Commodities JP Morgan & Co Inc, London*

A new lease of life for gold? *by Andy Smith*

George Bernard Shaw once wrote that the news media are "unable to discriminate between a bicycle accident and the collapse of civilisation." A timeless reminder why the hullabaloo over gold's two day backwardation last November - short term gold lease rates rising above money market rates - should be treated with caution. Now the dust has settled, the market implications of potentially tighter gold liquidity can be considered more calmly.



Bullish, bearish, confusing, or all three?

Those of us in the gold market who haven't yet burned all the text books will remember that theory is about as clear as mud on the relationship between lease rates and price (of any commodity). Short term backwardation is normal in oil, yet it has shown no trend in its spot price for four years. And if gold is viewed as a currency, then a rise in lease rates (like a rise in US, UK or German money market rates) might point to a devaluation ahead; more interest has to be paid to hold the stuff.

If theory is a poor guide, the data are worse. In fact, there's a negative relationship between (3 month) lease rates and spot gold prices since 1982 (of -0.16, where -1 would be a perfect negative correlation). Conclusion: when lease rates rise (as mining companies sell forward?), price tends to fall? Not so fast. Between 1982 and 1987 this relationship was very negative indeed (correlation -0.60), but since then it has disappeared, statistically. And even this tattered route map is no guide through today's terrain, for lease rates are still stubbornly well above the previous experience used to estimate even these ropey relationships.

Of course, as Shaw's contemporary Oscar Wilde recognised: "the only thing worse than being talked about is not being talked about." So there's no doubt that the gold squeeze helped promote gold from the footnotes to the front pages just before Christmas, when US funds were looking to fill their socks with new speculative ideas for '96. And while a lot of the discussion about lease rates may have been wide of the mark, the ill-defined but widespread feeling that 'something's changed' was spot on. The questions are 'what?' and 'for how long?'

On the 'what?', simply read the lips of major producers: "more and more of the producers...will be less willing to forward sell, purely because it makes less economic sense", noted Peter Munk, announcing Barrick's unwinding of a third of its 9 million oz hedge position. For given market interest rates and spot gold price, a tighter lease market (lower contango) naturally reduces the incentive to sell forward. Miners don't have to be bullish on the spot price to trim their hedges, but clearly they mustn't be bearish, or selling forward even at much reduced contangos would be welcome. And since most miners appreciate that the spot price can change (fall) for 1001 reasons unconnected with the lease market, the rush to remove hedges may be less than a stampede.

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Other impacts of higher lease rates attract less publicity but may be more profound for the market. For example, banks providing consignment stocks close to Middle and Far East end users at zero or near zero interest when market lease rates are 50-100 bp is one thing; foregoing 250-300 bp of interest may be quite another. Competitive banking pressures mean this practice won't change overnight. But if consignment stocks were run down, buyers might live hand to mouth, buying in smaller quantities but more often, and perhaps reducing price volatility.

Central bank reactions are harder still to predict. Of the 34,000 tonnes of gold held in official vaults, maybe only 10,000 tonnes comprise the lending pool (ie, excluding multilateral organisations, the USA, Switzerland and others with a long tradition of not managing their gold actively). Out of this pool, maybe 25%, say 2,500 tonnes, is lent. But this was at lease rates around 100 bp. Higher rates would eventually entice more lending from existing lenders (raising their lending limits) and from new, perhaps less inhibited lenders. (If it didn't, commercial banks wouldn't be doing their job properly!) And 'eventually' may happen just when the demand for borrowed gold (from producers) was falling.

Which partly answers the question : 'how long?' For the overwhelming consensus that 'good old days' of lease rates of 100 bp will never return is some reassurance that they will, isn't it?

Andy Smith *Union Bank of Switzerland (January 1996)*

The Mine Production Shortfall • The Reality Behind the Myth *by CPM Group*

Over the past few years the gold market has heard, often repeatedly, several recurring themes as to why a sharp rise in gold prices is inevitable. Meanwhile, prices fell until 1993 and, while they have risen since then, have traded between $380 and $400 for most of the 24 months since the fourth quarter of 1993.

One of the less credible "reasons" to believe that gold prices will rise has been the tired old truism that there is a "deficit" or shortage of newly mined gold, reflecting the fact that mine production of gold is less than fabrication demand.

This is a strange theory that was given currency in the silver market in the 1970s and 1980s, but neither stands up to statistical inspection nor tells us anything useful about the market. There is a simple reason for this: mine production of numerous metals, from copper, lead, aluminum and zinc, to steel, gold and silver, usually is less than fabrication demand. In all of these cases, this relationship between mine production and fabricators' metals needs has had little apparent effect on prices, except maybe in extreme conditions over very long periods of time.

In the case of gold, fabrication demand has exceeded mine production consistently since 1981, as the first chart illustrates. In eight of the 15 years since then, gold prices fell on a year over year basis. The second chart shows the lack of any visible relationship between these two factors.

Several things are wrong with this opinion.

First, using mine production as a surrogate for total supply is a mistake. In gold, more than 15% of total new supply each year is derived from secondary supply. Another 10% or more comes from exports from Russia, Uzbekistan and the other transitional economies. (While much of this represents mine production, the paucity of credible statistics from these countries, especially concerning secondary recovery and domestic fabrication demand, requires that the flow of gold from these countries into the international market still needs to be distinguished from other supply.)

The role of scrap as a source of supply is not limited to gold. In silver, perhaps 25% of total supply comes from secondary recovery and other miscellaneous sources.

In virtually all other metal markets, secondary supply accounts for anywhere between 10% and 35% of annual new supply, and often is a critical source of supply in order for total supplies to meet fabricators' requirements.

Second, the numbers simply do not add up to higher prices. As mentioned earlier, mine production regularly falls short of fabrication requirements, yet prices – for gold, and all of these other metals – rise and fall quite dramatically.

Statistically speaking, changes in the shortfall of mine production to fabrication demand explain only 13.7% of the annual changes in real, inflation-adjusted gold prices since 1968. Playing with lags reduces the role of the gap even more.

All right, it might be said, so the bulls got the semantics wrong. They meant total supply, which you say is more important than mine production, but they said mine production.

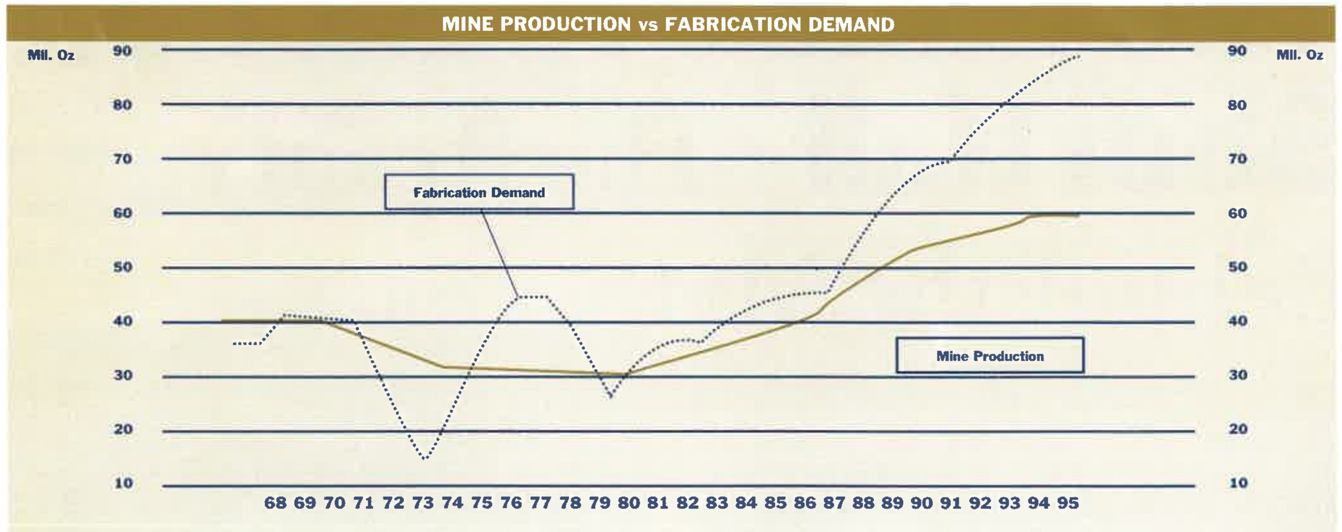
Granted, the relationship between new supply and fabrication demand is important, but substituting total supply for mine production in the calculations above only increases the predictive capacity of gold prices a few per cent.

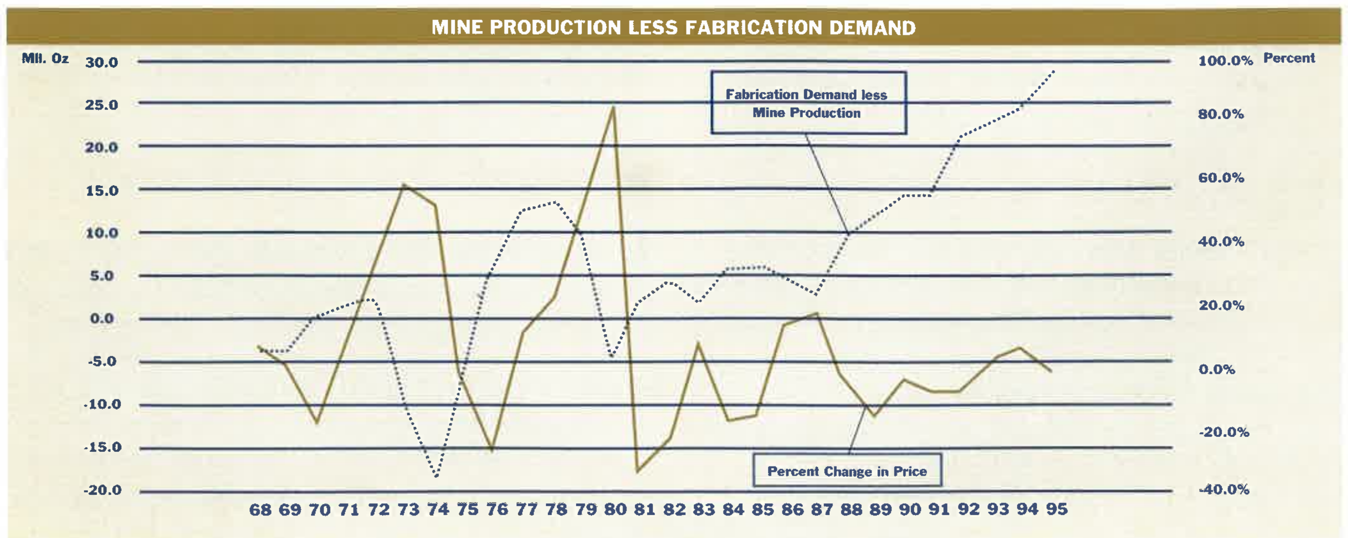
The shortfall of total new supply to fabrication demand explains 21% of the annual changes in real prices since 1968.

Clearly, something else is at work here. Actually it is several things. One is investment demand: changes in investment demand are much more dynamic – larger and more volatile – than are changes in mine production, total supply, and fabrication demand. They tend to affect gold prices much more than these other factors do.

Similarly, central bank transactions and changes in inventories exert important influences on gold prices, which are lost in the simplistic rubric that the "shortage" of gold will have to be reflected in higher prices, at least some day.

Extracted from CPM Group fourth quarter 1995 Precious Metals Gold Report





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LBMA News

Company News

- New Members: Bank of America National Trust and Savings Association London Branch, Chemical Bank and Engelhard-CLAL UK Limited were accepted as Ordinary Members with effect from 1 October 1995.
- Good Delivery Lists: Engelhard-CLAL UK Limited were granted Good Delivery status for gold from 4 October 1995; and PAMP SA of Switzerland and the National Bank of Romania attained Good Delivery status for silver from 1 October 1995 and 18 January 1996, respectively.
- Transfers to Former Lists:

  Gold and Silver: Engelhard Canada Limited
SA Johnson Matthey NV (Belgium)

  Gold: Engelhard SA (France)
Comptoir Lyon-Alemand Louyot (France)
Engelhard Limited (UK)
- Company Secretary: The LBMA's Registered Office address has shifted to 6 Frederick's Place, and the Chief Executive, Chris Elston, has taken over the role of Company Secretary from NM Rothschild & Sons. Our thanks to Adrian King at Rothschild for his work in this regard in the past.

Commitee Business

Management Committee

- Work is well advanced in the Working Party set up to produce a Bullion Definitions Addendum to the ISDA Master Agreement.
- We are looking at the possibility of expanding the information given on Reuters GOFO pages.
- HM Customs & Excise confirm that the new Fiscal Warehousing regime for silver will run in parallel with, and not replace, the Terminal Markets Order.
- Following the Budget, the VAT Special Accounting System for gold has been extended to cover alloyed gold grain.

Public Affairs Committee

- As indicated in the Editorial Comment on the front page, a panel has been formed to respond to press enquiries in an attempt to encourage consistent and informed comment. We are also considering our approach to press relations generally.
- The LBMA Biennial Dinner will be held on 12 September at The Gibson Hall, Bishopsgate, London.

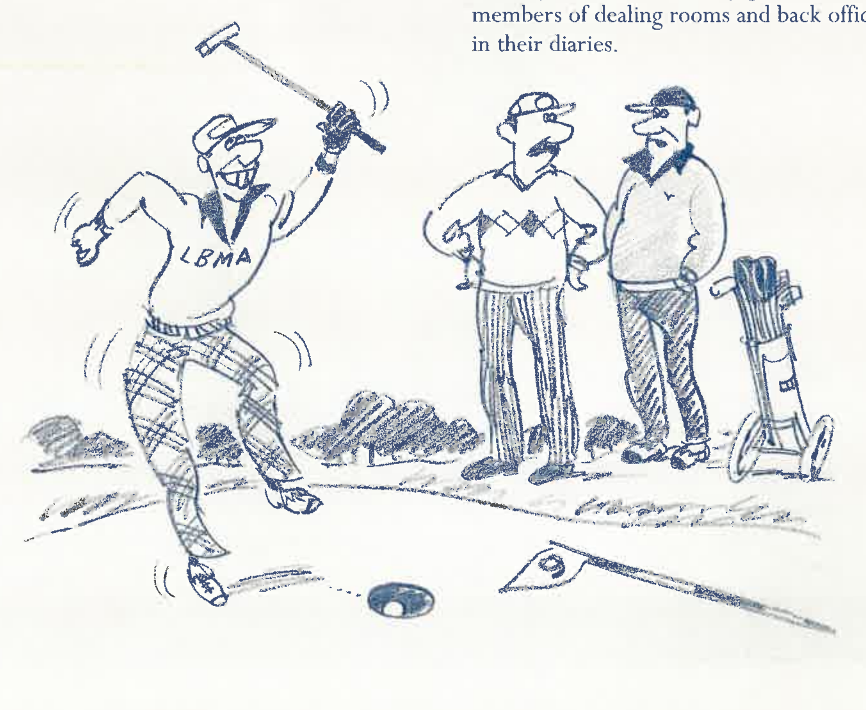
Physical Committee

- The first batch of questionnaires sent in November to those on our Good Delivery Lists have now been mostly returned and are being analysed. The second batch has been despatched, requesting a response by 13 May. Our thanks for the co-operation of those who have filled them in. They are greatly increasing both our contact with and our knowledge of our accredited refiners.
- We are also in correspondence with the Russian Federation Committee on Precious Metals and Precious Stones about the current status of the Russian refineries.

The 1996 Annual Golf Day will be held on Friday 31 May at Clandon Regis Golf Club, situated a few minutes away from the M25/A3 junction.

The morning round will be for the individual Jack Spall Trophy currently held by David Spraggs, and the afternoon round will be for the LBMA Team Trophy currently held by Bill Smit, Alan Wallis and John Coley.

Catering will be morning coffee, hot lunch and afternoon tea. Thanks to the generous sponsorship of Mitsui & Co. UK PLC and Sumitomo Corporation (UK) PLC, the cost of the day is being restricted to £35 in order to attract as many participants as possible. Last year one guest per member company represented was allowed, and it is hoped to be able to do the same again. We are very keen to see a really good turnout this year, and hope that members of dealing rooms and back offices alike will keep a space in their diaries.



'... SOMETHING ABOUT GOLDEN BALLS?'

People

- The Management Committee marked with regret the departures of Peter Hillyard and Martyn Konig. Their places have been taken by Martin Fraenkel (Chase Manhattan) and Philip Clewes-Garner (NM Rothschild & Sons).
- In addition, the Physical Committee has seen the departure of Roy McPherson, whose place has been taken by Jonathan Farr (UBS).
- The LBMA takes this opportunity to thank Peter, Martyn and Roy for their major contributions to the work of the two Committees.
- A vacancy remains on the Public Affairs Committee following Martin Fraenkel's transfer to the Management Committee.
- At the Bank of England, Roger Meads, after many years as Senior Manager in the Wholesale Markets Supervision Division, has transferred to the Banking Supervisory Policy Division. Our Chairman, Alan Baker, hosted a dinner in January to mark Roger's departure and to thank him for all his efforts on our behalf and for his wise counsel at meetings of the Management Committee. Roger's successor is Andy Murfin, whom we welcome to our deliberations.
- At Republic National Bank, Dick Gazmararian, a former Chairman of the LBMA, has transferred to Hong Kong. Phil Wilson of Standard Chartered Bank, Mocatta is also, for the time being, spending much of his time in Hong Kong.

Promoting the London Bullion Market

- A successful lunch-time Seminar was held at the offices of Sumitomo Corporation on 29 November on the subject of Gold-Portfolio Theory and Practice. An audience of more than 60 heard presentations by Martin Fraenkel (Chase) and Graham Birch (MAM).
- We aim to repeat such events in the future, and are currently planning another Seminar starting at 12 noon at the Carpenters' Hall, Throgmorton Avenue on Thursday 16 May.
- The Debate on hedging which we were planning to hold in Johannesburg in February this year, as announced in October's Alchemist, sadly failed to fly, but we are hoping that we may be able to get the idea off the ground for next year.
- The new Brochure has been widely circulated at home and abroad and has received numerous plaudits. We expect to need to go into a re-print in the near future, so any suggestions for textual corrections of omissions or inaccuracies (NB we are not going in for a major re-design) will be gratefully accepted by the Executive. In the meantime further copies are still available if required by members over and above their initial free allocation – at a cost of £5 per copy.
- Visitors for whom meetings have been hosted at the LBMA in recent weeks have included high-level delegations from Tajikistan and from the Bulgarian National Bank.

Obituaries

Guy Field (1926-1995)

During a brilliantly successful banking career lasting more than 40 years, Guy Field stimulated, inspired and delighted many friends and colleagues, and exercised an immense influence on the London market.

Guy was born in Paris in 1926 where he lived until June 1940 when, in order to escape the enemy, he and his parents walked to St Jean de Luz, a fishing town close to the border with Spain, from where they managed to catch the last ship, which happened to be sailing to Liverpool.

Guy had a conventional middle class English upbringing, and after leaving high school in 1947, confidently strode into Martin's Bank in Liverpool and asked for a job. He told them that he spoke French and read the Economist, and evidently they were sufficiently impressed to offer him a job in the Foreign Department.

In 1952 he transferred to London for a year, and whilst at a seminar in Brussels was noticed and eventually recruited by Samuel Montagu, whom he joined in 1954.

The majority of Guy's career was spent with Samuel Montagu, where he rose to be in charge of the Foreign Exchange Department, assuming in the late 1960s additional responsibility for precious metals trading, as the London market sought to create a new role for itself in the aftermath of the collapse of the international gold pool.

London's success in modernising itself as a global market maker eventually led to an influx of American trading houses, and much to the amazement of the London establishment, Derby & Co. Ltd., a wholly-owned subsidiary of Philipp Brothers, managed to entice Guy away from Samuel Montagu in 1977, to establish and manage the first new market maker in London for over a century. Soon after Derby started trading, they applied for membership of the fix, but in this they were unsuccessful. Nevertheless, Guy quickly established Derby as a leading force in the marketplace and the beginning of the "invasion" of the London Bullion Market was underway.

In 1982 Guy made his final career move, joining JP Morgan with responsibility for all aspects of their precious metals business world-wide.

Just before he retired in 1988 he once more played a significant role in the creation of the London Bullion Market Association. The entry in his diary on his last day at Morgan read "I go, I no come back", and he was true to his word.

When he retired, he devoted his time to local charities and causes in the village where he lived. He gave generously of his time and wise counsel to St Catherine's Hospice and to the Conservative Party, eventually becoming chairman of his local branch.

He was a great believer in sound education, and spent many years as a governor in both private and public schools. For relaxation he enjoyed the opera, particularly Glyndebourne and Wexford, the theatre, gardening and travelling, and was passionate about rugby and cricket.

Guy was made a freeman of the City of London in March 1983 and consequently joined the Worshipful Company of Fanmakers, in which he took an active part. He was also a loyal and hardworking member of the Association of Lancastrians in London.

About eight years ago he was invited to join the Ancient Marketeers, a professional and exclusive association of only 75 members at one time, made up of senior members of the money markets who had been decision-makers since the war.

Guy remained more French than English in his accent and manner, although very proud of his Liverpool connections, and this may account for his delightful use of mixed metaphors. He once said of someone who had upset him that they made his goat boil! He was quick-tempered, but equally quick to forgive and make amends. The greatest compliment he paid you was that he trusted and supported you. He let you go your own way. "Trade your feeling" was a constant entreaty.

The sort of character he seemed to be disguised his real personality. He was a modest, steadfast, generous man, and he will be missed by a great many people.

Guy is survived by his wife Dorothy, whom he married in 1953; his children Sonya and Alastair; and his mother, aged 92.

God bless him.

Martin Sievi

All of his many friends in the London Bullion market were deeply saddened to hear of the untimely death of Martin Sievi of Banque Indosuez, Geneva in mid December. Martin worked for many years in Lausanne with Bullion Exchange before moving to Geneva after that trading company was absorbed into Indosuez.

He was always a most professional, knowledgeable trader, but most of us will remember him for the warmth of his friendship. He was a committed family man and an active supporter of his local Church and community.

He will be sorely missed.

Our sympathy goes out to his family and colleagues.

Member firms

MARKET MAKER MEMBERS

AIG INTERNATIONAL LIMITED	(0171) 481-1098
J ARON & COMPANY (BULLION)	(0171) 774-1000
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THE CHASE MANHATTAN BANK N A	(0171) 962-5000
CREDIT SUISSE	(0171) 888-8000
DEUTSCHE BANK SHARPS PIXLEY	(0171) 971-7000
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MIDLAND BANK PLC	(0171) 336-2000
MORGAN GUARANTY TRUST COMPANY OF NEW YORK	(0171) 600-2300
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PHIBRO BULLION LIMITED	(0171) 721-4000
REPUBLIC NATIONAL BANK OF NEW YORK	(0171) 621-7800
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UNION BANK OF SWITZERLAND	(0171) 901-3333

ORDINARY MEMBERS

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E D & F MAN INTERNATIONAL LIMITED	(0171) 285-3000
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METALLGESELLSCHAFT LIMITED	(0171) 488-2244
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MITSUI & CO UK PLC	(0171) 822-0321
MORGAN STANLEY INTERNATIONAL	(0171) 513-8000
MOSCOW NARODNY BANK LIMITED	(0171) 623-2066
NISSHO IWAI (EUROPE) PLC	(0171) 628-6030
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ROYAL MINT	(01443) 222111
RUDOLF WOLFF & CO LTD	(0171) 626-8765
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SWISS BANK CORPORATION	(0171) 329-0329
TOMEN (U.K.) PLC	(0171) 321-6600
TRILAND METALS LIMITED	(0171) 236-4382

DIARY OF EVENTS

31 March – 2 April
Gold and Silver Institutes' 1996 Annual Conference – the Westin Regina, Los Cabos, Mexico

22-23 April
Financing Mining Projects, Second Annual Conference plus Workshop, Le Meridien, London

23-26 April
Global Derivatives 96 – Hotel Meridien Etoile, Paris

7-10 May
Peru: Second International Gold Symposium – Crillon Convention Centre, Lima

16 May
LBMA Seminar – 12 noon – Carpenters' Hall, Throgmorton Avenue, London

20-21 May
China Metals Industry, Hyde Park Hotel, London

22 May
LBMA Annual General Meeting – Further details to be announced

31 May
LBMA Annual Golf Day – Clandon Regis, Surrey

24-25 June
FT World Gold Conference – Hotel Excelsior, Venice

12 September
LBMA Biennial Dinner – the Gibson Hall, London

For further information please call
Jeffrey Rhodes at Standard Bank London Ltd on 0171 815 4210
or
Chris Elston or Stella Thompson
LBMA Executive
6 Frederick's Place
London EC2R 8BT
Telephone: 0171 796 3067
Fax: 0171 796 4345