Alchemist

LBMA

LONDON BULLION MARKET ASSOCIATION

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One Year on ...

Editorial Comment by Alan Baker

As the Alchemist reaches its first anniversary, it is encouraging to see the extent to which it has fulfilled our original aim as a forum for diverse views. In addition, it has undergone an evolution as we have responded to constructive comments.

We have been fortunate enough to publish a number of interesting papers in our first year and this edition is no exception with contributions from South Africa, London and the World Gold Council. Tom Main analyses the current scenario of the South African economy and, particularly, the challenges facing the mining industry, while Alison Wright of British Invisibles sets the London Gold Market in the wider context of the City's overseas earnings and Helen Junz contributes an in-depth and most interesting analysis of the demand factors for gold. In addition to this, we felt that it was appropriate to include copies of papers presented by Dr Stewart Murray and Dr Graham Birch at a successful seminar organised recently in London by the LBMA. The former is a useful round-up of the Gold Fields Mineral Services Gold and Silver Surveys, while the latter gives a fascinating insight into Far Eastern attitudes to gold.

At the LBMA AGM held on 22 May, I reported on an active year in which the Association was involved in ensuring the integrity of silver in the European Fiscal Warehouse regime which came into effect on 1 June this year. We continue to monitor developments and to contribute to the debate on VAT harmonisation for gold in Europe, looking to ensure that changes are not detrimental to our market.

As the use of netting agreements evolves, and to complement our International Bullion Master Agreement (IBMA), the LBMA has been working in conjunction with the International Swaps and Derivatives Association (ISDA) to introduce a Bullion Definitions Booklet which can be used with the ISDA Master Agreement. This will become available shortly and will make it easier for existing bilateral signatories to ISDA Master Agreements to encompass bullion by merely confirming their bullion transactions under that agreement and, thus, bringing them within the scope of its cross-product netting provisions. We feel sure that market participants will appreciate the convenience of this development.

During 1996, we also instigated a triennial review of our Good Delivery List of gold and silver refiners. This will enable us to monitor changes in status on what has become an ever-growing and changing list and one which, over time, has become the world benchmark.

The LBMA, as you will see from the report of the AGM on the back page, has tackled a number of important issues this year and will continue to work to maintain a healthy and efficient environment for the London Bullion Market.

Alan Baker, *Chairman, London Bullion Market Association;*
Divisional Director, Deutsche Morgan Grenfell.

Gold Contributes
To City's Overseas Earnings

by Alison Wright

Alison Wright is Director General of British Invisibles. She is a member of the Advisory Panel of the National Institute of Economic and Social Research European Financial Programme, a member of the Advisory Council, National Council for Voluntary Organisations, Council Member of British Consultants Bureau, a member of the ONS Advisory Committee and a trustee of the BBC Marshall Plan of the Mind.

Net overseas earnings of the financial sector continue to rise UK-based financial institutions – largely in the City of London – earn a remarkable net surplus of some £20 billion. This is double the figure 10 years ago and demonstrates the dynamic growth of the financial sector over the past decade. British Invisibles (BI) promotes these exports and increases the earnings. Earnings from invisible exports and overseas assets make a vital contribution to Britain's economy. In 1994, they accounted for one-half of current account inflows and represented 18% of GDP, a higher proportion than for any other G7 country. A growing proportion of the UK's workforce is employed in banking, finance, insurance and business services, increasing from 9% in 1984, to 13% in 1994.

The financial sector is the largest contributor to the balance of payments The financial sector, including receipts from services and overseas assets, is the largest positive contributor to the balance of payments. Overseas earnings arise from services provided by banks; insurance institutions, including companies, brokers and Lloyds; securities dealers; commodity traders; money market brokers; fund managers; the Baltic Exchange; Lloyd's Register of Shipping and trading in gold.

London is the world's leading international financial centre London is the world's leading centre for many financial markets; the recent decision by Deutsche Bank to integrate all its investment banking operations in London is a clear demonstration of international recognition of London as a world-class financial centre. Edinburgh and other cities in the United Kingdom also have significant strength.

London is the world's largest international banking centre, accounting for nearly 17 % of world cross-border lending, ahead of Tokyo and New York. Five hundred and forty foreign banks from over 70 countries are represented in London (more than in any other centre in the world).

According to the latest official international survey estimates, London's daily turnover in foreign exchange trading averages $464 billion, more than the combined turnover of New York and Tokyo.

London is also the leading international securities market and has the largest share of international insurance business. Most recent figures show net premium income of £10.5 billion – equal to 28 % of marine risk and 38% of aviation risk. It is the centre of the Eurobound markets. London's share of the international bond market in December 1994 was estimated at 60 % in the primary market and 75 % in the secondary market. London also dominates the foreign equity markets, accounting for 59 % of world turnover in foreign equities in 1994 (New York accounted for 36 %).

London is the main European centre for exchange-traded and over-the-counter derivatives and commodity trading. Its share of the world market in exchange traded financial futures and options increased from 7 % in 1988, to 17 % in 1994 and ranks second to the USA. London is the world's second largest fund management centre, after Tokyo, with over $750 billion of institutional equity holdings.

Maritime activity is also important. London is the largest centre for marine insurance, ship and cargo broking, arbitration, ship classification and professional consultancy. The Baltic Exchange is the world's largest shipbroking market.

London is the global clearing centre for gold and silver, forward trading, derivatives and precious metal financing. A recent survey conducted by the Bank of England estimated daily turnover among market makers at $3 billion a day, illustrating London's pre-eminent position in over-the-counter gold and silver trading.

Open markets and skilled professionals aid growth The growth of the financial markets in the UK has been based on openness, liberal policies and competition. The removal of barriers to trade in financial instruments and the openness of the London market to practitioners from all over the world has continued to strengthen London's position over the last 10 years. In addition, the legal and regulatory framework allows new developments to flourish. London has other advantages too – a time zone which links Tokyo and New York, the benefits of English as the predominant language of international finance, highly efficient telecommunications, international air connections and ample office accommodation and a well-developed physical infrastructure. The taxation system also increasingly takes account of the requirements of rapidly evolving international financial business.

The expertise of London's financial markets is enhanced by a wide range of highly skilled professionals including lawyers, accountants, actuaries, consultants and IT specialists. This concentration of financial and other specialists gives London a capacity for innovation and flexibility essential for success in today's highly competitive overseas markets.

World trade in services is growing faster than visible trade A country's capacity to export services successfully is vital as trade in services worldwide is growing at a faster rate than visible trade, reflecting the continuing shift from manufacturing to service industries in developed countries, and the growth of service industries in developing countries. The signing of the General Agreement on Trade In Services (GATS) at the end of July 1995 under the auspices of the new World Trade Organisation should accelerate the growth of financial and business services worldwide.

London, New York and Tokyo are the leading financial centres in the world. London's distinctive characteristic is the powerful international dimension of its markets. This makes it imperative that the City should have the capacity to maintain and increase its share of business in highly competitive and fast-changing overseas markets.

Gold Demand Situation • Where we are now, how we got here and where are we going

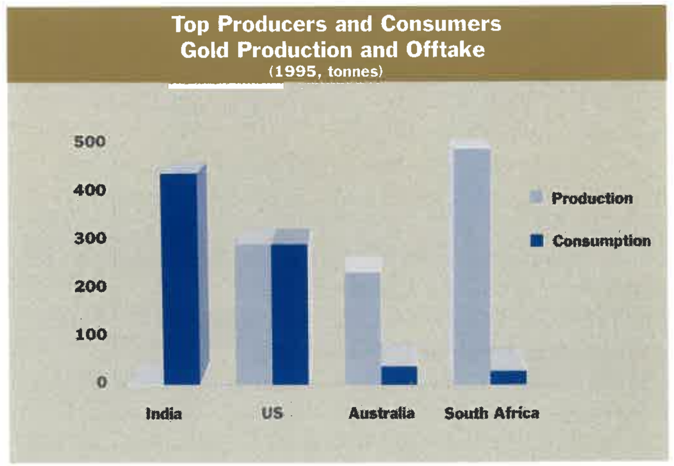
by H B Junz

As many will know, the mandate of the World Gold Council is the enhancement of global demand for gold. Accordingly, the focus of my article is, first and foremost, on gold offtake.

Interestingly, gold demand does not depend on how high a country's level of income is, nor on whether or not it is a major gold producer, nor even on where on the globe it is situated. In this respect, gold does differ from other commodities in that it has a demonstrated special appeal, rooted in historic, cultural, religious and emotional motivations, as much as in cold business sense.

For example, as the chart shows: of the two largest offtake markets, India and the United States,

• one produces virtually no gold; the other ranks number two among the world's gold producers;



• one has a per capita income barely above subsistence level, and relatively little financial asset choice; the other has high levels of discretionary spending and a proliferation of savings instruments.

Further

• the number one and number three among gold producers, South Africa and Australia, are both near the bottom of the gold consumption league, and although both, unlike the United States, depend for a relatively large part of their economic well-being on the mining industry, one is a developing and the other an industrial country.

All this demonstrates, once again, the broad range of motivations and appeal that gold has worldwide.

When we look at the developments in the gold markets in 1995, we again see this wide variation coming into play. For example, to the chagrin of some market participants, the gold price in US dollars was remarkably stable, with the 1995 average at $384.08 virtually unchanged from 1994.

1995 Highlights

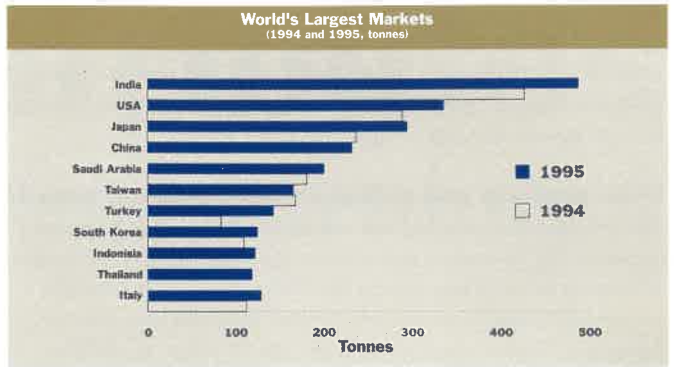
• All Markets	+12%	2725t
• Developing Countries	+10%	1807t
• Developed Counties	+13%	918t
• Jewellery Demand	+7%	2233t
• Bar/Coin Demand	+36%	433t
• Dental	+6%	59t

But

• 1995 was a banner year for gold offtake, with demand outpacing the previous record, set in 1992, by 7.6 %. In fact, based on the markets monitored by the World Gold Council (through 23 offices around the world), it set several records, even one for the number of records that were being posted;
• world gold demand reached a new peak with both developing and developed countries registering record highs;
• the number of markets consuming more than 100 tonnes annually reached new highs;
• jewellery demand rose by 7 % and investment demand by 36 %, which was record or near record growth for both.

The driving forces that brought offtake to record levels in both developed and developing countries were:
1. Good income growth, particularly in important markets that had experienced cyclical down-turns in 1994, such as the Middle East oil producers and Turkey.

But perhaps more importantly:
2. In 1995, a number of gold's special qualities manifested themselves convincingly yet again:
• its indestructibility and security in times of financial uncertainty triggered a 63 % jump, to 160 tonnes, in Japanese investment demand;
• its investment value, once the price was considered right, caused a doubling of coin sales in Germany;
• its role as a hedge against currency depreciation contributed to the strength of demand in India and Turkey;
• its cultural and religious significance continued to underpin demand growth in several Middle Eastern and Asian markets;
• and its basic adornment and intrinsic value attributes helped sales in the United States grow faster than total non-auto retail sales for the fourth consecutive year.

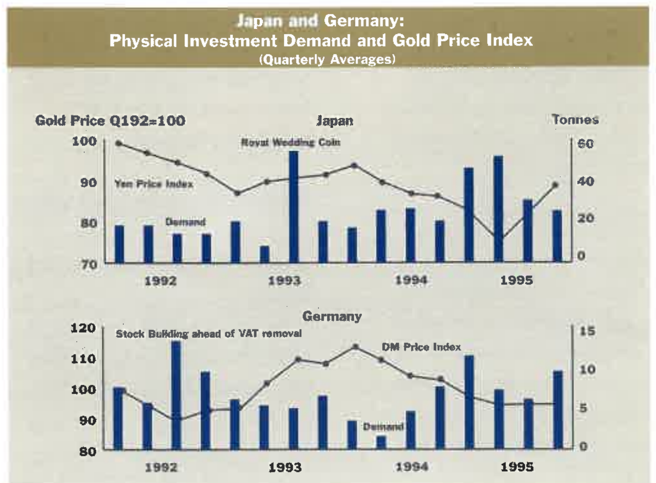


Not surprisingly, demand developments varied considerably among markets. As already noted, some, eg, Turkey and the Middle East, registered strong recoveries from cyclical lows, while others, especially China, Hong Kong, Taiwan, Mexico and Thailand, experienced cyclical declines, in most cases reflecting anti-inflation, austerity policies.

Consequently, while gold demand in Saudi Arabia and Turkey recorded large increases, in China and Taiwan it consolidated around previous levels of 224 and 160 tonnes respectively, but declined significantly in Hong Kong, Mexico and Thailand. In Mexico and Thailand, the downturn was largely policy induced, with recoveries emerging subsequently; in Hong Kong, the downward trend reflected the earlier asset shake-out and continuing political uncertainty.

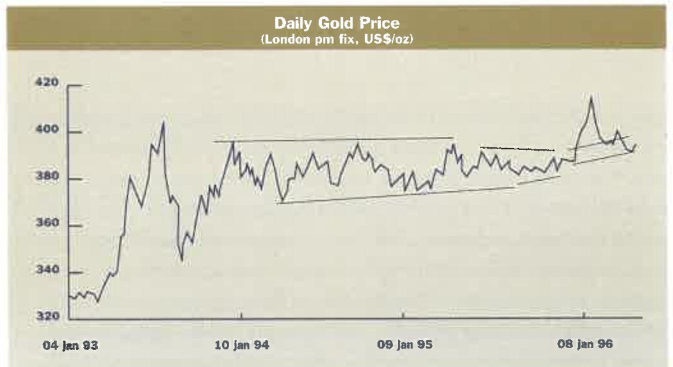
The three largest consumer markets, India, the United States and Japan, all registered significant increases. Perhaps most remarkable among these is India, where annual gold consumption jumped 14 %, to 474 tonnes in 1995. This was despite the rather large increases in the local price of gold as the rupee depreciated by 11 % against the US dollar in the second half of the year. The fact that demand held up so well reflected both good income growth – so that people could afford to devote somewhat larger nominal amounts to their traditional purchases of gold – and progress in liberalisation of the gold market, which made gold more accessible at a lessened premium over the international gold price.

It is this combination, of rising income and increased accessibility of gold, that has played an important role also in the large increases in gold demand posted in other important markets. In fact, the latter factor is so important that the World Gold Council is concentrating a large part of its efforts on increasing the efficiency in local gold markets through removal of regulatory and structural impediments to the free flow of gold.

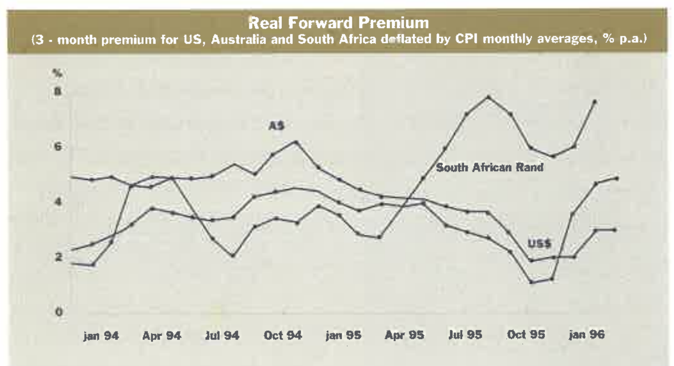


The importance of positioning gold and of generating a 'level playing field' for it was demonstrated forcefully by developments in the Japanese market last year, gold investment sky-rocketed by more than 60 tonnes during 1995, to bring total offtake to 289 tonnes. The Japanese story is particularly interesting because it illustrates how a confluence of circumstances – the fragility of the banking system, the Kobe earthquake and the low price of gold in yen terms – can help enlarge the benefits from earlier efforts to position gold as an important savings and investment vehicle. I am referring to the large growth in gold investment associated with gold accumulation plans. This savings instrument was developed with WGC support over the past several years. It was ready for broad expansion after Japanese savings banks were allowed to promote gold as a savings vehicle and the experience of a number of commercial banks had shown the potential of such savings plans. But actual expansion far outpaced expectations as it rode on the momentum provided by the exceedingly favourable environment. And even the large capital gains – over 30 % – that have been registered since Spring 1995 have triggered only limited profit taking so far.

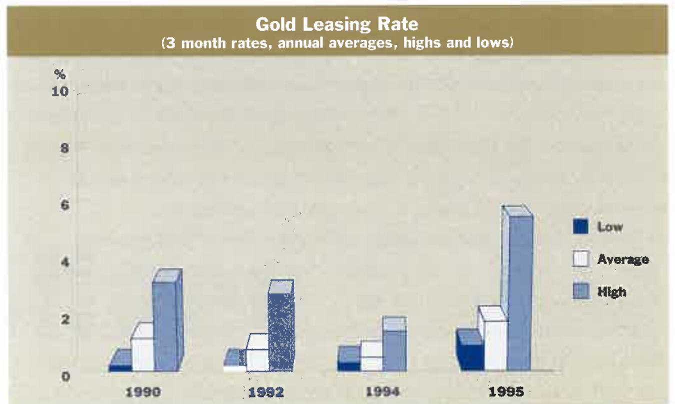
Similarly, in Germany, the removal of VAT on coin sales in 1993 paved the way for a virtual explosion of demand when the DM price of gold – at DM 17,200 per kilo – reached a two-year low in mid-1995. Concerns regarding the future stability of the local currency, triggered by discussions about the introduction of a European currency, may also have contributed.



All the good demand performance was obviously positive for the gold market, particularly inasmuch as the strength of demand put a firm, and actually rising, floor under the gold price throughout 1995. Yet, at the same time, grumbling was heard from the dealing community, who were looking for a rising ceiling price as well as greater price volatility. As is well known, the firm ceiling on the gold price, and therefore the shrinking volatility, resulted from the unprecedented levels of producer hedging activity in 1995.
To re-cap, South African producers, who had been relatively less



involved in hedging than their North American and Australian counterparts, elected to use the forward market also as a means for raising project finance in 1995. This, obviously, was not divorced from the strong incentive South African producers had, in terms of the "real forward premium" (the local premium minus the local inflation rate), to avail themselves of hedging possibilities. By contrast, US and Australian producers saw their real premium effectively disappearing by late 1995. This, together with the first quarter's seasonal lull for hedging activity, may help explain the calmer tone of the hedging market since. Nevertheless, gold leasing rates have stayed well above the 50-75 basis points level that was typical for the early 1990s.



The temporary liquidity squeeze in the forward market that materialised toward the end of 1995 may have helped focus market attention on gold and, together with rather belated recognition of the strength of underlying demand, contributed to the rise in investment and speculative activity that brought excitement to the gold markets in early 1996. These moves also gained from concern over the apparent vulnerability of bond and stock markets, motivating market participants to look for alternative homes for some of their funds.However, with the successful penetration of the $400 per ounce price level, the market quickly set new hurdles, looking to the price to go to $430 and higher and, thereby, setting the stage for virtually certain disappointment. In the event, disappointment was triggered both by profit taking and by the awareness that quick run-ups in the price of gold tend to cut relatively sharply into demand in highly price sensitive, high caratage jewellery markets. And these, in turn, are among the major and most dynamic offtake markets. Thus, the debate in the market about the strength of underlying demand quickly turned negative, despite a fair amount of evidence that showed demand developments to have remained rather more satisfactory than could have been expected under the circumstances.

As a consequence, speculators began to unwind some of their long positions but, with producer forward hedging also at fairly subdued levels, liquidity concerns disappeared. Still, the depth and relative resilience of the market was demonstrated by the fact that the news of a 203 tonnes sale by the National Bank of Belgium in a deal with another central bank had no immediate impact on prices. If, as some believe, this gold was, at least in part, fed into the market starting late last year, it was even more remarkable that prices did not appear to react visibly.

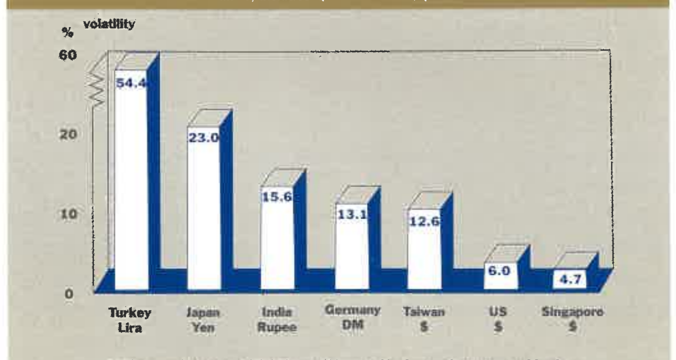
Higher lease rates are here to stay

It may be interesting to note that the possible addition to gold market liquidity through further mobilisation of gold in official hands is judged to be rather limited. If one takes account of those major holders of gold among central banks who are either legally, or through publicly declared self-imposed restrictions, prevented from engaging in lending activities, the number of holders of sizeable gold stocks, who are not already participating in these markets, appears small. Futhermore, non-participants are not likely to hold their gold in money market centres from where it could easily be onlent. This is important, because for a number of countries, especially outside the G7, but not necessarily excluding them, there would be a significant political constraint to being seen to move part of the national gold stock outside national borders. As a consequence, one should not expect large additions to gold market liquidity from potential new Central Bank participants and, therefore, the consensus appears to be that the higher lease rates are here to stay.

With respect to the possibility of outright sales by official holders of gold, the latest Belgian sale triggered virtually no speculation about similar moves by other central banks, in part, perhaps, because it was viewed also as a relative distress sale rather than a "let's get out of gold" type move. Even the possibility that the International Monetary Fund might sell some gold in its search to find resources to fund its main concessionary loan facility, the Extended Structural Adjustment Facility between 1999 and 2005 (when it is to become self-financing), is now looked upon with relative equanimity. (In any event, some major shareholders, including Germany, are continuing to oppose such sales.) This does not mean that the large above-ground stocks in both official and private hands might not be activated under some circumstances but, rather, that markets are sufficiently deep, and demand sufficiently strong at recent levels of the gold price, that this is not considered to be a major threat at this time.

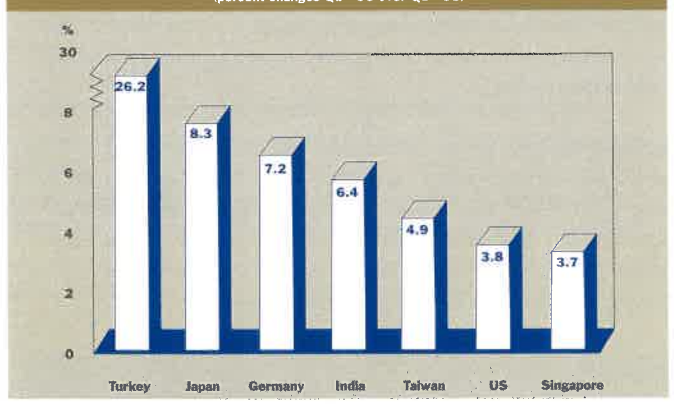
In this respect it should be remembered that, while the gold price in 1995 was remarkably stable in US dollar terms, it was not necessarily so in local currency terms.

This was particularly important in India and Turkey, where the local currency price rose sharply. But, in neither case did this local price rise seem to trigger liquidation of gold stocks held in private hands. Unlike in developed countries, such as Germany and Japan, where the recent price rise caused profit taking, experience shows that in many developing markets such disposals tend to occur mainly in response to distress situations, such as liquidity squeezes. Profit taking appears to play a lesser role, especially if the price rise reflects local policy problems.



Price volatility in Selected Currencies 1995*
(in %, includes Q1 - 96 for US$ price)

*Difference between 1995 high and low as % of annual average gold price, London pm fix in US$/oz converted into local currencies.



Chages in Gold Price in Selected Currencies
(percent changes Q1 - 96 over Q1 - 95)

Thus, a distinction needs to be made between consumer reactions to price rises induced by local, political/policy circumstances and those that stem from externally triggered, global price spikes. The latter, of course, are of interest to traders and producers, but they tend to confuse consumers. The speed with which consumer markets absorb such price rises will depend upon whether consumers are convinced that the rise is there to stay, as well as the strength of income growth. For example, while in India good income growth helped mitigate the effects of the rupee price rise from mid-1995 to year-end, the spike in the international gold price early in 1996 led to a "wait and see" attitude, with consumers returning to the market at the end of the first quarter. Equally important, different markets will react differently to gold price changes. For example, while jewellery demand in most developed countries is relatively insensitive to changes in the gold price, in Turkey the population tends to buy into a rising price trend, and in Hong Kong there tends to be active two-way trading in response to price fluctuations.

Mrs Helen B Junz *is Director of the Gold Economics Service of the World Gold Council.*

Mrs Junz joined the World Gold Council in July 1994 from the International Monetary Fund, where she had been employed since 1982, most recently as Special Trade Representative and Director of the IMF's Geneva Office.

Mrs Junz, a US national, was educated in the Netherlands and the United States, receiving her MA in Economics from the New School for Social Research, New York. Before joining the IMF, Mrs Junz held the positions of Economic Advisor, Organisation of Economic Co-operation and Development (OECD); Advisor, Division of International Finance, Board of Governors of the Federal Reserve System; Senior International Economist, US Council of Economic Advisors; Deputy Assistant Secretary for Commodities and Natural Resources, US Department of the Treasury; Vice President, First National Bank of Chicago; and Vice President, Townsend Greenspan and Company Inc, New York.

Mrs Junz, a highly respected economist both in the United States and Europe, has written numerous articles and reports for economic journals and has travelled extensively.

Conclusions

Where we are now

- Demand remains within historic highs

How we got here

- Cyclical recovery in major markets
- Instability of financial markets, eg, Japan
- Effects of deregulation
- Steady growth elsewhere

Where are we going?

- Consolidation of gold demands at high level
- Income factors likely to dominate

Bottom Line

- Solid base support to gold market

We believe that for gold demand 1996 is likely to be a year of consolidation at levels above those seen in earlier peak years, but not necessarily holding to those achieved in early 1995. To a large measure, whether the record levels reached in 1995 are maintained depends mainly on income growth. There, we see a certain consolidation in those major markets that had experienced demand recoveries in 1995, eg, Saudi Arabia and Turkey; continued steady growth in India and the United States; and stabilisation in Thailand and Hong Kong. However, growth performance in Europe is likely to be below earlier forecasts, although not as dire as some now believe.

The bottom line is that, in our view, consolidation of gold demand at the levels already reached, or even somewhat below, would continue to provide a strong fundamental base to the gold market.

Gold and Silver · An End-of-Term Report

by Stewart Murray

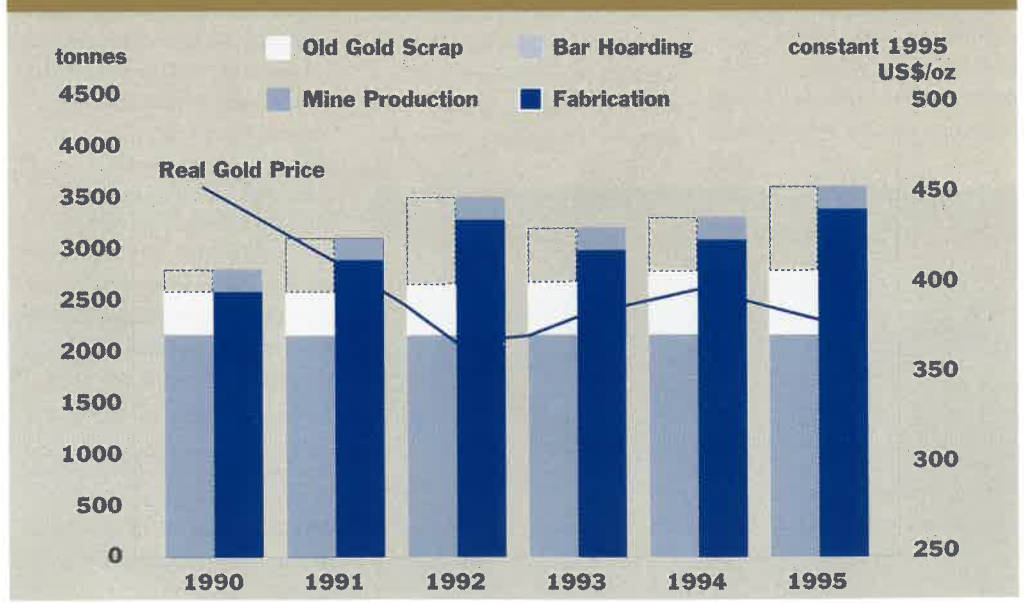
This paper highlights some of the more important aspects of the gold and silver markets which emerged during the compilation of this year's gold and silver surveys*.

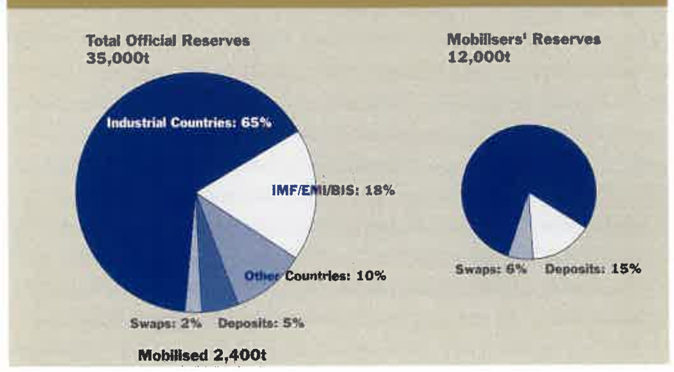
Gold

Does gold mine production matter?

You will probably be aware that world gold mine production fell back, albeit marginally, in both of the last two years. You will almost certainly be aware that South African mine production fell by 10 % last year – the latest figures, incidentally, indicate a further decline in the first four months of this year of almost 6 %. But there has not exactly been a rush to buy gold futures as a result. Is this because there have been compensating increases elsewhere or is it that mine production no longer matters? The question also needs to be asked because some commentators feel that supply does not consist of the additional metal mined each year but, rather, the total cumulative amount mined since the dawn of man. They argue that, because of the large above-ground stocks in the hands of private citizens and the central banks which can be lent, sold or otherwise mobilised, price formation is determined much

1. The Global Gold Gap





2. Official Sector Gold Reserves

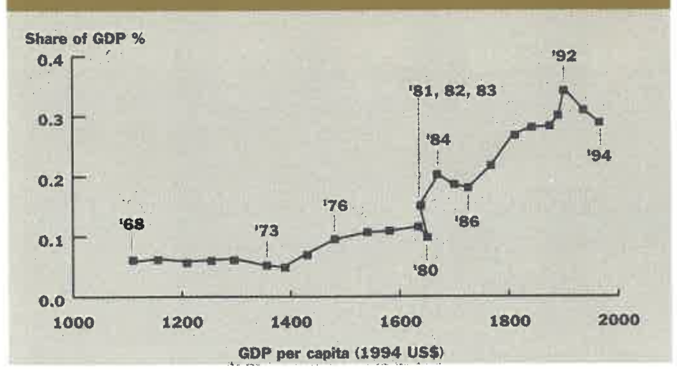
more by the behaviour of these holders, rather than by what the mining industry produces. While, on a short- to medium-term view, there may be some truth in this, in the longer term, mine production does matter. We saw this in the late 1980s, when there was a very widespread negative perception among investors, and even producers, about the prospects for the gold price because of the rapid rise in output. Looking even further back, we saw the opposite in the early to mid 1970s when the decline in world production helped stimulate investment in gold. But you cannot look at production on its own – which is why the concept of the global gold gap is important.

This is the difference between mine production and scrap on the one hand, and physical demand on the other, which shows how, in recent years, it has been possible to bridge or fill the gap with a mixture of official sector sales and lending. But the role that mine production plays in determining the size of the gap that has to be filled is one of the key elements in setting the future price of gold.

Is potential gold liquidity finite?

This question, of course, relates to the massive increase in producer hedging last year. For instance, the estimates in *Gold 1996* suggest that more than 461 tonnes of gold were required just to fund last year's increase in forward sales, with the corresponding liquidity required to cover all outstanding forward sales rising to more than 1,700 tonnes.

Simplistically, the answer of course, is yes – liquidity is finite. You cannot borrow more than all the gold that has ever been produced, even though with the panoply of derivatives now available (one only has to think of the synthetic gold loan which was popular a few years ago) it sometimes appears from the statements of some analysts that they regard liquidity as a totally nebulous concept unrelated to physical supply and demand. On the other hand, potential liquidity (the part so far untapped) appears to be huge relative to the amount so far mobilised. But, in practical terms, and especially after what happened to leasing rates last year, the real question is whether it will be as easy for the gold business to borrow, say, the next 1,700 tonnes of gold liquidity should it be necessary. Given that the official sector has provided more than 90 % of the total liquidity to date, it is important to look at what it has done so far.



3. LDC Expenditure on Jewellery

Gold 1996 estimated the total liquidity provided by the official sector as of the end of last year at 2,400 tonnes, representing around 7 % of total official gold reserves and made available mostly as deposits. It is worth noting, incidentally, that the deposits (but not the swaps) shown in Figure 2 are generally still reported as being in central bank reserves, even if the physical gold is currently sitting in a display case in Bombay rather than in the vaults of a central bank. One wonders what would happen if all the central banks suddenly decided that they would all like their gold back at the same time.

In that such an event is very unlikely, the concern is much more about where the next lot of gold borrowings are going to be found. At first sight (the left-hand pie in Figure 2), the position seems very reassuring – there is, after all, plenty of gold available – in both the industrial countries and in the official institutes (the IMF, the BIS and the EMI). However, when we look at the picture for just those central banks which are already active mobilisers, the picture shown in the right-hand pie is rather different.

Now we can see that just under 12,000 tonnes are included in the total and 21 % of these have already been provided to the market.

These active mobilisers do not just include developing country central banks, though this group has included the most active lenders. In fact, the larger part of the total official reserves of the mobilising central banks consists of industrial country reserves but because these banks have, so far, only activated a small part of their holdings, the bulk of the liquidity provided to date has come from developing countries.

But a third pie encompassing just the developing country mobilisers – the group with the greatest proclivity to provide liquidity to the gold business – would show that around 40 % of their reserves have already been lent.

If you were to judge that the major part of future liquidity is likely to come from the non-industrial group of countries, then the left-hand pie shows that only around 10 % of the so-far unmobilised official gold reserves (ie, 3,500 tonnes) come into this category.

The big questions that need to be addressed are, firstly, how much more and at what leasing rates will the current mobilisers be willing to lend and, secondly, how many central banks in the so-far non-active group, located mostly within the industrial countries, will eventually join the party? Lastly, there is the question of how much liquidity will be provided by the multi-lateral official institutions – it should certainly not be assumed that all the gold which they control is effectively sterilised.

Price, prosperity and population

Bearing in mind the importance of the global gold gap, what is it that determines the level of physical demand? The answer is a whole raft of economic, social, cultural, religious and demographic factors. But, the three most important are prosperity, population and price.

The available evidence suggests prosperity is of overwhelming importance. This can be seen by considering the way the developing world's expenditure on gold jewellery has developed since the start of our Gold Survey in 1968.

Many of the countries in the "Less Developed Country" (LDC) group are now more developed than some in the industrial group but, for consistency, the data in Figure 3 include all the non-OECD countries together, excluding the former communist bloc. This picture shows the estimated expenditure of this group on gold jewellery as a share of GDP. This is graphed not against time, but against wealth (or its proxy GDP per capita). What this picture reveals is that, overall, the developing group of countries has become more prosperous, with per capita GDP almost doubling over the past quarter century and, much more importantly, that the share of this rising wealth expended on jewellery has been rising. As people in this group get richer, they tend to spend more of their wealth on gold jewellery. It also shows that price does have an impact, as can be seen from the dips in 1973 and 1980, but it should be remembered that, over the whole period shown here, the gold price has just about doubled in real terms.

One of the best comparisons that can be made to illustrate this point is between the development over the past 15 years of per capita consumption of gold jewellery in India and Italy – two countries with very different cultures and levels of development but that have in common a similar cultural affinity for gold.

Indian consumption has grown steadily from a very low base, primarily due to the benefits of good harvests improving wealth and, to a lesser extent, a falling real price since the early 1990s. Italian consumption has also continued to grow, and, most importantly, without showing any sign of maturity (although the economic and political turmoil of the past several years has taken its toll on demand generally in the economy). Most importantly, the ratio of per capita consumption has moved within a range of between 5 and 10 in this period.

The main conclusion is that contrary to what one often reads, the gold market has nothing to fear from the process of economic development. Of course, Italians do not use gold in the way that Indians do (namely as their preferred means of saving). But, if India becomes more like Italy over the next few generations or centuries, we can be sure that, on average, its people will be buying more, rather than less, gold than they do now.

Finally, on population, the main thing to remember is how young Asia is, especially relative to an increasingly geriatric Europe. There is no doubt about the size of the next generation of gold buyers. The only question is whether they will have the income to make them actual, rather than potential, purchasers.

Inflation and investment

It is often said nowadays that gold's old role as a hedge against inflation is dead – thanks, in the main, to the development of sophisticated financial products, though it could be argued that it is inflation that has been missing, rather than gold's reaction to it, for most if the past 15 years.

It is certainly true that there was moderately sustained investment during the two waves of inflation in the 1970s (which incidentally seemed much more important then than they do now, because of the much smaller overall size of the market before the 1980s' booms in both fabrication and mine production). By contrast, investment since 1980 has had a much more speculative character, occasionally responding (positively) to higher prices, as in 1983 and 1987, while perhaps the only year to show a positive correlation between gold and inflation in the recent past was 1990. However, that year also saw the build-up to the Gulf War and the collapse of Drexell, so inflation was not the only thing on investors' minds.

But, looking to the future, if there should be a return of even moderately higher levels of inflation in Europe and North America, it is almost certain that this will be accompanied by renewed investment in gold, although this is likely to prove of a transitory nature. Much more important, and of longer term significance, is the cumulative impact of even moderate levels of inflation on the purchasing power of the dollar. This is reflected, for instance, in the rise in gold mine production costs in 1995. The problem is that the whole market is obsessed with the $400 level as if there was no inflation at all. This is what economists call money illusion. Thus, if gold were to stay at this level forever, it would simply get cheaper and cheaper for consumers and at the same time more and more difficult for miners to make money (and, last year, according to the analysis in *Gold 1996*, around 14 % of production was already unprofitable on a total cost basis).

Silver

By-product silver supply

Because the major part of silver mine production derives from by-product sources, GFMS has put a major effort into analysing the sources of silver from mines which were developed to produce, in the

Stewart Murray, Chief Executive, Gold Fields Mineral Services.

After qualifying as a metallurgist from London University, Dr Murray studied for a PhD at Imperial College on the subject of hydriding of titanium alloys. In the decade up to 1984, he worked for the International Wrought Copper Council in London, serving as its Secretary General from 1980 to 1984. He then joined Consolidated Gold Fields (CGF), being responsible for the Group's commodities research, until the company was taken over by Hanson PLC in 1989.

In that year, Dr Murray set up Gold Fields Mineral Services (GFMS), with the backing of Gold Fields of South Africa. The publications of GFMS include the authoritative annual survey of the gold market, formerly published by CGF, and now in its 29th year. Since 1993, this has been supplemented by two annual updates. In addition, in 1994, GFMS was appointed by the Silver Institute in Washington to undertake the preparation of its annual World Silver Survey.

Dr Murray is a member of the Council of the World Bureau of Metal Statistics, having been its Chairman from 1989 to 1991.

first place, copper, lead/zinc and gold. Perhaps the most interesting aspect of the supply chapter in this year's *World Silver Survey* is the way that the share of silver from the gold mining sector has risen steadily over the last five years, in spite of the flat trend in gold mine production. The reason for this is that those gold mines which have closed down have tended to be mining silver-lean ores, while those which have started up (especially in Latin America) have been silver rich. In 1995, however, it was the very large by-product silver content of just two major new gold-silver mines, Eskay Creek in Canada and Mt Muro in Indonesia, which produced a sharp increase in the contribution of gold mines to silver output.

Copper mining also contributed a substantially increased amount of by-product silver last year, whereas, by contrast, silver produced from the lead/zinc mining industry tended to stabilise after four years of falling output. However, this may change if higher lead prices result in more start-ups, like the Cannington lead-zinc-silver mine now under development in Queensland, Australia.

Fabrication

The importance of silver fabrication can be seen in the opening up of the supply/demand gap in recent years. The question is whether the three legs on which fabrication is supported are all going to prosper in the future.

Photographic demand, having dominated in the past, has slipped into third position due to the growth of the industrial/ decorative and silverware/ jewellery sectors. However, it is clear that the big photographic companies have not given up on silver halide imaging. Their announcement of the Advanced Photographic System (APS) represents a genuine commitment to silver-based photography and is likely to stave off the threat from digital imaging in the popular commercial sector, even if this new technology make inroads into areas such as X-radiography and photo-journalism. More importantly, rising levels of prosperity will result in whole new areas of the conventional silver halide market being opened up in the third world.

On jewellery, there has been good growth in a number of countries both developed and developing, although this is partly obscured by declines in the heavier items of solid silverware in a number of markets – especially Italy – over the past five years.

But it is, perhaps, the industrial area that holds the greatest potential for growth in silver demand. The electrical and electronics sector is dominant but this represents not a single use but a whole range of different uses. Although the late 20th century represents the flowering of the electronic age, it also needs to be remembered that electricity is needed to run it. Silver will benefit not just from the growth in semiconductor output, but also from still-to-be-seen electrification of countries like India and China. Finally, buried in the 'others' category are many other applications based on silver's unique combination of properties. It could be said that gold and platinum do one or two things very well, but at a price. Silver does a whole host of things well and very cheaply.

Silver – investment and savings

Like no other metal, silver has a past. Almost any book on economic history for almost any country will contain references to silver. As a result, the demonetisation of silver has led to large amounts of metal being recycled into the market in the past 50 years. Part of this is reflected in the private sector disinvestment which has been seen continuously over the past five or six years. The problem for silver is that it has a relatively low 'value density', meaning simply the value of a unit volume or weight of the commodity chosen to store wealth. Silver's is obviously a lot lower than that of platinum or gold. But, on the other hand, its liquidity (meaning its general availability) is a lot higher, at least in the special case of India.

To an extent then, as far as savings is concerned, silver is still the poor man's gold. So, the future of silver as a medium for savings and investment boils down to the question, will the rich man continue to sell and will the poor man continue to buy? As the Carlsberg people say, "Probably".

(4) Stocks

This brings us to the question of silver stocks. With stocks on the futures exchanges very much in the public domain, the main contribution of the *World Silver Survey* to the very important debate about the level of silver stocks is the quantity which is held in European dealers' vaults. In short, after four years of steadily falling dealers' stocks in Europe, the transfer of very large quantities of metal from the United States resulted in European stocks rising last year –though not quite to the level seen in 1993. But the real question is much more about the level of other private stocks –whether in the form of 100-ounce bars or coin bags, for example - which might still be mobilised, quite apart from the physical metal built up by speculators in the last two years. In other words, how much will come out at what price and in what time-frame?

Conclusion

Although this paper was not intended to have a single theme (and, thus, a single conclusion) the prospects for gold and silver can be interlinked via the question of what happens to the above-ground stocks. For gold, the year of the mouse came in like a lion. Whether or not it goes out like a lamb is likely to be determined by the decisions of the official holders of the metal in both the developing and the developed areas of the world. And, for silver, as far as stocks are concerned, is the silver trade beginning to scrape the bottom of the barrel or is it going to find for some time to come a few more bars in a corner of the stock-room to fill the supply-demand gap?

**Gold 1996* and *The World Silver Survey* are available from GFMS to purchasers in the UK at prices of £75 and £45 respectively.

Graham Birch joined Mercury Asset Management in October 1993. He entered the City in 1984 and worked for Panmure Gordon, Kleinwort Benson Securities and Ord Minnett as a mining equities analyst and stock broker. Birch is a geologist and holds the degrees of BSc and PhD from the Royal School of Mines in London. His primary responsibility in the Mining Team at Mercury is to manage the Mercury World Mining Trust, the world's largest public mining share portfolio.

Gold Shares • The Growing Importance of Far Eastern Investors

by Dr Graham Birch

The importance of Far Eastern investment in the gold market is well known. Most analysts would agree that the emergence of this region as a major driving force in the gold bullion market has been, perhaps, the key feature of the last decade or more. I suppose the spotlight really came on to the region when Japan bought hundreds of tonnes of gold to mint into coins for the Hirohito programme.

Whichever way you look at the statistics, it is perfectly clear that demand in the Far East has been growing at a significantly more rapid rate than in the rest of the world. This trend seems likely to continue. In her latest report, Rhona O'Connell, of T Hoare & Co, notes the slackening off in Far Eastern demand but still believes that the growth rate will at least match the expansion rate of broad economic activity. She feels that in some countries there is still room for substantial improvement. Given that overall economic growth rates in the region (ex Japan) still look good, one is inescapably led to the conclusion that the love affair of the region with gold is unlikely to end abruptly.

In the latest World Gold Council Report on gold demand trends, we learned (what to me was astonishing news) that overall aggregate demand in China, Hong Kong and Taiwan had held stable – despite the higher price prevailing at the time. In S E Asia and Korea, the World Gold Council estimates that total demand was the second highest ever recorded – surpassed only by Q1 demand in 1995! Japanese demand was down sharply but, as the World Gold Council notes, "given that gold investments made in April 1995 and sold in February 1996 yielded a 31 % capital gain, it was surprising that investment offtake amounted to a net 20 tonnes in Q1 1996". Thus, it concludes, investor interest appears to have remained solid.

There are many different factors that have acted as Cupid's arrows in the Far Eastern/South East Asian love affair with gold. The unifying principle, however, is that they all stem from either rapidly growing prosperity (widespread among the less developed countries in the region) or what I call 'excess prosperity' (which we see in the more developed countries such as Japan).

It is a fact of life that gold flows (like water) down the path of least resistance. Thus, we notice that gold tends to pass from rich countries that are getting poorer to poor countries getting richer. Rich countries getting richer also seem to be rather fond of the stuff! There are more poor people getting richer in the Far East and South East Asia than in any other region of the world.

The myth of inflation

At Mercury Asset Management we run some of the biggest gold mining portfolios in the world and, as you might imagine, we spend a lot of time talking to our existing customers and prospective customers. One of the most common questions that we are asked in the 'Western World' is, "how can gold do well without a return to high inflation?" We are never asked this question when we travel to the East. Why should this be? It would seem that the psychology of the gold market has become compartmentalised. In the Western World, we remain fixated by the US $850/oz peak price of 1980 and cannot ever envisage market conditions which would lead to such a gold price binge occurring again – we therefore tend to dismiss gold as an asset class for serious investment. We forever link in our minds that the high prices were caused by inflation. In fact, it was not really inflation itself, more the effect of wealth transfer to the Middle East. In 1980, as oil prices went sky high, enormous amounts of global wealth were focused on a small region of the world. Much of this wealth popped up in Switzerland where the done thing in those days was to immediately deposit 10 % of client money in gold. Vast amounts of investment gold were bought in this way. These wealth transfers were the main factor driving up gold in that period, not inflation itself.

Although not oil price-driven or inflation-driven, a wealth transfer of similar magnitude is taking place today, as money pours into the so-called emerging markets. This gives these parts of the world a completely different perspective on life. In places such as Taiwan, China, Indonesia, Korea, and even Japan, the excesses of 1980 are a distant memory indeed and have no bearing whatsoever on today's decisions as to whether or not to buy gold. What is perhaps different about today's gold market, compared with that of the 1970s, is that the new confident generation of gold buyers in Asia does not need the Swiss to make its decisions for it. Even if the money did go to Switzerland, then, very little of the Swiss money would today be invested in gold. One just needs to look around the gold shops of Hong Kong or Indonesia to see that they buy their gold by weight and they buy as much as they can afford. They are, in effect, using their gold as a type of savings as money – just like the old days in Europe really! This is human nature. When a poor man is given some wealth, his first instinct is to preserve some of it. He is probably distrustful of banks – for good reason – even if there is one near to him. Even today he trusts gold. He knows that he will always be able to turn his gold into money. He may not always be able to turn his money into gold. If you don't think that this philosophy still works in 1996, then just look at the Taiwan experience when people thought that the 'Mainlanders' were about to come across the water. World Gold Council figures show that demand from this country jumped 18 % in Q1.

Anyway, I digress. The theory that gold will only be bought when people are worried about inflation is clearly wrong. To prove this we need only look at Japan.

Since the middle of last year, the gold price has risen by around 35 % in Yen terms – despite the complete absence of inflation in Japan. The first half of 1995 saw exceptionally strong demand from Japan. So, here, we have an example of investors being rather astute, 'buying at the bottom' and really 'getting it right'. Believe me, this is very unusual behaviour by investors collectively. So unusual that it demands closer scrutiny. What on earth could have driven the Japanese to behave in this way?

Back at the beginning of 1992, an investor could deposit Yen for a return of 5 % against a gold deposit return of about half a %. This equated to a penal opportunity cost of 4.5 % for holding gold. All through 1992, 1993 and 1994 the opportunity cost steadily dropped and, about mid way through 1995, we saw the opportunity cost of holding gold turn into an opportunity profit. For those institutional investors who had the foresight to buy gold with a very overvalued Yen, the next few months became immensely pleasurable. Not only did these investors receive an income pick-up versus Yen but they also received a whopping capital gain. No wonder the Japanese fell in love with the gold market! By the end of 1995, it was even possible (briefly) for investors in high interest rate environments, such as the UK, to turn an opportunity profit on gold and, indeed, I did so myself for the Mercury World Mining Trust.

"Oh well," you might say, "it is all very well for institutional investors to do this sort of thing but what about the man in the street?" Well, it is clear that he too benefited, as the number of gold accumulation plans has risen rapidly as the opportunity cost of holding gold has fallen. Some people might disagree with the relationship but it seems very logical to me and I am a great believer in doing logical things.

- It is logical for Japanese people to buy gold when their interest rates are low and gold interest rates are reasonably high.
- It is logical for Chinese people to buy gold when they want to preserve some of their new-found wealth.
- It is logical for Hong Kong or Taiwanese people to buy gold if they feel a little insecure about mainland China.

With so many people in this important part of the world buying gold for perfectly logical reasons, why should we not expect them to continue doing so if the conditions remain intact.

Speculation

Having acquired a taste for gold for all the right reasons and made some money, it is not really surprising that people should want to 'roll the dice' a few more times and start speculating in it for fun and profit. This speculation is reflected in an erratic but general increase in the open interest position on TOCOM.

For a great many years, it was conventional wisdom that the Japanese investors didn't like gold shares. I, myself, whilst a stockbroker, visited Japan on a number of occasions to try and persuade them of the merits of Sons of Gwalia or Barrick or some such company. All I ever came away with was polite smiles and no orders.

Because my experiences were not unique, Japan alone, of all the developed world markets, did not have any gold share funds for public investment. This was really quite incredible as Japan was the largest stockmarket in the world. The success of the Mercury Gold and General Fund in 1993 (up by over 300 %: source Micropal), and the record-breaking launch of the Mercury World Mining Trust in early 1994, showed to the world, however, what could be done in this sector of the equity markets. Mercury subsequently teamed up with Nomura and together we launched the Mercury Gold Metal Open Fund – Japan's first gold share unit trust. Even within Japan, few people thought it would prosper and nobody outside Japan paid it the slightest bit of attention. Even today, very few people will have heard of it in London. Yet the timing was perfect. The Mercury Gold Metal Open Fund captured the rekindled Japanese love for equities and combined it with the new-found love for gold.

This growth in fund size is probably unprecedented. From a standing start, Japan had one of the world's largest gold funds in just over a year. It has not escaped the attention of competitors. As you can see here, a rival has just been launched by Invesco and we understand that Daiwa is also launching a fund. Credit Suisse is believed to be about to go live with a new fund too.

Nobody knows yet how this will develop in the long run. At a World Gold Council dinner a few weeks ago when I mentioned the growth of the Mercury Gold Metal Open Fund, one of the top analysts present sneered that it would be a craze no longer lived than skateboards. He may be right. What we do know, however, is that the investors have so far had a very pleasant ride – massively outperforming the Nikkei.

Mercury is a fund management company and it is our job to manage funds. Although not quite as spectacular, we have also been enjoying success in other parts of the region. We manage gold funds that are marketed in Singapore and Hong Kong and we receive huge turnouts for our presentations throughout the Far East. Whenever we travel in the region we are interviewed for TV broadcasts going out by satellite to truly huge audiences. There is no doubt that the interest is there and, in my opinion, the potential is hardly scratched.

Long-term ramifications of the Japanese-Singaporean-Chinese presence in the Gold Share Market

The strange thing is that most investors and mining companies in the 'Western World' are completely unable to see the long-term ramifications of Far Eastern involvement in the gold share market. They either take the view that it is a 'here today, gone tomorrow' fad (like the analysts mentioned before) or they just think it is a quirk of nature and too far away to be of relevance. This could be dangerously complacent. This new group of regional buyers is unique in that they are or have been large buyers of physical gold. They are buying gold because they like it and gold shares for gearing. Woe betide any gold companies that take that gearing away from them!

Now the gold mining industry is actually a very small pond for the new Asian buyers of gold shares to swim in. All the gold producers in the world are capitalised at only US $70 million. This is much less liquid than the gold market. The effect of such a big swing buyer could be immense. Inflows into the Japanese funds this year have exceeded inflows into US gold mutual funds! I think that it helps to explain why the gold shares have been one of the best-performing sectors in the world equity market this year, despite the fact that gold is only fractionally higher than it was on 1st January.
There are already signs that a two-tier gold share market is developing; anyone who has looked at the share prices of the hedgers and the non-hedgers will see this clearly. The unhappy performance of Western Areas shares since that company announced its hedging strategy is perhaps the best current example.

The selectivity that is now being shown towards gold shares is presumably the stimulus behind the launch of the AMEX Gold BUGS Index – this stands for "Basket of Unhedged Gold Shares". I feel sure that it is bound to catch on with investors.

I think that the skateboard theorists will be wrong. As long as the conditions of rising prosperity and/or low real interest rates persist, then the region will remain a hugely important buyer of bullion. Now that the early birds are making money in gold shares too, the habit could prove hard to kick. As gearing-mad swing investors, the Far Eastern buyers will penalise gold miners that forward sell excessively. This will lead to the progressive development of a two-tier market in which the non-hedgers have a lower cost of capital. No Mining House that looks at the Western Areas transaction and also cares about its outside shareholders will presumably consider doing such a thing again as it would be cheaper for them to raise money through the stockmarket. The ramifications for the long-term capital structure of the gold mining industry could be profound.

Note *This article is produced by Mercury Asset Management plc, regulated by IMRO.*
Past performance is not necessarily a guide to future performance.
The value of an investment, and the income from it, may fall as well as rise and investors may not get back the amount invested.
Changes in rates of exchange may cause the value of an investment to go up or down.

The Prevailing Position of the South African Economy • With Particular Reference to Gold

by Tom Main, Chief Executive, Chamber of Mines of South Africa

South Africa's economy is the largest, most diverse and most advanced in Africa. With less than 4 % of the land space of Africa and only 6 % of its population, South Africa accounts for more than half of Africa's electricity generated, 39 % of all telephones in use, more than half of Africa's motor vehicles, more than a third of continental GNP and more than half of Africa's merchandise trade with the rest of the world.

The South African economy is broad based, with manufacturing now dominating GDP (24 % of GDP), but with mining dominating exports (47 % in 1995). The construction, agriculture, power, water and financial service sectors also added considerably to GDP. South Africa has a modern industrial and financial infrastructure, and its telecommunications and communications infrastructures are of first-world standard.

In 1995, the South African economy grew by 3.3 % (GDP) to R430.4 billion (US $119 billion), and inflation was at its lowest level in 25 years at 8.9 %. Despite a number of promising economic indicators since the 1994 general election, the political euphoria has yet to be translated into real progress in the economy. A number of structural constraints to higher economic growth rates exist.

The levels of domestic savings and domestic investment, at 16.3 and 16.6 % respectively, are far too low to sustain high growth rates, despite a substantial improvement in investment by the private business sector. Foreign capital inflows in 1994 and 1995 have assisted in supplementing the low domestic savings pool (thus, SA has run current account deficits in those years), but much of this capital is speculative in nature. The domestic business and investment environment has faced a number of uncertainties with respect to the plethora of legislation under review and, more specifically, uncertainties about the Government's economic policy direction in a number of key areas. Such uncertainties include a lack of clear, coherent government policies on abolishing exchange controls, privatising state assets, taxation policy and the functioning of the inflexible labour market.

The South African gold mining industry

Gold mining has played a significant role in the economic development of South Africa over the past 120 years. Such cities as Johannesburg, Welkom, Orkney, Springs, Benoni and Klerksdorp grew out of gold mining, and much of the country's infrastructural development of roads, electricity generation, water reticulation, telecommunications, housing and the development of industry have resulted from gold mining.

Gold mining's contribution to Gross Domestic Product (GDP)

Gold mining contributed 4.8 % in broad macro-economic terms to GDP in 1995. This is substantially down from the 17 % recorded in 1980 when the gold price peaked. Taking into consideration the indirect contribution to the economy via various multiplier effects, gold mining's total contribution to GDP is closer to 10 %. Examples of the multiplier effect include industries which provide goods and services to gold mining, the balance-of-payments impact and the employment multiplier among others. Gold mining also contributes substantially to the fiscus. In fiscal 1994/1995, the estimated total direct taxation paid by gold mining was R1.5 billion with gold mines also paying levies, tariffs, surcharges and other financial imposts at various levels of government.

Gold mining's contribution to foreign exchange earnings

Gold has been South Africa's largest export for many years and, in 1995, earned about 20 % of South Africa's foreign exchange.

Gold mining, while being a very high net generator of foreign exchange, is also a very low net user of foreign exchange. The bulk of foreign exchange still needs to be derived from exports and, in this respect alone, gold mining has a major role to play.

Gold mining's contribution to employment

Gold mines employed some 340,000 workers in 1995, representing approximately 2.3 % of the total economically active population, or 3.5 % of all those formally employed in the economy. Approximately R8 billion was paid in wages. Employment levels have been at a steady rate of decline since 1987 when approximately 520,000 people were employed in the gold mining sector.

Countries, such as Lesotho, Botswana, Swaziland and Mozambique, between them supply some 40 % of the migrant labour employed in South African gold mines. Through the repatriation of part of employee earnings, these countries derive substantial benefits in foreign exchange earnings, and the employment of their nationals.

Special characteristics of gold mining in South Africa

The development of the technical capacity to mine deep-level gold ore bodies has seen South Africa become a world leader in deep-level mining technology. This has led to a dichotomy whereby gold mining is both labour and capital intensive. This is because of the substantial capital required for ventilation, cooling, hoisting, underground tunnelling and surface processing plants, and the need to have the mines operated by large numbers of workers, particularly in hard rock mining conditions. In the case of gold mining, the depth of operations has increased to levels of about four kilometres below the surface in some cases.

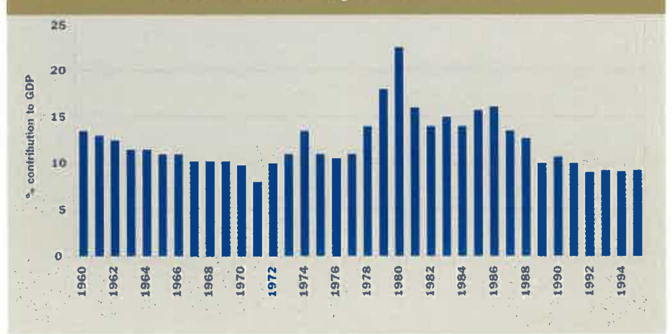
The challenges facing the South African mining industry

The most fundamental challenge facing the South African mining industry is the productivity of labour and capital and their impact on the cost of mining and extracting minerals. For most minerals, South African producers are 'price takers' as the prices are set on international markets. In order to remain competitive, particularly with many low-cost emergent world producers, South Africa's mining industry has to focus on productivity and cost trends.

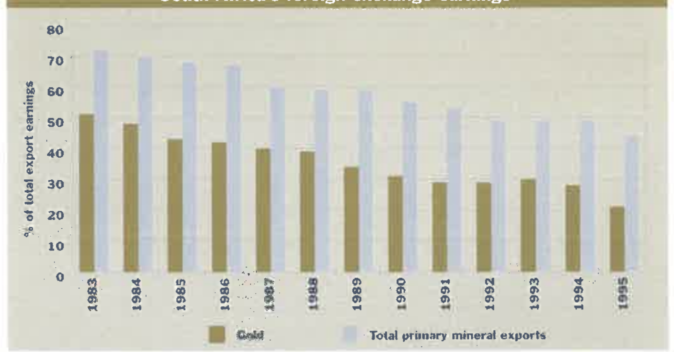
Operating margins have to remain, or become, competitive to attract investment into the industry, and to sustain existing operations. For the industry to remain competitive, it must be provided with an operating and investment environment that does not disadvantage it vis-à-vis other mining countries. Current inhibiting factors include restrictive government legislation (ring fencing, exchange controls), government intervention in the domestic economy (which has raised input costs to the industry, such as transport, taxes on fuels, etc.), high levels of domestic inflation and taxation (particularly on input costs).

To improve the productivity of labour and capital, a number of strategies have been developed, such as full calendar-year operations, two-tier bargaining and investment in human capital. An enabling economic and investment environment is also required to reduce investment hurdles rates and to stimulate further investment into the sector. Generally what is required is an economy based on a lean and efficient government and a thriving, prospering private sector based on free enterprise.

The contribution of mining to GDP in South Africa



The contribution of gold and total primary minerals to South Africa's foreign exchange earnings



Monthly average number of employees in service on gold mines, members of the chamber of Mines, (excluding contractorrs)

LBMA News

Annual General Meeting

The LBMA's AGM was held at the offices of Deutsche Bank Sharps Pixley on Wednesday, 22 May. Alan Baker of Deutsche Bank Sharps Pixley was reappointed Chairman for a third year and Martin Stokes of Morgan Guaranty Trust Company of New York was reappointed Vice-Chairman for a second year. Other members of the Committee, elected at the meeting, are as follows:

Philip Clewes-Garner, N M Rothschild & Sons Limited
Peter Fava, Midland Bank PLC
Martin Fraenkel, Chase Manhattan Bank
John Fairley, Johnson Matthey PLC
Colin Griffith, Standard Bank London Limited

In his report, Alan Baker said that 1995/1996 was a busy year for the Association. We received visits from high-level delegations from the central banks of Italy, Romania, Kazakhstan, Tajikistan, Bulgaria and from the President of Mongolia and a number of his Ministers. Particular issues addressed by the Committee were the Bank of England's Code of Conduct, a bullion market Addendum and Definitions to the ISDA Standard Agreement, VAT fiscal warehousing for silver and EU VAT harmonisation.

The specialist committees were also busy. In the Physical Committee a new Market Practice Agreement was signed by the clearing members; and steps were being taken to monitor, by means of a triennial questionnaire, the standing of refineries in the gold and silver good delivery lists.

The Public Affairs Committee gave the Association a higher profile with the publication of the new Corporate Brochure and the Alchemist – which aims to be outward-looking and to promote the London bullion market; and the quarterly publication of a Market Statistics sheet with the aim of increasing market transparency. Two lunchtime seminars were also held during the year and it was intended to continue these.

Finally, Alan Baker reported that membership of the Association had increased since the last AGM by a net 3, from 59, to 62, with the addition of Engelhard-CLAL, Bank of America, Chemical Bank and Commerzbank and the departure of Credit Lyonnais.

Annual Spring Seminar

The first of what we aim will be a series of Spring Seminars was held on 16 May at the Carpenters' Hall in London. Over 100 people attended. The subject was the "Outlook for Gold and Silver". Stewart Murray, Chief Executive of Gold Fields Mineral Services, spoke on "Gold and Silver – an End-of-Term Report", and Graham Birch, of Mercury Asset Management, spoke on "Gold Shares – the Growing Importance of Far Eastern Investors". This seminar was timed to coincide with the annual gathering in London of the Platinum and Palladium Market and to mark the overlapping interests of participants in the two markets. We are grateful to the LPPM for its co-operation in the arrangements for the Seminar. The two presentations by Stewart Murray and Graham Birch are published in full on pages 7 to 13 of this issue.

LBMA Annual Golf Day

The Annual Golf Day was held on Friday, 31 May at Clandon Regis Golf Club in Surrey. Thirty six players took part on a bright, but challengingly windy, day and all had a highly enjoyable and/or frustrating time. We are indebted to Mitsui & Co UK PLC and Sumitomo Corporation (UK) PLC who generously funded the refreshments.

In the morning, the Stableford Competition for the Jack Spall Trophy was held (it was good to see Jack himself in attendance) and the winner was Martin Turner of Chase with 36 points on count-back from Doug Bull. The guest prize was won by Terry Barnes of TFS with 37 points. In the afternoon, the LBMA Team Trophy, kindly donated by TFS, was won by Ken Easedale, Jeremy Kyd, Manny Kido and Tony Casey.

John Coley, of Deutsche Bank Sharps Pixley, as usual, did a brilliant job of organisation and – also as usual – picked up a number of prizes on the course. He was ably assisted – in the former – by Stella Thompson of the LBMA Executive. Our thanks are due to both.

DIARY OF EVENTS

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

24 – 26 June
Metals of the CIS III, Metal Bulletin Conference, Radisson Slavjanskaya Hotel, Moscow

12 September
LBMA Biennial Dinner, The Gibson Hall, London.
Principal speaker: Mr Howard Davies, Deputy Governor, Bank of England

16 – 19 September
Asia Gold Congress, Kowloon Shangri-La Hotel, Hong Kong

27 – 29 October
China Metals Conference, Metal Bulletin, Great Wall Sheraton Hotel, Beijing

End-November
Adam Smith Institute
First International Conference on the Mining and Processing of Precious Metals and Stones in the Former Soviet Union, London

8 – 10 December
South African Metals & Minerals, Metal Bulletin, Park Hyatt Hotel, Johannesburg.

"I SUGGEST A GOLD INLAY BEFORE THE MARKET TAKES OFF AGAIN"

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