Alchemist

LBMA

LONDON BULLION MARKET ASSOCIATION

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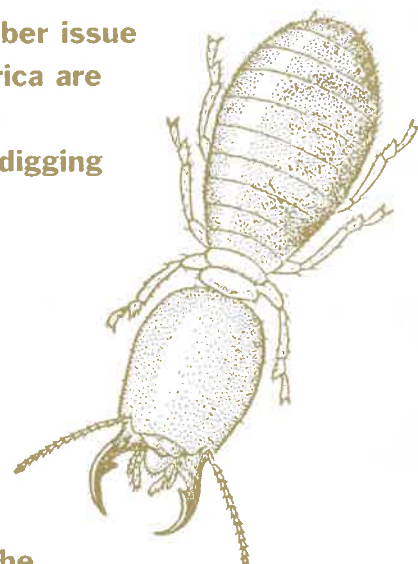
Gold Diggers

Editorial Comment by Susanne Capano

There's gold in them thar termite mounds?



Well, yes. According to an article in the December issue of National Geographic magazine, miners in Africa are testing the use of the mounds as indicators for subterranean treasure. It seems that the deep-digging insects reach depths of up to 250 feet below the surface, and then bring back whatever they find, including trace amounts of gold.

Closer to home, and above the surface, interested parties need not dig far at all to uncover the latest statistics on gold and silver clearing in London. Figures for the last quarter of 1996 were first released at a press conference in January, and published in the January edition of the *Alchemist*. For a review of the press conference – and some media reaction to the statistics – turn to the article on page three. For the most recent statistics, refer to the box on page two, as well as the accompanying Market Statistics sheet, which has been redesigned to accomodate them.

(continued overleaf)

In this issue:

• *"London is Gold Capital of the World", by Susanne Capano, Commerzbank AG, London Branch.*

• *The Demand for Physical Gold: The Impact of Asia, by Richard Lee, Rothschild Australia Ltd.*

• *The Hedging Debate: The Ayes Had It, by Chris Elston, Chief Executive, LBMA.*

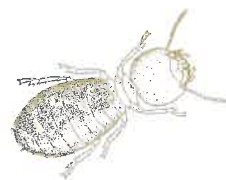
• *Silver Survey, by CPM Group.*

• *Go to GOFO=, by Susanne Capano, Commerzbank AG, London Branch.*

• *LBMA News: Chris Elston, Chief Executive, LBMA.*

Hedging row - The question of whether or not mines ought to hedge gold has been the subject of many discussions among market participants over the years. On 19 February, it was the topic of the LBMA's first overseas function: a debate sponsored as part of the Société Générale Frankel Pollak 20th Annual Investment Conference in Johannesburg and Cape Town.

The motion, "This house applauds the practice of hedging by gold producers", was proposed by Kelvin Williams of Anglo American Corporation and Guy Manuell of Normandy Mining, and opposed by Graham Birch of Mercury Asset Management and Brett Kebble of Randgold. The scene was set by Stewart Murray of Gold Fields Mineral Services. Two hours of brisk debate were followed by a formal audience vote, the results of which can be found on page eight.



Spotlight on silver - It is formed into everything from electronic components to dental filllings, coins to teapots. Ancient Egyptians valued it more highly than gold. More recently, it caught the fancy of a pair of millionaire brothers from Texas, though that love affair ended on a sour note. Although most traders today do not hold silver at quite the level of esteem of the ancient Egyptians or, for that matter, the Hunt brothers, it remains the focus of much attention. We have abstracted CPM Group's recently published 1997 edition of its Silver Survey in an article on page 12.

Asian gold - Asian physical demand for gold has outpaced that of the Western world, increasing at nearly double the Western rate during the last decade, and reaching the point where it now accounts for 46% of all demand. On page five, Richard Lee of Rothschild Australia Ltd., takes a look at what lies behind the phenomenal rate of growth and prospects for its continuation.

Letters to the editor - With two year's worth of issues behind us, and many more issues worth discussing, it's time we found out what *you* think. If you'd like to give us a piece of your mind, please send your letters to Susanne Capano, c/o LBMA Executive, 6 Frederick's Place, London EC2R 8BT ■

Susanne Capano, Editor

Clearing Turnover Statistics

The figures for the first quarter of 1997 show that average turnover activity for both metals increased from the final quarter of 1996, silver by 10.5% and gold by nearly 30%. February was the most active month for gold on record so far. As the price reached three-and-a-half year lows, $14 billion worth of the metal traded each day, versus an average of $11 billion over the final quarter. The ounces transferred increased by approximately a third during that month to 40.3 million over 1996's fourth quarter average of 29.50 million. March reflects a return to more normal trading patterns as price volatility and trading volume levelled off.

Beginning with the current issue of Market Statistics, the front page has been amended to include the most recent six months of clearing statistics together with the same period of Gold and Silver Fixings.

The new figures should not be interpreted as a precise counter of the gold and silver cleared in London: netting between counterparts precludes the possibility of accounting for every ounce of gold or silver transferred. The value of the statistics is more as a barometer of market activity than as a precise measure of total turnover.

"London is Gold Capital of the World"

The Guardian

by Susanne Capano, Precious Metals Trader, Commerzbank AG, London Branch

"For those of you who came to see 'a market showing its underwear in public', as one analyst suggested, I'm afraid I have to disappoint you", Alan Baker began his speech at the LBMA press conference on 29 January, where clearing statistics for the London Bullion Market were revealed for the first time.

Although no underwear was showing as assembled press, numbering 35, gathered to hear the announcement, no one present appeared disappointed. Speeches by Alan Baker and Martin Frankel, both of the Management Committee, introduced reporters to the current structure of the gold market in London and the role played by gold in today's financial market place.

Gold no longer reacts as violently as it once did to world events and its movements may be more easily influenced by a computer-driven trading fund than by movements taking place in other markets. It still remains, however, a uniquely flexible asset among a range of financial investments being, as we all know, the only financial asset which is no one else's liability.

Next the speakers turned to an explanation of the method used for gathering and determining the figures, before finally revealing the actual data. The numbers for October, November and December 1996, published in the winter edition of the Alchemist, spoke for themselves: on average, 30 million ounces of gold, valued at over $10 billion, and 250 million ounces of silver, valued at over $1 billion, were transferred each day. Even though most had anticipated that the amounts would be sizeable, the final tally drew surprise and attention – not only to the importance of London as a clearing centre for gold and silver, but to the depth of the bullion market worldwide.

Following are some extracts of media commentary:

FINANCIAL TIMES (30 Jan)

"Many people will be very startled to discover that the global bullion market is very big indeed... yesterday the London Bullion Market Association lifted the veil to quantify the volume of bullion business cleared in London, the international settlement centre for gold deals."

DAILY TELEGRAPH (30 Jan)

"London claims to have the world's biggest market in gold but has never until now published the figures to prove it... the LBMA and its mentors in the Bank (of England) are right to say more about their market. They cannot leave it to speak for itself, and gold's enemies will continue to decry it."

MINING JOURNAL (31 Jan)

"Although London is known to be the main centre for clearing gold trades, the size of the figure is surprisingly large... [it] indicates the importance of London in the international gold market."

GUARDIAN (1 Feb)

"... as the London Bullion Market – the biggest in the world – this week made clear, gold trading and settlements of gold deals remains a huge business."

GUARDIAN (1 Feb)

"LONDON IS GOLD CAPITAL OF THE WORLD... this total dwarfs the competition, principally America's Comex / NYMEX exchange, Tokyo's Tocom and the tiny Zurich market... not only are about 86 per cent of gold deals settled in London, but the City also lays down the currency in which the deals are to be paid: the London 'good delivery bar'."

The only negative notes to be sounded centred on the idea that the revelation of any facts at all by the London market was a compromise of confidentiality and might drive business elsewhere, as an analyst quoted in Metal Bulletin's 3 February edition suggested: "... it would be a grave mistake to think that the new disclosures will help London's trade, as I think in reality it will level the playing field and help other markets, particularly Switzerland". And a trader quoted in the 29 January Evening Standard suggested: "This move is more likely to discourage activity here. If there is a deal between two people in Singapore which is settled in London, and which will now appear in the statistics, they may think twice about settling it here."

Chris Elston of the LBMA Executive responded to these propositions with a letter which appeared in Metal Bulletin on 28 February, saying in part:

"Loss of anonymity suggests the revealing of client names. No names are being revealed, whether publicly, within the market, or to the LBMA Executive, where the figures contributed by the eight Clearing Members are aggregated.

Perhaps what is feared is loss of confidentiality. No confidences, in the form of the size or precise timing of any individual deals or, indeed, in any other form, are being revealed, either publicly, within the market, or to the LBMA Executive.

The so-called 'Market Analysts' who postulate that some London market users might consider moving business to Zurich – because of the LBMA's publication of statistics evidencing its considerable volume of clearing turnover – seem to display considerable naivety in their assessment of the strength and depth of the London gold market.

Would there be any sense in deliberately taking a large transaction outside the London market and placing it into a smaller, less liquid market, where it would stand out much more prominently? I would suggest not.

What the newly published figures show is that the international market – not just the London market – in Loco London gold is deep enough for such large transactions to pass with hardly a ripple."

The Demand for Physical Gold

The Impact of Asia

by Richard Lee, Managing Director, Rothschild Australia Ltd.

The focus of the physical gold market has turned from the North Atlantic to the Pacific. Not only is the Asian region (including the Far East Asian countries, China and the Indian sub-continent) the largest consumer of gold today, but it is also the fastest growing in terms of gold demand. The pace of economic development and the increased wealth in many of these countries has fundamentally important implications for gold demand over the next decade.

WHY IS ASIA SO IMPORTANT TO THE GOLD MARKET?

Showing the top 15 countries in terms of gold fabrication demand (*Table 1*) clearly demonstrates why the Asian market is so important to the present and future of the gold industry. Nine of the top 15 gold consumers for fabrication fall within the Asian region (Asia includes the Indian subcontinent).

Since 1986, world fabrication demand has increased 66% (from 1,955 to 3,257 tonnes). Over the same period, Asian fabrication demand has increased 123% (from 667 to 1,491 tonnes).

It is worth highlighting that the Asian region is both the largest consumer and has the fastest growth in gold demand. In the base metal markets, greater focus is now being given to the Asian region because of its high growth rates over the past decade, relative to the developed world. However, this region still represents less than 30% of total base metal demand. In contrast, Asia (excluding Japan) accounts for 40% of total gold fabrication demand and, including Japan, this share increases to 46%, up from 34% in 1986.

Asia's attraction to gold has been driven by two main factors: traditions, which have ensured gold plays a major role in peoples' lives, and the lack of alternative forms of investment. Therefore, increases in the region's wealth will both underpin further growth in demand for gold but also raise questions over its sustainability in the face of increasing investment options.

Table 1 Gold Fabrication Demand

	Total Fabrication Demand 1995 (tonnes)	Growth Rate since 1990 % p.a.
Italy	457.9	3.0
India	426.1	12.1
US	250.3	3.0
China	203.8	35.1
Japan	187.2	-1.8
Saudi Arabia & Yemen	156.1	17.4
Indonesia	133	9.6
Turkey	125.6	-1.2
Taiwan	110	2.4
Hong Kong	86.9	10.8
South Korea	80.9	3.8
Thailand	79.1	-1.5
Malaysia	77.8	11.6
Germany	70.4	-1.9
Egypt	60.7	-2.5

Source: Gold Fields Mineral Services

JEWELLERY DEMAND IN ASIA: THE IMPORTANCE OF INDIA

As Asian countries have developed and the population's wealth has increased, there has been a greater desire and ability to wear jewellery.

As *Table 2* shows, India is the largest consumer of gold jewellery. It is wedding and festival demand that underpins this position. There are an estimated 10 million wedding ceremonies each year, with an average of 30 grams of gold bought for each wedding. Much of the growth in demand for gold in India can be traced to the country's

Table 2 Estimated Jewellery Consumption

	1995 (tonnes)	Growth Rate since 1990 % p.a.
India	370.8	10.2
US	311	-33.4
China	272	23.7
Suadi Arabia	162.8	13.8
Indonesia	125.5	8.6
Italy	112.7	-5.5
Japan	105	-4.1
Taiwan	99.6	1.0
Turkey	98.3	-4.2
Egypt	64.7	-2.4
Germany	61.4	-1.3
South Korea	61.3	1.4
Hong Kong	58.4	9.7
Thailand	54.4	-5.2
Arabian Gulf	50.2	9.1

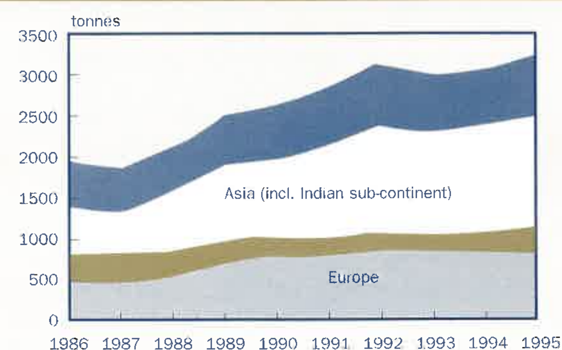
Source: Gold Fields Mineral Services

rapid population growth over the past decade. Recent evidence suggests, however, that while the total volumes of gold required are increasing, the quantities bought for each occasion are dwindling.

India's huge consumption of jewellery comes despite having one of the lowest economic growth rates per head for the five years up to 1995. However, the pace of Indian economic growth has picked up since 1994, and the potential for continued development over the next decade is enormous, given its population and widening ties with the developed world. As the population has grown, so has the volume of gold consumed. Another major contributor to the growth in Indian gold demand has been the liberalisation of India's physical gold market. The removal of restrictions on the issuing of licences to goldsmiths has resulted in a flood of new producers onto the market, contributing to the 82% increase in gold demand since 1991.

Accordingly, the combination of higher per capita wealth, liberalisation of controls, and population growth should lead to India continuing to be the leading consumer of gold jewellery into the next decade.

World Gold Fabrication



Source: GFMS

INVESTMENT DEMAND

In addition to the traditional reasons for buying gold jewellery, gold remains a major investment vehicle for much of the developing world, in contrast to the developed world, where in recent years such events as the Gulf War, the bond market crash of 1994 and the US dollar crisis of 1995 have failed to excite the gold price.

For countries where economic and political instability remain major concerns, gold is still seen as the best safe haven, particularly for people in rural areas, where gold is still considered a form of security. Hoarding of gold jewellery, coins and bars has been common throughout Asia. Evidence of gold's popularity in response to specific events in the Far East can be seen in the significant increase in China's demand for gold after the Tiananmen Square incident in 1989 and Taiwan's record month of gold imports in March last year, coinciding with the threat of Chinese missile attacks.

Japan and India are clearly the largest consumers of gold bars. The trend in many of the Far East Asian countries has been for a general decline in demand. However, the Indian subcontinent's demand for gold bars continues to grow, along with its growth in jewellery.

Table 3 GDP per capita growth

G7	Real GDP per capita growth 1990-1995 % p.a.	Asian 9	Real GDP per capita growth 1990-1995 % p.a.
US	0.9	China	10.4
Japan	1.1	Thailand	6.8
Germany*	3.1	Korea	6.5
France	0.4	Singapore	6.4
UK	0.8	Malaysia	6.0
Italy	1.3	Taiwan	5.6
Canada	-0.7	Indonesia	5.5
		India	1.5
		Philippines	0.1

*Note: Germany's growth rate is exaggerated by the effects of reunification
Source: Datastream

Some warning signs lie ahead, however. Improved living standards in Asia may also eventually serve to limit its potential for gold investment demand. The introduction of more sophisticated financial markets is inevitable as these economies develop, which will open up a whole new world of investment options to the average person. As bond and equity markets develop, it is reasonable to expect that gold will lose some of its role as a savings vehicle. It may take some time for the general population to become educated and for the average person to trust these new investment vehicles, but the weakness/stability of gold over recent years will make it difficult for it to compete with potential returns offered by these new markets.

DEMAND FROM ASIAN CENTRAL BANKS FOR RESERVE ASSETS

The Asian central banks have historically given a low priority to monetary gold in their reserves. Some analysts have suggested that, as these Asian economies develop, there may be a sudden increase in the demand for gold as a reserve asset. While it is true that most Asian countries hold very little gold in central bank reserves, it is unlikely that they will want to boost the proportion of foreign reserves held in gold assets to the high levels of the US (two thirds of total reserves) or European central banks (average 37%).

The rise in economic growth in the Asian region has coincided with the region's central banks adopting more modern business practices. These central banks are more likely to follow the reserves management practices of their Pacific neighbours, such as the Reserve Bank of Australia, rather than their European counterparts.

The RBA has maintained for some time that it should be possible to operate the international payments system on much lower levels of reserves – particularly with a regime of floating exchange rates – and certainly a much lower proportion of gold in total reserves.

WHAT IS THE POTENTIAL FOR ASIAN DEMAND?

Living standards in the developing Asian countries have improved rapidly over the past decade and, particularly, over the past five years. Real GDP per capita growth *(Table 3)* seen as a measure of improvement in living standards provides a basis for comparing the developing Asian region with the developed G7 countries.

Demand for gold from the Asian region has increased in line with this improvement in living standards. As per capita incomes have grown, so has the desire and ability to wear gold jewellery and to use gold as an investment vehicle.

Growth in this region has been a key driver of gold demand for the past five years and, given that this improvement in wealth and living standards still has some way to run, it will continue to drive gold demand for both fabrication and, to a lesser extent, investment into the next decade ■

Richard J Lee

Richard Lee joined Rothschild Australia in early 1986 as Director of Banking. In mid-1987, Mr Lee moved to Western Australia with part of his banking team and established Rothschild's Perth office as the operational centre of the Group's client-based bullion business. Mr Lee returned to Sydney in early 1990 and broadened his responsibilities to include the direction of Rothschild's banking activities in the Asia Pacific region. In 1992, Mr Lee was appointed Managing Director of Rothschild Australia Limited and, in April 1994, assumed the position of Chief Executive of the Rothschild Australia Group. He was recently appointed Global Head of Rothschild's banking activities in the natural resource industries. Mr Lee is also a Director of N M Rothschild & Sons Limited, N M Rothschild & Sons (Singapore) Limited and is Chairman of the Rothschild Australia controlled gold refining affiliate, Golden West Refining Corporation Limited.

Prior to joining Rothschild, he spent 16 years in the Sugar Division of CSR Limited. His principal responsibilities related to the marketing and financing of Australian raw sugar production and policy matters relating to the international sugar trade and the regulation of raw sugar production and the Australian domestic sugar market. He has maintained this interest through various activities in the Australian market since joining Rothschild.

THE LBMA BURSARY

For the 1997/98 academic year, the LBMA has decided to offer to the Royal School of Mines, Imperial College, London, a bursary to finance an overseas student for a one-year MsC course. The value of the bursary, after tax benefit has been received, is nearly £18,000.

The only stipulation is that the student should be acceptable to the Royal School of Mines and should come from a developing country with a domestic mining industry.

This bursary alternates by year with one offered to the Camborne School of Mines, University of Exeter, on the same basis. The latter bursary will be available for the 1998/99 academic year.

The Hedging Debate:

The Ayes Had It

by Chris Elston, Chief Executive, LBMA

To hedge, or not to hedge, that is the question-

Whether 'tis nobler in the mind to suffer

The swings and traumas of outrageous volatility,

Or to take out protection against a sea of speculators...

Offering his own version of Shakespeare's Golden Rule, Alan Baker of Deutsche Morgan Grenfell and LBMA Chairman introduced the first LBMA Debate. The international panel discussed the Motion "This house applauds the practice of hedging by gold producers".

The Michelangelo Hotel, Sandton was the venue for the Debate, which was followed by a cocktail reception for the guests, who came from a wide cross-section of the mining, investment and dealing fraternities. It formed part of the 20th Annual Investment Conference of Société Générale Frankel Pollak to whom for their encouragement and help the LBMA is much indebted.

Alan introduced the speakers: Stewart Murray (Gold Fields Mineral Services) to set the scene, Kelvin Williams (Anglo American Corporation) and Guy Manuell (Normandy Mining Limited) proposing the Motion, and Graham Birch (Mercury Asset Management) and Brett Kebble (Randgold) opposing.

Alan suggested three thoughts on the concept of hedging:

- *The dividing line between hedging and speculation is a thin one.*
- *Not to hedge is to speculate.*
- *It is not always necessary to hedge but sometimes it is foolish not to.*

He concluded by describing why hedgers in the gold market find themselves in a unique situation: while other metals can be analysed in terms of the fundamentals of supply and demand and the external economic situation, in gold a wild card exists in the deck - the stocks held by central banks, whose intentions remain clouded in mystery. It is these stocks which provide for probably the most efficient hedging and financing facilities in the world of commodities.

Setting the scene

In painting the backdrop Stewart Murray commended the LBMA for the timing of their Debate since over the two previous years we had seen, in 1995, an unprecedented supply from producer forward sales and, in 1996, an unprecedented fluctuation in producer positions with, over the year, little net change. Claiming to be daunted by addressing such a gathering of specialists, he drew comfort from his role as the bean-counter of the international bullion market.

Murray provided a brief history of hedging: the modern version dates from the early 1980s and as the years passed expanded in both volume and types of products. Gold loans were followed by forward sales, which were in turn followed by options in all their wondrous flavours. These products fulfil the differing needs of all players involved. These he saw as (i) financing new mine production; (ii) fixing the future price of gold not yet produced; (iii) interest income for lenders, i.e. mainly central banks, and (iv) revenue for bullion banks and dealers.

LONDON BULLION MARKET ASSOCIATION

Murray then contrasted the contangos present in the gold and silver market over recent years with the almost continuous backwardation in copper, and noted the considerable differences between short- and long-term gold leasing rates. He noted the difficulty producers face in deciding whether to go for fixed or floating lease rates given the side volatility of rates and the difficulty of matching the producer's preference for a long-term arrangement with the central bank lender's usual reluctance to lend much beyond one year. This potential mismatch provided the bullion bank with a vital role in intermediating between the ultimate borrower and lender and ensuring that short-term positions could be rolled over to provide the long-term cover sought by producers.

In concluding Murray described the impact of hedging on the spot physical market. The existence of some 30,000 tons of gold in central bank reserves made gold hedging very different from that of any other metal. It was the willingness of the holders of this gold to lend their metal cheaply which had underwritten the steady increase in hedging positions over the past decade or more. As a result, he noted, some of the gold stated as being held by central banks was in fact hanging around the necks of ladies in the Middle East or India. GFMS estimates showed that world forward selling positions had taken off from a negligible level in 1984 to around 1,700 tonnes in each of 1995 and 1996, with Australian, North American and South African producers all prominent.

For the future Murray found it difficult to judge whether the hedging business had reached a mature position and was therefore likely to level off. One pointer, however, was the still large proportion of central bank reserves unattached to hedging programmes. What in his view was clear, was that gold hedging would remain substantial and interesting.

The Debate

In proposing the Motion, Kelvin Williams set out to refute the arguments used by anti-hedgers. First, hedging was not speculation, he said, but the converse. It was a modest locking in of the return on the massive capital investment made to acquire access to reserves. For the majority of gold producers, hedging was seen as a fundamental tool - and only one among many - for managing financial and market risk.

Secondly, there were many reasons for hedging and they were often mine-specific. There was the obvious benefit of the price leverage obtained through the contango, there were the benefits of being able to manage one's price rather than be a passive price-taker, there was revenue and budget certainty, profits and dividends could be smoothed, capital expenditure programmes could be protected from interruption or abandonment owing to a fall in the gold price, the cost of capital could be lowered as banks were offered the security of a known sales price and revenue flow, and in areas like South Africa producers could provide greater security for all stakeholders through continuity of operation.

Thirdly, Williams turned his guns on those who expressed concern about the negative effect of hedging on the gold market itself and the depressive effect on the supply/demand balance of bringing forward future physical production to current market supply. This was a superficially sound, but mistaken argument, since price movements were more often than not influenced by players other than the gold producers.

Williams went on to criticise

those who thought that the natural movement of the gold market was always upwards. It may have been true once, but was no longer the case. The current market was more liquid and like most markets was two-way. Price rallies today therefore were more likely to be stopped out by the absence of follow-through of investor and speculator buying or by profit-taking by those speculators; physical demand very soon dried up at higher price levels; and central banks could add to the dampening effect as short call option positions moved into the money.

Why did not the critics of hedging, therefore, also direct their fire, if their ambition was to remove a hypothetical price cap, on to the central banks, the IMF, most Middle and Far Eastern holders of gold investment instruments, floor dealers on Comex and fund managers in the developed markets? It was significant, he claimed, that when in late 1995 and early 1996 three major North American producers adopted the exact course advocated by the critics of hedging and bought back millions of ounces, it made no difference whatever to the price of gold.

Williams also asserted that the idea that investors were not enamoured of companies that hedged was mistaken. The evidence suggested otherwise: the share price of the 10 or 12 largest hedging producers in Australia had out-performed the ASX gold index by a substantial margin.

In opposing the Motion Graham Birch set out his stall as the successor to Julian Baring who had started MAM's well-known campaign against hedging. He was, he said, happy to take up the cudgels and oppose what he called "this deplorable Motion". He firmly believed that the effect of hedging on the gold industry was like drug addition: it gradually took a firmer grip and it sapped energy. There was only one cure: cold turkey.

Close out the speculative gold hedges today and practically every mining company could walk away with a profit. Would they do it? Sadly, he thought not. It was hard to give up when you were ahead. But, he warned, it was even harder when you were down - a position that few miners had experienced in the Golden Contango Casino.

Birch sought to dispel the view that hedging had no depressant effect on the market. He cited in evidence several analysts quoted in Alchemist No. 6 who all saw hedging as a contributory factor to market weakness. The most alarming part was that producers were selling more and more of the gold not yet produced at lower and lower prices - the action of an out-of-control gambler and creating a dangerous dealing house environment in which the "double or quits" culture appeared to be rewarded. Were there, he asked, adequate controls in place to prevent reckless trading?

Birch next criticised the complexity of so many hedging programmes, which was such, he claimed, that not even the directors of the hedging companies could understand all their ramifications. He cited one example where it was impossible for investors to understand the hedge details; they therefore decided it looked too risky and sold the shares, which duly plummeted.

He also criticised the producers who were happy to lock in low prices at a profit margin of, say, only $50/oz above costs, when investors had to pay, say $100/oz above costs for gold in the ground. That was as much fun for investors as tearing up £10 notes under a cold shower. The more gold that producers pre-priced at low levels, the surer the investor became that he was unlikely to see a return, so he sold his shares.

Left to right
Jessica Cross, Crosswords Research
Sandy McGregor, AGIC Limited
Alan Wright, Gold Fields

A further worrying portent was that to justify the economics to their bankers, producers were having to hedge further and further forward: 12-year deals were now commonplace - scary stuff, especially when one realised that most of the directors who signed the contracts today would be safely retired when they matured.

Birch next sought to counter the miners' claim that hedging provided revenue and budget certainty. A delusion, he claimed. If the price of gold fell during construction of a project, so that the mine was no longer viable, then it was no longer viable, however much hedging was in place. In his view, if a project could not withstand a period of low prices it should remain undeveloped.

Looking to a possible ghastly vision of the future, he saw gold mining companies laying the foundations for an almighty bull market in hedged metal. Prices could rise to where the losses on hedge books became significant. Lending banks could begin to pull the plug, central banks could become nervous about lending short to bullion banks who had lent long to the mining companies. Gold interest rates could soar, institutional investors could pile into gold for the first time in a generation. What option would that leave to the management of a hedging company other than to make for the nearest window-sill?

Birch concluded by seeking to persuade producers to reverse their hedging strategies to their own advantage (the gold price would rise, or a low gold price would make them leaner and fitter, they would face less risk and would be more attractive to investors, so that the cost of capital would fall). And he suggested that investors should demand that mining companies should eat their cold turkey, take their profit while it was there and propose that all hedging programmes should mature before the Chairman's retirement date.

Next Guy Manuell spoke in support of the Motion. Whereas Kelvin Williams had sought to refute the arguments of the anti-hedgers, Manuell's aim was to put the positive arguments for hedging.

These were the familiar ones of:

- enhanced revenue and budget certainty;
- revenue predictability enabling stock analysts to make more informed comment on profitability;
- additional revenue allows more exploration and faster development;
- continuation of profits and dividends;
- otherwise uneconomic ore can be mined or low-grade ore such as tailings can be processed;
- in the event of a fall in the gold price, revenue from hedging can meet the high cost of closing a mine or putting it on a care and maintenance basis;
- the creation of employment in corporate treasuries and bullion dealers.

Hedging, said Manuell, was not speculation, which was risk-taking. It was, on the contrary, risk-management. He concluded by waving a headline from that day's Australian Financial Review: "Normandy hedges pay off in profit rise". He rested his case.

Finally Brett Kebble, in support of the opposing Motion, said investors bought gold shares because they sought exposure to the gold price, not to an arcane hedging policy. Producers who hedged put themselves in the hands of the bullion banks and dealers, the highly-paid bears who made the most money out of the gold industry. Randgold did not hedge and it out-performed hedged mines such as Western Areas, Freegold and Beatrix.

In Kebble's view, it was cheaper to issue equity than to engage in hedging schemes and the gold price would be higher in the absence of hedging. He concluded by echoing the Shakespearean tone with which Chairman Alan Baker had begun: "Alas, poor Barrick....."

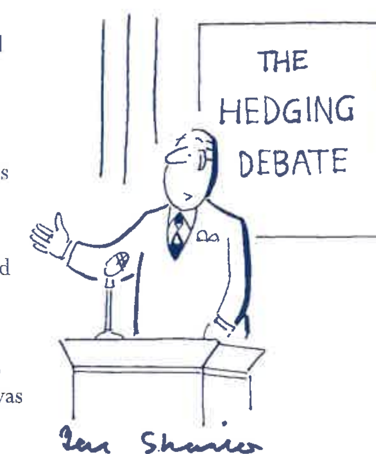
When the Debate was opened to the floor the first on his feet was Bill Nairn, Chairman of Western Areas. He disagreed fundamentally with Graham Birch: he knew precisely what his hedging strategy was all about. His South Deep system required R2.7billion for a 7-year project. Hedging was the way to raise that sort of money: it could not have been raised in the equity market.

John Brownrigg, MD of JCI's gold division, pointed out that Brett Kebble's Randgold had out-performed non-hedgers more than hedgers. Anglogold's Nigel Sutherland argued that gold, like any other commodity, was cyclical. A relatively small hedge kept a mine and reserves in play during bad times and enabled them to take advantage of the spikes.

Guy Manuell came back with the statistical fact that since 1980 the 5-year contango had been such that maturing hedges were invariably above the spot price - a clear vindication of a relatively short-term hedging programme.

The Final Vote

Ultimately, after two hours of debate and due consideration of all the arguments, the audience of about 110 voted 66-16 in favour of the Motion. Debate was lively, but never rowdy, and we are extremely grateful to our speakers for their contributions and to our audience for their participation in a timely debate on a topical subject. There are many entrenched views on the issue and it is doubtful if any of them were changed by the arguments presented. But we at the LBMA saw value - and we hope our audience did as well - in bringing the many-faceted arguments on both sides into sharper focus in a single public forum. The fact remains, of course, that there is no one answer: the decision to hedge or not to hedge depends on a wide range of variables which are specific to companies, to areas and individual mines, to time and to a whole range of financial and gold market factors ■



Silver Survey

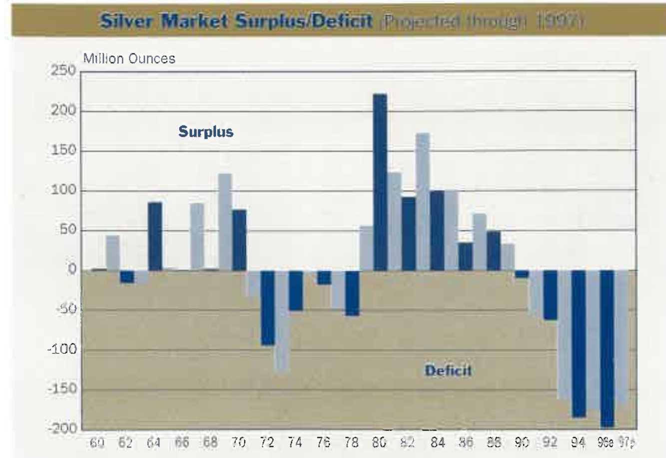
by CPM Group

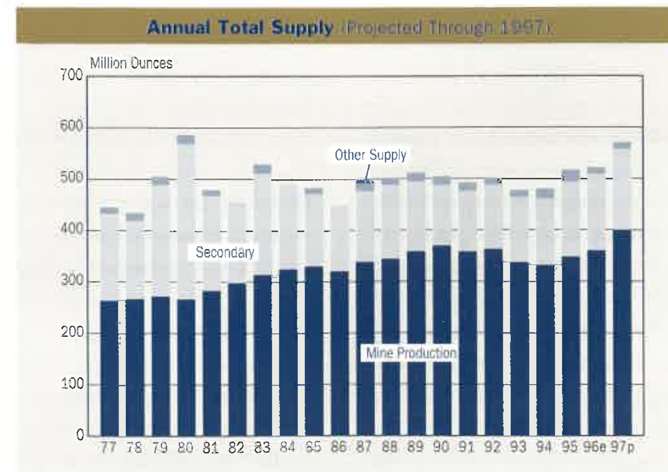
CPM Group's recently released Silver Survey 1997 shows that the silver deficit widened during 1996, as supplies at their highest level since 1980 were once again outstripped by growing demand. The deficit is projected to narrow, however, during 1997.

The following highlights are abstracted from the Silver Survey.

SUPPLY

Silver supplies remained essentially flat during 1996, rising just 0.9% from 517 million ounces in 1995. However, they are projected to rise a strong 9.4% in 1997, to 570.6 million, taking supply levels near the record high of 586.8 million reached in 1980, driven by an increase in mine production to a record 400 million ounces.





New Mine Production

Total silver mine production grew to an estimated 359.9 million ounces during 1996, boosted not only by growing production from primary silver mines, but by increased copper, gold, zinc and nickel mining. This is a 3.5% rise over the 1995 levels, an increase that is projected to augment rapidly during 1997 as new mining operations continue to come onstream. By far the largest silver producing nation is Mexico, which contributed 75 million ounces during 1996, an 11.4% increase over the previous year. Peru, the second largest silver producing nation, accounted for 55 million ounces.

Scrap Recycling

Scrap recycling plants should see a continuing steady supply of material, not from price-induced recycling, but from growing fabrication demand resulting in higher levels of scrap. In recent years, most silver refined from scrap has come from industrial scrap – old catalysts and batteries and photographic materials. It has not come from the recycling of jewellery, silverware and old coins – as was the case when spot prices rose as high as $48 per ounce in 1980. In fact, currently, only 1.7 million ounces of recycled silver comes from old coins, an amount that has remained fairly constant for the past three years and which last year represented only approximately 1% of all recycled silver.

Dishoarding of silver decorative objects and jewellery by private individuals in India no longer plays an important role in supply. Prior to 1990, when India's struggling economy was further beset by natural disasters, the hardships placed upon families often led them to sell silver bearing decorative objects. The drop in these sales represents a combination of the strong growth the economy has begun to experience and an absence of natural disasters affecting the rural economy.

Other Supply

Government disposals fell sharply from high levels in 1995, which had been boosted by Indian Government sales of illegal imports of silver. In order to meet rising demand and reduce the large quantities of silver being smuggled into India, special import licences were introduced in 1994. The result was that last year saw an estimated 965,000 ounces smuggled, compared with 20.3 million ounces in 1993.

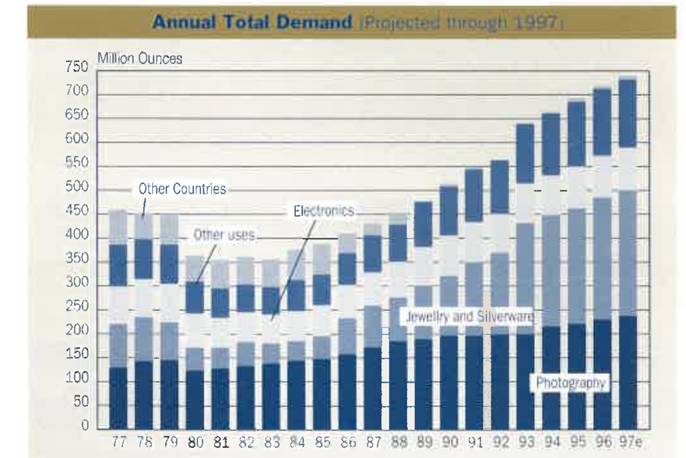
DEMAND

Fabrication Demand

Silver demand rose in all major sectors in 1996, leading to an overall increase of 3.8%. This is expected to be followed by a more modest increase of 2.8% during 1997, which assumes positive worldwide economic conditions next year.

Rates of increase varied acording to sector, with the largest growth seen in jewellery and silverware. There were divisions among geographic regions as well, where the sharpest increases came from emerging economies, led by India, Thailand and Mexico. Emerging economies now account for 32.4% of all silver fabrication demand. The largest consumer remains the United States, which used an estimated 146.7 million ounces. Demand in Japan, the second largest consumer, rose nominally from its level of 123.2 million ounces to a record 124.3 million ounces, due to strong growth in the photographic sector. Indian demand, fuelled by a new influx of supplies, rose 13.9% after two straight years of decline. Demand for silver jewellery there actually fell somewhat, as more affluent consumers turned to gold jewellery instead, but silver decorative items remain the gift of choice for weddings and business occasions.

It is generally assumed that higher silver prices will dampen fabrication demand, however, in reality, the effect of higher prices depends on the application. In many industrial applications, such as



electrical components, there is no suitable substitute for silver, and its cost relative to the final cost of the unit produced is nominal. Photographic demand proves somewhat more elastic in its response to higher prices, but the effect is limited. The temptation when the silver price rises might be to cut back on the amount used per unit, but quality and speed of film can become compromised. Jewellery and silverware, however, being discretionary purchases, tend to be affected by higher silver prices.

Investment Demand

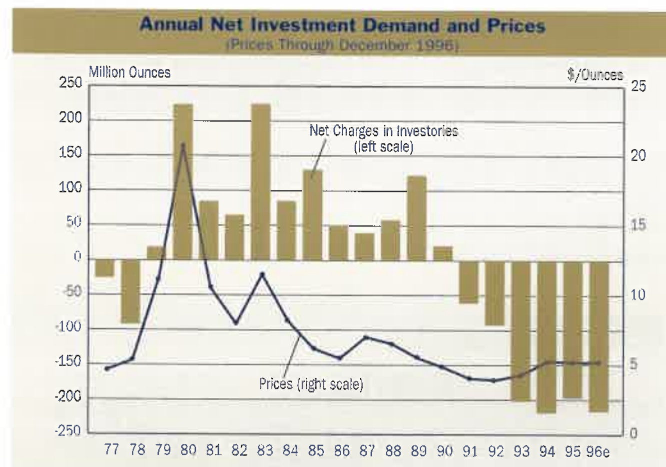
During 1996, investment demand in all precious metals surged at the beginning of the year, propelled by fears that the equity markets might have run out of potential. It proved to be the opposite case, however, and, upon realising that, investors fled the precious metals market with as much enthusiasm as they had entered it. They stayed away from silver for the balance of the year. Investment demand being the driving force for price direction, it is not surprising that

silver prices peaked in early February and thereafter fell into a decline that lasted into the beginning of 1997 as the US and other equity markets continually climbed.

In increasingly illiquid markets, silver became more vulnerable to short-term trading strategies put in place by banks and dealing companies, as well as short-selling by a number of smaller commodity funds dealing primarily in the futures options markets.

What might awaken investor interest?

A sudden, sharp decline in equity markets would not necessarily send investors immediately scurrying for silver, as corrections have recently been seen only as buying opportunities. What is needed to turn investors sour on equities would be a perception that they had maximised their value and no longer had the potential to provide double-digit returns.

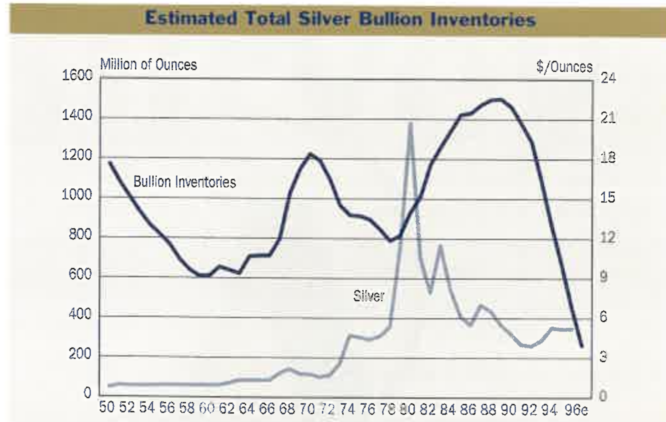


Alternatively, investors interested in silver purely as a commodity could become buyers if, on a fundamental level, underlying strong demand and tightening supplies lead them to conclude that it is undervalued.

INVENTORIES

Participants in the silver market have long wondered how much silver exists worldwide in available stocks, and how price sensitive holders of the stocks are. Watching demand outstrip supply for seven years running without the price able to sustain significant progress from its low of \$3.523 on 2 February 1993 leads to a certain amount of bafflement.

The solution to the puzzle lies in the existence of large unreported inventories of refined silver. As long as the holders of these stocks have been willing to liquidate them at prices close to the market, the effect has been to dampen any rally that shortfalls might cause. This situation has existed in the past. For example, from 1950 through 1959, fabrication demand outstripped new supply by nearly 600 million ounces – but the US Treasury had a stockpile of more



than 2 billion ounces, which it readily sold to users. Again, from 1971 through 1978, deficits existed and, by the end of that period, much of the accumulated stocks had been drawn down.

After the 1979–1980 rally, the silver market realised a cumulative surplus that lasted in the 1980s until 1989, this excess being added to current stocks throughout the world. Such large inventories depressed prices. The resulting low prices meant that silver was cheap to use, expanding demand, but relatively expensive to produce as a primary metal, squeezing fresh supply. This combination led to the current period of deficits. The cumulative deficit of those seven years – 1,022.4 million ounces – was the largest seen yet and did lead to a price rally in 1995, from \$3.52 to as high as \$6.16 per ounce. Enough metal still remained to keep the price relatively low and from rallying further, but more than 1 billion ounces of inventories had been used up.

The difficulty in estimating how much of the inventories remain is due to the fact that some of them are unreported. Reported inventories have declined from a peak of 350.6 million ounces in September 1992, to 188.2 million ounces at the end of 1996 (before adding in previously unreported stocks in Wilmington Trust Company). Unreported inventories may have dropped much more dramatically.

After evaluating statistics dating back as far as 1950, prior to which reliability is extremely questionable, CPM Group has calculated a high, medium and low range for private sector inventories. The low estimate would be around 711.8 million ounces, the medium estimate 821.8 million and the high 946.8 million.

What is clear concerning any of these estimates is that there has been a massive drawdown of inventories since 1990, whatever the level at which they stood at that point, and that stocks are lower today, by a wide margin, than they have been since at least the beginning of the 1950s ■

CPM Group's Silver Survey 1997 is available for US\$35.00 from: CPM Group,
30 Broad Street, 37th Floor; New York, NY 10004.
Telephone 212-785-8320. Telex 212-785-8325.
email: jchristian@cpmgroup.com

Go to GOFO=

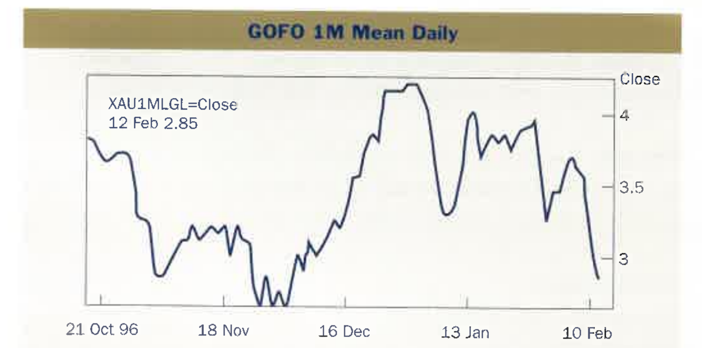
by Susanne Capano

The original GOFO display has now been joined by a second page, GOFO=, enhancing the capabilities of the data shown. The new "GOFO=" resembles the original GOFO page, which continues to be available, but has expanded capabilities: because it provides logical data, it will allow the user to easily apply the rates to other applications, such as spreadsheets and charts, which can be developed for any or all of the rate periods, going back as far as two years. In addition, chains for each of the Market-Makers can be obtained by typing GOFO=XXXX, where XXXX is their contributor identification. The data from any one or more Market-Makers can then likewise be applied to a spreadsheet or chart. See page LBMA07 on Reuters for a full list of contributor codes ■

GOFO= Gold Forwards

Time	Contributor	Period	Rate	Period	Mean at 11am LON
14:07:34	Morgan GT	1M	3.55	1M	3.50
14:07:34	Morgan GT	2M	3.80	2M	3.79
14:07:34	Morgan GT	3M	3.90	3M	3.88
14:07:44	Morgan GT	6M	4.05	6M	4.00
14:07:34	Morgan GT	1Y	4.05	1Y	4.01

** See <LGLR> Implied Mid Market Gold Interest Rates ** LBMA Index <LBMA01>



The LBMA Second Annual Spring Seminar

Thursday 22 May, 11:45am for 12:15pm
The Drapers' Hall, Throgmorton Avenue, London EC2

Robert Pringle, World Gold Council,
on Central Bank Gold - Where Next?

Ian Lamont, Yorkton Securities,
on Gold and Equities

Cocktails and Buffet Lunch

For more information and tickets please contact LBMA Executive:
6 Frederick's Place
London EC2R 8BT
Tel: 0171 796 3067 Fax: 0171 796 4345

LBMA News

by Chris Elston, Chief Executive, LBMA

Membership Following the merger in July 1996 of Chemical Bank and The Chase Manhattan Bank NA, to form The Chase Manhattan Bank, with effect from 1 January 1997 the Ordinary Membership of Chemical Bank was withdrawn.

Following the transfer last October of Lehman Brothers Inc from Market Making to Ordinary Membership, with effect from 1 January 1997 the Ordinary Membership of Lehman Brothers Commodities Limited was withdrawn. Ordinary Membership is now retained in the name of Lehman Brothers International (Europe).

With effect from 1 April 1997 the address and telephone number of Engelhard Metals Limited (Ordinary Member) changed to 63 St May Axe, London EC3A 8NH, telephone (0171) 456 7300.

People The LBMA records with sadness the death on 13th February 1997 of Matthew Lill, Managing Director of Brambles Securities UK Limited.

Committees

Management Committee

As noted on page seven it has been decided to supplement the alternate-year Bursary to the Camborne School of Mines with a similar Bursary in the intervening years to the Royal School of Mines.

The Bullion Addendum to the ISDA Master Agreement has expanded in scope and is now into its fifth draft, which it is hoped should take it near to completion.

A revised reminder about fraudulent approaches was circulated to the Membership in March 1997.

The Annual General Meeting of the Association is to be held at 4.30pm on Wednesday 4th June at the premises of Deutsche Morgan Grenfell, 23 Great Winchester Street, London EC2P 2AX.

Public Affairs Committee

The Committee has organised the Press Briefing on Clearing Turnover Statistics held at Deutsche Morgan Grenfell on 29 January (see report on pages three to four); and the LBMA Debate on Hedging in Johannesburg on 19 February (see report on pages eight to eleven).

On Thursday 22 May, in connection with Platinum Week, we are to hold our second Annual Spring Seminar at the Drapers' Hall (see panel on page fifteen).

Reuters now carries on pages LBMA 01-14 details of the LBMA including on page LBMA 12 the monthly Clearing Turnover Statistics.

These are published at 12 noon on the 12th of each month or the next business day if he 12th falls at a weekend.

The new gold lease mid-rates for 1 month to 1 year are now appearing on Reuters page LGLR.

Physical Committee

Changes to the Good Delivery List:

Transfers to Lists of Former Melters and Assayers of Good Delivery Bars:

Gold and Silver– Spain, Industrias Reunidas Minero-Metalurgicas S.A.(Indumetal), with effect from 21st November 1996.

Gold and silver– Former USSR, State Refineries, with effect from 1 January 1997. We aim to apply the accreditation procedure to qualifying individual Russian refineries.

Gold and silver– Democratic People's Republic of Korea, Central Bank Pyongyang Refinery, with effect from 12 February 1997.

Silver– Italy, Mariovilla, SpA with effect from 21 March 1997.

Questionnaires: The process of sending questionnaires to all those companies on our Good Delivery Lists in now virtually complete with the last batch sent on 21 March 1997. We are left with three companies for which we lack contact names and addresses (all on the Silver list):

Peru: Empresa Minera del Centro del Peru (Centromin Peru)

Spain: Sociedad Minera y Metalurgica de Peñarroya-España SA.

Former Yugoslavia: Trepca

Any information which readers can offer on these companies will be gratefully received by the Executive (please contact Chris Elston).

Visitors The LBMA has recently received visits from The Russian Federation (Mr Lev Weinberg, Head designate of the Russian Gold Market, and delegation from Gokhran and the Ministry of Industry); and The Czech Republic (Mr Ludek Vondrus and delegation from Safina Precious Metals Refinery).

Social The LBMA Golf Day is to be on Friday 30 May at Brickendon Grange Golf & Country Club, Pembridge Lane, Brickendon, Near Hertford, Hertfordshire SG13 8PD ■

DIARY OF EVENTS

8-9 May 1997
Metal Bulletin, 4th International Metals Finance Conference, Toronto Hilton, Toronto.

13-16 May 1997
Mining Finance Congress, AIC Conferences, Marina Mandarin, Singapore.

20 May 1997
London Platinum and Palladium Market Cocktail Reception. Stationers' Hall, London.

21 May 1997
London Platinum and Palladium Market Annual Dinner, The Savoy, London.

22 May 1997
LBMA Second Annual Spring Seminar, Drapers' Hall, Throgmorton Avenue, London. EC2. (see P 15)

30 May 1997
LBMA Golf Day (see this page).

2-6 June 1997
Derivatives and risk Management in the Mining Industry, the Marco Polo, Singapore.

4 June 1997
LBMA Annual General Meeting 4.30pm at Deutsche Morgan Grenfell.

16-17 June 1997
The FT World Gold Conference, Prague Hilton Atrium, Prague.

1-3 September 1997
World Gold '97 Conference, The Australasian Institute of Mining and Metallurgy, Shangri-la Hotel, Singapore.

17-19 September 1997
3rd European Precious Metals Conference- Eurometaux, Sheriton Firenze Hotel, Florence, Italy.

18 September 1997
Metal Bulletin, Platinum Group Metals Seminar, Inter-Continental Hotel, NY.

23-25 November 1997
IV International Gold Symposium in Venezuela, Venezuelan Gold Association, Hotel Caracas Hilton.

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Given the freedom of expression offered to contributors and whilst great care has been taken to ensure that the information contained in *The Alchemist* is accurate, the LBMA can accept no responsibility for any mistakes, errors or omissions or for any action taken in reliance thereon.