GOLD

By Gold Fields Mineral Services Ltd, London, UK

2001 may one day be remembered as the year in which gold ‘turned the corner’. The price trended upwards not only in US dollars but also in euro and yen terms. A rise in all of the major currencies could be construed as a bull market, although, as Gold Fields Mineral Services (GFMS) has explained, at this stage a rather fragile one. The interesting thing is that this rally occurred during a global economic slowdown that was a major factor behind a no less than 7% fall in world fabrication demand. There were two main reasons why last year’s lower jewellery and electronics demand did not result in weaker prices.

First, producer hedging emerged as an important factor on the demand side. GFMS’ analysis shows that outstanding hedge positions declined by 147 t last year (mostly in the fourth quarter). This outcome was driven by a variety of factors, including the collapse in the contango and the perception that the outlook for the price was brightening.

Second, there was a distinct improvement on the investment front. This was already clear prior to the events of September 11 and gathered speed thereafter. However, to a great extent, this shift was more a question of short sellers being squeezed out of the market plus the ending of much of the physical disinvestment seen the previous year in Europe and North America, rather than a great deal of new, buy-side interest. (The majority of ‘gold investment’ in 2001 was in the form of mining shares rather than the metal.)

In large measure, the outlook for the price in 2002 will depend on the same kind of trade-offs (GFMS is not expecting major changes in, for instance, the level of mine production or official sector sales). Thus, in the first half, at least, GFMS sees little prospect of a recovery in fabrication demand. It is possible that the picture could improve in the second half if global GDP growth picks up strongly. Nevertheless, it is important to note that fabricators and consumers have already adjusted to the higher price range. This has helped yesterday's price ceiling become today's price-floor.

When it comes to producer hedging, GFMS expectation is for a further decline in outstanding positions and for this to provide additional support for the price. In time, if interest rates were to rise, the contango might increase sufficiently to tempt some producers to add to their books but this is not expected to occur to any great extent in 2002. Furthermore, as long as miners and their shareholders are convinced that prices will rise, hedging is likely to remain out of favour.

In conclusion, even though the rally in gold has so far proved to be hesitant, GFMS advises that betting against a significant price rise might be dangerous if circumstances combine to promote heightened investor interest in bullion. On the other hand, a 'normalisation' of economic and political conditions this year could well limit the chances of such an investor-led increase in the price.

Prices

In the light of recent strength that took gold over the US$300/oz mark, it is easy to forget how fragile the price seemed as recently as September last year. It is easier yet to overlook just how weak gold appeared in March and April, when, albeit for a brief moment, the price was moving in the direction of the low of US$252 seen in 1999. So what, if anything, has changed?

Looking at the first half of 2001, the GFMS view is that weaker fabrication demand, itself a function of the global slowdown, underpinned the softness in the price (recall that the use of gold in jewellery and industrial products fell by 6% in the first half). That gold did not fall further was due to movements on the other side of the balance. Supply pressures eased in the first half; official sector sales were down by a not inconsequential amount, and selling pressure from investors, captured in the residual, fell to less than half of what had been seen a year previously. Significantly, producer hedging was only a very modest source of supply in the first half, but perhaps more importantly, there was a large swing of 130 t between the first and second quarters (ie supply in the former and demand in the latter).

Prices might have been higher had it not been for the fact that sentiment towards gold had not yet turned. If anything, investor attitudes, amongst both the fund and non-fund universe, were still mildly negative, a stance reflected in physical selling out of Europe and North America and in net short positions on the Comex for much of the first half (through to May).

September 11 was an important turning point for gold's short- to medium-term price prospects. There is little doubt that this was the most significant single event for prices in 2001, triggering an immediate rally in the market with prices up more than US$20/oz in five (trading) days (from US$271.50 on the 10th to US$293.25 on the 17th).

For gold, for the first time in many years, this event seems to have established a virtuous cycle; improved sentiment in the market has been feeding back positively on the fundamentals, which in turn has boosted sentiment further. The situation prior to '911' was, it needs to be stressed, already looking up. Gold had begun its steady exodus from the US$260s on the back of a more optimistic outlook. Changes in the supply/demand balance point to why this was the case.

To begin with, the data suggest that there was positive investment in the second half. CFTC figures indicate that the fund universe had already moved onto the long side well in advance of '911'. Additional support was provided by investors in the Asian hoarding countries, especially in Japan (although this was more of a fourth quarter phenomenon). Finally, the nascent rally in gold equities began to have a positive impact on sentiment in the broader investment community.

The producer community was also making its own contribution, both directly through the steady running down of outstanding positions and some buybacks (both of which contributed to physical demand), as well as positively influencing sentiment via these actions.

The post-'911' run up in the price would have been expected, considering the catastrophic events of that day, but the rally was actually quite modest and short- lived, consistent with our contention that political and economic shocks will only have a modest impact on the price unless they unleash a bout of investor buying. Ironically, the fact that the price fell back was probably good for gold's longer-term prospects.

The main reason for this can by found by looking eastwards, to the main physical markets. Sharp upward movements in the gold price tend to be unsustainable because of the associated collapse in physical demand, and allied rise in scrap. Most traders in the souks of the Middle East would confirm that what is important to maintain regular physical offtake is price stability. The absolute price level, within limits, is arguably of less importance.

Supply in 2001

Total supply declined by 2.6% in 2001, primarily due to a sharp fall in physical disinvestment. Mine production grew by a modest 20 t, but due to a reduction in net producer hedging, the mining industry's overall contribution to supply was 112 t lower.

Top 20 Producing Countries

	2000	2001
South Africa	428	394
US	355	335
Australia	296	285
Indonesia	140	183
China	164	173
Russia	154	165
Canada	155	157
Peru	133	134
Uzbekistan	88	85
Ghana	74	72
PNG	76	68
Brazil	53	51
Mali	45	30
Chile	50	40
Tanzania	17	34
Philippines	35	32
Argentina	26	31
Mexico	27	26
Kyrgyzstan	22	25
Zimbabwe	25	22
Rest of World	236	249
TOTAL	**2,584**	**2,604**

South Africa

Gold output last year stood at 394 t, the lowest level recorded since 1953. In fact, the year-on-year decline of some 35 t was the largest measured decrease since 1995, when output declined by 11% or over 60 t. The fall in production can largely be explained by the declining average ore grade at some of the older mines and operational difficulties, which are partly due to the maturity of the industry and the depth of the mining. Last year's big decline was the result of continued downscaling at a number of mines, shaft closures and lower output from operations that changed hands as a result of industry consolidation. Today, three producers account for 80% of the country's production: AngloGold, Gold Fields and Harmony.

On a regional level, declines in output were recorded in all three of the major producing gold fields. In the West Rand, production declined by a significant 10% to 165 t, while a 13% decline was reported in the Free State leaving output at 86 t. A moderate drop from mines operating in the Klerksdorp gold field saw output 4% lower at 76 t.

As regards the introduction of the new Minerals Bill proposing changes to South African mineral law, expectations are now that the Bill will become law in the second half of the current year. Importantly, the revised draft addresses the concerns expressed in some quarters about security of tenure.

North America

In North America, growth in Canada was cancelled by the decline reported in the US, which left output 4% lower year-on-year at close to 500 t - almost 20% of total global production.

In spite of a strong first half, a significantly weaker second half saw output in the US decline 6% year-on-year to reach 335 t. Production was down at both of Barrick's Nevada operations: Betze-Post reported a 6% decline, in part due to lower grades in the second half of the year, as mining of high-grade ore was completed in the second quarter, whilst production at Newmont's Carlin Trend was 13% lower at just less than 84 t. On the positive front, strong growth was reported at the Cortez joint venture, where output was up 18% to just less than 37 t. This gain reflects new heap-leach production from the adjacent South Pipeline deposit and a higher contribution from the sale of stockpiled carbonaceous ore.

Gold output in Canada increased 2% to reach 157 t. Remarkably, the increase in production can largely be attributed to the ‘start up’ of a single operation, Goldcorp’s Red Lake mine in Ontario. Red Lake is not in fact a new mine, and has been in operation since 1948 but by the mid 1990s had become a marginal producer with output of less than two tonne per year. The discovery and development of a high-grade zone at deeper levels saw output reach over 15 t last year. There was additional support from Agnico-Eagle’s LaRonde mine, where output has more than doubled over the last two years.

Latin America

Combined gold output from Latin America declined modestly for the second successive year to reach just over 375 t. Nevertheless, last year’s output still represented an increase of over 70% from the levels recorded a decade ago.

The region’s largest gold producer, Peru, recorded a narrow 1% increase in output last year to reach 134 t. Yanacocha (Peru’s and Latin America’s largest gold mine) contributed to the gains, with production increasing 6% year-on-year to reach 60 t. Further increases are anticipated at Yanacocha in both 2003 and 2004, when output should peak at around 78 t. Increased production was also reported at the country’s other large mine, Pierina, which at 28 t reported an 11% increase year-on-year.

Output in Brazil amounted to 51 t last year, a fall of roughly 4%. Production has been declining for the past decade, largely due to reduced output from the informal mining sector. Lower real gold prices, improving economic conditions in the country and stricter environmental controls have in part, encouraged many people working in the informal mining sector, or garimpos as they are known locally, into more formal employment. Last year, however, higher local gold prices (the local currency depreciated by close to 30% against the US dollar) resulted in a reversal of this declining trend, with garimpo output increasing 4% (half a tonne) to roughly 13 t. The fact that the response to the significantly higher local gold prices was so trivial, highlights the fundamental changes that have taken place within the informal sector over the past decade. The modest gain in informal output however, was negated by production declines from the formal mining sector where production dropped 6% year-on-year to 38 t.

Closures of primary gold mines during 2000 and 2001 impacted on Chile’s output last year, which declined by a significant 21% to just short of 40 t, the lowest recorded production since 1993. During the second half of 2000, Dayton’s Andacollo and Coeur d’Alene’s Fachinal mines were closed. These two mines had contributed five t in 1999 and a further three t in 2000. In addition, moderate losses were reported following suspensions at Coeur’s Petorca operation in August, while in May the Refugio mine was closed. A further 3 t of output was lost year-on-year at Barrick’s El Indio mine.

Australia

Gold production in Australia peaked in 1997 at 313 t. Since then, it has declined by an average of just over 2% per year, with production in 2001 standing at 285 t. This downward trend seems to be primarily attributable to the closure of a number of older operations, the result, in the main, of ore depletion. Last year for example, mining came to a close at Kidston, Dalgaranga, Mt Leyshon, Mt Charlotte, Boddington and Union Reefs. In 2000, these mines contributed over 35 t to the country’s total, whereas last year, this had dropped to 23 t. In addition, losses were reported at the country’s largest operation, the Super Pit, whilst heavy rain resulted in a fall in output at Granny Smith.

The impact of these losses was reduced somewhat by the start-up of three new mines in 2001, whilst higher production was recorded at Normandy NFM, St Ives and Jundee.

China

Estimates for 2001 suggest that mine production increased some 5% year-on-year to total close to 173 t. It is worth mentioning again that GFMS' mine production series for China is derived from adjusting official reports of the country's output to account for both smuggled and undeclared gold. As regards the former, during the first six months of last year, the official Chinese buying price was on average 1.4% higher than the international price. More importantly, in January, the premium was in excess of US$7/oz for 13 days, while in February it exceeded US$10/oz for eight days, providing considerable opportunity for gold to be brought into the country and presented to the PBOC (People's Bank of China) as 'mine production' in order to gain the local premium. In contrast, during the second half of the year, the price offered by the PBOC was lower than the international price (on average a discount of US$2.47/oz or just less than 1%). This situation tends to result in an increase in gold sold directly to small refiners and jewellers. This informal, or undeclared, production would not be captured by the official production statistics.

CIS

Combined output from the Commonwealth of Independent States (CIS) increased again in 2001, rising by an impressive 5% to 300 t.

The biggest producer in the region, Russia, recorded a 7% increase last year to 165 t. Most mining enterprises are reliant on Russian commercial banks for funding, and robust growth in the country's output over the past few years has primarily been the result of the increased activity of these credit institutions. Commercial banks not only fund the bulk of the mining enterprises but they are also the major purchasers of gold in the country, and in 2001 are thought to have bought 85% of the year's production. In a recent development, a new presidential decree (effective from January 2002) allows the mining companies to export their bullion directly and not only through the commercial banks, as before. However, it remains to be seen how many of the smaller enterprises will take advantage of this. Importantly, a later ruling has cancelled a 5% export duty on refined gold, which had been in force since 1998. This is expected to contribute to the further increase in Russian output anticipated in 2002.

Gold production in Uzbekistan fell for the second consecutive year to reach roughly 85 t, a year-on-year decline of 2%. The reduction can largely be explained by lower output from the Zarafshan-Newmont Joint Venture. The operation produces gold by crushing and heap leaching low-grade oxide ore from stockpiles at the government- owned Muruntau mine. The grade has been in decline over the past few years, with the result that output has fallen from 17 t in 1999 to 13 t last year.

Kyrgyzstan produced just under 25 t of gold in 2001, 12% more than in 2000. This rise was almost entirely due to output gains at the Cameco Joint Venture, Kumtor mine, reflecting an 11% increase in average grade and higher recovery rates.

Indonesia

Indonesian gold production soared more than 30% in 2001 to reach over 180 t. This has positioned the country ahead of both China and Russia as last year's fourth biggest producer. Most of the increase was the result of a surge in output at Grasberg, the world's largest single gold-producing mine. Output at Grasberg stood at over 108 t in 2001, an increase of 48% year-on-year, corresponding to an extra 34 t of gold production. Gold output at this copper mine reached a new peak due to exceptionally high grades last year. The year-on-year increase was exaggerated by the weak results reported in 2000, when output was much lower than expected due to an accident at the waste dump and lower than average grades.

Growth at another copper mine, Batu Hijau, contributed further to the country's increase. The mine, which is in its second full year of production, reported output of over 16 t, considerably higher than the 10 t produced in 2000. Rio Tinto's Kelian mine also reported higher gold output last year, signalling a return to normal operations following the industrial action that impacted on production during 2000. Some of the gains were cancelled out by lower output at Minahasa where lower grade stockpiles were the predominant mill feed. Mining activities ceased late last year at the mine. However, it is expected that processing will continue until 2003.

Cash Costs

For the fifth consecutive year, weighted average cash costs in the Western World (as expressed in US dollars) declined in 2001, falling by US$11 (or 6%) to US$176/oz. Not all of this saving was felt in the bottom line, though. The 3% fall in the average dollar gold price reduced the impact of the impressive cost reductions somewhat. When cash costs fell by US$9/oz in 2000, producers benefited from an 11% widening of cash margins. In contrast, last year the US$11/oz decline in costs saw margins only modestly higher at US$95/oz, a 3% increase.

Cash costs in South Africa declined dramatically last year by 11% in US dollar terms, to a weighted average of US$196/oz. Significantly, this was just US$7 higher than the US cash costs in 2001, compared with the US$99 difference that separated the two countries in 1995. (Of course, the narrowing of the gap needs to be seen against the 137% depreciation of the rand over the period.) Last year roughly, 95% of the country's output was produced at cash costs below the average spot price.

The impressive decline in US dollar terms was primarily the result of currency depreciation. Production costs expressed in local currency terms actually increased by 10% year-on-year, but as the rand depreciated by 24% (the fourth quarter was particularly noteworthy with the local currency posting an all time low of US$1/R13.5), costs expressed in US dollar terms declined.

The Australian dollar also continued to weaken last year; having lost 11% against the US dollar during 2000, it depreciated by a further 12% year-on-year in 2001. The weakening currency has no doubt been the most important factor in the large declines reported in cash costs over the past two years. In 2001, the 8% decline in cash costs in US dollar terms positioned Australia as the lowest cost gold producer in the world. Cash costs in 2001 for the country were measured at US$175/oz. Around 90% of Australian costed output was produced last year at total costs lower than the average spot price. In addition, 50% of the costed gold output reported cash costs less than US$170/oz.

In the US, cash costs increased almost 5% to reach US$189/oz. Lower output and more expensive energy were chiefly responsible for the higher costs. Power costs alone added an estimated US$4 to US$5/oz to unit costs at operations in Nevada. Barrick's Goldstrike operations reported a significant US$24/oz increase year-on-year, of which roughly 80% was attributable to the 6 t decline in production. Newmont, meanwhile, reported costs at its Carlin Trend mines US$19 higher at US$222/oz. Again, the bulk of this rise was accounted for by the 11 t drop in output. Higher costs were also reported at the Cortez joint venture in Nevada (a substantial 38% higher at US$83/oz). The rise was the result of increased expenditure associated with South Pipeline, which came on stream in the second quarter last year.

Average cash costs for Canadian mines last year declined 9% to reach $176/oz. Most of the fall can be accounted for by the start-up of the low-cost, high-grade Red Lake mine. Last year the mine added over 15 t at a cash cost of only $59/oz to the country's weighted average. Red Lake's very low costs were primarily a function of the exceptionally high grade of the ore, which averaged over 77 g/t.

Producer Hedging

The decline in the global producer hedge book was one of the most remarkable features of the market during 2001. To put the fall in perspective, producer hedging had been a consistent and, at times, substantial source of gold supply since the late 1970s. But last year was the second consecutive year that outstanding positions declined. Moreover, at 147 t the decline was much more significant in terms of size than the modest 15 t fall recorded in 2000.

Of course, a net reduction in outstanding positions would imply gold being withdrawn from the market, or demand. Thus, through their hedging activities, producers last year contributed to physical demand.

As a result, total supply from the mining industry was actually lower than in 2000, in spite of the small increase in mine production discussed above. In 2001, producers generated 4% less gold to the physical market than in 2000.

There were several reasons for the decline in producer hedge books. First and foremost, there was less reason to hedge than before. Miners typically hedge future production for one of two reasons: either for opportunistic purposes, because selling production forward enables them to benefit from a 'forward premium' in the form of the gold contango; or for more defensive purposes, to protect revenue against falling prices and to secure a minimum income. For the greater part of last year, neither reason seemed particularly persuasive.

The first factor responsible for the decline in hedge books was the contango. For much of last year the contango was so poor as to make hedging unattractive, particularly in the shorter tenures. Successive cuts in US interest rates sharply eroded the contango from just below 5% at the start of the year to only 1% by year-end.

There is even less reason to hedge in such a narrow contango environment when expectations are that the price will improve rather than deteriorate. Although the average price was almost 3% lower in 2001, the price weakness was more a feature of the first half than the second. Towards the end of the year (and even more so in the first months of this year), the price strengthened visibly and the consensus outlook appeared to become increasingly positive.

There were a number of other reasons for the decline in hedging. First, many producers now face a declining future production profile that is an inevitable result of several years of reduced exploration and development, as well as forced high-grading. This means that there is simply less future production in the pipeline that could potentially be hedged.

Second, in a small number of cases producers wished to hedge but could not, owing to credit restrictions associated with deeply underwater local currency denominated hedge positions. This was particularly relevant in South Africa and Australia, where many producers were unprepared for the sharp decline in the value of their currencies.

Third, for those producers wishing to raise money, debt and the associated hedging often insisted upon by lenders was no longer the only available option. Because of the stellar performance of gold shares, it once again became possible to raise money through issuing equity.

Finally, mention should be made of corporate activity. A phenomenon that marked 2001 was the deepening gulf between 'hedgers' and 'non-hedgers'. Recently, share price performances indicate that 'unhedged producers' appear to be favoured by investors, which makes sense when seen against the generally upbeat price outlook shared by most of these investors.

This issue was complicated by the high level of corporate activity witnessed last year and through into 2002. A number of 'non-hedgers' found themselves in possession of significant books, which meant that the line between the two camps became rather blurred. The distinction now seems to be drawn more along philosophical than factual lines. But fully hedged and lightly hedged producers alike have been restructuring their books to try and maximise participation potential, further contributing to the fall in the global book.

Scrap

Scrap supply rose by 16.5% to 706.5 t last year. Just three countries, namely Turkey, Egypt and Indonesia accounted for 71 t or 70% of the total increase in scrap. In each case, a combination of a deteriorating economic environment and high local gold prices resulted in additional scrap supplies coming to the market.

Official Sector

In the past three years, the supply of gold to the market from net central bank sales has been remarkably stable: 478 t, 489 t and, last year, 504 t. The main reason for this is the influence of Europe and the September 1999 Central Bank Gold Agreement (CBGA). The limit of 400 t it has imposed on European sales within each 12-month period from September and the willingness of its signatories to sell up to this level, has provided the market with 65% of all net central bank sales from 1999-2001.

The existing CBGA expires in September 2004 and, not surprisingly in the light of its impact on the market, an increasing focus is being placed on prospects for its renewal. This has particularly been the case since the German Bundesbank declared its intention in early 2002 to reduce the level of its gold holdings. The probability of a new Agreement, this time with Germany at its core, has undoubtedly increased further. Of critical importance to the market will be the details of any such second CBGA, including the length of the agreement, level of sales permitted and the regime to be applied to gold lending and derivative activities.

Net sales from the rest of the world, of course, make up the balance of supply from the official sector. Data for the past three years show that, after selling 363 t in 1999, sales from outside the CBGA have settled down in 2000 and 2001 to 68 t and 82 t respectively. An important question is whether the outlier here is the most recent two-year period or 1999. The high figure in 1999 was certainly influenced by the slump and then recovery in the price that year and by ‘front running’ of European sales in the wake of developments in the UK and Switzerland. A sanguine view on the probable future level of net sales from the rest of the world is also encouraged by the historical data, which show that net sales from outside the CBGA countries averaged 117 t from 1989-98. On the other hand, it should be recognised that there are several countries outside the CBGA bloc that possess sufficiently large bullion holdings to boost net sales in any given year.

The other two areas covered by the CBGA are lending and derivative activities. As regards the former, GFMS estimates that in 2001 the volume of gold lent to the market fell by 164 t, the first reduction since 1993. Looking to the latter, these days the official sector does not loom large as a player in the gold derivatives market, partially because the CBGA has effectively removed potential customers from the market.

Demand in 2001

Jewellery Demand

The economic slowdown and political uncertainty resulted in world jewellery fabrication in 2001 falling by over 5% to 3,006 t, with marked reductions taking place in all major regions.

European jewellery fabrication fell by 5.5% to 702 t in 2001, with Italian jewellery fabrication estimated to have fallen by a fairly substantial 6% to 479 t, due to a decline in exports. The US remains by far the most important export market for Italy, taking around a third of the total. As such, the 8% drop in its imports from Italy (basis US customs statistics) was critical. Looking to fabrication in the other major European markets, demand in the UK, Switzerland and, to a lesser extent, France was strong whilst Spain and even more so Germany witnessed falls.

Jewellery fabrication demand in the US fell by 13% to 158 t in 2001, the first annual decline in output since 1991. There were several reasons for the weakness of jewellery fabrication last year. First, a poor retail season in 2000 had led to excess inventory being accumulated at the trade level. This depressed the level of new orders from retailers and wholesalers in 2001. The excess inventory was only fully worked off in the fourth quarter, when, rather ironically, retail sales turned out to be much better than had been feared. Second, US GDP growth trended lower in 2001, with the economy skirting with recession in the second half. As a result of this, retailers and wholesalers were very cautious when ordering new product. After the September 11 terrorist attacks this tendency was exacerbated, further depressing activity at the manufacturing level. Finally, imports captured a larger share of the declining US market.

Jewellery fabrication in the Middle East declined by 12% to 556 t, with the largest losses occurring in Turkey, Saudi Arabia and then Egypt.

Following a modest rise in 2000, domestic fabrication in Saudi Arabia experienced a sharp fall of 10% in 2001, in line with a 10% fall in domestic consumption. There were several factors that triggered the sharp overall fall in fabrication, most obviously the government's programme of 'Saudi-isation', a scheme whereby Saudi nationals would replace ex-patriate workers. In 2000, all involved in the gold market were given a year to comply with this policy but many fabricators and retailers failed to meet the deadline, as they had been under the expectation that it would not be enforced rigorously. When, in mid-year, it became apparent that no relaxation of any kind was on the horizon, a degree of panic broke out, accompanied by talk of cancelled orders and even inventory liquidation. In response to strong industry pressure, the government relaxed these rules in late August, giving businesses three years to comply.

Turkish jewellery offtake fell by 25% to 133 t. A sharp downturn in the local market, coupled with flat tourist demand, more than cancelled out the upbeat performance of the export sector. The weakness in the domestic market can be traced back to the end of 2000 when the banking crisis emerged, contributing to a sudden rise in interest rates. The slowdown in consumer demand then accelerated in the wake of the February economic crisis. During the second half of 2001, any hope of a recovery in local gold demand was dashed by September 11. (The IMF estimated that 2001 real GDP fell 6.1%.)

After a positive start to the year, Egyptian fabrication fell markedly during the second half of 2001 to leave annual demand 10% lower at 97 t. This was partly due to successive currency devaluations, which led to higher domestic gold prices.

Other Fabrication Demand

Electronics demand for gold in 2001 is estimated by GFMS to have fallen by over 28%, after having registered growth of almost 15% in the previous year. All Fabricating countries registered declines in output. Of the top 10 countries, the US suffered the largest percentage fall, offtake declining by over 35%. Japan remained the largest producer, although the 69 t of offtake recorded translates into a year-on-year drop of 35% and brings output down to 1993 levels.

Lower demand in the US contributed to a 1.4% fall in global dental fabrication last year, whilst other industrial and decorative demand slipped by nearly 2%.

An 11% fall in Turkish demand was the main factor behind the 5.5% fall in global medal and imitation coin fabrication during 2001. The decline in Turkish coin fabrication was closely linked to the performance of the local economy, which was beset by financial and economic crises.

World coin fabrication recovered in 2001 but was still significantly lower than during the

1990s. European offtake was nearly 50% higher last year, almost entirely due to a German commemorative issue. The 12 gramme, one-deutschemark coin, which accounted for 12 t of gold, was released to mark the end of Germany's currency and the introduction of euro notes and coins.

Bar Hoarding

Bar hoarding rose by a modest 7% in 2001 to 232 t. Much of the gain came from the Middle East, India and Japan. Dishoarding was the norm elsewhere in Asia.

Bar hoarding in India is estimated to have risen by around 11% to 89 t. The rise in hoarding appears to have a number of causes: first, a lack of attractive, secure investment alternatives; second, the disillusion of some with the quality of jewellery; third, it has been suggested that there has been a rise in total bar hoarding demand by those with questionable sources of income who wish to keep their wealth beyond the gaze of the tax authorities; finally, ongoing tensions between Pakistan and India fuelled fears of the possibility of an extended conflict, with implications for the economy and the value of the rupee.

Japanese hoarding rose by around 19% or 10 t year-on-year, to 60 t, the third highest level recorded in ten years. GFMS estimates that the first half of the year was actually quite weak and close to two-thirds of demand was recorded in the second half (with most of this in turn being concentrated in the fourth quarter).

The main drivers of this demand revolved around deepening concerns over the Japanese and global economy. Domestically, fears about the banking system and the imminent limiting of bank deposit insurance prompted buying. Additional motivations for moving into gold have been record low interest rates and the dismal performance of the stock market.

The rise in fourth-quarter hoarding, however, paled in comparison with the surge in demand seen in the first quarter of 2002. Preliminary GFMS estimates point to hoarding demand having increased by over 40 t. (This excludes coin imports, which surged over this period as well.)

Investment

Investment demand recovered strongly in 2001. However, the improvement should be put into perspective: 2000 was an exceptionally poor year, with a small but absolute decline in private sector bullion holdings. World investment in 2001 was distinctly ordinary when measured against 1999's outcome.

Nevertheless, it would be churlish to dismiss the shift that took place on the investment side during the year. Even prior to September 11, there was a distinct improvement on the investment front. As early as May, a rally in gold shares indicated a change in mood. This was also evident from the structural shift in fund positions on Comex from net short to net long that occurred at about the same time.

After September 11, there was a brief flurry of interest in gold, mainly from private investors in Europe and, especially, the US. There was also limited buying by some funds. However, the move into gold was relatively short-lived. Furthermore, the higher gold price in the aftermath of '911' was to some, particularly Asian investors, a signal to sell.

The return of the investor is proving to be a drawn out affair. Nevertheless, the underlying situation continues to improve even if purchased volume, for example, in the first quarter of 2002, has remained modest. In part, sentiment has become more positive due to the perception that gold's supply/demand fundamentals are looking better, perhaps especially the ongoing reduction in producer hedge positions that was commented on earlier.

Of greater importance though, are external economic and political developments. Chief among the former are the worsening financial situation in Japan and the fear of a major decline in stock prices on global equity markets. The first of these has already been a factor behind a wave of bullion purchases by private investors in Japan during the first quarter. When it comes to the equity markets, there are fears that the US economic recovery will falter, leading to disappointing earnings growth and a new slump in stock prices.

On the political front, the Israeli-Palestinian conflict and the distinct possibility of another US war with Iraq have raised tensions and not just in the Middle East. These developments are combining to alter the mindset of investors. The more defensive investment strategies slowly emerging from this process should continue to bolster the case for gold investment.

This extract is taken from Gold Survey 2002

Contact GFMS for further information.

Tel: +44 (0)20 7539 7820. Fax: +44 (0)20 7539 7818.
E-mail: gold@gfms.co.uk Website: www.gfms.co.uk