Plenderleith: Developments in the gold market

Speech by Mr Ian Plenderleith, Deputy Governor of the South African Reserve Bank, to the London Bullion Market Association Biennial Dinner, London, 26 October 2004.

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I want first to thank you very warmly for the chance to join you this evening. It is a particular pleasure for me because, having spent the main part of my career in the City of London at the global centre for gold *trading*, I now find myself back up the supply chain working in the country that is the leading global gold *producer*. So it is a great privilege for me to join this notable gathering of the glitterati of both camps, so gracefully hosted by the London Bullion Market Association.

Arriving this morning from South Africa, where summer on the highveld is now in full bloom, to the cold, damp, gloom of an English October dawn was a salutary reminder of the realities of globalisation. But, as evidenced by the attendance here this evening, globalisation is no new phenomenon for the gold market. Gold has been a global monetary asset since at least the days of King Croesus of Lydia - whose habit of sprinkling gold dust on his food made me look rather carefully at the salt and pepper on the table this evening; and gold has been a store of value and a source of beauty in artefacts for a lot longer.

It is by recognizing the global nature of the gold market that the LBMA has been able to raise its act in promoting and serving the gold market around the world, and in the process help strengthen London's position as the pre-eminent international financial centre. That LBMA membership has this year exceeded the 100 mark reflects the value it is delivering, and I want therefore to pay tribute to the excellent work lead by Simon Weeks, your Chairman, Jeremy Charles, your Deputy Chairman, Stewart Murray, your Chief Executive, Martin Stokes, your immediate past Chairman, and their team of dedicated committees and staff. Their efforts have, for example, helped the Good Delivery List remain the world standard of bar quality: the procedures the LBMA have put in place for pro-actively monitoring the List are a welcome and successful initiative in ensuring that technical standards are maintained. The LBMA's contribution to strengthening the regulatory framework, and the steps it has taken to improve the transparency of market data, are also welcome progress towards meeting modern market standards. Alongside these initiatives, the LBMA's information and educational programme, through its conferences and seminars, has been well-focused and continues to provide valuable opportunities for industry issues to be debated. We in South Africa are particularly delighted that next year's conference is to be held in our country and we look forward to welcoming you to a decent climate and outstanding wines. We regard your visit as good practice for hosting the soccer World Cup in 2010 - though we hope it will be a somewhat less intimidating experience.

Looking back over the past year or so, there have been some notable developments in the gold market. I want to touch on just two.

First, the news in April that NM Rothschild were withdrawing from gold trading marked a sad moment in the long history of the London market. That they chaired the London Gold Fixing for 85 years, continuously from its inception from 1919, may not, I suppose, be entirely in line with modern-day precepts of corporate governance, but it represents a long-running commitment to promoting the quality and international reach of the London market which has played an important part in maintaining its pre-eminence. We all owe a great debt of gratitude to the House of Rothschild and I want tonight to pay unreserved tribute to the contribution they have made over the years.

The market, nonetheless, will continue, and I was delighted to see the decision to move to conducting the fixing by telephone, which I believe was the means by which it was originally conducted in 1919 before moving to more gracious surroundings at Rothschilds. This is a delicious illustration of the paradox, of which I have become increasingly aware, that part of the process by which we edge our way into the future is by inadvertently re-inventing the past.

The other notable event to which I want to allude is the renewal from last month of the Central Bank Gold Agreement. Though widely expected, this is welcome evidence of the continuing ability of central banks to work together to align their interests and those of the markets in a sensible arrangement for orderly marketing. The LBMA's input to this process, through its survey of the views of market participants, was well-timed and helpful. There are, of course, plenty of other fields where we, as central banks, and our governments need to show a similar dedication to international good order in addressing potential imbalances.

Elsewhere, of course, the market has continued to digest significant shifts in the trading environment. Earlier this year, prices reached a 15-year high, and are now again close to that level. On the producer front, the process of consolidation amongst mining companies has continued, though not all of them, as recent events have shown, entirely in harmony. De-hedging has also continued. That process - in either direction - is of course a perfectly normal commercial activity, but I strongly advise you to find a better term than “de-hedging’, because friends of the countryside - never very well disposed to mining operations - might be inclined to take ‘de-hedging’ as an environmentally-unfriendly activity designed to flatten the landscape. It has, of course, had much that effect on leasing rates. I assume that is why much is written these days about the contango - which, again, the uninitiated might be forgiven for supposing was the gold market’s distinctive contribution to resolving the Argentinian debt crisis.

Before leaving the past year, I want to recognize one other notable personal contribution to the standing of gold - Kelly Holmes’ outstanding achievement in winning two of the most thrilling Olympic gold medals any of us can ever wish to see. I mention this particularly because it gave rise to my own personal golden moment of the past year. As you may know, Kelly Holmes trains in South Africa, and, by chance, my wife and I found ourselves alongside her at the security check at Johannesburg airport a few weeks ago. She was carrying her gold medals, and so had to produce them for inspection. While we were admiring them, we were interrupted by the public announcement that our flight was ready for boarding and we were warned that it would take 15 minutes to get to the gate, whereupon I found myself, to my horror, saying “Well, if we stick with Kelly, it should take us only 47 seconds” - a remark so crass that my wife quite rightly refused to speak to me for most of the rest of the flight.

With these and other challenges, or in my case bloopers, behind us, what now are the prospects looking forward? Here, I think the prospects for the gold market can best be described in much the words that tended to be used in my own personal career performance assessments by my superiors over the years: in the medium term, the fundamentals look quite promising, but in the short run, performance has been erratic and the outlook is uncertain.

If one looks at the fundamentals, I think a good reason for being positive about the medium term - and a factor that is sometimes not given sufficient attention - is that gold has the benefit, uniquely so far as I am aware, of enjoying demand from four separate markets: it is a core ingredient in high-quality artistic artefacts, notably jewellery; it has applications in industrial production; it is a universal and long-standing outlet for private financial investment; and it is a monetary asset. Other commodities or artefacts share some of these sources of demand, but none covers the field so comprehensively. I do not, for example, think that my wife would be too thrilled if I have her a lump of coal, or even a can of petrol, for Christmas.

Of these four markets, a striking feature - and again, a feature that I do not think gets enough attention - is that over the years demand for fabrication, notably jewellery, has consistently outrun current mining production. Current production, on the supply side, and fabrication, on the demand side, are not of course the whole picture. The stockpile held by central banks can be, and has at times been, an important influence on price expectations; but the Central Bank Gold Agreement has helped to provide stability in this area in recent years. Equally, supply can fluctuate depending on scrap sales and producer hedging or de-hedging activity. But the underling balance of demand and supply, viewed over the longer run, strikes me as a good deal more healthy than in sometimes suggested.

Jewellery fabrication remains the major source of demand, and here prospects seem to me to be generally encouraging. As the global economy extends its recovery, and as emerging market economies make further progress in raising living standards for their large populations, higher continuing levels of consumer spending should bring increased demand for high-value artefacts, as indeed luxury good retailers around the world are already noticing. There should be increasing opportunities here for the gold industry to expand jewellery sales. But, to reap the full benefits, it will be important that efforts are put into design quality, product innovation and plain, straightforward marketing. LBMA members might wish to reflect whether enough emphasis is placed on these key industry-support elements - particularly marketing.

Industrial use of gold is smaller scale, but nonetheless not insignificant, and may also benefit from continuing global economic growth. But the other main source of demand is for gold as a personal financial investment. Here, as with jewellery, there should be excellent opportunities for broadening the market as rising personal wealth stimulates wider interest in gold-related investments. But here, too, I wonder whether we do not sometimes not so much undersell the product as approach it from the wrong angle. Economists, of course, have always struggled to rationalize the merits of gold as a financial investment. But economists, as I have learnt from personal experience, can all too often fall into the trap of being presented with something that works in *practice*, and objecting, “That’s all very well, but you’ll never make it work in *theory*!” Perhaps for this reason, we tend too often to promote gold as some kind of exotic alternative investment - as asset that best gains in value when everything else is collapsing. Gold is thus presented as a hedge against disaster. But its value concept should perhaps be put more constructively, as an asset with distinctive characteristics that offers its own prospects of long-run return, based on a rational analysis of supply and demand dynamics; and one that, as such, has a part to play, less at some times, greater at other times, in a diversified financial portfolio.

Financial investment in gold also seems to me to be an area where, in degree, as with jewellery demand, the gold industry can help to shape its own future. Products designed to attract broader private investment demand have been with us for some time. Initially the focus was mainly on bullion coins - led by the British sovereign and the South African krugerrand, which seem to me to set the standard for solid reliability, though maybe I am biased, and followed by a galaxy of imitators, of which my favourite is the golden nugget, which seems to me to border on the indecent and can only have come out of Australia. More recently, financial engineering has entered the field and is producing a range of outlets to reach a wider investing public. The London Stock Exchange’s initiative in listing Gold Bullion Securities is welcome in this field. But as rising personal wealth, particularly in the newly-emerged economies, seeks outlets for its savings, there must be much that the gold industry can do to maximize investment interest in gold.

In this vein, I want to leave you with a vision. Earlier this year - a year in which we have been celebrating ten years of democracy in South Africa - the South African National Assembly took delivery of a new mace, the symbol of the sovereignty of Parliament and a tangible manifestation of the strength of the democratic process that has taken root in South Africa in the past decade. The head of the mace is an 18-carat gold book inscribed with the preamble to the Constitution in all the national languages. There are, I believe, currently around 185 sovereign nations in the world. All of them, and their regional and municipal governments, and their state bodies, not to speak of their commercial and social institutions, have emblems of their authority and gold will in most cases be the natural choice for such prominent instruments. With gold occupying such a powerful place in our emotions, I am confident that, provided we take advantage of the opportunities, the gold market has a long and fruitful role to play in the future, and I commend the work of the LBMA in pursuing that goal.

It is with great pleasure therefore that I ask you all to join me in wishing continuing success and good fortune to the London Bullion Market Association.