

# **GOLD IN THE TWENTY FIRST CENTURY: QUO VADIS?**

## **Outline of an address by Bobby Godsell, AngloGold CEO, at the 1998 Goldman Sachs Commodity Conference. London, 20th October, 1998**

At the outset today, I want to say – absolutely unreservedly – I am optimistic about the prospects for gold in the new millennium. That I represent the world’s largest producer is almost incidental. I believe in this lustrous metal that has captivated mankind for centuries. I am supremely confident of its future. I know I stand against a wave of counter views – and some shifting sands.

### **1. The Two Horsemen of the Apocalypse**

Listening to public voices on gold, two possible futures are offered.

The predominant, indeed strident voice proclaims the end of history – at least for gold. It is finally revealed as Keynes’ primitive relic. It has ceased to be a store of value and the 34 000 tons that sit in the vaults of central banks and international institutions are redundant and must be sold, sooner rather than later. Gold has become “just a commodity”, and for this reason (though the logic is not supplied) must dramatically reduce in value.

The second view, in tiny minority, though perhaps gaining some ground in recent weeks, presents an Apocalypse not for gold, but for everything else. In a world of artificial and uncertain value, where governments have had free reign to run their economies on an unsustainable basis, economic crisis beckons, and will only be resolved by a return to a gold standard of some type.

## **2. A view from history**

What does history tell us? Let's take a long view backwards. Graphs, it is true, are like abstract paintings. They invite their viewer's own, idiosyncratic interpretation. The longer the time line, the less the distortion of starting and ending points. This graph starts from 1820. It is in nominal terms, though an inflation-adjusted graph shows similar trends. The interesting thing about this graph is that it offers little support for either of our apocalyptic futures. It does clearly suggest that the very high gold prices of the early eighties were an historical anomaly. Removing this, a reasonably consistent pattern is suggested.

## **3. A gold producer's view of the future**

I assume my invitation to speak here carries an expectation of a gold company's view of gold in the new millennium. I very much hope it does not carry the expectation of price prediction. This is either a very brave or a very foolish thing to do about gold. Andy Smith recently made some very specific predictions. Up to \$340, if I recall correctly, for "a few months" then back to \$280. Time will apply the right adjective to these predictions. I offer none. My colleague, Kelvin Williams, says emphatically that the gold price is completely unpredictable. He's right.

I am not sure that gold alone has this enigmatic future status. Was the Asian crisis foreseen? Did not exchange rate instability, bank illiquidity and equities volatility occur exactly in the climate where many were describing a new paradigm, an end to the business cycle, and a new era of deflation? The future is the future: unpredictability is in its genes. Yet today's actions have profound consequences for tomorrow.

How then can governments, companies and individuals "manage" in the face of this uncertain future? Pierre Wack, while he was head of planning for Shell, invented what he described in his Gallic way "scenario painting". If the future cannot be foretold, then at least internally coherent and plausible alternative futures can be painted. This at least should alert human actors to possible futures, and test their actions of the present against possible future consequences.

For our company, AngloGold, we have developed two alternative gold scenarios. They accommodate neither Apocalyptic vision mentioned at the outset. Indeed, they do not differ all that dramatically, one from the other. The development of these two alternative price scenarios has had important consequences for our company.

#### **4. The lower playing field**

The first “plausible future” is essentially a continuation of trends evident in the last three or so years. Here, a combination of net official sector gold sales, net increases in producer forward and option selling, and net speculative sales by managed funds and other investors perpetuates negative sentiment about gold. Volatility is easier to create on the way down than on the way up. An essential, additional element of this would be a prolonged depression in Asia, which would slow growth in Asian gold demand and weaken that demand floor under the gold price.

In these circumstances, a gold price which got stuck somewhere around \$250 to \$280 seems plausible.

#### **5. The higher playing field**

Here, essentially two scripts exist.

In the first, official net sales stabilise at below 500 tons per annum. Physical gold consumption (please note I call this gold consumption rather than gold jewellery consumption) resumes its impressive growth trend of the last decade and a half in the low double digits, with Asia again leading the way. Firm demand produces a tighter market and firmer prices.

The second script of the higher playing field, however, comes close to that of the second Apocalypse. If the problems we see in financial markets today intensify, then a period of great historical discontinuity seems on the cards. At the very least, a season of uncertainty and disequilibrium is possible – a period similar in economic consequence to the Napoleonic Wars, the First and Second World Wars, and more recently, the oil price-induced inflation squeeze of the mid-seventies to mid-eighties.

In either of the above scenarios, it seems likely that the gold price would trade up, perhaps into a range of say \$320 to \$350 per ounce.

Again, I must say, we would be very foolish to present the above as a set of price predictions, and you would be even more foolish to place any store by such price predictions.

In fact, it is not the numbers that are really important at all. Rather, it is what these two scenarios exclude that is interesting. Let me explain.

Anyone who seriously interrogates the future for gold must consider the following:

- Central banks are very unlikely to eliminate or even dramatically reduce their gold holdings over a short period of time. Most major holders have recently affirmed their intention to hold high levels of gold. The EU 15 per cent is a high number when viewed from the perspective of desirable, official sector asset allocations. Particularly in those countries that are still large holders of the metal, selling gold is politically unpopular.
- Last year, some 800 000 million people worldwide bought 1.6 billion pieces of new gold jewellery. In Asia, particularly, gold is both an adornment and a store of value, evidence of both prosperity and an insurance against crisis.
- In the West, individual consumption has been limited either to the gold coin market, or to high margin jewellery. Gold coins, except to commemorate particular events, have never been popular in the East. They sell at a premium to their gold content; they cannot be worn or shown; they capture neither religious nor life passage significance. Again, the so called “jewellery sector” is better described as the gold sector. It has offered eastern customers a wide range of gold artefacts, with low margins. The gold trade in the East is high volume, low value. And it has grown dramatically.
- There is no plausible reason why Asians should stop buying gold. Clearly, as and when this region of the world returns to its growth pattern, so can we expect gold sales to return to the double digit growth pattern of the past 15 years. Except in the context of total economic failure, there seems no good reason to expect a market collapse in individual gold consumption in Asia.
- Significant price elasticity is evident in Asian individual gold consumption. Of course, this is a normal characteristic of a consumer market. It does provide an important element of floor and ceiling to prices.

## **6. Some strategic conclusions from the above for AngloGold.**

1. We need total costs of around \$200 or below. If we are to accept an equal possibility of a lower or a higher price scenario, with the outside edges of uncertainty somewhere around \$250 and \$350, then we must run our company to make decent profits, even at the low end of the price range.
2. We must run our company as any other; as a company that can generate earnings and pay meaningful dividends in even the worst price circumstances. Other sectors have had to do this. We are sure that we can.
3. Ironically, if we can do these two things, then we are in a position to promote investment in gold equities, not as a gamble on a higher price, but as a value investment.
4. We must – and will - support the renewal and strengthening of the World Gold Council (WGC). With regard to individual consumption, the gold industry as a whole has done relatively little to promote markets or products. Certain producers were responsible for the creation and ongoing support of the WGC. It has done remarkable work in market liberalisation, product and design innovation, and the enhancement of the chain from manufacture to retail, particularly in Eastern markets. However, the body has never achieved comprehensive representivity. And it has been starved of funds in recent times.
5. With the gold industry, including the official sector, we must play our part in ensuring gold markets that serve all participants. Whilst those calling for a return to a gold standard may be whistling in the wind, there is clearly a case for greater transparency, perhaps greater co-ordination, in regard to both official gold sales and gold lending. This should be an important part of the new international financial architecture for which so many are now lobbying.
6. We must take the lead in making gold a product for everyone. The story of individual gold consumption in the East and West is starkly different. Eastern markets have grown on the back of a “gold is for everyone (and every day)” culture. In Western markets gold remains an elitist and exceptional good: perhaps like

champagne. It is an artefact of the Concorde class. Does this have to be? In the West we live with mass markets:

- where tracksuits with designer labels command huge premia;
- where products as different as sunglasses, cell phones and running shoes have become fashion goods with mass fashion markets;
- and where even the personal computer has suddenly entered the fashion parade, with Apple iMac, which offers itself as furniture rather than just a screen.

In such markets, why should gold be any different? And why should gold companies not be involved in seeking to bring gold in a broad range of product forms to a broad range of 21<sup>st</sup> Century consumers? AngloGold is taking the lead in 1999; as much in this as with WGC funding.

If companies like AngloGold achieve objectives such as these I am sure that we can be one factor in that equation which will see gold on the higher playing field as our world enters its new millennium.