
INDUSTRY OVERVIEW

ROLE OF GOLD

Gold is one of the earliest metals discovered and is regarded as the world's oldest international currency due to its scarcity, high dollar convertibility and unique features. Though gold is seldom used to effect purchase and payment, it is in demand in fiscal, industrial and commercial areas. The demand is due to the following reasons:

1. Official reserve

According to the World Gold Council, central banks have held significant amounts of gold in their official reserves for more than 100 years, and this will continue for the foreseeable future. Presently, following the US dollar, gold represents the second largest percentage of the official reserves of the world. In 1870, 1913 and July 2003, the amount of gold in the official reserves of the world was estimated to be approximately 700 tonnes, 8,000 tonnes and 32,114.3 tonnes respectively.

The following table sets out the latest recorded amount of gold, and the percentages they represent of the official reserves (by country) as of July 2003:

	Tonnes	% to total foreign reserves		Tonnes	% to total foreign reserves
United States	8,134.7	57.0	France	3,024.8	55.2
Germany	3,443.0	43.2	Italy	2,451.8	45.8
Switzerland	1,781.4	33.0	Netherlands	842.5	48.5
Japan	765.1	1.7	China	600.0	2.1
United Kingdom	313.2	8.8	Philippines	275.5	19.2
India	357.7	5.4	Singapore	127.4	1.7
South Africa	123.8	16.1	Indonesia	96.5	3.2
Australia	79.6	3.9	Canada	13.1	0.4
			All countries	28,705.4	11.0

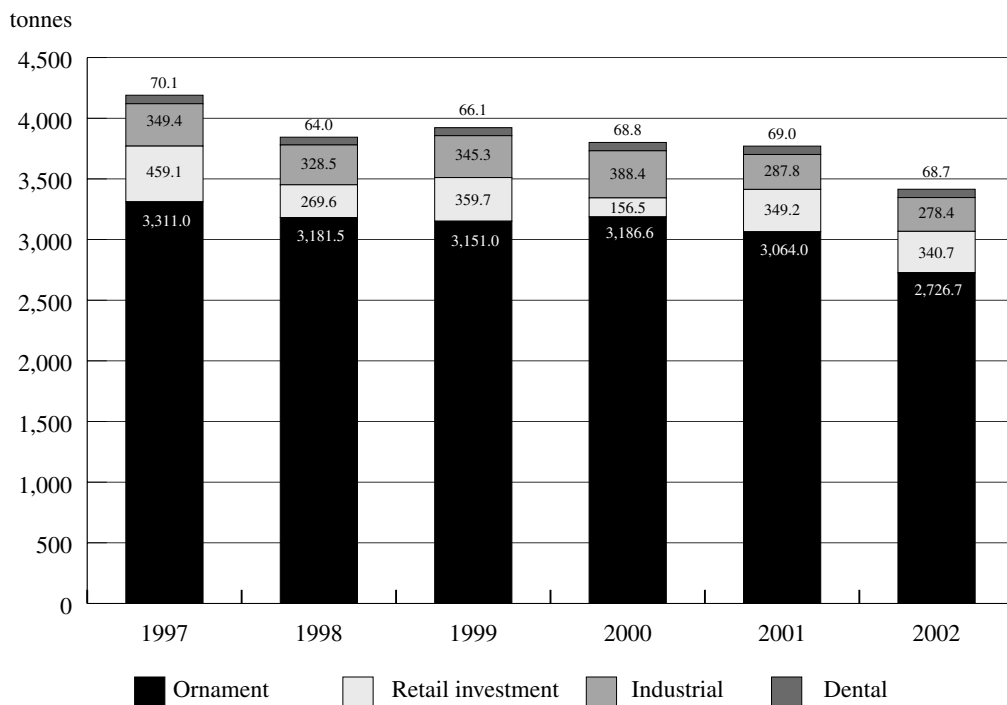
Source: World Gold Council

As shown in the above, gold, as a percentage of the official foreign reserves of China, is far below the average of all countries and of other developed countries. The official reserves of China are over US\$268 billion and the conversion of an additional 1% of foreign reserves into gold would mean the mobilisation of approximately US\$2.68 billion (assuming the foreign reserves of China remain unchanged despite its annual GDP growth of over 7%). At a gold price of US\$350/ounce, this would result in the purchase of approximately 246 tonnes of gold.

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2. Physical demand

In 2002, physical demand for gold (including for use as retail investment and for industrial and dental use) of the world was 3,414.5 tonnes. Of this, physical demand for gold ornament represented the majority.



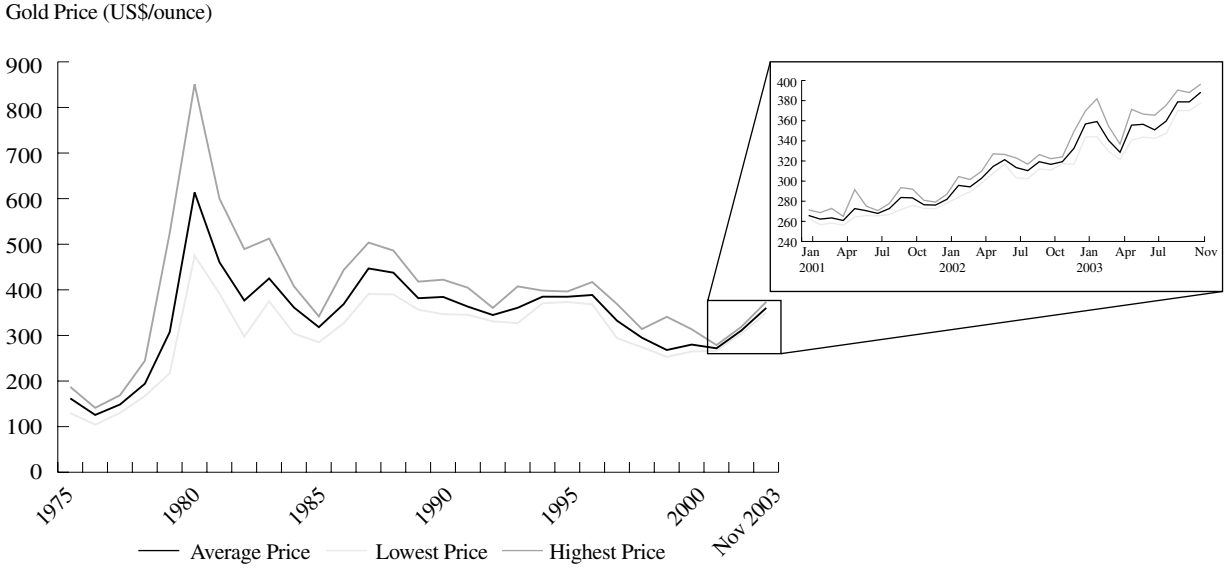
Source: World Gold Council

China is the third largest gold consumer in the world, after India and the US. According to the World Gold Council in 2002, physical demand for gold in China was approximately 215 tonnes, or approximately 6% of the physical demand for gold of the world. In 2002, demand per capita of China was approximately 0.16 grams, against an average demand of the world of approximately 0.7 grams and of 1.42 grams of the US. With rapid growth in GDP and the liberalisation of gold jewellery manufacturing, wholesaling and retailing to foreign companies in China, physical demand for gold is expected to increase in China.

3. Investment

Gold has been regarded as a currency and as an investment for thousands of years. According to the annual market commentary of World Gold Council, gold was the strongest major currency in 2002. The following illustrates the trend in prices of gold in the international market during the past three years:

Gold Price



Source: Bloomberg

Since 2001, gold prices have largely reflected the fact that investors have used gold as a risk management tool and a profit-making investment. In general, investment in gold in recent years has been driven by geo-political concerns, and reflects currency concerns, as well as the desire to manage risks in the equity and bond markets and during regional crises.

CHARACTERISTICS OF GOLD

Gold is attractive to central banks and potential investors mainly due to the following reasons:

Economic security — the value of currencies such as the US dollar and the euro, held in reserves, depends on the economic policies of the issuing government. Gold does not suffer from defects in the policies of reserve bankers (and may in fact even benefit from them). There is also no possibility of gold being repudiated. Repudiation has, albeit in extreme circumstances, occurred on occasions in the past with fiat money and government securities. A sharp depreciation in the value of reserve currencies on the foreign exchange market can also amount to repudiation, entailing losses for foreign holders of those reserves.

Physical Security — countries frequently impose exchange controls which restrict, or even prevent, the free transfer of their currencies. If external reserves are held entirely in the form of financial instruments or bank deposits denominated in the currency of a reserve centre, they are vulnerable to such restrictions or preventions. Gold is the ultimate means of payment, is perceived to have an element of stability, and is the ultimate value of a currency.

Unexpected needs — gold is not only held for prudential reasons but also to meet unforeseen contingencies. It provides a form of insurance against improbable, but highly damaging, events. Such events might include war, an unexpected surge in inflation, a generalised crisis leading to repudiation of foreign debts by major sovereign borrowers, a regression to a world of currency and trading blocs, or the international isolation of a country. Gold is found to be especially valuable in periods when the world is moving from one sort of monetary system to another, such as from fixed to floating rates in the 1970s, or the earlier transition from the period when sterling was the dominant currency to one dominated by the US dollar.

Diversification — the addition of gold to a portfolio brings significant benefits in risk/reward terms which do not depend on the price of gold at a given moment in time. Returns on gold tend to be neither correlated to other financial assets nor to macroeconomic variables such as GDP, inflation and interest rates.

Income — gold is sometimes described as a non-income earning asset. This is untrue as the existence of a gold lending market allows reasonable returns to be made, and for gold to be traded to generate profits.

Store of value — over short periods of time, gold may not retain its real value. However, over the last two centuries, gold has maintained its purchasing power in real terms.

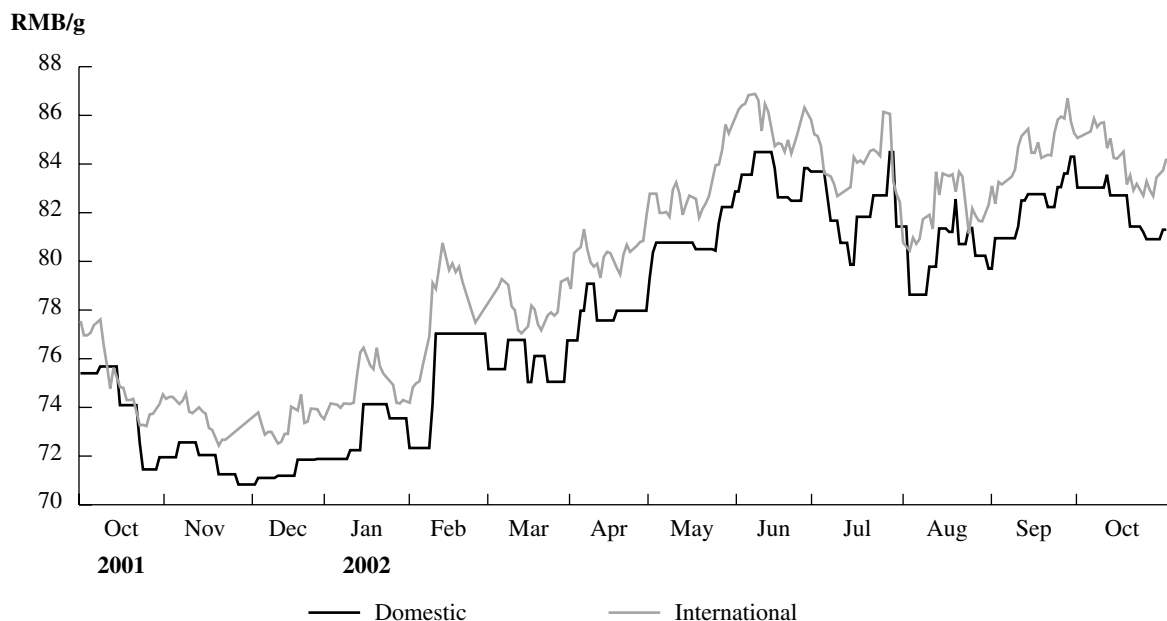
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OVERVIEW OF THE PRC GOLD MARKET

The proven gold resources of the world were approximately 89,000 tonnes (of which approximately 7%, or 6,230 tonnes, was attributable to China) with an annual growth of 2%.

The PRC government regards gold as a special mineral resource and has implemented a stringent control system in respect of gold mining and exploration activities. From 1949, the PRC government has implemented a centralised purchase and allocation system for gold, which has restricted the production, circulation and consumption of gold. As a result, the price of gold in the PRC has not been in line with that of the international market. In recent years, the gold market in the PRC has been liberalised considerably.

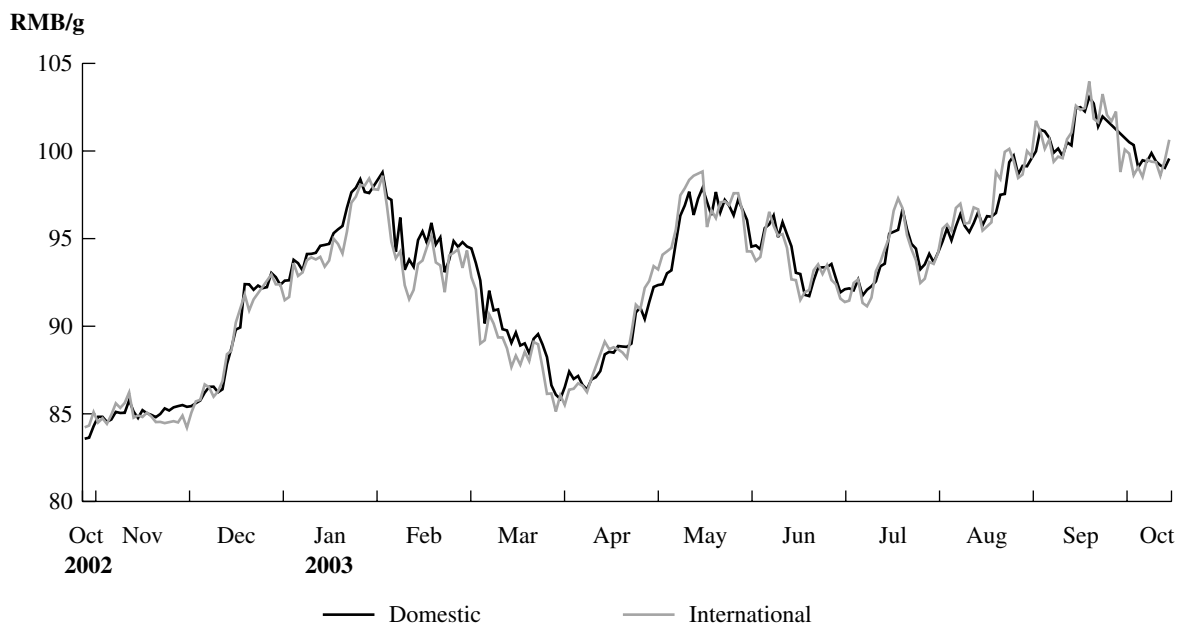
Comparison of prices of gold prior to the commencement of the Shanghai Gold Exchange



Source: *The Shanghai Gold Exchange*

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Comparison of prices of gold after the commencement of the Shanghai Gold Exchange



Source: *The Shanghai Gold Exchange*

On 30th October, 2002, the Shanghai Gold Exchange commenced operation under the supervision of the State Council. Thereafter, the PBOC ceased its gold allocation and gold purchase operation. All transactions of gold are now conducted through the Shanghai Gold Exchange, and prices of gold are determined by market supply and demand, which essentially converge with the prices of gold in the international market. Under the relevant laws and regulations of the PRC, the PBOC regulates the Shanghai Gold Exchange to ensure that the market is stable and orderly. The Shanghai Gold Exchange was initially established for spot trading to meet the day-to-day demand of domestic gold enterprises. With improvements in the gold exchange mechanism, new products (including investment products) can be further developed in the gold market.

From 31st March, 2003, administrative approvals for 26 items (including the acquisition of gold and the manufacturing, processing, wholesaling and retailing of gold products) are no longer required. From this date, the PBOC relinquished the administration of the gold market, save for the import, export and reserve rights of gold. As the gold licensing system for jewellery market participants has been abolished and the gold investment market has been liberalised, domestic demand for gold is expected to increase rapidly. A completely new gold market mechanism will enhance gold production standards in China, which will gradually come in line with those of the international market.

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GOLD MINING INDUSTRY IN THE PRC

For decades, the gold industry in the PRC has been developing. At present, there are over 1,200 gold producers, which are independent and fully-fledged enterprises with mining, refining, construction and installation, project design and technological research divisions. In general, however, development in the gold industry in the PRC has been slow as there are many small-scale poorly managed enterprises with limited finances. The technology utilised by such enterprises lags behind those in developed countries. For example, under similar geological conditions, the scale of mine operation in China is below that of developed countries, with only half to one-fifth of the output of mines in developed countries. In addition, utilisation of mining resources is low. The utilisation rate of State-owned gold resources is approximately 59% and in villages and towns is generally below 40%. These rates compare unfavourably with the utilisation rates of developed countries, which range from 76% to 90%. As a result, the gold industry in China is in need of consolidation, expansion of scale and enhancement in technology.

Statistics show that gold production volume in recent years was approximately 170 tpa of metal. In 2000, the volume of gold production in the PRC was 175 tpa of metal, and in 2001 was 182 tonnes, which was fourth in world.

At the end of 2000, there were approximately 800 mining enterprises in the PRC, with 400,000 employees in total, a daily ore processing capacity of 50 tonnes and a production capacity of 170 tpa of gold metal. At the end of 2001, there were only 7 gold mining and production enterprises with a production capacity of 2 tpa of gold metal or above. These are listed below:

The top seven gold mining and production enterprises in the PRC

Names of enterprises	Production output in 2001 (kg)
Fujian Zijin	5,262.00
Shandong Gold Mining Co., Ltd	3,105.00
Shannxi Jianchaling Gold Mine	2,977.69
Shandong Laizhou Jinchang Mining Co., Ltd.	2,916.18
Shandong Zhaoyuan Gold Co., Ltd.	2,818.43
Henan Shanmenxia Jinqu Gold Mine	2,520.82
Shandong Fenglai Heilangou Gold Mine	2,074.66

Source: The PRC Gold Industry Yearbook 2002 and Company's information

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The gold market of the PRC has gradually become deregulated in recent years and the PRC government has established a series of policies to promote the development of the gold industry. The policies emphasise a production process of high efficiency, low consumption and low contamination. The policies also emphasise the use of new techniques and the combined utilisation technique of refractory resources using the hydrometallurgy method. The State Planning Commission and SETC have also confirmed that the combined recovery of refractory gold ores and gold-containing tailings is one of the key development techniques for non-ferrous metals. The “Guiding Catalogue for Foreign Investments”, issued in March 2002, provides that foreign investment is encouraged in industries which explore and process low-grade and refractory gold ores in the PRC.

The PRC government also strongly encourages gold mining enterprises to use advanced technology in the mining and production of gold by granting them preferential treatment on taxation.