

Official Sector Activity in Gold Full Year 2007



January 2008



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Overview

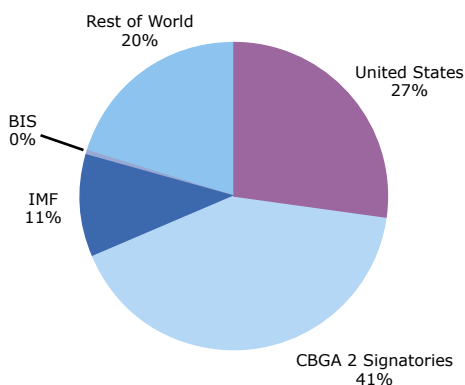
GFMS' estimates of the impact of official sector activity on the gold market are based on a combination of publicly available data and information collected through field research. Due to there often being a lag between central bank activity in gold taking place and it being identified, our estimates are often revised through future updates.

Net official sector sales in 2007 are estimated to have reached 488 tonnes, up by a third year-on-year. When assessing the seemingly dramatic increase recorded last year, it should be noted that this came from an unusually low base in 2006. Indeed, one could argue that, if anything, there was a return to "normal" levels last year, close to the 500-tonne per annum average of the last decade.

As has generally been the case in recent years, the bulk of official sector gold sales was accounted for by signatories to the Central Bank Gold Agreement (CBGA). Our estimates suggest that the group released more than 500 tonnes of gold into the market over the calendar year. On 26th September 2007, the third year of the current CBGA came to an end, with total sales by the signatories over the period having reached 476 tonnes. A detailed discussion of CBGA signatory activity over the third Agreement year and a review of probable sales over the remainder of the accord is provided in the dedicated focus box at the end of this report.

Official Sector Gold Holdings

end-October 2007
total: 29,916 tonnes



Background Information

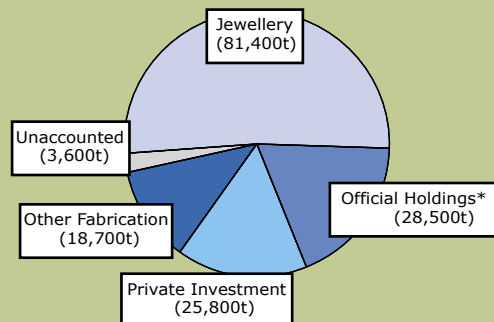
Largely due to gold having been the basis of monetary systems from as far back as the early part of the 18th century through to the 1960s, the yellow metal has continued to take up a significant portion of the official reserves of central banks around the world (a global 10% at end-October 2007). According to GFMS data, these holdings accounted for some 18% of total above-ground stocks of gold at end-2006. The figure is equivalent to more than 10 years of global mine production at current levels.

Given this information, the importance of official sector gold activity to the market and for the price of the metal is self-evident. Moreover, history provides the evidence to support this. First of all, the shift by the official sector from a broadly neutral position in the 1970s and 1980s to substantial net sales in the 1990s and through to the current decade was a factor (among others) that resulted in gold prices falling well below the \$300 mark in the late 1990s. In addition, the rise in central bank lending over the 1990s provided the liquidity required for producers to enter short positions in gold, during a decade when producer hedging accounted for over 6% of annual gold supply.

More recently the "anti-gold" climate that was prevalent throughout the 1990s and in the early part of the current decade seems to have come to an end. Although the official sector remains a net seller overall, sentiment towards gold, as suggested by comments made by central bank officials, as well as the appearance of small-scale purchases by certain countries, has shifted to one considering the metal to remain an important reserve asset. This change in sentiment has been boosted particularly by the prolonged period of US dollar weakness, coupled with gold's strong performance and demonstrable portfolio diversification properties.

Above-Ground Stocks of Gold

Above-ground Stocks, end-2006 = 158,000t



* Excluding gold lent or supplied
Source: GFMS

Central bank lending continued its secular decline in 2007, driven by the persistence of low leasing rates as well as, it seems, concerns over counterparty credit risk. However, although lease rates did increase somewhat in the second half of the year, they remained low by historical standards.

Sales & Purchases by Country

Sales

Gross sales in 2007 reached 552 tonnes.

Approximately 94% of the figure was accounted by sales from CBGA members. The biggest seller from the European group was Switzerland. Over the June-December period, the Swiss National Bank released 145 tonnes of gold into the market. At year-end, the country's gold reserves stood at around 1,145 tonnes.

The second largest seller from within the CBGA appears to have been Spain. In July the country sold 25 tonnes of its gold reserves. Earlier in the year, the Banco de España had stirred the market with a series of sales amounting to 110 tonnes over the March-May period. At the end of November, Spanish gold reserves were estimated at 282 tonnes, accounting for nearly 40% of the country's total reserves (at market prices).

Through regular releases over the year, France's reserves seem to have fallen by 96 tonnes in 2007 through to November. The sales were part of the country's ongoing programme to sell 500-600 tonnes

over the course of the second CBGA. French reserves at end-November amounted to 2,624 tonnes, at market prices equivalent to 57% of total official reserves.

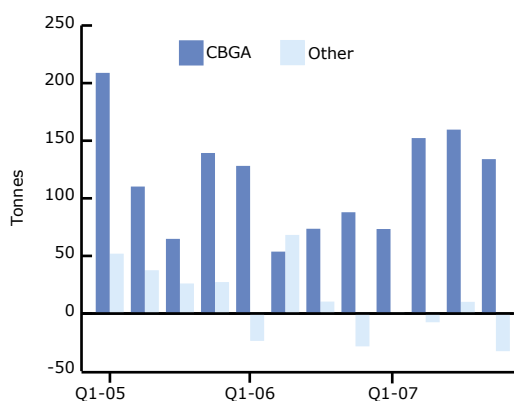
Other confirmed sales from the CBGA group in the January-November period were made by Austria, Sweden and Germany, amounting to nine tonnes for the first two countries and five for the last one. The three countries' gold holdings at the end of November can be seen in the table on page 6.

Finally, information extracted from weekly financial statements of the Eurosystem suggest a further combined 20 tonnes left the vaults of at least two members of the Eurozone late in 2007.

Based on official IMF statistics, the largest sales outside the CBGA came from the Philippines, which sold a net 14 tonnes through to end-October. The year also saw gold reserves of a handful of other countries, including Mongolia and Montenegro, decline at the margin. Coupled with the small number of purchases seen over the year (discussed in the following section), this led to non-CBGA members becoming net purchasers of gold.

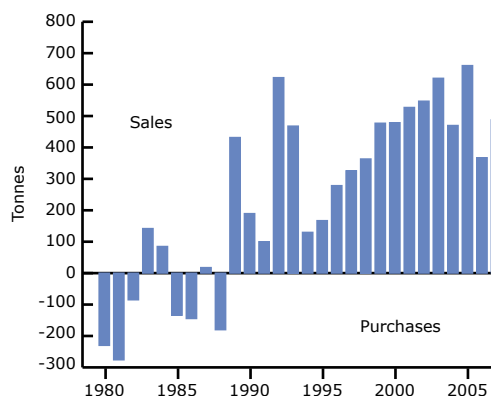
It is finally worth mentioning that at this stage it is hard to estimate sales from the Bank for International Settlements' own reserves. Information on its activities in the gold market over most of 2007 will be included in its next annual report, due later this year.

Quarterly CBGA & Other Sales & Purchases



Source: GFMS

Annual Net Official Sector Sales & Purchases



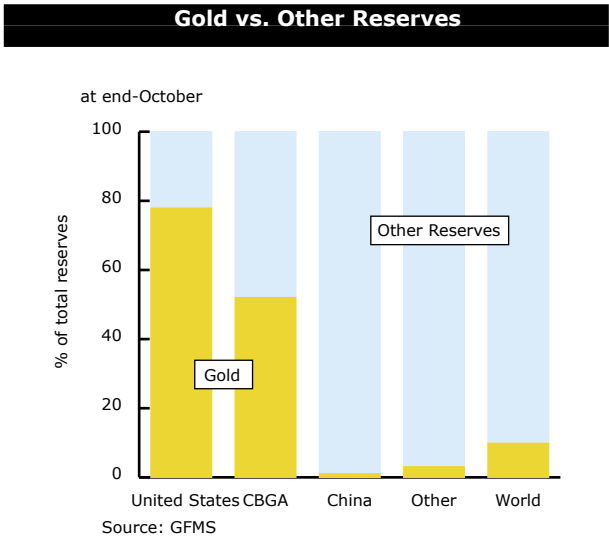
Source: GFMS

Purchases

Gross official sector purchases in 2007 reached an estimated 64 tonnes. With the exception of a coin purchase of small magnitude from within the Eurozone, all purchases seen in 2007 were made by countries outside the CBGA.

A significant portion of the total was accounted for by unannounced activity by two countries, details of which cannot be revealed in respect of confidentiality. Our estimates for the smaller balance of announced purchases include the 12-tonne inflow into Qatar’s gold reserves and marginal increases in the holdings of Kazakhstan.

Top-10 Forex Holders	
(US\$ bn, end-October 2007)	
Country	Foreign Exchange Reserves
China	1,455
Japan	931
Russia	436
Taiwan	266
South Korea	260
India	256
Brazil	168
Singapore	158
Hong Kong	142
Algeria	104
Source: IMF	



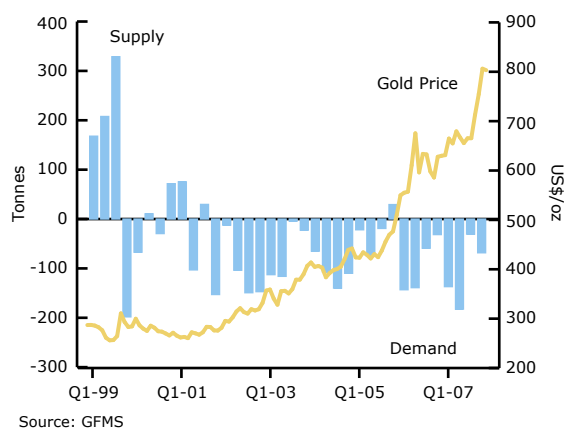
Central Bank Activity in the Lending Market

Over the course of 2007 central banks continued to withdraw from the lending market. During the January to August period, this was largely fuelled by the persistence of very low leasing rates that has kept central bank lending on a declining trend in recent years. Moreover, the gradual flattening of the yield curve has reduced incentives to enter or renew long term arrangements, while the ultra-low short term rates have meant that lending on this basis does little more than, at best, pay for storage costs.

In addition to this ongoing trend, GFMS believe that, a further disincentive to the lending of gold bullion developed over the last few months of the year and indeed through to the present time. The credit market crisis that erupted in August and the widespread impact it had on global markets put central banks' focus on counterparty credit risk. It is perhaps significant that the 3-month rate averaged 31 basis points over the August to December period, compared to a mere 14 basis points average over the rest of 2007. As indicated in the accompanying graph, rates on longer tenures also registered gains in the last four months of the year, although these were more modest, in relative terms.

Despite the increases discussed above, it is important to stress that lease rates remained at historically very

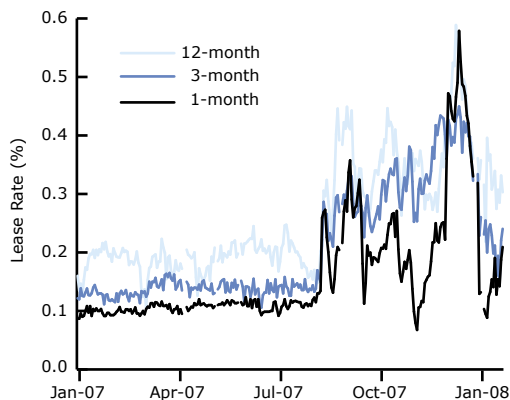
Net Producer (De-)hedging



low levels through to the end of the year as well as more recently, at the outset of 2008. This can be clearly seen when comparing the two graphs below.

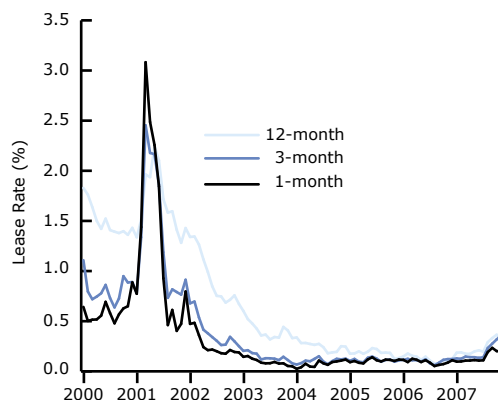
Low borrowing costs have been a feature of the gold market since 2004 despite the central banks' consistent withdrawal of gold from the market. The explanation for this is the declining demand for gold borrowing that has characterised the market in recent years. This in turn has been the result of a continued scaling back of the producer hedge book, averaging more than 300 tonnes annually over the period, coupled with limited interest in short positions in the metal by the investor community. In addition, the high price environment of recent years is believed to have led to a decline in fabrication related borrowing, be that due to weak demand in certain years or by the industry's growing efforts to limit work-in-progress and inventories.

Gold Leasing Rates



Indicative only - calculated using daily Libor & Gofo data
Source: LBMA

Gold Leasing Rates - Historical



Indicative only - calculated using daily Libor & Gofo data
Source: LBMA

Outlook for Central Bank Activity in the Gold Market

GFMS expect that the first half of 2008 will see central bank sales move down somewhat from the levels seen last year. Specifically, gross sales around the mid-200 tonne mark (largely coming from within the CBGA) are expected to be partly offset by small scale purchases, leaving net official sector sales in the low 200 tonnes over the period.

Starting with signatories to the CBGA, Switzerland will most likely continue selling at a rate similar to that seen in the last quarter of 2007 (if not somewhat higher, given the high price environment). France will probably continue to offload bullion in regular tranches, towards its 500-600 tonne target. Smaller sellers, such as Sweden and Austria will continue to provide marginal quantities, while Germany has stated that it is not going to use its 120-tonne per annum option in this new CBGA year (save an amount of up to eight tonnes, to provide material for the country's coin programme). Finally, it is possible that the ECB will release part of its reserves into the market some time in the first half of 2008, keeping with the tradition set in the first three years of the current Agreement.

For reasons explained extensively in the dedicated focus box at the end of this report, Italy is not expected to appear as a seller in the short to medium term, while the Netherlands seems to have now ended its programme. Having already sold a significant part of its reserves in 2007, in our opinion Spain is unlikely to feature prominently (if at all) as a seller this year. This leaves a handful of non-regular potential sellers, such as Portugal and Belgium, any possible releases from which are likely to remain limited.

Moving to countries outside the CBGA, we expect that this group will remain generally neutral on a net basis. Strategic purchases of limited magnitude, such as those seen over much of last year, remain possible, although these are likely to be largely offset by opportunistic sales.

Any purchases that do take place will probably come from certain central banks, seeking to diversify away from the US dollar, be that due to the latter currency's bleak outlook or due to political motivations. It should be noted here though, that as gold remains close to the all-time highs it achieved recently, it is possible that some of the potential buyers could decide to postpone purchases until a correction has taken place. Elsewhere, we expect that small scale purchases of local mine production could continue.

Partly offsetting any gross purchases, GFMS expect that some central banks outside Europe could undertake opportunistic sales, driven by the very high gold price environment and, probably also in some cases, due to existing options positions.

As far as the impact of net official sector sales on the gold price is concerned, we believe this will be, if anything, limited. The shock the market received as sales from within the CBGA ramped up in the March-May period and from the news of fresh Swiss sales will most probably not be repeated, as investors have now priced in CBGA sales much closer to quota than they perhaps expected in the early part of 2007.

Looking at central bank lending, we expect that the continued credit market crisis will remain an additional disincentive to the low lease rates environment for central banks to lend gold into the market. When it comes to the impact on leasing rates of this perhaps accelerated move out of the lending market, we believe that the current, slightly elevated, levels of leasing rates will be maintained if not exceeded to some extent.

Although somewhat higher than the ultra-low levels they were at until fairly recently, lease rates are expected to remain contained in the short to medium term. After all, there remains an abundance of central bank liquidity on the sidelines of the market, part of which would be mobilised if rates were to grow sufficiently, this factor essentially putting a cap on any potential increases for the time being. Moreover,

looking at the demand side, with net producer hedging unlikely to appear in the short term and investors' appetite for short positions in gold being limited there is very little scope for a borrowing demand-led rise in leasing rates.

In the longer term, this picture could change. As the volume of outstanding producer hedges has already fallen to its lowest level since the early 1990s, the risk develops, that net producer hedging will eventually again appear on the supply side. Such a new drain on liquidity for gold could well mean that lease rates

will eventually register material increases, with levels well in excess of 50 basis points for short-term rates possible. However, given the large amount of central bank gold withdrawn from the market in recent years - much of which could re-enter the market if rates were sufficiently attractive - and the probability that any return to net producer hedging will be at more modest levels than in the past, it is difficult to see rates recovering to the peak levels seen in the late 1990s and in the early part of this decade.

Gold & Other Official Reserves						
	Country	Gold in Tonnes	Gold in US\$ bn¹	Other Reserves in US\$ bn	Gold as % of Total Reserves	Data as of end-
1	United States	8,134	204.9	59.9	77.4%	November
2	Germany	3,417	86.1	44.4	66.0%	November
3	France	2,624	66.1	50.6	56.7%	November
4	Italy	2,452	61.8	31.7	66.1%	November
5	Switzerland	1,155	29.1	42.8	40.5%	November
6	Japan	765	19.3	950.9	2.0%	November
7	Netherlands	622	15.7	9.6	62.0%	November
8	China	600	15.2	1,457.0	1.0%	October
9	Taiwan	423	10.7	270.1	3.8%	November
10	Russia	446	11.2	452.2	2.4%	November
11	Portugal	383	9.6	1.0	90.2%	November
12	India	358	9.0	265.2	3.3%	November
13	Venezuela	357	9.1	21.7	29.5%	October
14	United Kingdom	310	7.8	49.7	13.6%	November
15	Lebanon	287	6.9	13.4	33.8%	September
16	Spain	282	7.1	11.4	38.3%	November
17	Austria	280	7.1	10.5	40.2%	November
18	Belgium	228	5.7	10.2	36.1%	November
19	Algeria	174	4.4	107.2	3.9%	November
20	Sweden	149	3.8	28.2	11.8%	November
21	Libya	144	3.7	75.9	4.6%	October
22	Saudi Arabia	143	3.6	31.3	10.4%	October
23	Philippines	130	3.3	29.1	10.2%	October
24	Singapore	128	3.2	n/a	n/a	November
25	South Africa	124	3.1	29.1	9.7%	November
26	Turkey	116	2.9	72.7	3.9%	November
27	Greece	113	2.8	0.7	80.6%	November
28	Romania	104	2.6	37.6	6.5%	November
29	Poland	103	2.6	65.6	3.8%	November
30	Thailand	84	2.1	82.5	2.5%	November

¹ Market valuation based on end-month gold prices respectively
n/a refers to data in Other Reserves matching the latest data in Gold Reserves not being available
Source: IMF and central bank websites

The End of the Third Year of the Second CBGA

26th September marked the end of the third year of the second CBGA. Over the course of the twelve-month period, signatories to the Agreement sold a total of 476 tonnes. The table below features a breakdown of individual countries' sales over the first three years of the current Agreement, while the accompanying graph overleaf provides a more detailed breakdown, of monthly sales.

Following the underselling by CBGA signatories of their quota by more than 100 tonnes in the second Agreement year and given a lack of obvious candidates to take up the full allowance for the third one, market expectations at the beginning of 2007 were for the group to sell far less than its 500-tonne limit. Indeed, for the first ten weeks of the year, the rate at which CBGA members released gold was very slow, averaging below three tonnes per week.

Sales Under CBGA 2

(tonnes)	Year 1	Year 2	Year 3	Target
Austria	15	14	9	up to 90
Belgium	30	-	0	not public
Finland	-	-	-	not public
France	135	132	115	500-600
Germany	5	5	5	option for up to 600
Greece	-	-	-	no intentions to sell
Ireland	-	-	-	no intentions to sell
Italy	-	-	-	not public
Luxembourg	-	-	-	not public
Netherlands	55	67	14	165
Portugal	55	45	-	not public
Slovenia	n/a	n/a	2	not public
Spain	30	62	149	not public
Sweden	15	10	10	60
Switzerland	130	-	113	380
ECB	47	57	60	15% of reserves
Total*	517	393	477	

*The figures presented above are based on end-month data from the IMF (the sole public source of individual country numbers). As Agreement years end on 26th September, published total CBGA volumes per Agreement year may thus differ from IMF-derived totals.

The first signs of change came from mid-March onwards, as weekly financial statements of the Eurosystem showed a marked increase in the rate of sales within the region. Spain was soon identified to be the driving force behind this increase. By end-May, the country had sold no less than 110 tonnes of its reserves, with further releases of 25 tonnes taking place in July. According to the central bank, the motivation behind these sales was portfolio diversification away from an arguably overweight position in gold.

In addition to the Spanish sales, mid-April saw the announcement of a new sales programme, under which the Swiss National Bank would sell 250 tonnes of gold by the end of the current Agreement. Unlike the previous sales programme, the proceeds of which were distributed to the federal and cantonal governments, the purpose of the current one is portfolio diversification, against the backdrop of reserves still said to be overweight in gold. For instance, as can be seen in the table on page 6, at end-November gold accounted for more than 40% of the country's total reserves, valued at market prices.

Although the motive behind Switzerland's current sales programme is different to its previous one, the method used seems to be similar. Specifically, regular quantities appear to be coming out of the country's vaults (initially amounting to just over 30 tonnes monthly, while more recently around 10 tonnes monthly).

Although the absolute level of the additional supply due to the emergence of these two players was by no means dramatic (particularly against the backdrop of relatively low-field sales from France and the Netherlands and the lack of sales from the likes of Portugal and Belgium), its indirect impact on the market was significant. Having priced in European sales of no more than 400 tonnes, investors considered news of sales closer to the CBGA limit as generally

bearish. Together with a handful of other factors prevalent at the time, this certainly contributed to the gold price failing to breach the \$700-mark in the first half of the year, as well as the liquidations seen in May and June.

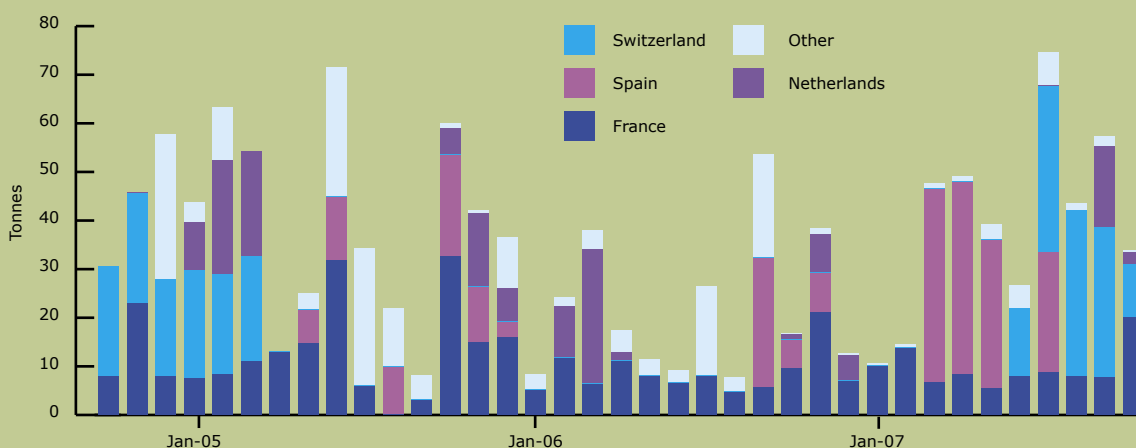
Over the next few months, as mentioned in the main body of this report, we expect CBGA sales will continue at levels somewhat lower than those seen last year. As a result, total sales from the group in the fourth Agreement year will almost certainly fail to reach their 500-tonne limit and are likely to also fall short of the 476 tonnes they achieved in the third year.

Having already stated GFMS' expectations for Swiss sales, it is interesting to discuss the remaining assumptions on which the above forecast is based. Starting with Spain, as the country sold over 240 tonnes during the second CBGA and was left with a little more than 280 tonnes at end-December, it is hard to see the magnitude of any future sales coming close to those seen in the third CBGA year. This is quite apart from any other considerations such as the political sensitivity of gold sales during an election year - the programme-to date having created quite a lot of controversy in the country, particularly in the light of subsequent increases in euro gold prices.

With regards to Italy, last year saw much discussion take place over the prospect of the country's gold reserves being utilised to partly fund its budget deficit. GFMS believe this is unlikely to materialise for a number of reasons. First of all, although at 2,452 tonnes Italian reserves are the fifth largest globally, their mobilisation would only fund a small portion of the overall debt the Italian government faces. Secondly, given the decision over any sales lying with the Banca d'Italia and the European Central Bank, it is questionable whether either of the two organisations would accept such a sale, particularly with the example of the Bundesbank having resisted pressure for similar action in the not too distant past.

With releases from France, Sweden, Austria and Germany essentially a given, and the Netherlands' programme completed, this leaves a handful of non-regular potential sellers, such as Portugal and Belgium to provide the balance. Although fresh sales from these two countries are possible, their combined volume would probably be limited and insufficient to prevent a significant shortfall from the 500 tonne CBGA limit.

Monthly CBGA Sales



Source: IMF, Central Bank Websites

About GFMS

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GFMS Ltd, the world's foremost precious metals consultancy, specialising in research into the global gold, silver, platinum and palladium markets. GFMS is based in London, UK, but has representation in Australia, India, Russia, Germany, Spain and China, and a vast range of contacts and associates across the world.

GFMS is credited with producing the most authoritative surveys of the gold and silver markets, the annual Gold Survey and World Silver Survey, and produces a range of other publications dealing with all aspects of the precious metals markets. GFMS also provides consultancy services in the form of tailor-made research into selected areas of the precious metals markets. GFMS' research team of fifteen full-time analysts comprise experienced economists and three geologists.



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