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Publication of Gold Survey 2004 - Update 2

Gold Price Forecast to Bounce Back from Early 2005 Correction to Average $447 in First Half as Investment Builds Again

GFMS released *Gold Survey 2004 - Update 2* today, their latest report on the gold market. A summary of the findings of Update 2, a preliminary review of 2004 and a forecast for the first half of 2005, was given by Bruce Alway, GFMS' mine production and hedging specialist, at a seminar today in Toronto organised by the precious metals consultancy.

Arguably the report's chief finding is that, despite the recent modest correction in the gold price, the first half of 2005 is expected to see renewed market vigour; the consultancy forecast limited downside risk and are looking for a rally back over early December's 16-year high ($454.20). Alway did, however, add a note of caution, "we're not expecting to beat the 1988 high, $483.90. But the recovery should be strong enough to give us a first half average around $447".

GFMS see investment as the prime driver of this rally, with the focus within this category continuing to shift to the longer term, more fundamentally driven players. Their rationale for interest in gold was ascribed to such economic factors as ongoing dollar weakness, the US fiscal and current account deficits and low real interest rates. Alway added, "it's a good idea to remember that we only need a small shift in the allocation of institutional funds to bring about a quite hefty rally in the price".

Update 2 also cautions against a too bearish interpretation of its forecasts for the other fundamentals (many on the demand side are forecast to fall and on the supply side to rise). Most, however, are expected to respond quite positively should prices ease back. All this explains why GFMS forecast dips below $420 to be limited in their extent.

The dominance of investor activity was a theme GFMS feel very much applied to the past year. Alway commented, "it may seem odd that we're talking about investment as the prime driver when 2004 as a whole saw modest implied net disinvestment and a 13% price rise. But what's important to remember is the swing of over 180 tonnes we had between the first and the second halves of the year. It's this recovery, mirroring the sustained slide in the dollar, that largely explains the direction of prices last year".

The report this year devotes a greater amount of space to investment, partly to accommodate an analysis of a relatively new area, exchange traded funds or ETFs. Alway noted, "the ETFs, especially New York's streetTRACKS, are looking quite exciting at the moment. Their combined holdings after all aren't that far off the 200 tonne mark".

GFMS, however, are keen to stress that investment was far from being the sole driver of price strength last year. The report singles out the major importance of producer de-hedging, which is estimated to have risen by over 50%. It was also noted to have responded well to any dips in the price last year, helping prevent the bouts of speculative selling from turning into a wholesale price rout. Mine production itself was also, and slightly unusually, said to have been a contributor to price strength in that it fell unexpectedly by a sizeable amount.

"The low level of official sector sales was also important," Alway continued. "There was a sizeable drop, particularly in the first half - just as investors were getting the jitters." The report details how constrained selling by the signatories to the Central Bank Gold Agreement (CBGA) was the prime cause of the decline for the year as a whole, though quite numerous purchases by others, most obviously Argentina, was also significant.

The consultancy lastly feels sentiment was critical. This is normally seen in the context of where western investors and the major mining companies think the price is going but on this occasion the report ranks of similar importance the growing acceptance by the traditionally price sensitive countries of prices above $400 as fair and sustainable. This they see as a key reason as to why jewellery fabrication could manage a modest rise and scrap fall by a fair amount. Alway mentioned, "If you said a year back that India would see a 6% rise in jewellery offtake in the face of a 9% increase in the rupee price, you'd have been thought of as hopelessly optimistic. Yet that's what looks to have happened".

The statistical highlights of the report are outlined overleaf:

Statistical Highlights:

Supply

- **Mine production** fell by just over 110 tonnes or 4% in 2004, its largest annual decline since the 1940s. Much was due to temporary factors which hit such countries as Indonesia or Australia. Weak domestic gold prices, however, were more significant for South Africa. A recovery from these temporary matters is forecast to help lift global output in first half 2005 by almost 7%. Currency effects, higher energy charges and lower output largely explained the 13% rise in January-September **cash costs** to almost $250/oz. South Africa saw some of the largest gains though US and Australian costs also rose substantially.

- Net **official sector sales** are estimated to have fallen by 19% to just under 500 tonnes in 2004. This was largely due to low sales in the first three quarters by CBGA signatories, though there were significant purchases outside the Agreement. Net sales are forecast at just under 250 tonnes in first half 2005, up nearly a quarter on the unusually low figure for first half 2004.

- Despite the 13% price rise, **old gold scrap** is estimated to have fallen by over 12% to 829 tonnes. This apparent mismatch is chiefly explained by growing acceptance of prices over $400 and by currency stabilisation in Egypt. On the assumption that prices continue strong, scrap is forecast to rise by 4% in first half 2005.

- Heavy liquidation during the first half of 2004 of longs built up in late 2003 generated **implied net disinvestment** of over 110 tonnes in that period. The second half, however, saw a fair recovery in interest, cutting full year disinvestment to just over 40 tonnes, though this was still in sharp contrast to 2003's *in*vestment of over 650 tonnes. The first half of 2005 is expected to see a continuation to this recovery with implied net investment reaching 175 tonnes.

Demand

- **Jewellery fabrication** rose by 4% in 2004 in spite of the price rise as a result of an acceleration in global GDP growth and greater accustomisation to higher prices. Much of the increase occurred in India, Turkey and China whilst significant losses were again seen for Italy. The global year-on-year comparison though is flattered by the absence of events as acute as 2003's SARS or the official Iraq war. This and a further forecast price rise form much of the reasoning behind the forecast 6% fall for jewellery in first half 2005. **Other fabrication** saw a more buoyant 8% rise in 2004, largely thanks to strength in the electronics sector.

- Net **producer de-hedging** is estimated to have seen a jump of 52% to comfortably over 400 tonnes, primarily through delivery into existing positions though buy backs were still significant. De-hedging is forecast to retreat noticeably in first half 2005, largely as a result of higher prices and a shrinking number of hedged producers, not as hedging has come back into fashion.

- **Bar hoarding** rose by over a third in 2004 to 245 tonnes, chiefly due to gains in East Asia. This plus higher **coin fabrication** (up 7%) meant **world investment** (the sum of bar hoarding, coin demand and implied net (dis)investment) stayed positive at 314 tonnes but was still heavily down on 2003's figure of well over 900 tonnes. The second half of 2004 saw much higher world investment than the first and a further recovery for all its components is forecast to continue into first half 2005.

Gold Survey 2004 - Update 2 provides a review of the gold market in the first half of 2004 and a forecast for the full year with 40 pages of statistics, commentary and analysis on all aspects of world gold supply/demand and on gold prices in various currencies. The publication can be ordered from GFMS for £205 or US$375 / €315 per copy. For orders and to receive further product information please contact Ms L. Perrard on: Tel: +44 (0)20 7478 1777, Fax: +44 (0)20 7478 1779, Email: sales@gfms.co.uk, Web Site: www.gfms.co.uk

Note to Editors about GFMS Limited: GFMS Limited is 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, China, India and Russia, and a vast range of contacts and associates across the world.

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