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Publication of *Gold Survey 2005 - Update 1*

Strong Physical Markets Lay Solid Foundations for Investor-Led Rally towards the $480 mark.

GFMS released *Gold Survey 2005 - Update 1* today, their latest report on the gold market. A summary of the findings of *Update 1* was given by Philip Klapwijk, Executive Chairman of GFMS, at a seminar in London organised by the precious metals consultancy.

A key element of the report is its forecast for the gold price. This the consultancy believes should hold firm in the coming months on the back of buoyant fabrication demand, before investment returns in force to drive the price towards the $480 mark before the year is out. This is not expected to prove the market top, however, with GFMS expecting gold to clear the $500 hurdle sometime in the first half of 2006.

GFMS see the robustness of the physical market as the main reason average prices rose further in the first half and have the potential to move yet higher. As Klapwijk pointed out, "After all, jewellery offtake came in 200 tonnes higher in the first half. If we hadn't had that, prices could easily have slumped back under the $400 mark in the face of a 180 tonne jump in supply."

The consultancy saw higher fabrication across a range of countries that might typically have shied away with prices safely into the $400s. India was singled out as it alone accounted for around 140 tonnes of the global jewellery rise. Klapwijk added, "there were some important background considerations behind the global increase - decent economic growth for instance. But to me, what's of interest is sentiment. Prices around $430 were seen as quite 'normal' and sustainable. So, any dip below this typically led to bullion dealers seeing a flurry of buy orders materialise."

Klapwijk went on to stress, "If you're looking at the true call on the bullion market, the figure you should focus on is jewellery demand *excluding* scrap. And this surged by not that far off 30%. That all traces back to a 11% drop in first half scrap. It may seem odd to have a drop in scrap in the face of high and rising prices but, in the light of expectations for prices to at least stay steady, then it makes perfect sense."

This change in the physical markets meant investment no longer dominated prices in quite the way it had. The *Update*, however, still sees it as having played an important role, for example in driving day to day moves. That its importance was somewhat downgraded was linked to a small rise in implied net disinvestment (a residual which approximates to western and primarily institutional investment). This the report attributes mainly to a sell off during May in the over-the-counter (OTC) markets in response to a period of dollar strength, which countered strength elsewhere such as the growth in exchange traded funds (ETFs).

The consultancy, however, remains upbeat about prospects for investment, especially in the fourth quarter, forecasting a 164 tonne swing to a sizeable positive implied figure for the second half. Klapwijk noted, "Investors still seem quite jumpy over prospects for the dollar. We've long been expecting a day of reckoning for the greenback given the colossal scale of the US budget and fiscal deficits and nothing has really happened to bring us any reassurance on these fronts. If anything, in the wake of Hurricane Katrina, things have got worse. The hike it triggered in energy costs boosts the appeal of gold as an inflation hedge and it's not going to do a lot for consumer sentiment either. If that falters and US economic growth falls away, alternative investments could be hot property."

The supply shock alluded to above was the surge in official sector selling which the consultancy believe to have more than doubled to over 400 tonnes in the first half. This was ascribed mainly to sharply higher sales by countries within the Central Bank Gold Agreement (CBGA). GFMS believe the origin of the sales was important as their greater degree of predictability unsettled the markets less and high early sales will implicitly restrict sales in the remainder of the Agreement year (to 26th September).

One former price stalwart, producer de-hedging, was seen to have slipped back noticeably in the first half to not much over 100 tonnes. However, as Klapwijk noted, "It'd be wrong to see this as any kind of swing by the producers in favour of hedging. That seems to remain as out of fashion as ever. What it does highlight is the impact that book restructuring by a couple of the majors can have on the global total and we're expecting a fair recovery in de-hedging to more normal levels in the second half."

The statistical highlights of the report are outlined overleaf:

Statistical Highlights:

Supply

- **Mine production** dipped by just over one tonne to 1,172 tonnes in the first half, chiefly as heavy losses in South Africa and, to a lesser extent, the CIS outweighed gains from a handful of new mines and a recovery at Indonesia's giant Grasberg mine. The full year is forecast to see growth but, at just over 1%, output could still prove the second lowest since 1997.

- **Cash costs** for the three months to June averaged $272/oz, a noteworthy $11/oz improvement from the first quarter, but still some $24/oz higher year-on-year. A fair portion of this increase was attributable to higher energy and steel costs.

- Net **official sector sales** reached a record half yearly total of a little over 400 tonnes or more than double those seen in the first half of 2004. Much of the gain was due to sharply higher sales by signatories to the CBGA (which accounted for around 75% of gross sales). The net figure was also boosted by the absence of any substantial purchases.

- **Old gold scrap** fell a hefty 11% in the first half despite higher prices. Much of the losses were attributable to India and the Middle East, in particular Saudi Arabia. Growing accustomisation to prevailing levels was, perhaps, the main driver of this fall.

- A heavy sell off in the OTC market in May linked to temporary dollar strength helped generate a modest level of **implied net (dis)investment** for the first half. Many other areas of institutional investment, such as ETF holdings, in contrast saw gains in this period. The second half is forecast to see a marked swing to implied net investment, in part due to renewed dollar weakness.

Demand

- **Jewellery fabrication** staged an impressive increase of 16% or around 200 tonnes in the first half, with India, the Middle East (in particular Turkey and Saudi Arabia) and China seeing the largest gains. Strong economic growth in key markets and acceptance of prevailing price levels were the chief reasons for this. Jewellery demand **excluding scrap** saw a yet stronger increase of 27%. **Other forms of fabrication** saw a modest rise of 4% as losses in electronics and dental offtake trimmed gains elsewhere.

- Net **producer de-hedging** slowed considerably to just over 100 tonnes, largely in response to book restructuring by two of the majors in the first quarter. The pace of de-hedging is expected to return to more 'normal' levels in the second half, though the forecast full year total of just over 240 tonnes would still be over 40% lower than 2004's record volumes.

- **Bar hoarding** rose by a third to 164 tonnes, thanks in the main to a sharply higher figure for India. This plus higher **coin fabrication** (due mainly to growth in Turkey) were sufficient to counter the modest levels of implied net disinvestment such that **world investment** (the sum of these three) in the first half increased by 21% year-on-year to over 170 tonnes. World investment in the second half is expected to continue growing to over 280 tonnes, thanks chiefly to the swing to implied net *in*vestment.

Gold Survey 2005 - Update 1 provides a thorough and comprehensive interim analysis of the most recent developments in the global gold market. In just 40 pages, *Update 1* identifies the most important economic, socio-political and market-specific issues facing the gold market.

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, Germany and Russia, and a vast range of contacts and associates across the world.

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