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Publication of *Gold Survey 2005 - Update 2*

First Half 2006 to Average 'Only' $521 as Investment Growth Briefly Slackens and Jewellery Fabrication Slumps

GFMS released *Gold Survey 2005 - Update 2* today, their latest report on the gold market. A summary of the findings of *Update 2* was given by Philip Klapwijk, Executive Chairman of GFMS, at a seminar in Toronto organised by the precious metals consultancy.

A key part of *Update 2* is its outlook for the price over the first half of 2006 and this is expected to be largely confined to a $490-$550 range, with the average coming in at $521. Philip Klapwijk commented, "some people might think that sounds a bit pessimistic given that much of January has been in the $530s and $540s. But I think many would see the market's ability to sustain prices comfortably above $500 as something of an achievement. And we're not ruling out further, possibly hefty, gains later in the year".

GFMS base this view on two key variables - a pause in the recent investment boom and a dramatic slump in jewellery demand. As regards investment, the consultancy expects this to remain at elevated levels for the first half of 2006, if not quite match the surge seen in the fourth quarter of 2005. Explaining this, Klapwijk noted, "most of the forces sustaining investment, prospects for a sustained fall in the dollar being a good example, are still with us. But, it looks like a fresh impetus is needed for a major hike in the inflow of funds. Another bull run for energy prices, for example, is one of the triggers that could do this. And we can't forget the scope for further investment remains huge - the proportion of funds allocated to gold in comparison to bonds etc, even by 'alternative' investors, is still tiny. That's what creates strong upside potential for the price in the second half and beyond".

The report also highlights the critical role that investment played during 2005, particularly in the second half. The factors that were felt to have boosted investment last year included rising inflation concerns in the wake of spiralling energy costs, a surge in Japanese investment during a phase of marked yen weakness, expectations of a longer term decline for the dollar on account of the US current account and fiscal deficits and the sheer momentum of the gold rally.

Update 2 details how surprisingly robust jewellery fabrication was for the first three quarters of 2005. This was largely attributed to buoyant GDP growth (especially in India and China), booming demand from the oil-rich Middle East and a growing acceptance of prevailing prices. Klapwijk added, "this was significant as it really helped sustain prices at a time when investment was looking a little tired". However, the report then notes that the absolute price levels reached and rising volatility in the fourth quarter finally curtailed fabrication. Higher forecast prices in the first half of 2006 largely explain why GFMS expect a marked slump of almost a quarter in jewellery fabrication, with India accounting for around three-quarters of this. However, it is also thought that there is a sizeable volume of pent-up demand which would quickly re-emerge on any price dips and provide a firm base for the market.

Potential problems with the US dollar have also spilled over into the supply side in their link to GFMS' forecast of a dramatic fall in net official sector sales in the first half of 2006, which was seen further underpinning prices. This change is expected to be driven chiefly by expectations of a selected number of countries buying bullion, though this list was not thought to extend to the likes of China or Japan. Klapwijk also added, "2005 was an interesting year for the official sector as net sales soared to record levels over 660 tonnes and yet prices rallied - clear testament to the strength of jewellery demand and later investor interest".

Prices were also helped in 2005 by the slight change in scrap, which was thought to have risen by just 1%. This limited response was seen as due, chiefly, to the acceptance of higher prices and expectations of further increases. The report adds that this was beginning to change in late 2005 and this largely explains why scrap in the first half of this year could grow substantially.

GFMS see producer de-hedging as having been less supportive of the price last year as it more than halved though that was from a somewhat exceptional 2004 and projected levels for the first half of 2006 are expected to continue at the more 'normal' rate recorded in 2005. Mine production was thought to have risen by just 1% in 2005, but of more interest is the forecast rise of almost 5% for the first half of 2006 which GFMS see as the start of a significant phase of growth.

The statistical highlights of the report are outlined overleaf:

Statistical Highlights:

Supply

- **Mine production** edged up by just 1% to 2,494 tonnes in 2005 from 2004's 8-year low. The rise was in the main due to new mines in Latin America and a marked recovery at Indonesia's Grasberg, countering a near 50-tonne drop in South Africa. First half 2006 world output is expected to rise by a weightier 5%, as new mines ramp up and other projects come on stream. Higher fuel costs, tyre shortages and currency effects explained much of the near 10% increase in global **cash costs** for the first nine months of 2005, though these moderated somewhat during the year with third quarter costs some $6/oz lower than those for the first.

- Net **official sector** sales in 2005 rose by more than 40% to over 660 tonnes, the highest level GFMS have ever recorded. The main driver of the increase was a higher sales volume from the second Central Bank Gold Agreement (CBGA) signatories. Lower gross purchases and some opportunistic selling outside the CBGA provided an extra boost to the overall net sales figure. A sharp fall of over 40% is forecast for the first half of 2006, largely as a handful of non-CBGA banks are expected to enter on the buy-side.

- **Old gold scrap** grew by only 1% in 2005 despite higher prices due, mainly, to widespread acceptance of prevailing levels and expectations of further price gains. This anticipated price strength is forecast to mean a sizeable scrap rise in the first half of 2006.

Demand

- **Jewellery demand** is estimated to have risen by almost 5% in 2005, though the second half of the year fell by 7% year-on-year as the rally and price volatility hit offtake. **Excluding scrap**, the annual total rose by 6% but the second half slumped by 13%. Much was due to India's strong first half gains and later losses, though the oil-rich Middle East and booming China saw sizeable gains in both halves of 2005. Jewellery offtake is forecast to drop by almost a quarter in the first half of 2006 as $500-plus prices curtail demand. **Other fabrication** rose in 2005 by 4% as much of the gains for electronics were erased by lower dental offtake.

- Net **producer de-hedging** is estimated to have more than halved to slightly under 200 tonnes in 2005. To some extent, however, this represents more a move to 'normal' levels in comparison to 2004 and its exceptional events, such as the collapse of Sons of Gwalia. This normalisation means the first half of 2006 is projected to see similar half-yearly levels of around 100 tonnes.

- **World Investment** (the sum of implied net investment, bar hoarding and official coin demand) more than doubled in 2005 to just over 600 tonnes. The annual figure for **bar hoarding** rose slightly, despite strong second half losses, whilst **coin fabrication** also saw modest overall growth, thanks chiefly to Turkey. Of far greater importance was the swing in **implied net investment** (a residual that proxies 'western' investment) from 77 tonnes of disinvestment in 2004 to 226 tonnes of *in*vestment last year. This swing was largely due to such factors as rising inflationary expectations in the wake of surging energy prices, strong buying in Japan as the yen weakened, concerns elsewhere over future US dollar weakness and rising general investor interest in commodities. Further, if quite modest, growth in investment is forecast for the first half of 2006 as the conditions supporting investment remain intact but a new event, whether macroeconomic or geopolitical, seems needed to stimulate substantial growth in the influx of funds.

Gold Survey 2005 - Update 2 provides a thorough and comprehensive interim analysis of the most recent developments in the global gold market. In just 40 pages, *Update 2* 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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