



Publication of *Gold Survey 2008*

Fourth Quarter 2007 Strength in Investment Expected to be Sustained in 2008, Pushing Gold to Fresh Records but End Game Possibilities Now In Sight

GFMS launched *Gold Survey 2008* today, the 41st edition of their authoritative annual survey of the world gold market, at events in London, Toronto and Johannesburg. The following details some of the highlights of the survey from the briefing given at the London launch by Philip Klapwijk, chairman of the independent precious metals research consultancy.

The possibility that gold could again rally strongly and post fresh highs was a key theme of the presentation surrounding the survey's launch. As Klapwijk commented, "we weren't at all surprised that the market saw a hefty correction in the last few weeks, as the speed of the earlier gains looked a little unsustainable. However, we don't think current hesitancy means it's game over for the rally. Many of the drivers behind this investor push after all - dollar weakness, skeletons in banks' closets - are still very much with us. But quite where it'll top out is a difficult call - maybe \$1,100 is achievable this year but \$1,200 plus could be going a bit far".

Part reason that the consultancy warns against "irrational exuberance" is their concern over the rapidly widening gap between mine production and jewellery demand, the main home for the metal, as this could jump from under 100 to around 500 tonnes this year, with the report suggesting that longer term equilibrium prices could be closer to the \$600 mark.

The *Gold Survey* sets out how during 2007 it was the interplay between investors and the jewellery sector that largely determined the course that prices took. Investment was certainly seen as the chief instigator of the rally from September onwards as capital flowed into such homes as exchange traded funds (ETFs), allocated metal accounts and the futures markets. The consultancy feels that the nature of many of these destinations was useful in highlighting one of the key drivers behind this increase, namely a desire for wealth preservation, with Klapwijk adding "we've seen confidence in banks take a severe hit. And more than a few have questioned the solidity of conventional assets in the face of a US recession, resurgent inflation and so on". Other supportive factors that the report highlights included dollar weakness, lower interest rates, geopolitical turmoil and rising oil prices.

One perhaps surprising statistic was that GFMS' measure of western investment, implied net investment, fell markedly last year. This decline the report chiefly ascribes to the heavy profit taking and stop loss selling, chiefly in the over-the-counter (OTC) market, that was witnessed in the first half and, in particular, the second quarter. Klapwijk commented, "much of the blame for this lies at the door of the rally failing at \$700 several times, events such as June's bond market crisis and talk of higher central bank sales".

The consultancy believes that the main reason the price merely trod water, rather than actively falling, in the first half last year was in turn the resilience of the jewellery sector. This was thought to have shrugged off high prices due to robust GDP growth in many developing world countries, stable prices, especially in local currency terms, and anticipatory buying in advance of an expected return of price strength. The possibility of higher future prices in conjunction with subdued local prices also affected the physical market as GFMS believe that these were some of the key reasons why scrap supply fell last year, as potential sellers held back. It was also apparent that much of the loosely held stock had been shaken out during the April-May 2006 price spike.

A final area thought to have had a material impact on prices was producer de-hedging as this rose somewhat unexpectedly and reached a record level. Klapwijk added, "timing was important here - the majority of this de-hedging was seen in the first half last year, or just when investors bailing out could have put the price into a tailspin". Mine production was also thought to have contributed to price strength at the margin, perhaps more so through sentiment as strikes, safety issues and ultimately this year power shortages disrupted South African output.

Official sector sales, however, were thought on balance to have been a negative factor for the gold price, with the report noting a 30% increase in net sales last year, chiefly as sales by signatories to the Central Bank Gold Agreement (CBGA) returned to 'normal'. Sentiment was also thought significant here as the absolute level of sales reached could perhaps be viewed as unexceptional on a historical basis but unexpected Spanish sales and news of future Swiss disposals upset investors. Klapwijk noted here, "it was remarkable seeing how sentiment changed during the year - after their earlier wobble, investors just brushed aside stories this February of possible IMF gold sales".

The statistical highlights of the report are outlined overleaf:





Supply Highlights

- Global **mine production** fell by a slight 0.4% in 2007 to an eleven year low. Africa saw the heaviest regional drop at 29 tonnes (chiefly due to South Africa) while output in North America and Latin America also fell (largely thanks to US and Peruvian losses). In contrast, Asia saw gains, centred on Indonesia and China, with the latter becoming the world's leading gold producer in 2007.
- Global **cash costs** in US\$ terms rose 25% in 2007, partly through producers undertaking development and waste stripping work.
- Net **official sector sales** grew by 30% in 2007 to just over 480 tonnes, chiefly as a result of CBGA sales returning to 'normal' after a subdued 2006. Outside the Agreement, central banks became net purchasers for the first time in over a decade. Central bank lending saw a further decline last year, mainly due to low lease rates although counterparty risk concerns also featured.
- **Scrap** fell by 15% in 2007, largely as a result of price expectations (as some sellers held off hoping for yet higher prices), price gains in non-dollar terms at times being quite muted for some and comparisons being made against record 2006 volumes.

Demand Highlights

- **Jewellery demand** recorded very different results during 2007 as the first half saw year-on-year growth of 22% and the second half a drop of 9%, with the fourth quarter particularly weak. This left the full year up 5% at just over 2,400 tonnes. In terms excluding scrap, full year fabrication rose by 10%. Much of the swings were driven by the price and its impact on demand in India, with Chinese offtake in contrast seeing gains in all quarters. The Middle East also saw gains whereas Italy and south east Asia's exporters saw losses, in part as a result of a slump in US consumption. **Other fabrication** rose slightly to 671 tonnes, chiefly due to higher coin minting plus modest gains for electronics and other industrial & decorative while dental demand fell.
- **Implied net investment** last year fell noticeably to just under 160 tonnes as disinvestment in the OTC market, chiefly in the first half, countered much of the substantial inflows into other areas such as physical metal, ETFs and futures, mainly in the fourth quarter. The market was again dominated by institutional players and high net worth individuals, with demand from retail players limited. Initial lethargy was principally due to the failure of the rally to breach \$700 on a number of occasions, risk aversion at times proving hostile to commodities and periods of dollar strength, whereas fourth quarter enthusiasm was largely due to the sub-prime crisis, concerns over financial institutions' stability, lower interest rates, a weaker dollar and higher energy prices. **Bar hoarding** was flat last year as losses in East Asia (centred on Japanese selling) balanced gains elsewhere.
- Producer **de-hedging** proved surprisingly strong in 2007, rising 9% to reach a record of almost 450 tonnes due to a wave of book eliminations and partial buy-backs. The bulk of activity took place in the first half. By year-end, the global producer hedge book stood at little more than 800 tonnes in delta-adjusted terms.

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Gold Survey 2008 contains over 120 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 £325 or US\$595 / €440 per copy. For orders and to receive further product information please contact Elena Patimova - Tel: +44 (0)20 7478 1777, Fax: +44 (0)20 7478 1779, Email: sales@gfms.co.uk, Web Site: www.gfms.co.uk, Online Shop: <http://shop.gfms.co.uk>

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