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Publication of *Gold Survey 2006 - Update 1*

Return of Investor-Led Rally Forecast to Lift Gold Over $700 before Year End though Potential for Shorter Term Weakness Still Exists

GFMS released *Gold Survey 2006 - 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 to the *Update* is its forecast for the gold price, which GFMS believe could well track higher, clearing $700 before year-end. The prime driver of this move was seen as the return of significant investor buying. Klapwijk noted, "pretty much all the conditions are still there for a big up-tick in investor interest. As ever, these centre on the dollar and we're still bearish on that given the huge US trade deficit". Looking further into 2007, GFMS also added that prices could go yet higher, particularly if we were to see a major 'event' such as US military action against Iran.

But Klapwijk warned, "timing is everything. Recent weakness hasn't surprised us that much as there's little around to drive the price up at the moment - certainly with the jewellery sector still looking shaky - until the investors come back in force. But we could be getting close to the start of a big move higher. We've just had news on how weak the US housing market is and that, for some, has set alarms ringing that a period of lower US economic growth and a fall in interest rates are getting closer".

The consultancy did, however, caution that longer term price strength was by no means guaranteed. Klapwijk continued, "if the US economy really does come off the boil and Chinese growth falls heavily, we could see widespread price corrections across the commodity spectrum. Gold could get caught in the downdraft but we think, on balance, we'd see more of a 'flight to quality' and that would sustain gold, if not push it higher".

The consultancy certainly does not expect any rally to be derailed by the supply side. Net central bank sales, for example, are forecast to fall a fair amount in the second half. One factor that Klapwijk suggested was worth watching was any news on sales by the Central Bank Gold Agreement (CBGA) countries in the soon to close Agreement year, adding, "we've already seen how sensitive the market can be, with rumours at the start of the week of heavy CBGA sales hitting prices hard. That seems a little overdone and, if as expected we see confirmation that sales have undershot quota, the price could firm a little". As for countries outside the CBGA, GFMS continue to pour cold water on the idea of purchases of substance any time soon to diversify away from the dollar.

The year-on-year drop in official sector sales in the second half was broadly expected to counter the forecast very slight increase in mine production and the relatively modest increase in scrap. Klapwijk noted, "some people might be surprised that our forecast for second half scrap is just a 5% rise but, if you have a sluggish third quarter and the rally doesn't really come about until sometime into the fourth, you can't expect too much to come out. Also, we've already seen how expectations in India of further price rises could limit scrap and we could well see a repeat of this".

The main area of weakness highlighted by the report is jewellery demand, which GFMS see falling again in the second half of this year even though the last six months of 2005 were a very sluggish period. Much was expected to be a function of the forecast price rise in the fourth quarter hitting the price sensitive regions such as India and the Middle East, though structural changes in western jewellery consumption were expected to further undermine the weight of gold sold. Nonetheless, even though this sector was seen as unlikely to ever drive the price higher, the report did see jewellery as providing a firmish base as pent-up demand and a refilling of the jewellery pipeline were expected to materialise on any dip in the price, such as during times this week well below $600.

A final area of weakness was de-hedging, which was forecast to fall sharply from the high level seen in the first half of 2006. This was, however, just seen as a function of the comparison being made against a period with an unexpectedly high level of de-hedging due to a one-off close out stemming from industry consolidation; not to any change in attitudes towards hedging. GFMS noted some fresh hedging had occurred but the bulk of this remained linked to project finance, not opportunistic exploitation of high prices.

The statistical highlights of the report are outlined overleaf:

Statistical Highlights:

Supply

- First half 2006 **mine production** fell by 1.5% year-on-year to 1,168 tonnes. The biggest single decline came from Indonesia, whilst substantial losses were also seen in South Africa, Australia, the United States and Canada. Notable gains, however, were recorded in Latin America and, to a lesser extent, Mali and China. Full year world output is forecast essentially unchanged on 2005.

- **Cash costs** rose by just over 10% in the first half of 2006, to a weighted average of $306/oz, with all the major reporting countries noting increases. Much was due to higher energy charges, though labour and operating consumables' costs also rose.

- Net **official sector sales** in the first six months fell to just under 170 tonnes, down a dramatic 60% year-on-year. The decline was primarily driven by falling sales from signatories to the second CBGA, though countries outside the Agreement also featured as modest net purchasers. Full year total net sales are forecast to dip to a little below 400 tonnes.

- **Scrap supply** rose by around 50% in the first half of the year, with the increase driven overwhelmingly by the gold rally. Most of the main regions generated notably higher flows, especially the Middle East, though the Indian response was relatively muted.

Demand

- Largely as a result of higher prices and volatility, **jewellery fabrication** slumped by over 400 tonnes or nearly 30% in the first half of 2006, though in terms **excluding scrap**, the decline was more severe at over 40%. The falls were greatest for the price sensitive regions of India and the Middle East, but western markets' offtake was also hit as its exporters saw a fall in sales and nervous distributors shied away from purchasing. **Other fabrication** rose 8% in the first half, largely as gains in electronics and official coins outweighed losses for dental and other industrial & decorative demand.

- Net **producer de-hedging** made a strong contribution to demand in the first half, reaching just under 300 tonnes. The more than three-fold increase year-on-year was largely due to the elimination of Placer Dome's open hedge position, closed out by Barrick following its acquisition of the major. Second half de-hedging is expected to be far more modest at a little under 100 tonnes.

- The first six months of 2006 saw **implied net investment** reach almost 170 tonnes. Whilst in itself substantial, it was markedly lower than the second half 2005 investment figure of almost 500 tonnes, not because investment had fallen in importance but more as the first half of this year saw the build-up of marked two-way activity in the market. As for the other forms of investment, **bar hoarding** fell by 80 tonnes, chiefly as a result of the price rise and with East Asia, in particular Japan, largely responsible for the decline. **Official coin** sales were up by over 10 tonnes, mainly due to higher US minting. This left World Investment (the sum of the implied figure, bar hoarding and coins) in the first half at almost 330 tonnes, up sharply year-on-year but down notably on the figure for the second half of 2005 at 620 tonnes.

Gold Survey 2006 - 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 £215 or US$395 / €325 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, Online Shop: http://shop.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, Spain, Germany and Russia, and a vast range of contacts and associates across the world.

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