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Publication of *Gold Survey 2009 - Update 1*

Gold at Crossroads of Either Disinflationary Price Retreat or More Probable Strong Price Phase thanks to Inflation Linked Investment Boom

GFMS released *Gold Survey 2009 - Update 1* today, their latest report on the gold market, at a launch in London and, simultaneously and in association with the Denver Gold Group, at an event in that US city. The following details some of the highlights of the report from the briefing given at the London launch by Philip Klapwijk, chairman of the independent metals research consultancy.

A key element of the *Update* is the consultancy's forecast for the gold price in the coming months, which shows that two quite divergent paths are possible. Klapwijk commented, "on balance, we're still favourably disposed towards the price in the medium term. That's mainly because we see it as highly likely that debt monetisation and ultra-low interest rates, especially in the US, will at some point feed through to a build in inflationary pressures. Throw in dollar weakness and disappointment over conventional assets as the green shoots argument withers and then gold well over $1,000 becomes perfectly feasible". The *Update* did warn, however, that the path to this may not be smooth as a brief dip could occur in advance of longer term strength, with Klapwijk also adding that the recent spike could readily unwind as its foundations looked shaky.

The report, however, noted that it is far from guaranteed that the bull run in gold prices will continue. GFMS believe the basis for this still possible but less likely reversal in trend would be the various monetary and fiscal stimulus programmes failing to rejuvenate the world economy, feeding through to a disinflationary conditions. It was expected that its impact on gold would in turn probably be magnified by investors seeking out the security of US Treasuries, which would act to boost the value of the US dollar.

While inflation/deflation may be important for the future, the report believes that, in the first half of this year and in particular during the very early weeks, it was counterparty risk that investors feared most. Klapwijk noted, "it wasn't that surprising that, in the wake of the collapse of Lehman Brothers and other financial institutions, people should choose to park some of their capital in gold very specifically because it essentially has no counterparty risk. Add in the dollar's slide from December and equity markets coming under pressure as the world economy went into recession and that largely explains the leap in investment - and basis our World Investment series to record levels over 750 tonnes in the first quarter alone".

GFMS are aware that some market observers may have felt that investment 'under-performed' in the first half, given that it failed to rally the gold price over $1,000. However, the consultancy believe this judgement somewhat unfair and that more emphasis should be placed on the amount of bullion the jewellery sector was buying; the *Update* notes that, in the first quarter, jewellery fabrication collapsed and was overtaken in scale by scrap, which boomed to almost the same size as mine production. The report lists two main reasons for this event, the onset of a global recession and currency weakness in various consuming countries translating into record local gold prices. Klapwijk added, "as soon as we saw, early this year, that countries like India, Turkey and Italy had become net bullion exporters, it was obvious to us that the rally should soon grind to a halt and probably go into reverse".

GFMS report that a key reason as to why gold prices did not collapse after the rally topped out was the restrained nature of supply, with, for example, scrap retreating as near market supplies dried up and first half official sector sales slumping. The latter was believed to be of particular significance since, as Klapwijk noted, "not only did we lose the actual impact of the heavy selling that we'd seen in previous years but the low level of sales must have assisted investor sentiment and that was at a time when many could have cut and run if they thought the longer term outlook for gold was turning shaky".

The last main area of the supply/demand balance, mine production, the consultancy feels to have been mildly negative for the price, with GFMS statistics showing a first half year-on-year increase of a respectable 7%. Its price impact was, however, mitigated by much of the rise coming from the 'one-off' of new project starts ups and many in the market were instead tending to focus on the difficulties in maintaining output in the more mature producing areas. The market also had to face the slump in producer de-hedging, although its price impact was constrained by it largely reflecting just the greatly reduced scale of the outstanding producer hedge book and not a shift by some miners in favour of fresh hedging.

The statistical highlights of *Update 1* are contained overleaf.

Supply Highlights

- **Mine supply** in the first half of 2009 increased by 7% year-on-year. The growth was mainly driven by a rise in output from established operations in Indonesia, China and Russia, and supported by the onset of a raft of new projects, predominantly in Australia and Canada. Notable gains in west Africa were dampened somewhat by South African losses. Producer **cash costs** remained almost flat in the first half, halting the trend of strong cost inflation of recent years.

- Net **official sector sales** in the first half contracted sharply, by almost 75% year-on-year to total around 40 tonnes. The acute fall was mostly attributable to lower disposals from the CBGA signatories, as well as modest net purchases from countries outside of the Agreement. Sales were concentrated in the first quarter and the official sector was in fact a net purchaser in the second quarter.

- Global **scrap supply** surged to a record high of almost 900 tonnes in the first half of 2009. The majority of the action took place in the first quarter of the year, in reaction to high gold prices which reached record local levels in several instances. Distress selling, in reaction to GDP declines or slowdowns, added to the total. Significant gains in scrap supply were seen from the Indian Sub-continent, the Middle East and East Asia, whilst Europe and the United States posted new record highs.

Demand Highlights

- **Jewellery offtake** fell by almost 25% in the first half of 2009, to around 760 tonnes. Losses were recorded across the board of key jewellery fabricators, with India and Turkey registering the sharpest falls. China proved the exception, as its fabrication rose by 7%. High local prices on the back of a stronger US dollar combined with a grim economic climate to precipitate much of the global fall. The weakness of jewellery offtake in the period is highlighted by it falling below levels of scrap supply. The second half of 2009 is expected to register another fall, taking the full year total to its lowest level in over two decades. **Industrial fabrication** slumped by a similar extent to jewellery consumption. This was headed by the decline in electronics offtake, due to weak consumer demand and concerted destocking of inventory, and compounded by falls in other industrial & decorative, and dental demand.

- **Implied net investment** rose markedly in the first half to reach over 990 tonnes, an increase of more than five times over the first half of 2008. Most of the inflows occurred in the first quarter, as investors sought refuge in gold when fears over counterparty risk and the global economy remained rampant. This is in stark contrast to the 75% collapse in bar hoarding, driven by liquidation in India – last seen in 1980 – which occurred mainly as a result of price expectations. Demand for official coins, however, almost doubled, whilst offtake for medals and imitation coins dropped by almost 60%. Nonetheless, World Investment (the sum of the implied figure, official coin demand, medals and imitation coins, and bar hoarding) leapt by almost 180% year-on-year.

- **Net de-hedging** slumped in the first half to around 30 tonnes, leaving the book at end-June standing at just below 460 tonnes. This low net figure was determined largely by the limited scale of the outstanding producer hedge book, due to previous years' heavy de-hedging. AngloGold Ashanti made the only cut of note, as it continued to restructure its hedge book. Fresh hedging, totalling some 20 tonnes, was seen by Catalpa Resources and Apollo Gold in the first quarter.

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Gold Survey 2009 - Update 1: In just 40 pages, *Update 1* identifies the most important economic, sociopolitical and market-specific issues facing the gold market. The publication can be ordered from GFMS for £250 / US$460 / €350 per copy. For orders and to receive further product information please contact Elena Patimova - Tel: +44 (0)20 7478 1750, 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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Press Contacts: Philip Klapwijk or Paul Walker, GFMS Limited, Hedges House, 153-155 Regent Street, London, W1B 4JE, UK, tel: +44 (0)20 7478 1777, fax: +44 (0)20 7478 1779, email: gold@gfms.co.uk, web site: www.gfms.co.uk

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