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Publication of *Gold Survey 2007 - Update 2*

Gold at $1,000 "A Clear Possibility" in 2008 as Investor Enthusiasm Pushes Aside Forecast Slump in Fabrication & Higher Scrap

GFMS released *Gold Survey 2007 - Update 2* today, their latest report on the gold market. A summary of the findings of the report was given by Philip Klapwijk, Executive Chairman of GFMS, at a seminar in Toronto organised by the precious metals consultancy.

A key aspect of the *Update* is the forecast for the supply and demand variables moving forward and, based on that, the outlook for the price itself. This the consultancy has projected to average $840 over the first half, with further increases indicated as a possibility for later in the year. Klapwijk commented, "investor appetite for gold at the moment seems undimmed and this should push gold higher over the year. Predicting the top is never easy but we always thought the $900 barrier could easily fall quite soon and then we have to start viewing $1,000 as a clear possibility for later this year".

GFMS expect the surge in investment to be driven by those factors that fuelled the boom witnessed in the final four months of 2007, namely a weak dollar, record oil prices and their inflationary consequences, the US sub-prime crisis and its threat to GDP growth in the United States, and perhaps elsewhere, and lastly geopolitical tensions. Klapwijk continued, "it's far easier to argue that we're at the start of a period of higher inflation and lower US growth, rather than we're emerging from the worst. All that is strongly pro-gold moving forward. And we can easily see higher gold prices without fireworks in the Middle East or Pakistan, though any political drama there or elsewhere is highly likely to rally the price yet further".

The report does caution, however, that a short to medium term correction is possible, chiefly as a result of the speed of the recent price rise and the huge fund overhang on Comex. Should a retreat occur, it was thought a slide back to the low $800s might occur, partly as physical buyers are not expected to rush back in the face of such price volatility at elevated levels. Klapwijk noted, "this temporary fall back explains why our forecast average for the first half at $840 could seem a bit low in light of current levels. But that's still up almost 30% year-on-year and, with this period of consolidation out the way and the funds in a position to expand their net long again, that's when we should see the convincing drive towards $1,000".

High prices and volatility were the two chief reasons that the consultancy expects fabrication to slump by almost a fifth in the first half this year. Less marked gains for local prices due to dollar weakness and continued robust GDP growth in many emerging economies were expected to partially mitigate the impact of the expected gold rally. Such factors explain why GFMS see the 'jewellery floor' (the level deemed fair and sustainable at which physical buyers return) as having moved up to the low $800s, a result which the consultancy feels to be "remarkable". However, doubt was cast on the solidity of prices moving forward, given the huge volumes investors would have to pick up to keep the market in balance as jewellery demand slips well under mine production.

The report also outlines how there is little else on the demand side to push prices higher. Producer de-hedging, for example, is expected to contract sharply in the first half to levels roughly a third of those a year prior and, given the GFMS estimate of the hedge book now being under 1,000 tonnes, the scope for support from this area is becoming limited. Few signs were at least said to have been seen of any desire by producers to undertake any major fresh hedging.

GFMS believe that investment should still be in a position to easily drive prices higher with poor demand elsewhere thanks to a relatively limited supply reaction. Mine production, for example, is forecast to increase, but by only a few percent. In contrast, official sector sales are expected to slip and that result is chiefly driven by changes to sales by signatories to the Central Bank Gold Agreement - gross purchases outside this group are thought likely to remain modest. Klapwijk added, "we're not expecting any of the major US dollar holders to appear on the buy-side in a major way any time soon. But any whiff they were about to would no doubt be interpreted as strongly bullish".

The only major supply response that GFMS expect is for scrap, though even with the consultancy's forecast 15% rise, first half 2008 volumes would remain well under the first half 2006 record, illustrating just how much near-market supply has already appeared and how high price expectations have already risen.

The statistical highlights of the report are outlined overleaf:

Supply Highlights

- **Mine production** in 2007 fell by just over 1%, partly through delays to development and expansion projects. Losses centred on South Africa, Peru and the United States, while gains focused on Indonesia and, in particular, China whose increase knocked South Africa off the top spot to become the world's largest producer. Output in the first half of 2008 is forecast to grow by just over 2%.

- Global **cash costs** rose a dramatic 24% year-on-year for January-September and hit a record level just over $400/oz in the third quarter. The rise was driven by such factors as US dollar weakness, higher royalty payments and mine development work.

- Net **official sector** sales in 2007 rose by a third to 488 tonnes. The rise was driven by sales from signatories to the Central Bank Gold Agreement (CBGA) returning to 'normal' levels after the low levels seen in 2006. Those outside the CBGA saw modest net purchases in 2007. First half 2008 sales are forecast to contract slightly to just over 200 tonnes.

- Old **scrap supply** contracted by almost a fifth to just under 900 tonnes, chiefly as much of the loosely held supplies in price sensitive countries had been shaken out in 2006 and there was little repeat of the heavy trade inventory clear-out seen in the western world the year prior. Scrap in the first half of 2008 is projected to increase by around 15% to safely over 500 tonnes.

Demand Highlights

- **Jewellery fabrication** in 2007 grew by 5% though, in terms **excluding scrap**, it rose 11%. This occurred despite the gold rally, as gains in the more stable first half outweighed second half losses when yet higher prices and volatility took their toll, with these swings largely driven by India. Elsewhere, China and Turkey saw strong growth, Italy near stability but US consumption fell heavily. Price damage in first half 2008 is forecast to slash demand by around a fifth to almost 1,000 tonnes. **Other fabrication** in 2007 rose by 2%, thanks to gains for medals and electronics, whereas in first half 2008 it is expected to see a decline of over 10%.

- **Producer de-hedging** in 2007 rose by a provisional 14% to within a whisker of the 2004 record of 422 tonnes, with the bulk of activity taking place in the first half. Initial expectations for levels in the first half of 2008 are a fall to just under 100 tonnes.

- For the full year 2007, **implied net investment** stood at a perhaps surprisingly restrained level of only just over 100 tonnes. However, this masks a major swing from *dis*investment of around 200 tonnes in the first half to *in*vestment of around 300 tonnes in the second as a result of such factors as a weak dollar, energy price gains and the US sub-prime crisis. In first half 2008, implied investment is forecast to grow yet further to well over 400 tonnes. **Bar hoarding** rose by a modest 3% last year, despite major price-led second half losses, while official **coin fabrication** fell by 3%. World Investment (the sum of bar hoarding, coin demand and the implied figure) totalled 465 tonnes last year, which represented a drop of just over 40%.

About Gold Survey 2007 - Update 2: In just 40 pages, *Update 2* identifies the most important economic, sociopolitical 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 Elena Patimova 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, France, Germany and Russia, and a vast range of contacts and associates across the world.

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