

G F M S

The Gold Market

Have the physical markets mattered in this rally?

Paul Walker

DGG, 24th–26th September 2007

GFMS Ltd.

- World's leading independent research group on gold, silver and PGMs markets.
- GFMS' statistics on gold, silver and PGMs supply/demand the accepted benchmarks for the industry.
- Our history begins with the first annual "Gold Survey" in 1967; still our flagship product.

GFMS gratefully acknowledge the generous support from the following companies for this year's *Gold Survey* and its two *Updates*

 Commerzbank Global Precious Metals	 Valcambi sa	 Tanaka Precious Metals Group	 www.pamp.com
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40 Years of the *Gold Survey*

1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979

1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991

1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003

2004 2005 2006 2007

Forecasting the Gold Price

Some key points to bear in mind...

- Gold is a commodity, with supply/demand fundamentals important, especially in the long-run
- But, it is different from most other “pure” commodities due to gold’s residual monetary characteristics and role
- Investment demand can result in an effective price premium or shift in the gold demand curve
- Over time the relative importance of ‘commodity’ and ‘financial’ factors in shaping the gold price can change!

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Prices

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US Dollar Gold Price

Weekly Averages



Source: GFMS

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Euro Gold Price

Weekly Averages



Source: GFMS

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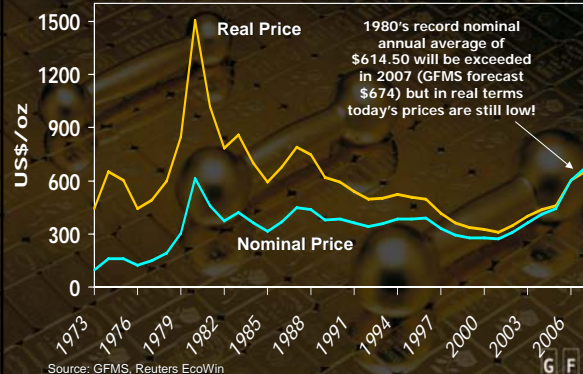
Gold Price Correlations (based on log-returns on daily prices)

	Q2.06	Q3.06	Q4.06	Q1.07	Q2.07
US\$/Euro Rate	0.50	0.39	0.46	0.35	0.46
US\$/Yen Rate	-0.44	0.21	0.36	-0.20	-0.07
Silver	0.64	0.61	0.54	0.62	0.59
Oil (WTI)	0.33	0.13	0.14	0.00	0.07
GSCI Index	0.51	0.26	0.12	0.16	0.12
CRB Index	0.59	0.33	0.22	0.14	0.18
S&P 500	-0.18	-0.21	-0.01	0.18	0.05

Source: GFMS

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Real & Nominal Prices: Glass Half Full or Half Empty? (real price in constant 2006 terms)



Source: GFMS, Reuters EcoWin

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Supply

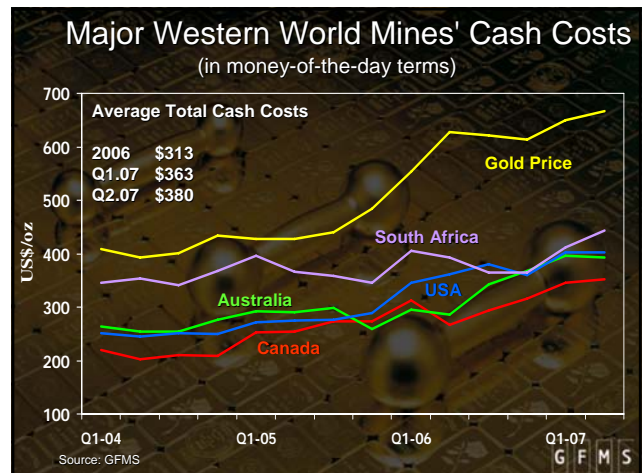
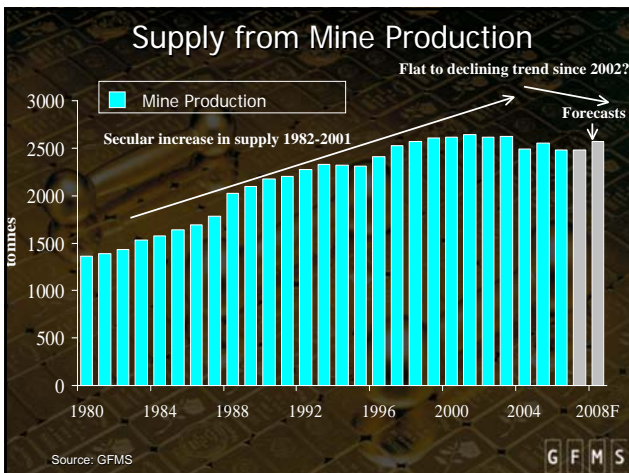
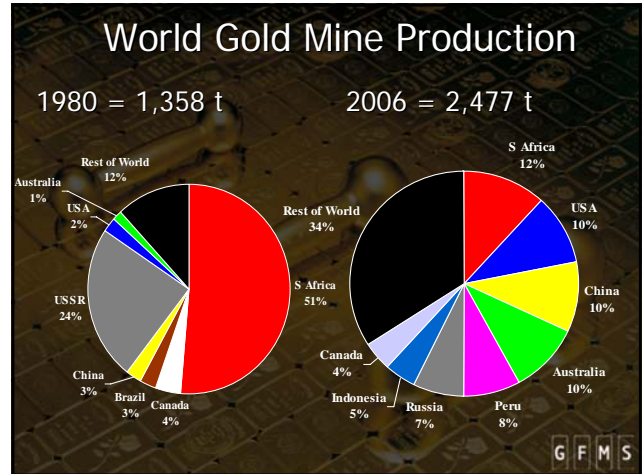
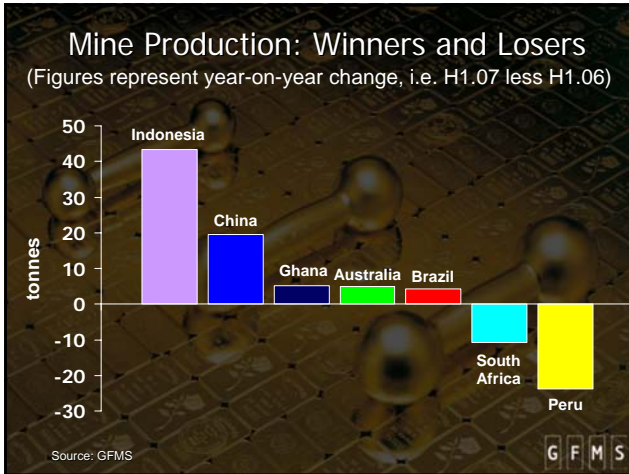
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Gold Supply Forecasts for 2007

	2006	2007F	y-o-y
Mine production	2,477	2,485	0.4%
Official sector sales	352	502	42.5%
Old gold scrap	1,105	856	-22.5%
Implied net disinvestment	-	110	N/a
TOTAL SUPPLY	3,934	3,953	0.5%

Source: GFMS

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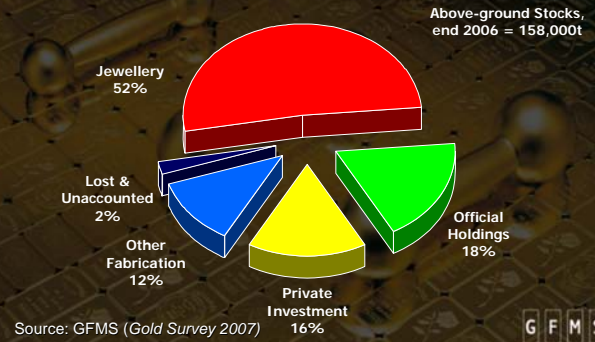
Mine Production

- Decline of 74 tonnes or 3% y-o-y in 2006. Left output at a 10-year low. Losses in South Africa, Australia, Indonesia, the United States and Canada. Latin America the only region to return a meaningful rise, posting a 35 tonne or 7% increase.
- In first half 2007 global mine production up 2.6% yoy to 1,201 t. Indonesia (up 43 t) and China (up 19 t) steered world output higher. Heaviest losses in Peru (-24 t) and South Africa (-11 t).
- GFMS forecast production to rise around 0.4% in full year 2007 and for a 3% increase in 2008. Output in 2009 potentially could be +/- 10% or 250 tonnes higher than in 2006 but this does not take into account project delays etc.

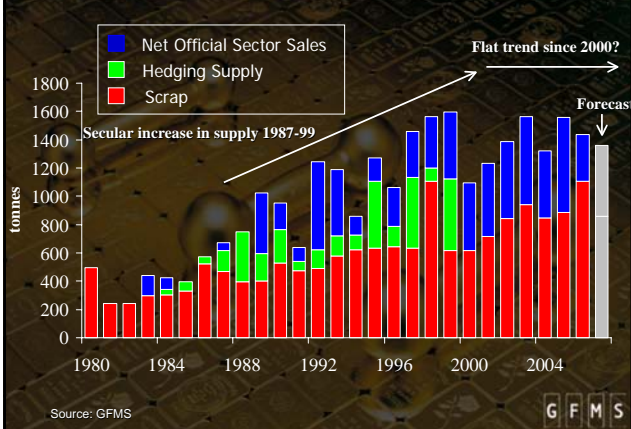
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Above-Ground Stocks of Gold, end-2006

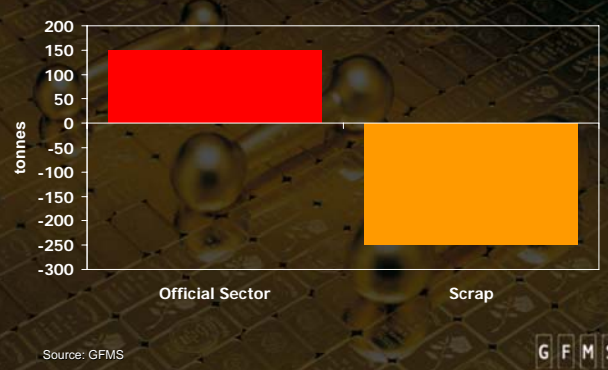
Gold is not “consumed” like most commodities; stocks can be available at the right price...

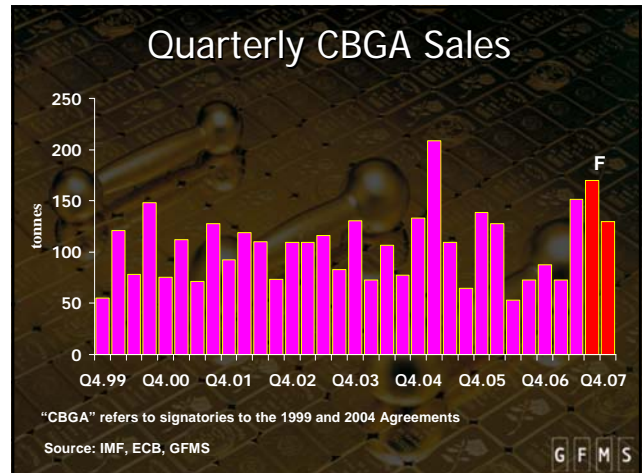
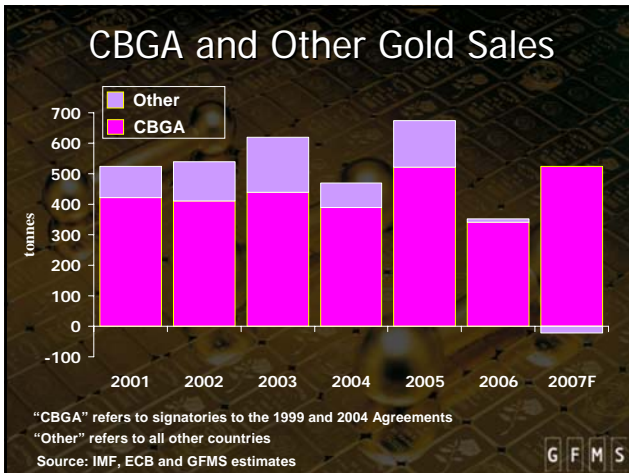
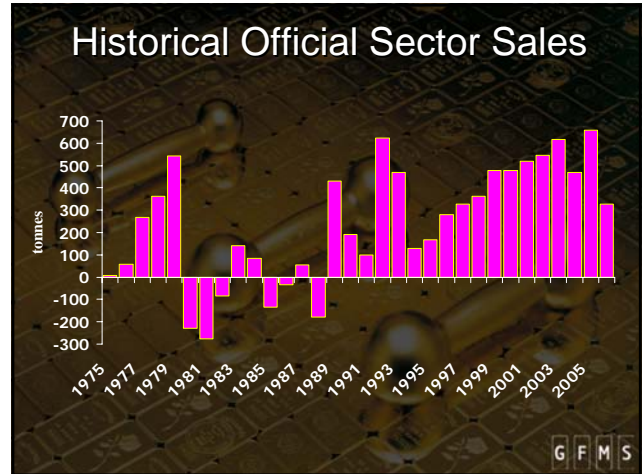
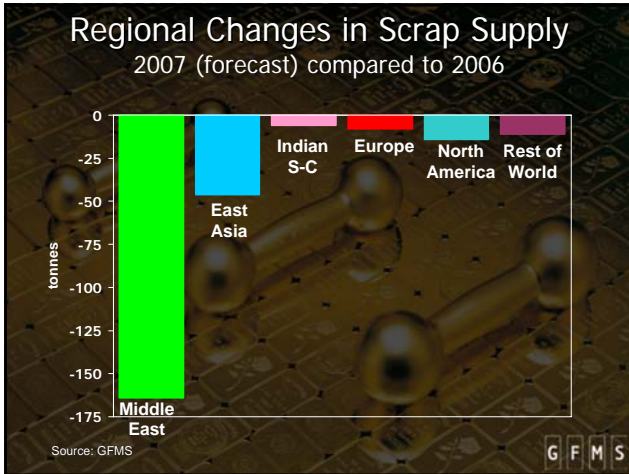


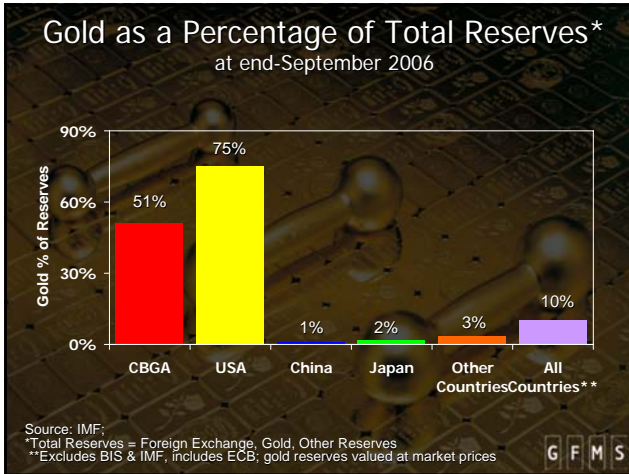
Supply from Scrap, Hedging & Official Sales



Change in Supply from Above-Ground Stocks 2007 (forecast) compared to 2006







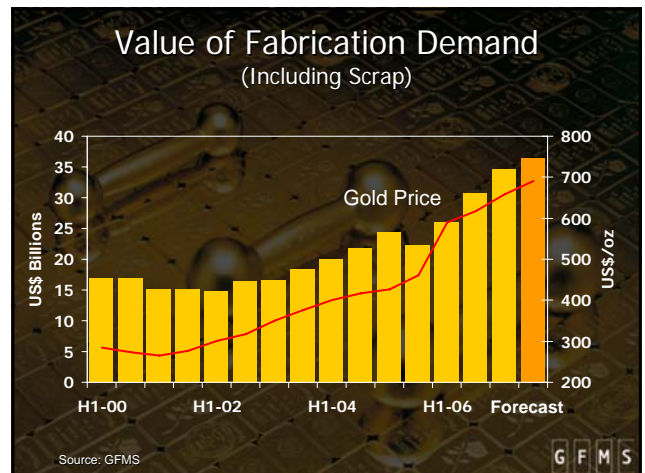
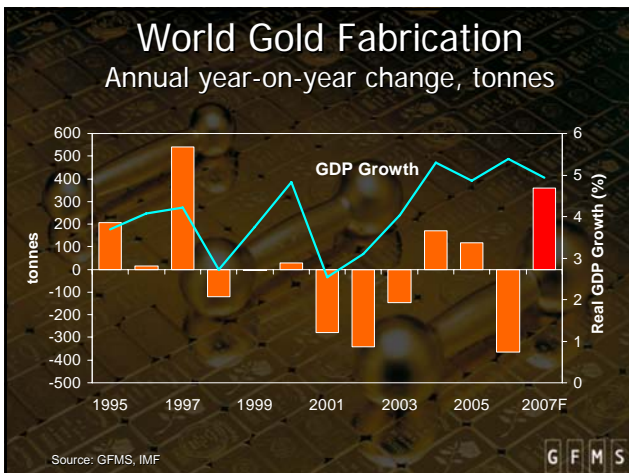
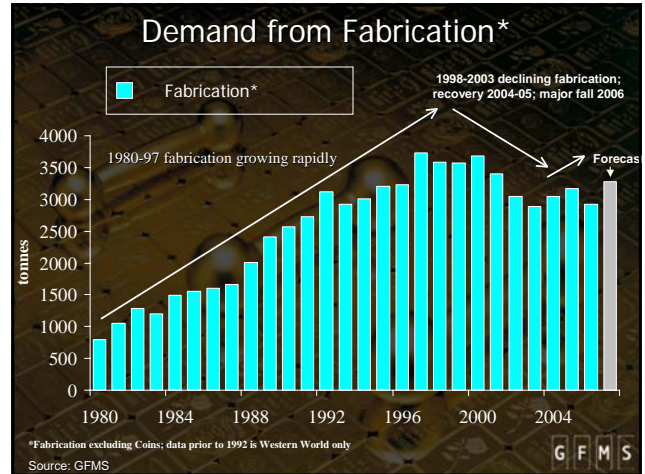
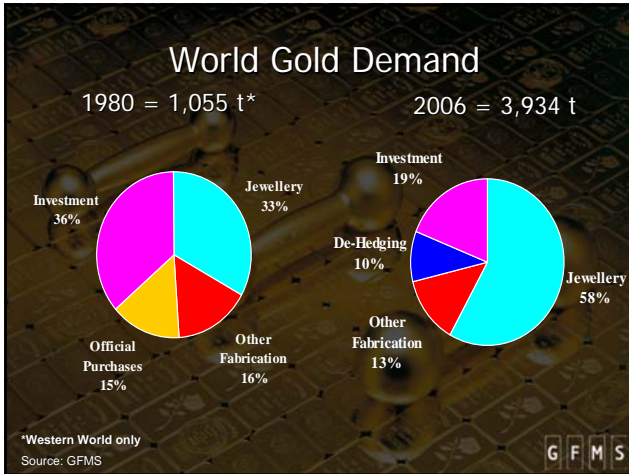
- ### Supply from Above-Ground Stocks
- Supply from above-ground stocks peaked in 1999.
 - Scrap supply should moderate in 2007/08 unless/until new price high reached.
 - Eventually scrap supply will resume uptrend due to underlying growth in jewellery stocks.
 - Net official sector sales will continue to be norm but could decline in volume if more and larger buyers emerge.
 - Producer de-hedging will in time be replaced by net hedging, probably exacerbating the by then declining trend in price.
 - Possibility of net supply to market from net disinvestment at some point over coming years when market turns. But this would be short-lived.

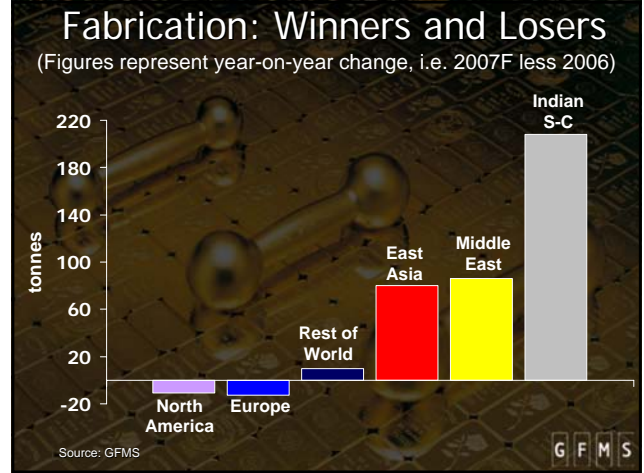
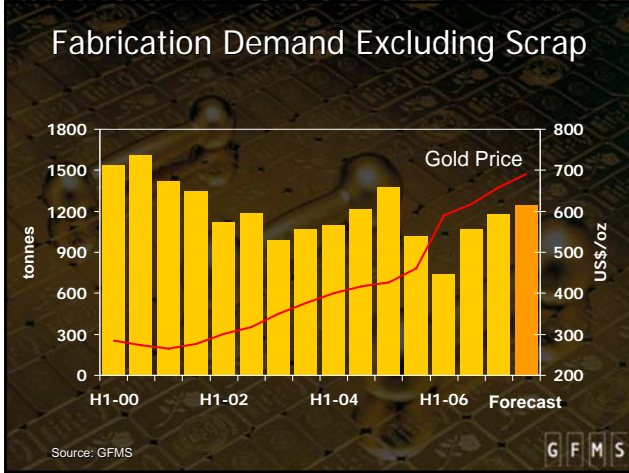
Demand

Gold Demand Forecasts for 2007

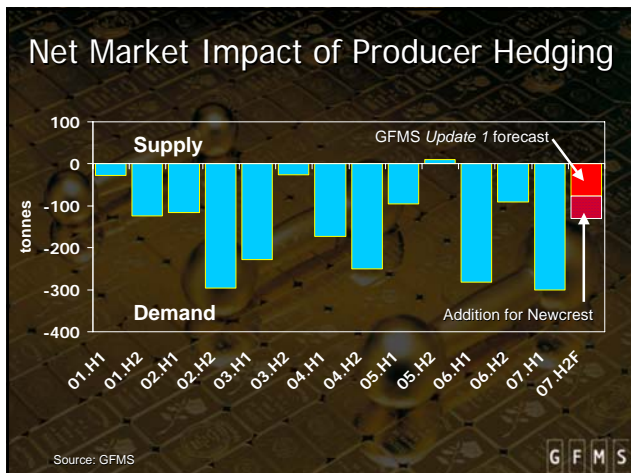
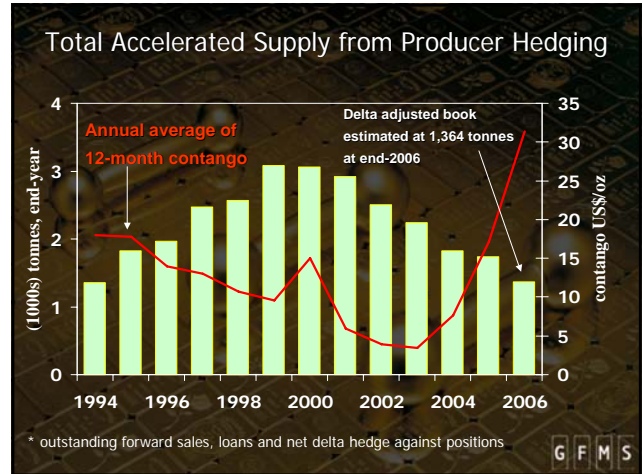
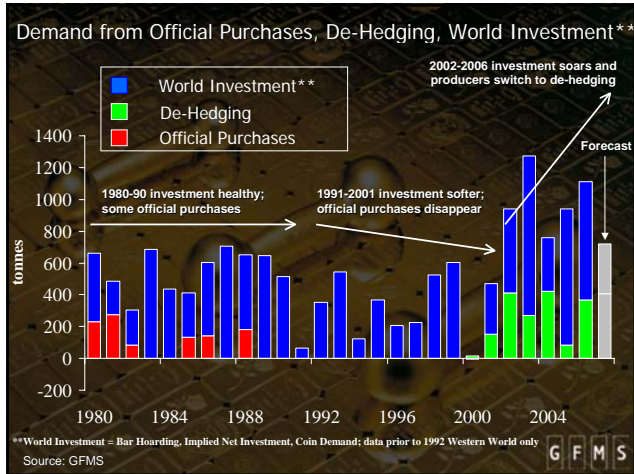
	2006	2007F	y-o-y
Fabrication			
Jewellery	2,279	2,597	13.9%
Other	640	681	6.4%
Total Fabrication	2,919	3,278	12.3%
Bar hoarding	223	294	31.7%
Net producer hedging	369	382	3.6%
Implied net investment	423	-	N/a
TOTAL DEMAND	3,934	3,953	0.5%

Source: GFMS



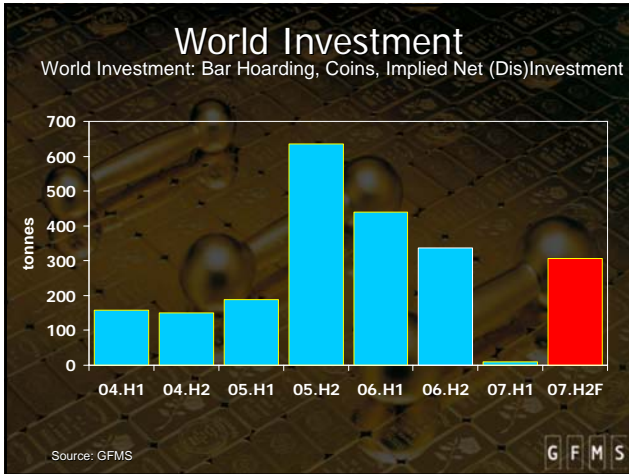


- ### Fabrication Demand
- Collapse in jewellery demand the key factor behind 2006's 11% or 363 t drop in fabrication to 2,919 t, a 15-year low. Demand hit by 36% year-on-year rise in price and very high levels of price volatility.
 - Recovery in 2007, centred on developing countries (especially India) and based on rising incomes, some adaptation to higher prices and price volatility returning to more 'normal' levels.
 - Growth in demand expected to slow in second half due to higher base in H2 2006 plus impact of stronger prices from September.
 - Demand will continue to be concentrated during periods of weaker prices. Firm price support from fabrication demand has moved from \$580s one year ago to probably around \$670s currently.
 - Longer-term positive factor of growing prosperity in large developing countries but to be (partly?) offset by changing tastes and spending priorities.
- Source: GFMS



Producer Hedging

- Producer de-hedging surged to a fresh high in the first half, generating 305 t of demand, leaving total book at end-June at 1,064 t.
- Greatest contribution provided by Barrick, outright book eliminations by Newmont, Lihir and Gold Fields.
- Original GFMS forecast (August '07) saw de-hedging in the second half of 2007 reach just under 80 tonnes.
- Recent developments (Newcrest buy-back & bought puts) suggest a higher number, comfortably exceeding 100 tonnes.

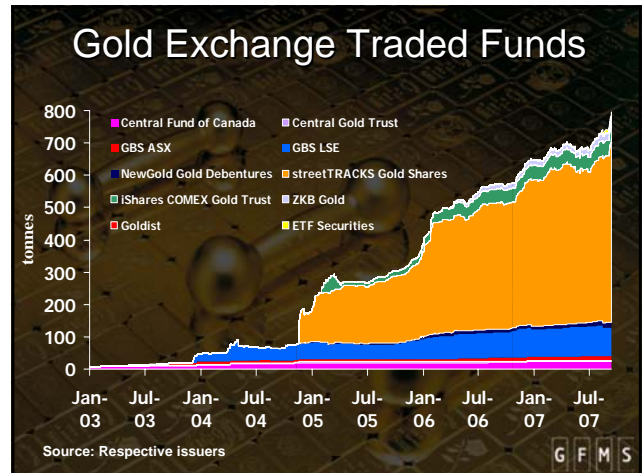
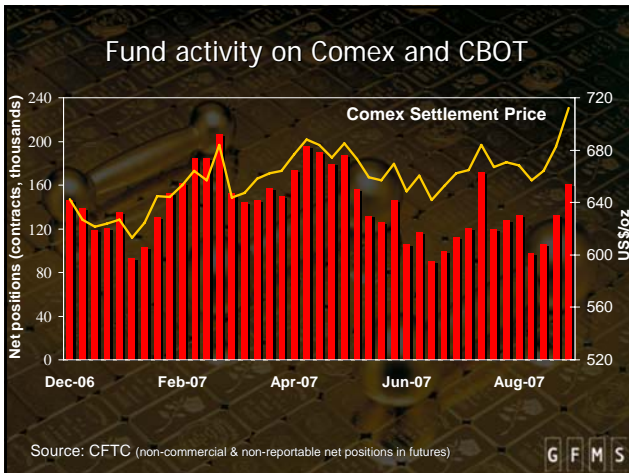


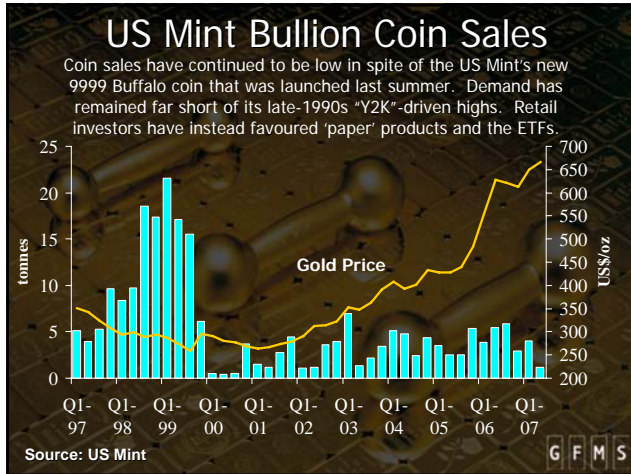
World Investment

	2005	2006	2007F
Official Coin Fabrication	111	129	132
Implied Net (Dis)investment	480	423	-110
Bar Hoarding	263	223	294
World Investment	854	775	316
Approximate Value*	\$4.4 bn	\$12.7 bn	\$6.8 bn

*Approximate value of World Investment based upon volume multiplied by annual average price.

Source: GFMS





- ### Investment in 2007
- In the first eight months of the year, net selling by "western" investors:
 - Disappointment at gold price not breaking through \$700.
 - US dollar decline limited.
 - Bearish news of increased official sector sales.
 - Financial crises (equity, fixed income and sub-prime markets) initially led to sell-offs in all liquid assets.
 - More recently investors have moved back into gold. Search for a safe haven, in the aftermath of the ongoing credit market crisis behind this move.

Summary and Price Outlook

- ### Price Outlook - Fundamentals
- Fundamental Supply & Demand – Positives:
 - Mine production & scrap supply forecast down year-on-year.
 - Fabrication demand will continue at fairly healthy levels and respond to dips in the price.
 - Fundamental Supply & Demand – Negatives:
 - Marked decline expected in producer de-hedging.
 - Moderate increase in net official sector sales.
 - This year, support level provided by fundamental Supply & Demand factors has continued to rise. Recently to around the \$650s, probably has moved up further in light of current rally.
 - However, return of investment demand behind breach of \$700 level and key to sustainability of plus-\$700 prices.

Investment Issues

- The credit market crisis is far from over.
- Further liquidations across all markets are likely, with a potentially negative short-term impact on the gold price.
- Liquidations likely to be limited to short-term players (e.g. hedge funds).

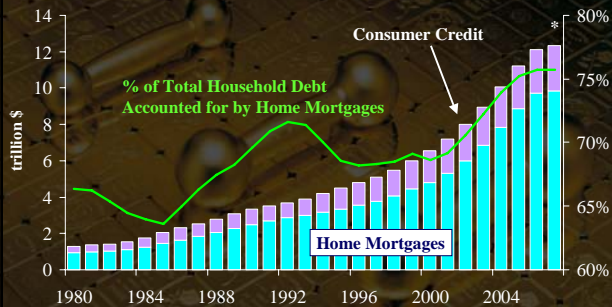
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Investment Issues

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- The US economy remains leveraged on an increasingly problematic housing market.

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US Consumers' Leverage to the Housing Market at Historical High



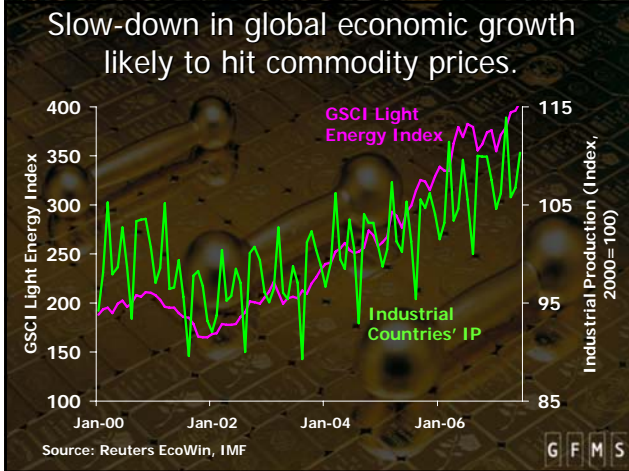
Source: Reuters EcoWin
*N.B.: 2007 figure refers to end-Q1 data

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Investment Issues

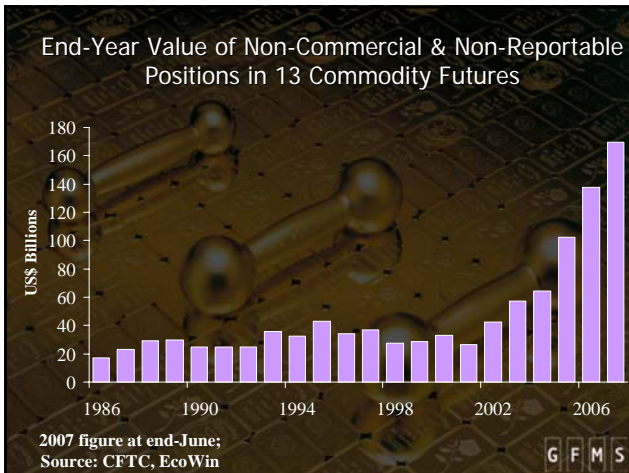
- The sub-prime market crisis is far from over.
- Further liquidations across all markets are likely, with a negative short-term impact on the gold price.
- Liquidations likely to be limited to short-term players (e.g. hedge funds).
- The US economy remains leveraged on what increasingly seems to be a problematic housing market.
- This is likely to develop into a slow-down in US GDP if not recession, which would certainly impact global growth.
- This will lead to lower Industrial Production, which would have an adverse affect on commodity prices.

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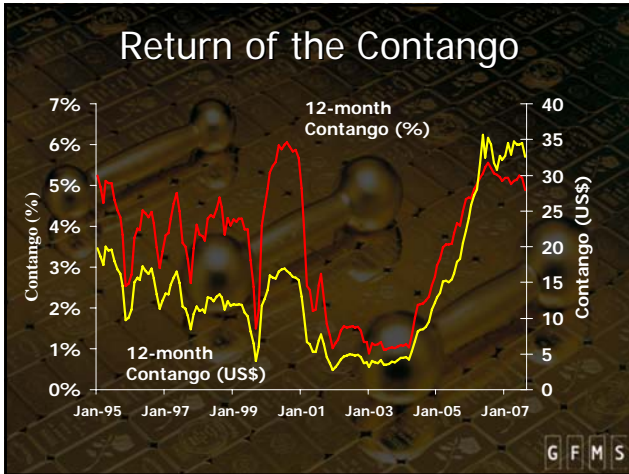
Investment Issues

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- However, GFMS believe that gold will largely de-couple from most other commodities, as investors focus on its monetary role.
- Rising interest rates had translated into increased cost of carry of gold and a theoretical incentive to short the metal.

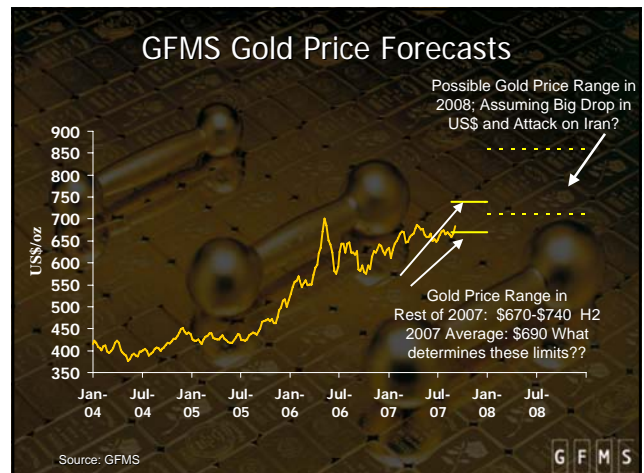


Investment Issues

- The impact of a slow-down on the commodities complex will certainly affect the gold price in the short term, through liquidations in basket products.
- However, GFMS believe that gold will largely de-couple from most other commodities, as investors focus on its monetary role.
- Rising interest rates had translated into increased cost of carry of gold and a theoretical incentive to short the metal.
- Financial markets crisis plus worsening economic outlook is leading to easing of monetary policy and will result in a lower contango.

Investment Issues

- Reduction in US interest rates and US slow-down/recession expected to force dollar to new lows, boosting gold investment demand. Investors would be further encouraged if inflation also picks up (1970s-style 'stagflation' a possibility).
- Inflows into gold are expected to intensify further in the future if the market crises are coupled with rising geopolitical tensions (e.g. heightened expectations of a US attack on Iran).



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