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Are Gold and Silver Entering a New
Paradigm?
Some Thoughts on the Upside and Downside
Risks Going Forward.

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IIC Indaba

Cape Town, 4 January 2008

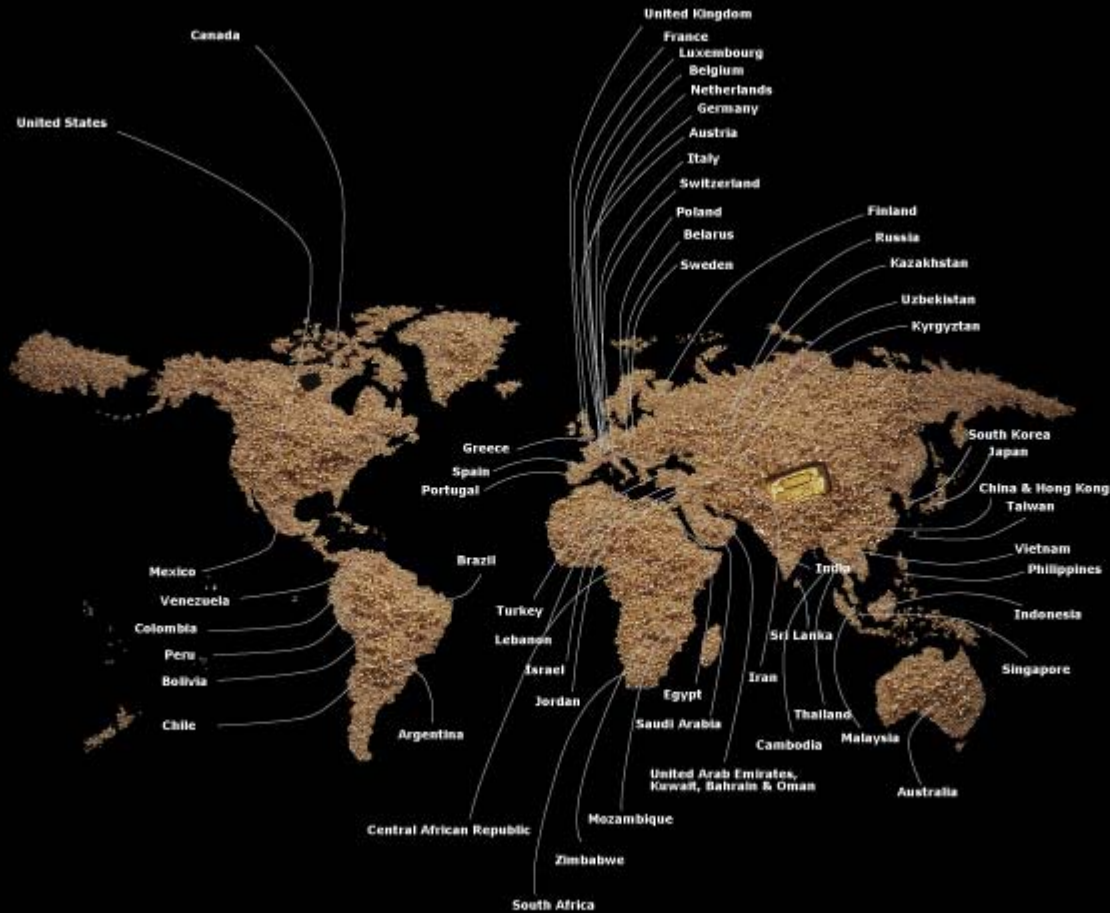
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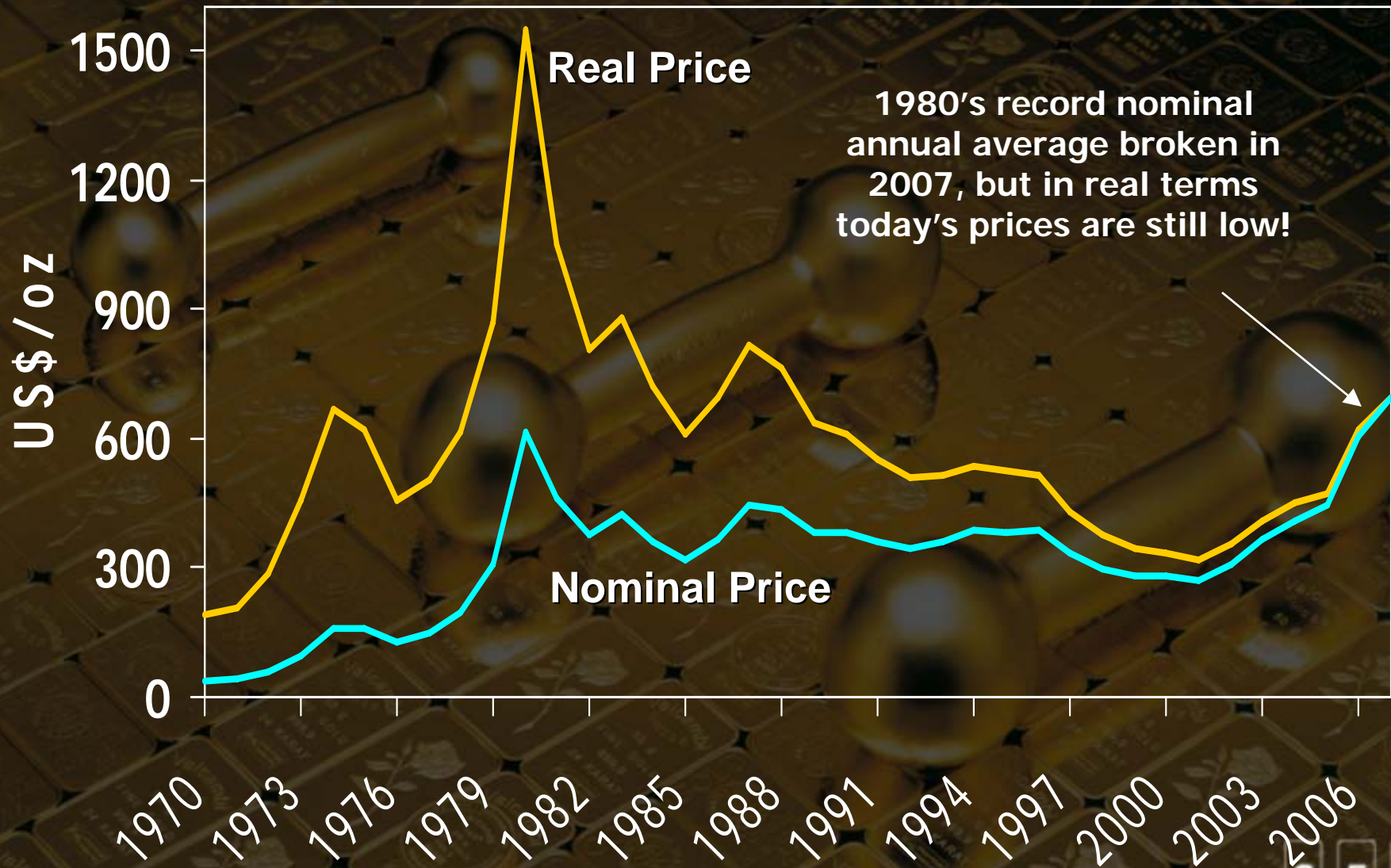
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Presentation Outline

- **Gold Prices:**
 - Is this just a dollar story? Or does gold have its own dynamic?
- **Economic Backdrop:**
 - Further Problems Ahead for Markets, US\$ & Economy
- **Gold Supply:**
 - Growth Potential Limited
- **Gold Demand:**
 - Investment Compensating for Weaker De-hedging & Fabrication
- **Gold Conclusion:**
 - Continuation of the Bullmarket in 2008?
- Silver – some brief comments

Real and Nominal Gold Prices

(real US\$ price in constant 2007 terms)



Source: GFMS, Reuters EcoWin

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Gold Price Correlations

(based on log-returns on daily prices)

	Q4.06	Q1.07	Q2.07	Q3.07	Q4.07
US\$/Euro Rate	0.44	0.35	0.46	0.47	0.67
US\$/Yen Rate	0.36	-0.20	-0.07	-0.08	-0.09
Silver	0.55	0.62	0.59	0.44	0.50
Oil (WTI)	0.03	0.00	0.07	-0.12	0.45
GSCI Index	0.12	0.13	0.12	-0.04	0.49
CRB Index	0.22	0.14	0.18	0.33	0.28
S&P 500	-0.01	0.18	0.05	0.05	0.10

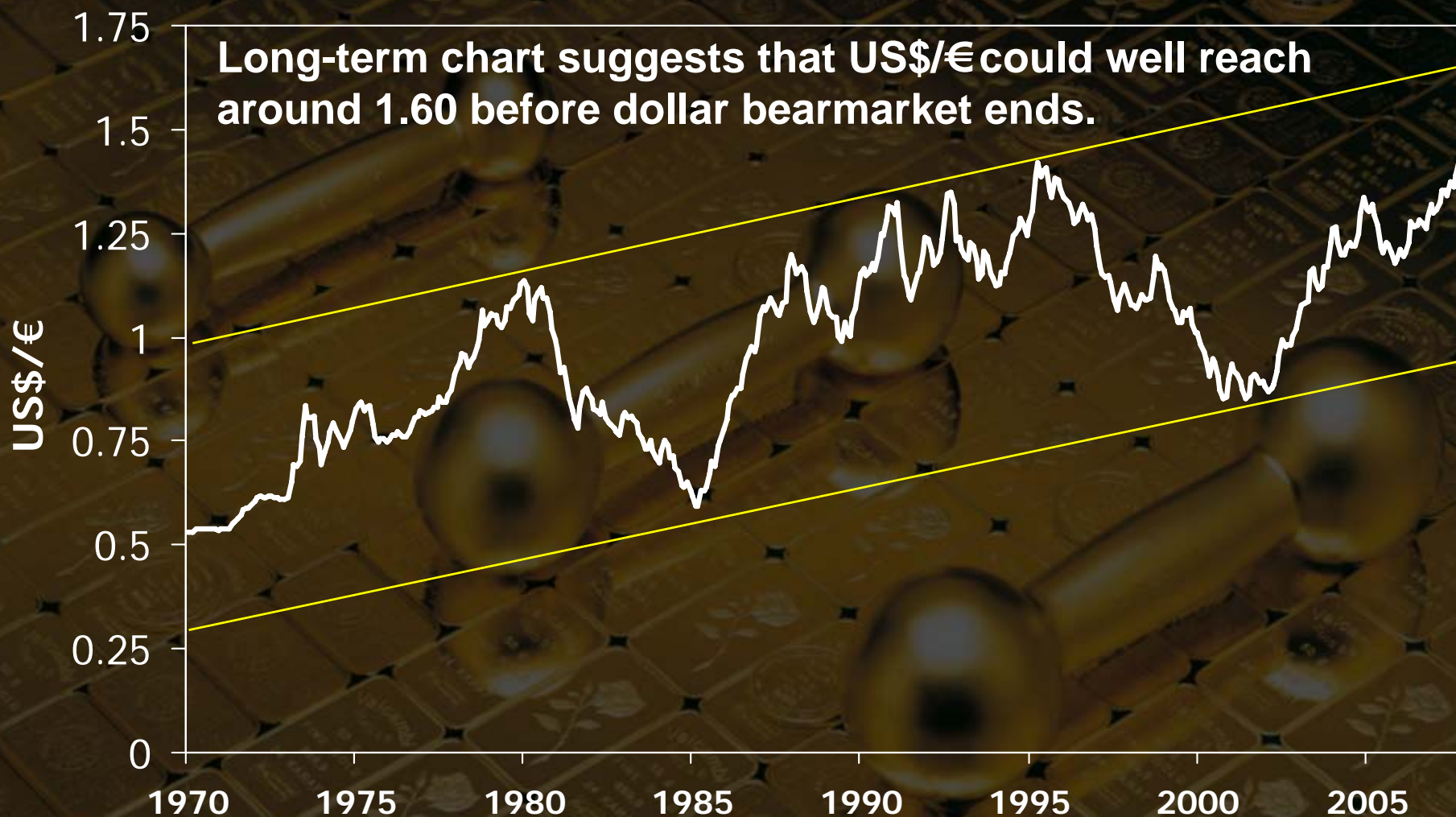
Source: GFMS

Economic Backdrop

Economic Backdrop

- **Impact of credit markets crisis is broad and ongoing**
 - **Financial markets directly affected:**
 - **Liquidity impaired & price discovery compromised**
 - **Counterparty credit risk to the fore**
 - **Second order effects considerable:**
 - **Further blow to housing market**
 - **Tipping US into recession; RoW slower growth (lower profits and therefore slide in stock prices)**
 - **Cuts in US interest rates (but growing inflation risks, especially with high oil prices)**
 - **Weaker US dollar**
- **Positive economic and financial backdrop for gold**
 - **Flight to quality; safe haven ('asset that is nobody's liability')**
 - **Competing assets unattractive: lower stock prices, weaker US dollar, negative real interest rates**

US Dollar's Long-Term Decline



Source: GFMS

*Data prior to 1999 is calculated using the Deutsche Mark spot rate



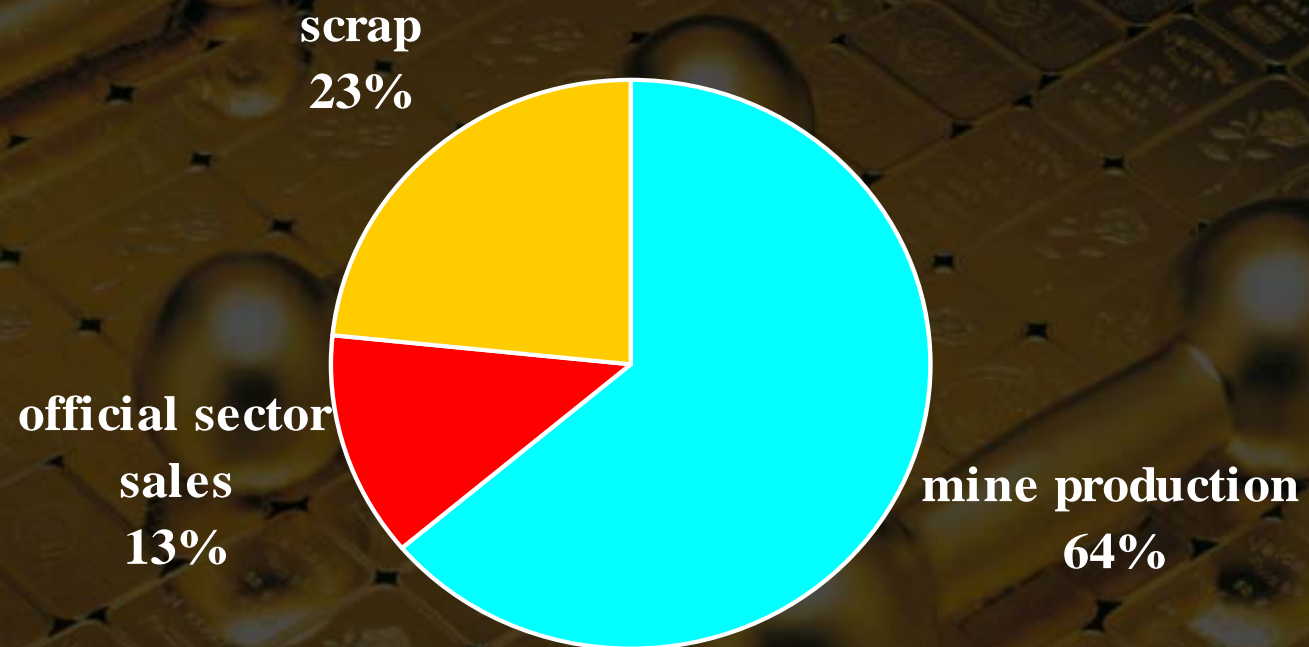
Slow-down in global economic growth likely to hit commodity prices...but will gold de-couple?



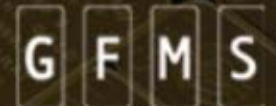
Source: Reuters EcoWin, IMF

Supply

World Gold Supply in 2007

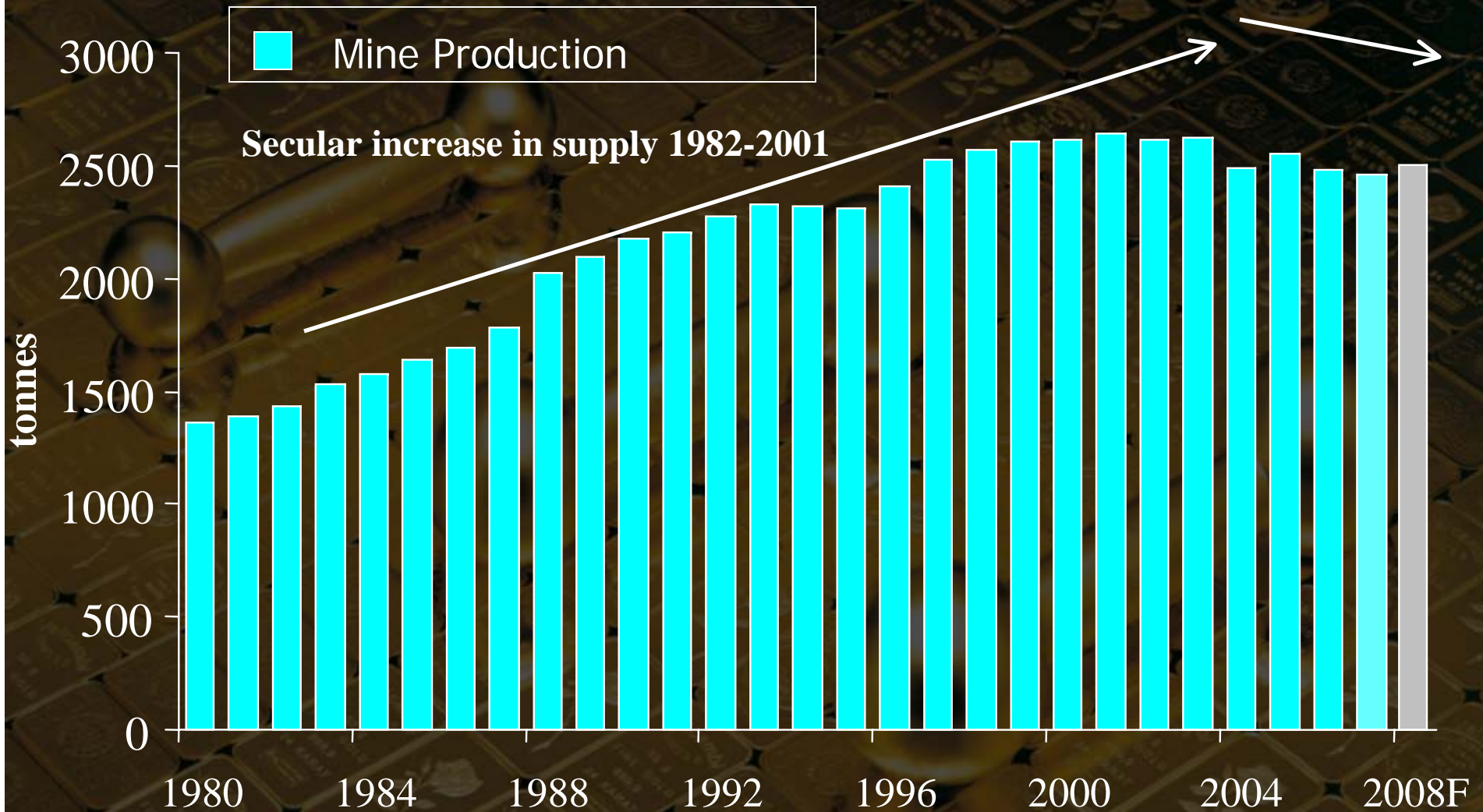


Source: GFMS



Supply from Mine Production

Flat to declining trend since 2002?



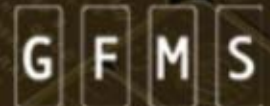
Source: GFMS

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Total Production Costs nominal (money-of-the-day) terms



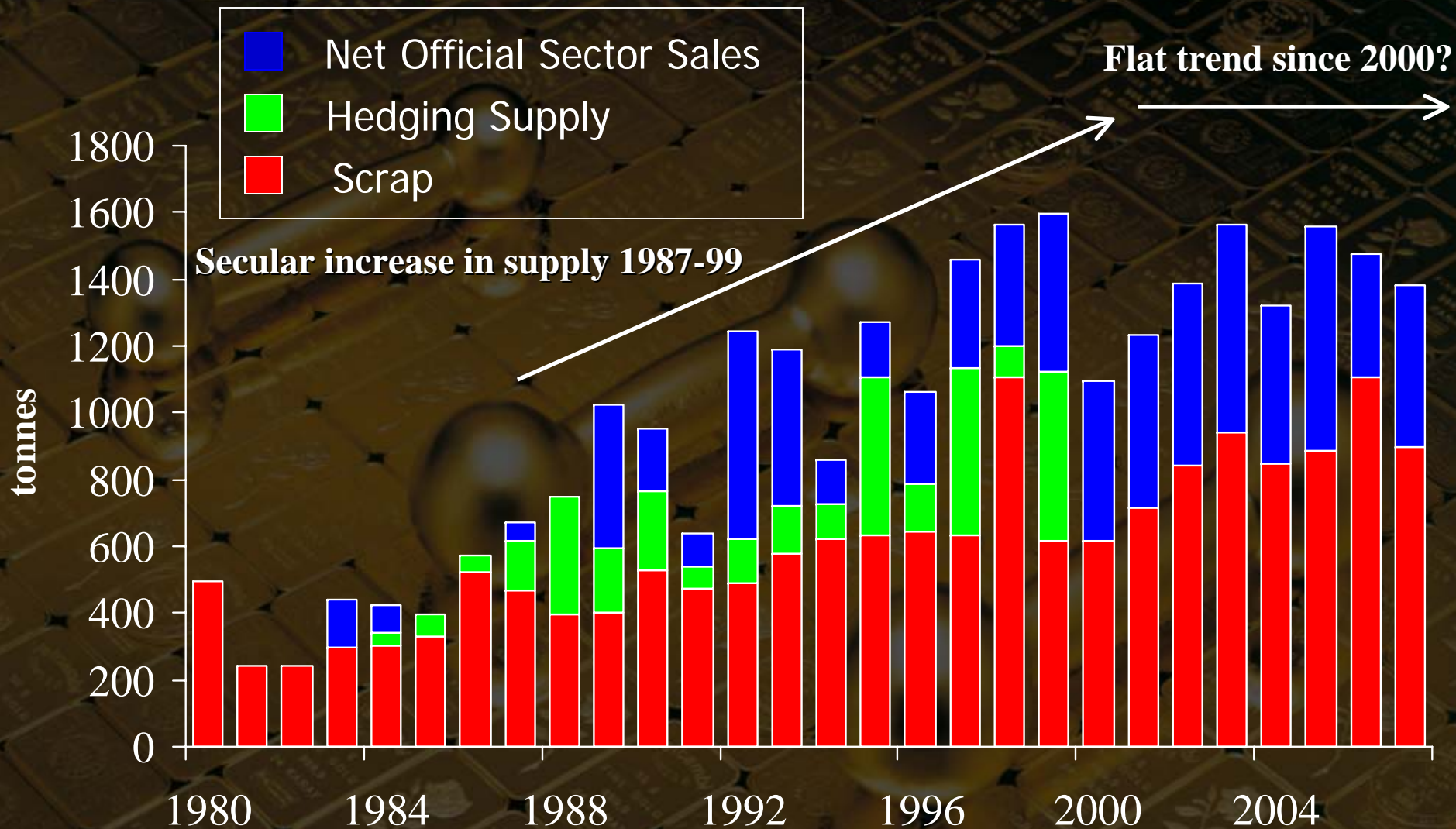
Source: GFMS



Mine Production

- During rally-to date trend has been flat
- So far not a lot to show for leap in exploration spending
- Costs increasing rapidly but cash margins even more so
- GFMS forecast over 250t growth in output between 2007 and 2010; not an issue in 2008 but could exacerbate eventual downturn in price.

Supply from Scrap, Hedging & Official Sales



Source: GFMS

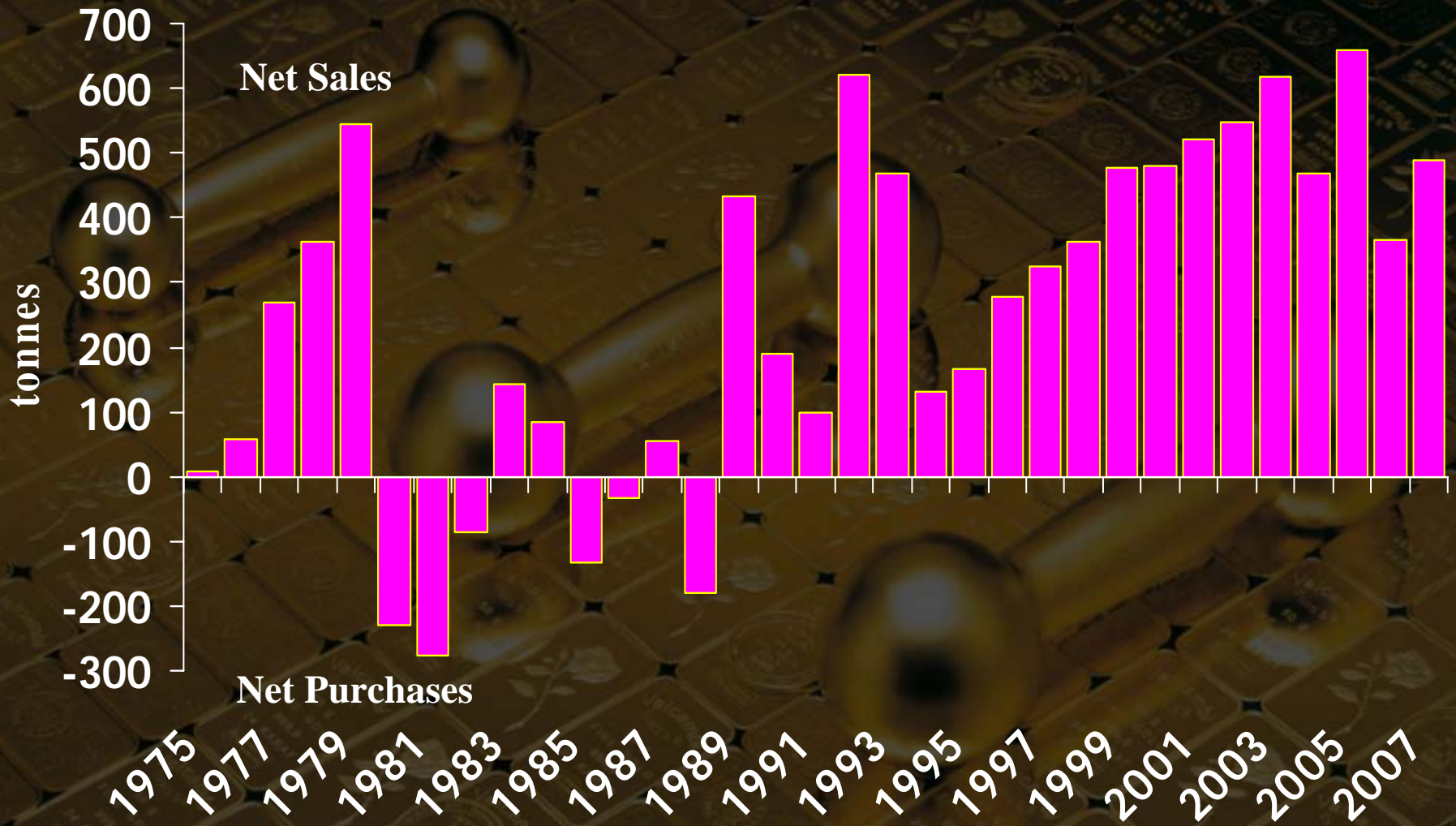
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Scrap Supply

- Volume declined year-on-year in 2007 in spite of higher average price
- Price spike in 2006 mobilised a lot of loosely held old jewellery
- In many key markets for scrap local currency price gains and volatility more modest than for US dollar prices last year
- Scrap supply has grown again with breach of \$900 level but still less than 2006 peaks
- Probably need \$1,000 plus to generate a new, record surge in jewellery recycling

Historical Official Sector Sales

Net sales every year since 1989 but after trend increase are we on verge of trend decline in net sales volume?

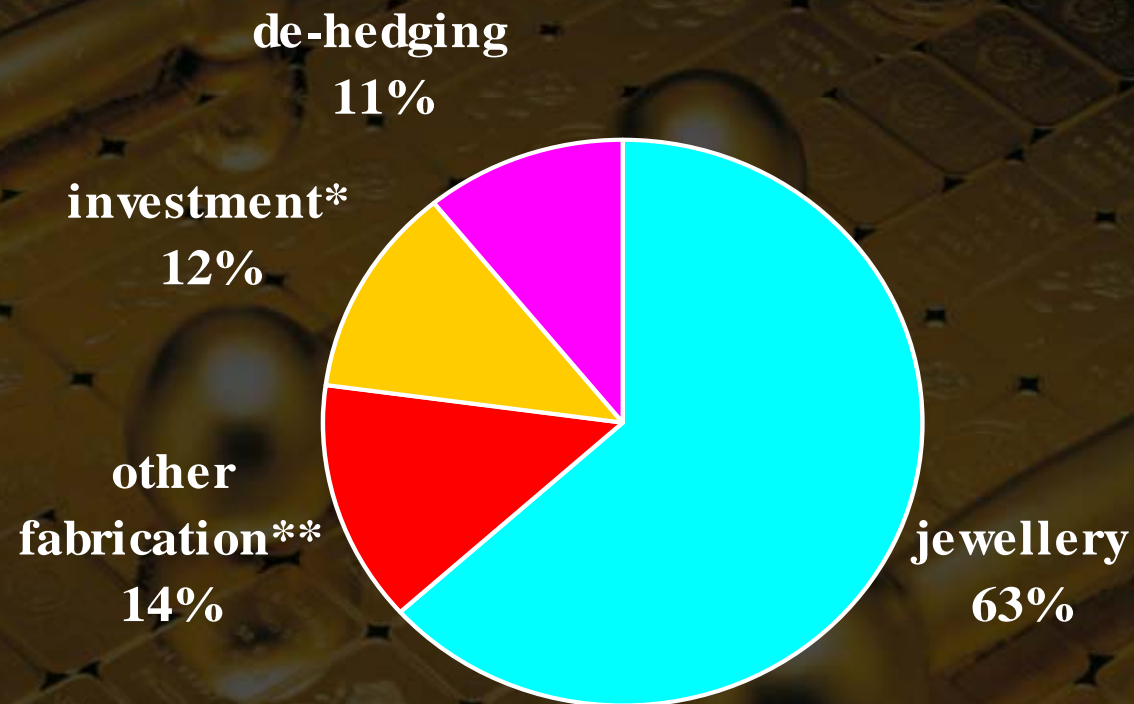


Supply Summary

- Mine production expected to grow modestly in 2008
- Scrap supply could rise back to 2006's record level, depending on scale of price rise and volatility
- Net official sales likely to be flat-to down year-on-year in 2008
- Overall supply therefore expected to increase back up to around 4,000 tonnes (a little less than 2005's level) but this representing no change to broadly flat trend since 2000

Demand

World Gold Demand in 2007

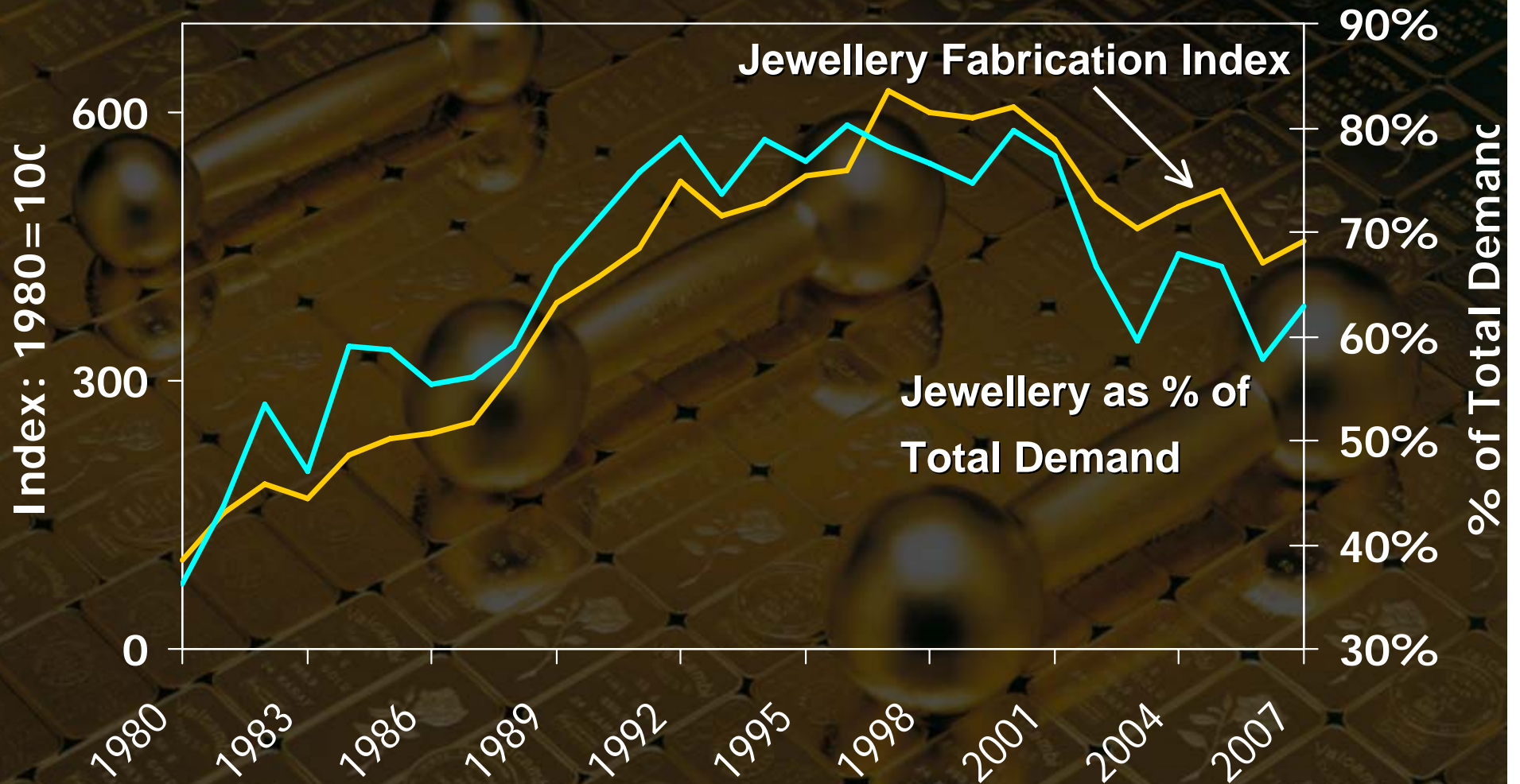


*Investment includes implied net investment, bar hoarding and bullion coins

**other fabrication excludes bullion coins

Source: GFMS

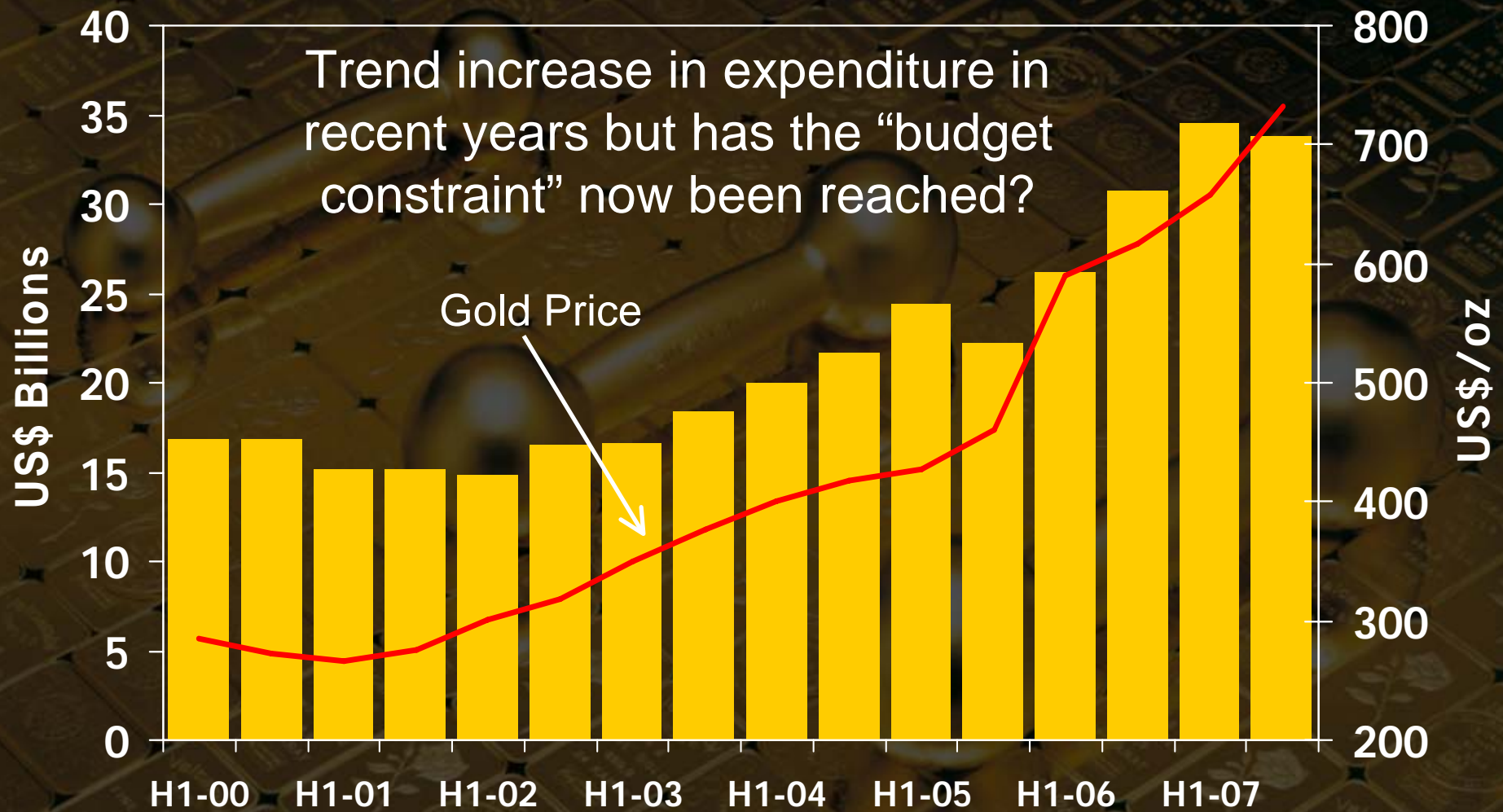
Jewellery Fabrication Demand



Source: GFMS

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Value of Fabrication Demand (Including Scrap; Half-Yearly)



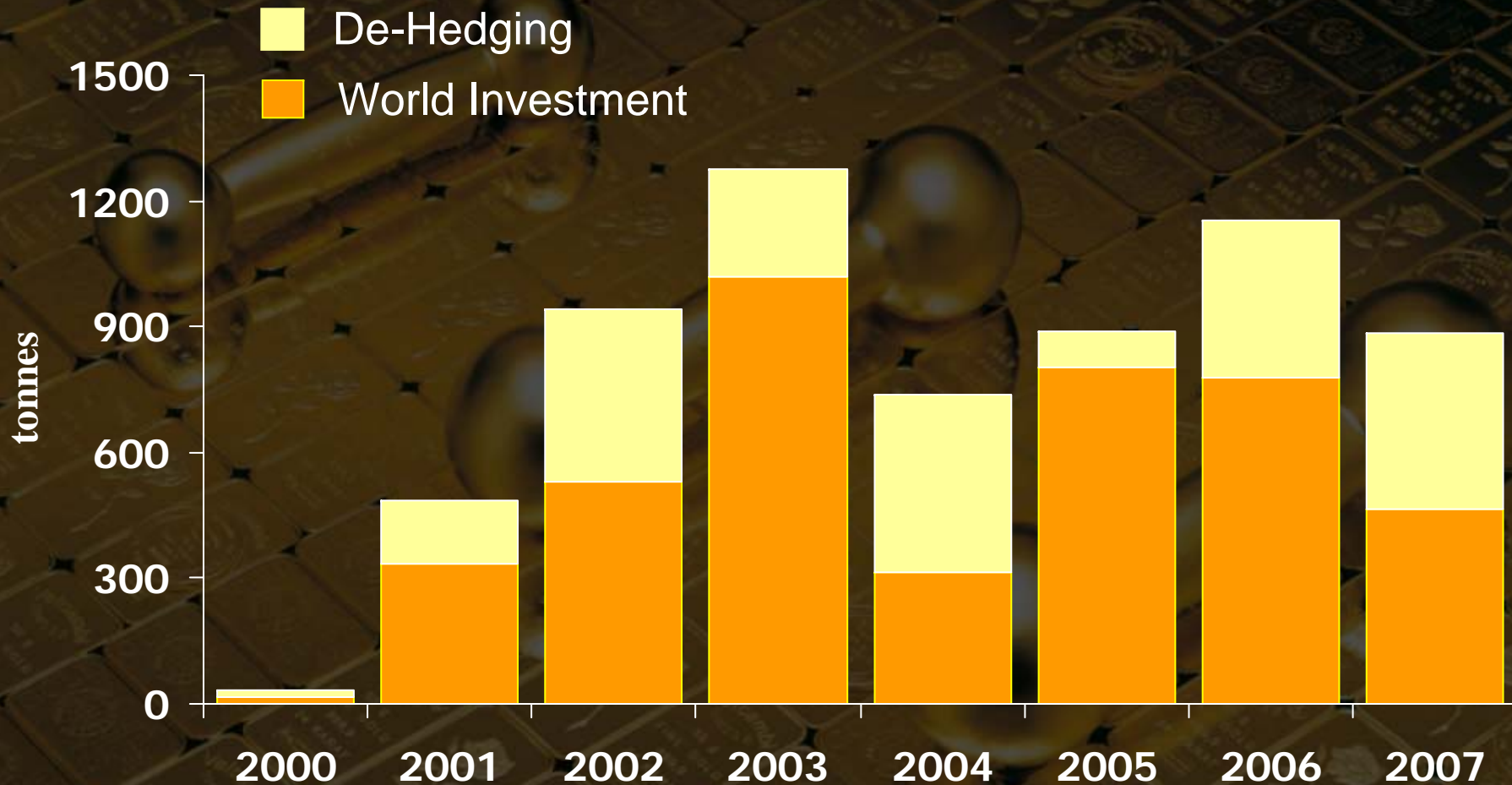
Source: GFMS

Jewellery Demand

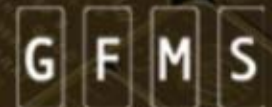
- Jewellery demand the key to maintenance of the price floor: the platform from which investment can drive the price higher
- Jewellery demand had adapted quite well to move in prices from sub-\$300 to \$600 level
 - In 'western' markets trade was typically already using higher prices (e.g. \$500) for pricing articles and consumer spending in some countries (e.g. the US) was buoyed by growth in debt
 - Demand in developing countries boosted by gold/jewellery market liberalisation and rapid personal income growth
 - 2000-05 global jewellery volume fell by 16% but in crude value terms (average annual price x volume) demand rose by 35%
- Gold's rise in 2006 to well above \$600 plus jump in price volatility saw demand fall by 16%; modest recovery in 2007 driven by higher consumption in East Asia, Indian S-C and the Middle East.
- Global jewellery demand in 2008 could fall to below 2,000 tonnes and account for only a little more than 50% of total demand making gold highly vulnerable to any setback to investment

World Investment & Producer De-Hedging

De-hedging almost exactly 50% of World Investment in 2000-07

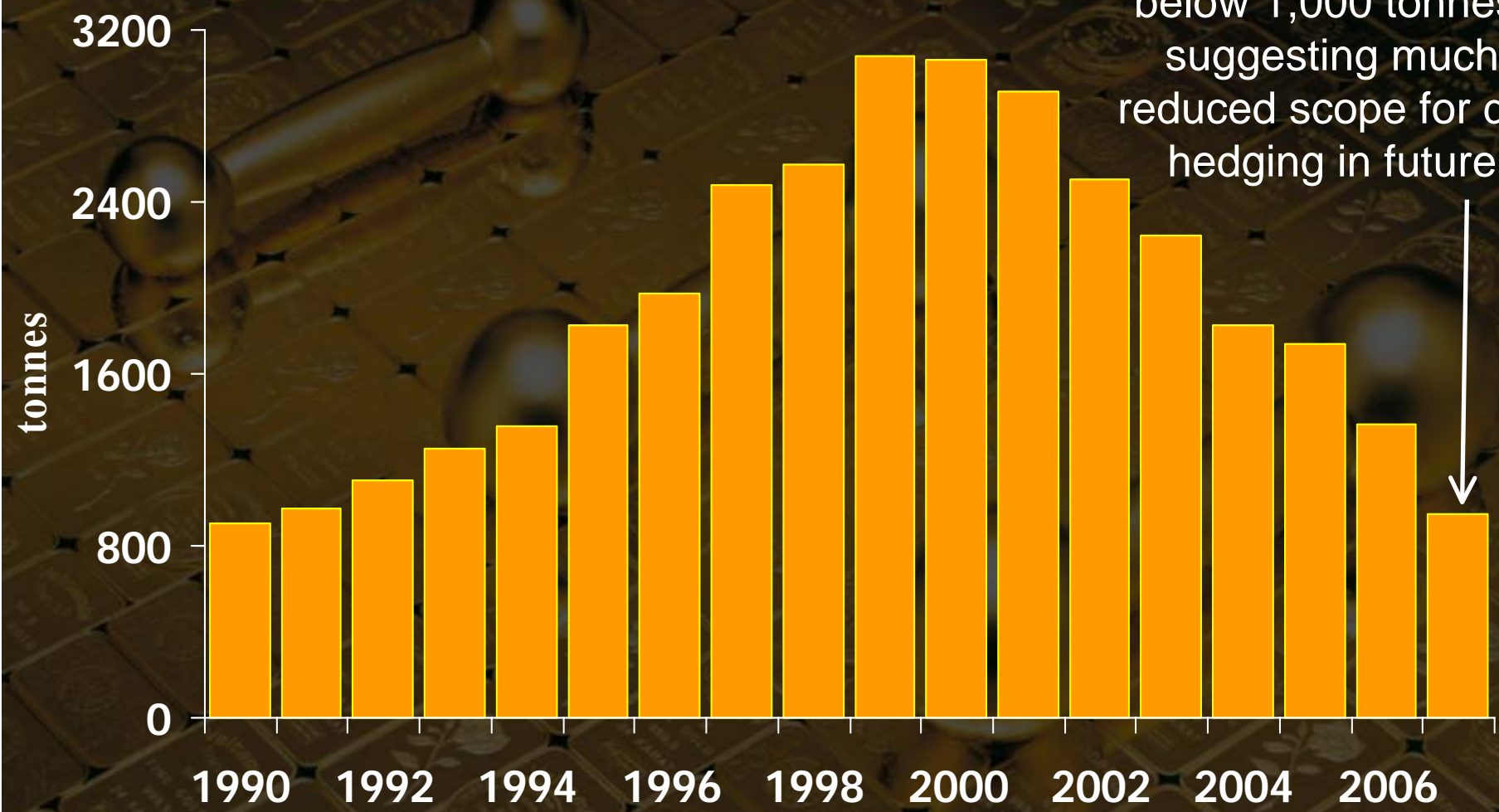


Source: GFMS

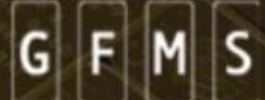


Net Producer Hedgebook (outstanding delta adjusted position)

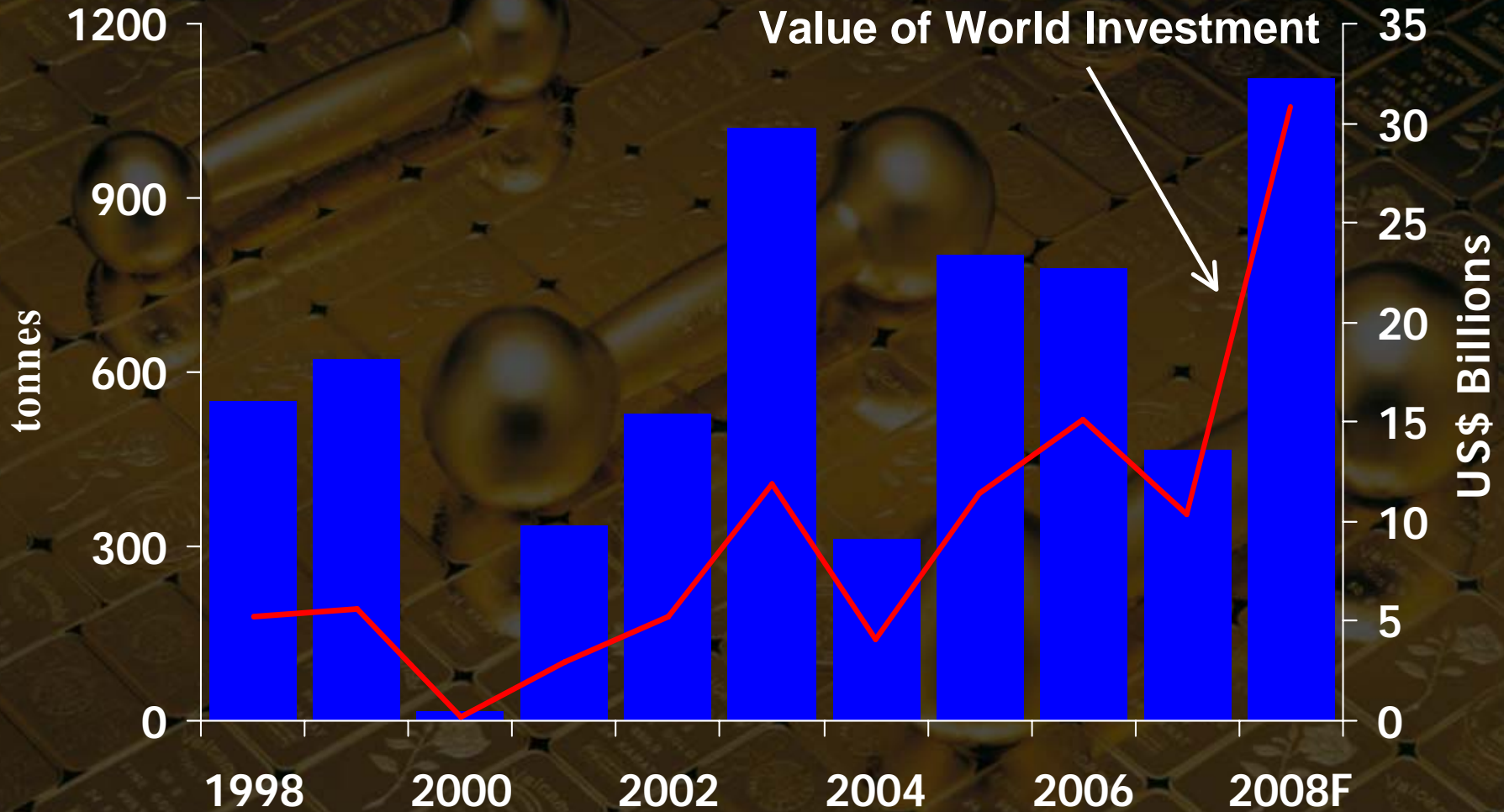
Position end-2007 well below 1,000 tonnes, suggesting much reduced scope for de-hedging in future



Source: GFMS



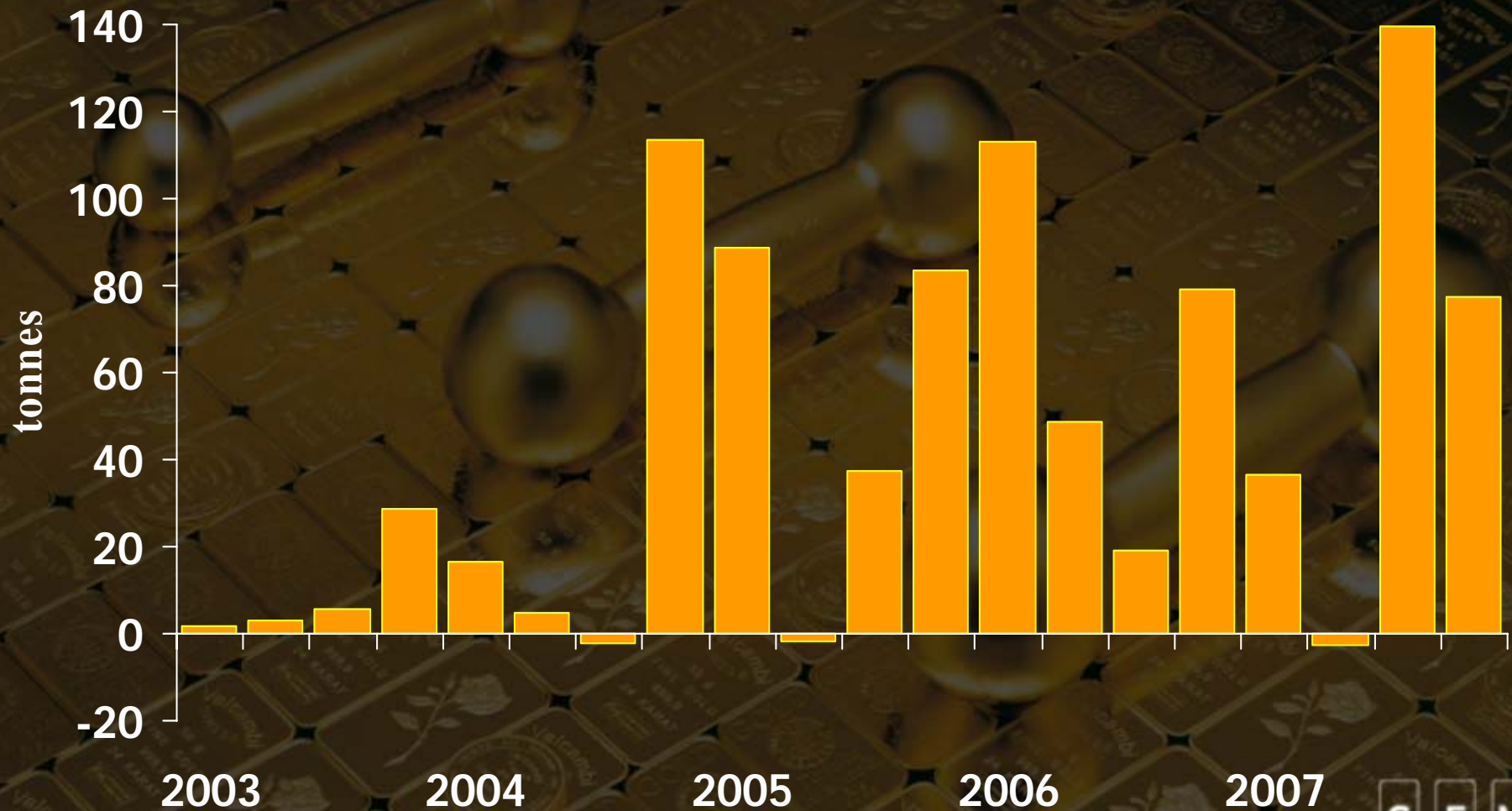
World Investment



Source: GFMS

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Quarterly Flows into Gold ETFs & Other Similar Products



2003
Source: GFMS

2004

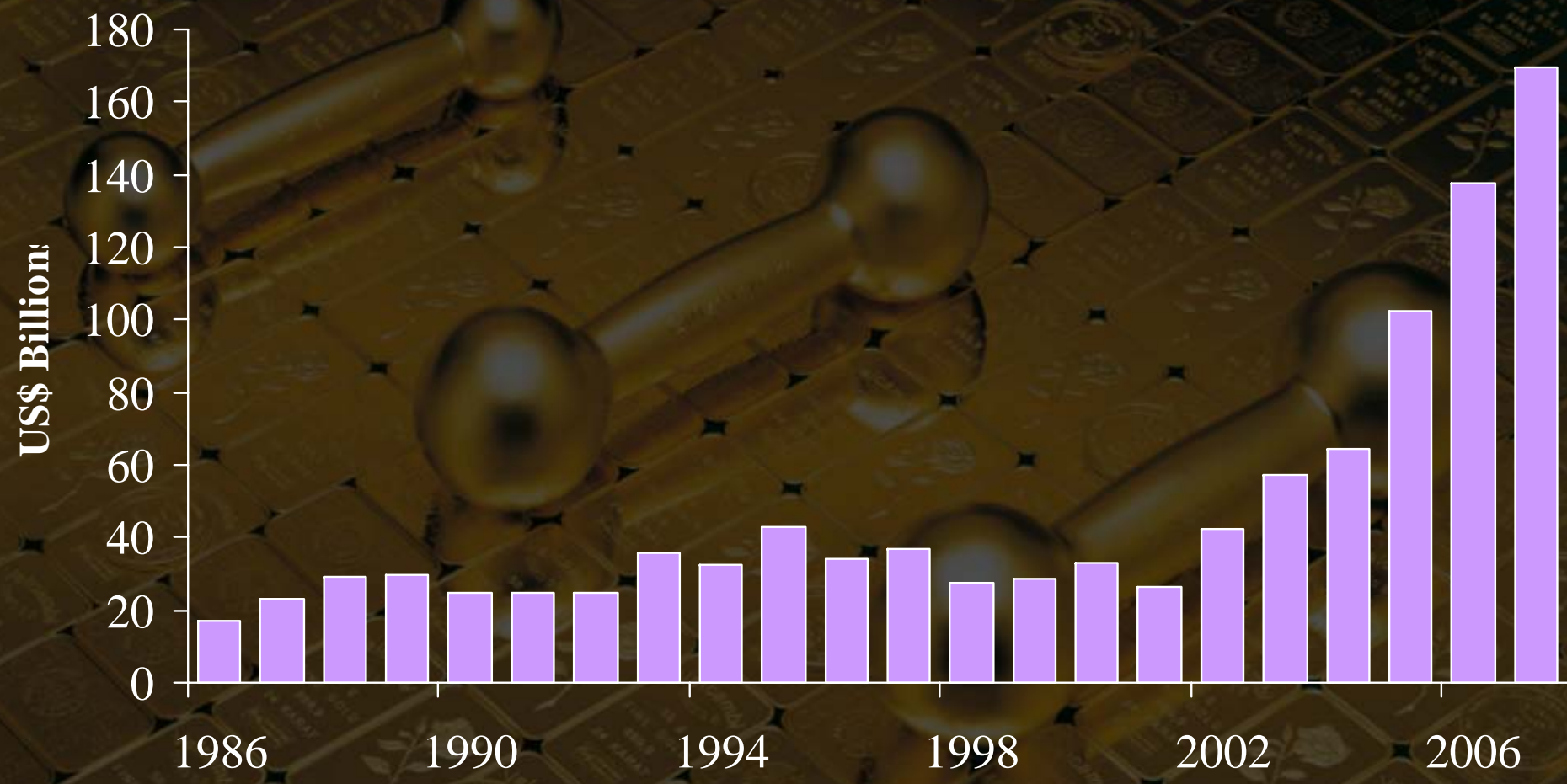
2005

2006

2007

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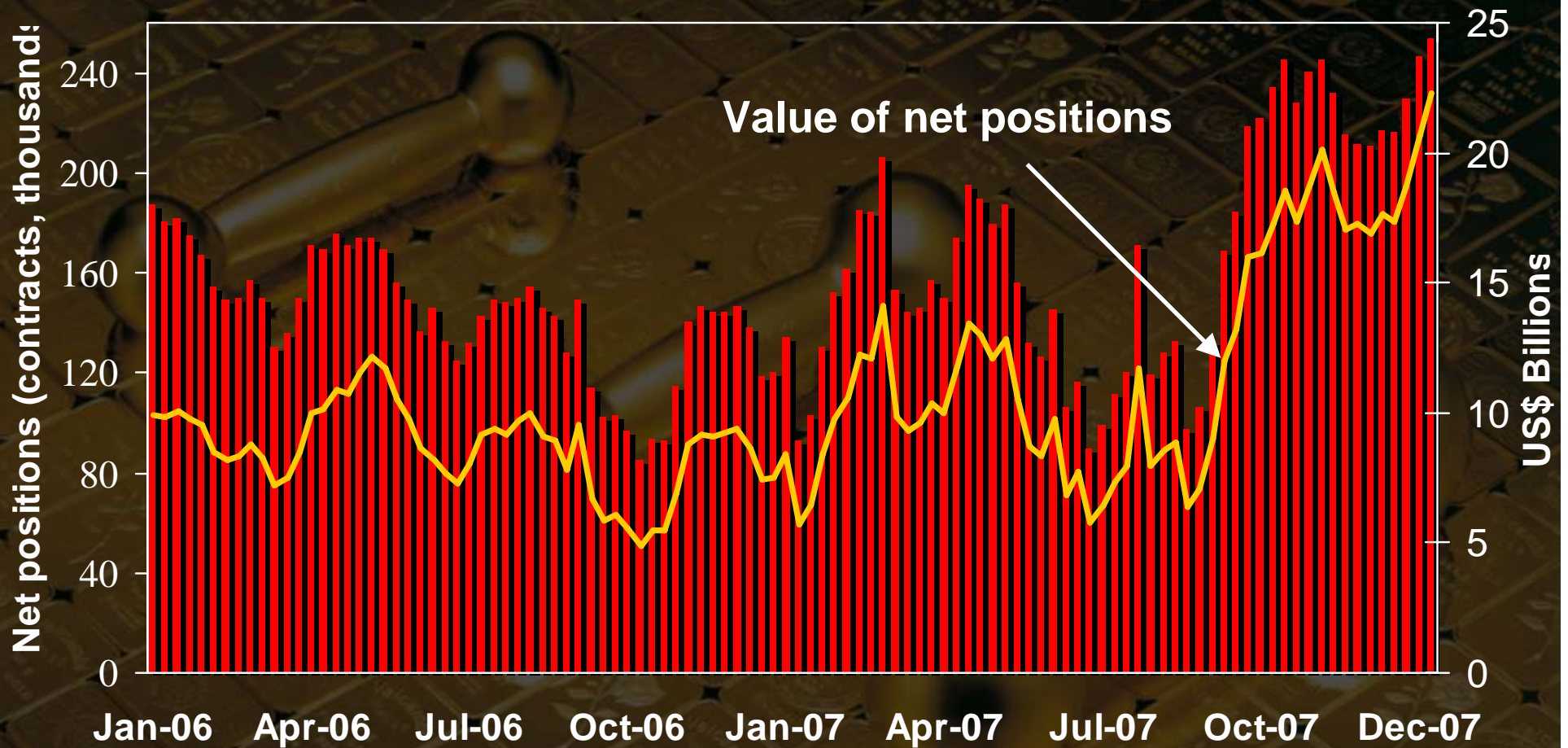
End-Year Value of Non-Commercial & Non-Reportable Positions in 13 Commodity Futures



2007 figure at end-June;
Source: CFTC, EcoWin



Fund* Net Positions on Comex and CBOT



Source: CFTC (*non-commercial & non-reportable net positions in futures)

Investment in 2008

- **Recent boom linked to:**
 - Credit markets crisis
 - US dollar decline
 - US interest rate cuts
 - Oil price rally
 - Inflation risks
 - Secular growth in investment in commodities
 - Rising & well-defended floor from fabrication demand
 - Turkey / Iraq / Iran / Pakistan geo-political tensions
- **Short term expectations – Momentum keeping gold above \$900 versus Comex ‘overhang’**
- **Medium term outlook: Rebound after sharp correction?**

Demand Summary

- Jewellery demand suffering at prices well above \$850
- “Budget constraint” likely to bite even in Asian markets that were strong in 2007
- Longer-term problems building for carat gold jewellery category (substitution by other metals; further push towards gem-set)
- De-hedging’s contribution set to decline in 2008, although any swing to net producer hedging still a long way off
- Investment will have to substitute for weaker fabrication and de-hedging demand
- GFMS expect that in 2008 conditions will continue to favour investment and that the net new dollar inflow into gold will increase substantially over 2007’s level

Conclusion

Conclusion

- **Marginal growth in mine production and higher jewellery scrap recycling will boost supply-side this year**
- **Level of gold supply in 2008 will nevertheless remain within range seen in recent years, with no trend increase**
- **Fabrication demand is set to fall sharply in 2008**
- **Investment demand will rise sufficiently strongly to more than compensate for lost demand from fabrication and de-hedging**
- **BUT...how does NET demand stack up against mine supply? Into relatively uncharted territory.**
- **GFMS' forecast last week in conjunction with annual LBMA survey is for average price in 2008 of \$866, with low of \$810 and high of \$1,001**

Silver Price Outlook

Supply

- Mine production forecast to increase by 6% in 2008.
- Scrap supply expected to be flat or down slightly year-on-year.
- Government sales probably set to fall.
- Producer hedging? Although swing to net supply in 2007, no sign of miners' aggressively taking advantage of high forward prices.
- Overall, marginal supply growth forecast in 2008 but only expected to have a very limited impact on silver prices.

Silver Price Outlook

Demand

- After several excellent years, including 2007, outlook for industrial demand is now looking negative in 2008 due to potential impact of global economic slowdown.
- Photography still declining but at a lower absolute rate in volume terms.
- Jewellery & Silverware up a little in 2007 but could see moderate setback in 2008, especially if prices much higher.
- Overall fabrication demand in 2007 moderately higher year-on-year. Significant decline expected in 2008.
- Investment? Headwinds from weaker fabrication demand, expected growth in mine production and, probably, lower base metals prices. However, investors expected to follow gold's lead.

Silver Price Outlook

Conclusion

- Silver could be dragged in different directions by base metals (downwards) and gold (upwards) in 2008.
- Gold expected to be the dominant influence.
- Silver's supply/demand fundamentals (excluding investment) turning negative in 2008, i.e. start of wave of new mine production and, especially, lower fabrication demand.
- More reliance on investment demand to sustain silver price or drive it higher.
- GFMS expect silver prices will be volatile but tend to increase, though silver likely to underperform gold in terms of its annual average price gain.
- GFMS' silver forecast for 2008 made in early January for LBMA:
 - Average: \$15.45 High: \$19.25 Low: \$14.20

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