



Publication of *Gold Survey 2006*

Possibility of Bull Run to Historic Highs Forecast for Gold as Surge in Investment Overrides Collapse in Physical Offtake

GFMS launched *Gold Survey 2006* today, the 38th edition of their authoritative annual survey of the world gold market, at events in London, Toronto and Johannesburg. The following details some of the highlights of the Gold Survey from the briefing given at the London launch by Philip Klapwijk, chairman of the independent precious metals research consultancy.

The possibility of a further strong increase in the gold price was a key finding of *Gold Survey 2006*. Philip Klapwijk commented, "levels safely over \$600 are now in our sights and further hefty gains over the next year or two are quite possible - in the right circumstances, the 1980 high of \$850 could even be taken out".

The consultancy feels this bull run would be overwhelmingly driven by investment and the report details what factors sustained this in 2005 and should continue to do so moving forward. Much emphasis was put on the supportive background of unsustainable global economic imbalances, revolving around the twin US deficits. But Klapwijk continued, "investors often look for a reason to jump in and this arrived at end-August in the form of Hurricane Katrina and a rally in the energy complex". Other key triggers the Survey highlighted for 2005 were investors' belief that central banks were becoming friendlier to gold and a phase of marked yen weakness which boosted investment in Japan.

For 2006, the chief drivers of investment were expected to remain the high probability of a sharp slowdown in US economic growth and a slide in the dollar. Other supportive factors were thought to include greater inflationary pressures and political tensions in the Middle East. The sheer success of investment to date in gold was also thought significant and certainly would not harm another dramatic possibility; a range of new players, pension funds for example, entering the commodities market in general. Klapwijk commented, "you're playing with fire if you ignore the weight of money argument, looking ahead into 2006. We'd only need to see a tiny slice of mainstream assets diverted into gold, which comparatively is a pretty small market, and the price could really take off".

With the gold price having risen substantially in 2005, the Gold Survey contains a quite surprising statistic; jewellery demand rose by almost 100 tonnes last year. The report, however, does stress that this strength was essentially confined to the first half, when price stability and a growing acceptance of prices in the low \$400s in conjunction with strong GDP growth in Asia led to a surge in the jewellery sector. This was thought to have done much to underpin prices, just at a time when investment was looking somewhat jaded and official sector selling was at its peak. In the fourth quarter (and into early 2006), however, marked weakness was noted in countries such as India as the rally got underway and price volatility increased.

These swings were also seen in scrap supply, which fell in the first half before surging in the fourth quarter. Looking ahead, GFMS see physical offtake as an area of concern. Klapwijk cautioned, "from what we've heard for the first few months of this year, we could see jewellery demand slumping back almost 500 tonnes for the full year. That'd leave jewellery offtake some 400 tonnes below mine production. That's just not sustainable in the long term".

A part of the reason for this threat is increasing mine production. The Gold Survey notes that this rose by a modest 2% in 2005, thanks largely to new projects in Latin America and recovery in Indonesia, but this growth should pick up to around 4% in 2006 as further new mines come on stream or ramp up to full capacity. Some compensation should at least materialise in the form of higher levels of de-hedging, which the consultancy feels could recover to 2-300 tonnes from around 130 tonnes in 2005.

The Survey reports that net official sector sales rose by 40% to record levels in 2005. Much of this was attributed to a jump in sales by Central Bank Gold Agreement (CBGA) signatories. However, there was no repeat of sizeable purchases outside of this bloc, such as that by Argentina in 2004. Looking ahead, the report pours cold water on the idea that some of the major East Asian dollar holders could purchase significant quantities of bullion in the short to medium term. However, it does expect decent levels of buying elsewhere such that non-CBGA countries could swing from a typical position of net sellers of 100 or so tonnes to modest net buyers.

The statistical highlights of the report are outlined overleaf.





Supply Highlights:

- Global **mine production** rose by 2% in 2005 to a little over 2,500 tonnes. Much of the increase was attributable to a dynamic Latin America, where several new projects came on stream, and to a recovery at Indonesia's giant Grasberg mine. Other notable gains were recorded in China and Mali. In sharp contrast, South African output fell a hefty 46 tonnes to its lowest level since 1923.
- Weighted average **cash costs** rose 7% to \$269/oz, due to currency effects and higher prices for consumables such as energy.
- Net **official sector sales** soared by 40% to record levels over 650 tonnes in 2005. The rise was primarily due to higher sales by the Central Bank Gold Agreement (CBGA) countries, particularly in the first half, though there was also a major fall in purchases by non-CBGA countries. Due to historically low leasing rates, central banks continued to withdraw from the lending market in 2005.
- **Scrap** rose just 1.5% in 2005. There was a marked pick up in volumes in the fourth quarter due to the rally but the first half was subdued, in countries such as India, chiefly as a result of growing price acceptance and a belief prices could soon move higher.

Demand Highlights

- In 2005, **total fabrication** grew by 4% to a four year high of almost 3,300 tonnes. Much was driven by the near 100 tonne rise in **jewellery demand**. This strength was essentially confined to the first half (up 218 tonnes) whilst the second half actually saw a marked decline (down 119 tonnes). These price-driven swings in each half were more pronounced in terms of fabrication **excluding scrap** and were strongly influenced by India. That country, China and Turkey all saw sizeable full year gains whilst Italy suffered another substantial drop. Other fabrication rose by 3%, chiefly as a result of strength in the **electronics** sector and in **imitation coins** plus a modest contribution from **other industrial & decorative** offtake. **Dental** demand in contrast fell sharply.
- 2005 saw a dramatic surge in **implied net investment** to over 360 tonnes from net *disinvestment* in 2004 of almost 60 tonnes. Much took place in the fourth quarter as the first half of 2005 in fact saw slight *disinvestment*. The switch between these two phases was a result of the combination of a supportive economic background for gold investment, such as the twin US deficits, and triggers to stimulate buying, such as Hurricane Katrina, a phase of yen weakness and changes in investors' view of central banks' stance.
- Other areas of investment, namely **coin fabrication** and **bar hoarding**, in contrast, were lacklustre. The former saw a 3% fall, mainly due to US losses, whilst the former only saw a 2% increase, largely as India's sizeable gains were balanced by Japan's drop.
- Producer **de-hedging** slumped to around 130 tonnes in 2005 from comfortably over 400 tonnes in 2004. This was not a function of any mood change for the miners, who tended to remain hostile to hedging, but was instead due more to exceptional circumstances in 2004, such as the financial collapse of Sons of Gwalia.

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Gold Survey 2006 contains over 100 pages of statistics, commentary and analysis on all aspects of world gold supply/demand and on gold prices in various currencies. The publication can be ordered from GFMS for £275 or US\$495 / €395 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>

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