



A Surprise Response: Gold Scrap's Reaction to Price Moves

» by Neil Meader, Research Director, & Cameron Alexander, Senior Analyst, GFMS

It might be expected that, given the surge in the gold price from mid-August, we would have seen a marked acceleration in the volume of old gold scrap being generated. Furthermore, it might be assumed that the reaction would be strongest in traditionally price sensitive regions, such as the Middle East or the Indian sub-continent.

However, recent field trips have shown that the overall response of scrap to the price rise has been

comparatively subdued and that some supposedly price insensitive areas, parts of western Europe for example, have demonstrated a relatively strong reaction.

Perhaps the greatest surprise here concerns India. The received wisdom is that India is a highly price sensitive market where higher prices would typically equate to lower jewellery demand and higher scrap volumes. And whilst at times this stylised fact has indeed shown

up in the data, scrap volumes in the main have been on a declining trend for much of the bull rally. Consider, for example, that average scrap volumes were over 30 tonnes per quarter in 2003 but, so far this year they have fallen to under 20 tonnes on average. The most simple explanation of this appears to be that, as expectations of higher (and ever higher) prices have taken hold, consumers have reduced the amount of old jewellery they are willing to sell back.

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Similarly in the Middle East, the reaction to the rise in the metal prices has been controlled, with current scrap supply supported by the distribution chain unloading slow moving inventory rather than individuals offloading gold assets as was the case for much of 2006. A large portion of individual stocks were shaken out in the first half of 2006 and metal prices would need to return to levels close to \$850 to encourage a further surge in recycling. Demand for jewellery in Dubai, the trading hub of the region, has been modest with consumers buying solidly on dips in the gold price but they do not appear at this stage to be selling, or exchanging jewellery, with the expectation of higher prices on the horizon.

In East Asia, both trade and individuals have been active recently in taking advantage of any significant price volatility with scrap flows from the beginning of October notably higher. These markets are typically very price sensitive and with modest margins applied to the retail trade (often below 5%) any significant fluctuation in the gold price allows for a quick turnaround and the recycling of the jewellery item. That said, a lot of the material currently being recycled is "new" gold rather than old jewellery items, with this jewellery (mostly chain) purchased by individuals as a short term investment vehicle with the intention of selling back the item should the price move in an upwards direction.

Having mentioned earlier that the industrialised regions had seen a comparatively strong response, this does not change our view that their scrap supply in 2007 fell. This is largely because this year has seen a lesser clear-out by the jewellery distributive trade and fabricators,

especially in Europe, of slow selling or old fashioned stocks, in contrast to the major re-melt that followed the April/May 2006 price spike. Instead, we have seen a marked build up in the volume of scrap coming back to the market from individuals. There are several drivers behind this. There is, for example, an element of distress selling thanks to the credit crunch and we are beginning to see the start of selling back of inherited pieces, purchased originally when western consumption boomed post-War.

The rise in the gold price, even in euro terms, obviously features but its direct importance should not be overstated, given ongoing consumer ignorance of the gold price and the hefty discount received. This is a clue to perhaps the most important factor, namely the improvement in facilities for the recycling of old jewellery. This in turn stems from both the rise in the gold price and the very buoyant margins currently available, with individuals selling facing a discount that can easily reach 35-40% of the world price.

Such margins have led to new entrants to the business (such as French companies setting up special events in hotels at which they buy old jewellery), to retailers adding the service of buying back consumers' old pieces (the now ubiquitous 'compro oro' - I buy gold - signs in Italian jewellers' windows being a good example) and to greater marketing efforts by existing players' (witness the higher advertising spend of US pawnbrokers).

In summary, the greater weighting of the developing world in total scrap and its sluggish response plus the smaller western world trade re-melt mean scrap supply in 2007

could well still show a fall when results are published in *Gold Survey Update 2*. Looking further ahead, enhanced scrap facilities in the West in conjunction with prices holding at elevated levels should keep this element of scrap at a surprisingly sustained level. Developing world scrap would be highly likely to grow significantly in the event of a marked rally in the price, or greater volatility, though, as shown in 2007, volumes might well undershoot conventional expectations.



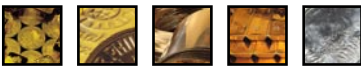
Neil Meader holds the position of Research Director and is responsible for most of Europe, having previously covered the

Arabian Gulf countries. Prior to GFMS, Neil worked as an analyst in the energy industry and in soft commodity trading. He holds a degree in economic history from Exeter University.



Cameron Alexander is an Australian based Analyst with GFMS and is responsible for research in South-east Asia, Australasia and the Gulf States in the

Middle East. Prior to his joining GFMS in December 2005, Cameron worked for over seven years with precious metals refiner AGR Matthey.



Saudi Arabian Scrap Volumes Sluggish

» by Cameron Alexander, Senior Analyst, GFMS

With gold pushing through \$800 in early November, this sharp rise was expected to have provided the impetus for a flood of recycled gold from Saudi Arabia (the world's largest supplier of scrap last year). However, this has not been the case, with scrap flows from the Kingdom surprisingly weak in the second half of this year.

This was the conclusion reached by GFMS analyst, Cam Alexander, who has just returned from a research trip to Saudi Arabia. There, he met with several dealers involved in the scrap market and they were perplexed at the lower volumes of scrap currently being returned to local gold souks in spite of a 27-year high for the gold price.

In the opinion of these dealers, much of the "loose" and easily liquidated gold assets appear to have already returned to the market in 2006. In addition, with gold prices at historically high levels, the replacement of gold assets (predominantly in jewellery form) has not been a priority for many consumers, which meant less fresh near-market supplies for potential disposal.

The majority of gold scrap being collected appears to have originated from the retail trade, rather than individuals, and their selling back of plain 21-carat gold in particular, which is characterised by low retail markups (as low as 5% over the gold price). This was partly due to the rapid rise in the gold price in recent months which has led to an increase in margin calls for the trade, who have had to liquidate a portion of their holdings to cover their positions. This unsold retailers' inventory is simply sold and exchanged for cash, with the metal sent to Dubai or directly to European refiners for smelting.

A comparison against 2006 requires qualification as, in that year, the country's scrap supply reached record levels (133 tonnes), almost doubling on the previous year. Price was obviously important as consumers rushed to offload their gold assets at the elevated gold prices recorded in the first half of the year. However, volumes were boosted by the selling seen in early 2006 as investors sought cash to place in the booming Saudi stock market and then again by gold assets being later sold to generate

cashflow in the wake of the stock market's spectacular collapse. Nonetheless, likely 2007 volumes still appear sluggish in comparison to the years prior to 2006.

Looking ahead to next year, it is unlikely that Saudi scrap volumes will return to 2006 levels unless a significantly higher gold price is achieved. The resultant slump in jewellery consumption would be likely to encourage a portion of retailers to take advantage of record prices and liquidate their entire holdings and move away from the industry. To this would be added a likely surge in supply from individuals that would undoubtedly be shaken out by the price spike.



Cameron Alexander is an Australian based Analyst with GFMS and is responsible for research in South-east Asia, Australasia and the Gulf States in the Middle East. Prior to his joining GFMS in December 2005, Cameron worked for over seven years with precious metals refiner AGR Matthey.



NEW AT GFMS

3-Year Silver Forecast

Published four times a year, this report gives GFMS' independent insight into the latest developments and trends and offers a 3-year forecast on supply, demand and the price for Silver.

Background

This report is the result of rigorous analysis of key market dynamics such as fabrication demand, mine production (feeding off GFMS' unique mine production and costs database), investor trends (including analysis of ETFs, OTC and futures market activity), producer hedging, government sales, stock and trade flows and macro economic factors – incorporating forecasts for GDP growth and exchange rates.

The report offers three different scenarios for silver over the next three years: a Low GDP Growth

scenario, a Base Case and High GDP Growth scenario. These three scenarios in turn are strongly influenced by three different paths for the world economy in 2008-10 that are described in the forecast.

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Support

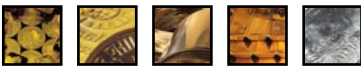
Subscribers will have access to the GFMS team of professional and highly experienced metals analysts and economists to discuss the report and its contents.

Annual Fees

The list price for the Silver Forecast is £5,450, however, we can offer you a discounted price of £4,950 if ordered by 15th January 2008.

The sister *Three Year Gold Forecast* is out now and GFMS' new *Three Year Platinum and Palladium Forecast* will also follow early in 2008. All three precious metals forecasts are available for a special discounted package price of £9,450.

» **Please contact Charles de Meester if you are interested in purchasing these forecasts or if you have any questions at charles.demeester@gfms.co.uk Tel: +44 (0)20 7478 1777**



The Base Metals Strategic Briefing – The Prospects Out to 2013

This new bi-annual service from GFMS Metals Consulting, which will be launched in January 2008, builds on the success of the Base Metals Market Briefing that provides regular analysis on the base metal markets.

The Base Metals Strategic Briefing is the most comprehensive and cost effective source of analysis on the long-term prospects for base metals sector. Although the report covers all the base metals, the service is structured to allow companies to subscribe just to the metals that affect their business. This enables subscribers to enjoy significant savings compared to other research services.

Report coverage

The recent bull market has raised many issues for the base metals sector:

- » Will China continue to drive base metal demand?
- » Will India be the next China in terms of demand growth?
- » Is growth within the emerging economies in addition to, or at the expense of, consumption in the OECD countries?
- » Will substitution become an important issue as the bull market is extended?
- » Is mine production beginning to catch up with refined output in China, and how will this impact TC/RCs?

- » How will the process of industry consolidation affect the supply response of producers?
- » How much new supply is in the pipeline?
- » What are the financial, political and technological risks associated with the next generation of mine and smelter projects?
- » What impact will investment funds have over the course of the price cycle?

Availability

If you wish to receive more details concerning the Base Metals Strategic Briefing, please contact:

info@gfms-metalsconsulting.com



Rhona O'Connell Named "Commodities Analyst of the Year"

Rhona O'Connell, Managing Director of GFMS Analytics Ltd., has been named the winner of the inaugural "Commodities Analyst of the Year" award for the Association of Mining Analysts.

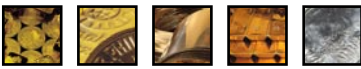
At a ceremony at the Mines and Money Conference in London in late November 2007, Rhona received her award from AMA Chairman Tony Mahalski, who commented that it should perhaps be a lifetime award given Rhona's longevity in the markets. She does however, have no intention whatsoever of retiring quite yet!



Rhona spearheads GFMS Analytics Limited part of the GFMS Group, providing precious metals market analysis and comment. The metals covered are gold, silver, platinum and palladium, looking at the markets themselves in the context of the economic, political and financial environment while considering also the performance of other asset classes and related mining equities. She is a recognised authority in the metals markets, with over 20 years' experience as an analyst in the sector.

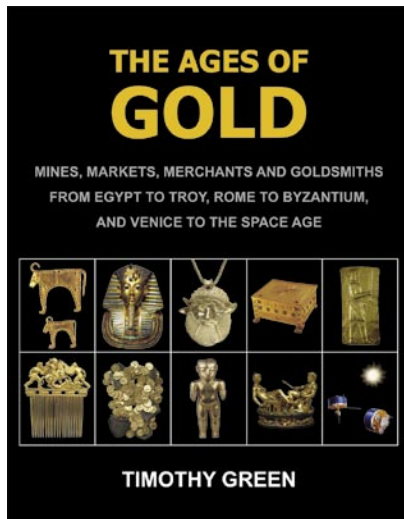
After graduating from Cambridge University with a law degree she gained her first experience in the precious metals markets working for mining company Consolidated Gold Fields Ltd. The company was then the producer of the Gold Surveys that are now under the auspices of GFMS, and Rhona was involved in the compilation of these Surveys along with in-house analysis of silver and the platinum group metals for mine feasibility studies and marketing

plans. She subsequently worked for commodity brokers Rudolf Wolff, was the precious metals analyst for investment bankers Shearson Lehman and spent ten years as a metals markets analyst in the stock broking fraternity (including T. Hoare and Co., latterly Canaccord (Europe)) before managing the gold market research at the World Gold Council. She joined forces with GFMS Ltd in 2004 thereby almost, but not quite, coming full circle.



PUBLICATIONS AND PRODUCTS

GFMS Presents 'The Ages of Gold' by Tim Green



GFMS published Tim Green's latest book *The Ages of Gold* on 14th November. This is the first book on the history of gold published by GFMS.

Tim Green is a well known author in the gold market having written *The World of Gold*, *The Gold Companion* and *The Millennium in Gold*. Tim also worked as a consultant on the annual *Gold Surveys* of Consolidated Gold Fields and Gold Fields Mineral Services (now GFMS) for almost three decades, focusing on the Middle East, India and the Far East.

Synopsis

The Ages of Gold recounts the story of the mines, the markets, the goldsmiths and the merchants who, over the last 6,000 years, made gold a symbol of wealth and power, both in wonderful ornaments and as money in people's pockets. Tim Green has sought out gold's ancient

origins in Mesopotamia, Egypt, Troy, Minoan Crete, Greece, China, Rome, Byzantium, Venice and Pre-Columbian Latin America.

The Ancient World (pre 4000 BC - 1 BC), when the gold trade expanded beyond Mesopotamia (modern day Iraq) and Egypt around the Mediterranean. The Phoenicians established international precious metal trading routes, the Etruscans and Scythians became 'virtuoso' goldsmiths, Croesus launched gold coins while Alexander the Great seized the Persian treasure.

Empires (AD1-1200) reports on the growth of four major empires, China, Rome, Byzantium and Islam, each playing significant, but differing roles in the world of gold.

New Horizons (1200-1700) reveals the trading power of Venice which held the first gold 'fixings' and the unique talents of Pre-Columbian goldsmiths in South America whose ornaments were melted down by Spanish invaders. That gold was squandered furthering Spain's imperial ambitions.

Gold Standard (1700-2000) examines the rise and fall of the gold standard, first in Britain and then worldwide after the Californian, Australian and South African gold rushes. Finally, today's role for gold as jewellery, in electronics and as an investors' safe haven in dangerous days is examined.

Availability and Order Information

The Ages of Gold is available to order through the GFMS online store at <http://shop.gfms.co.uk>

Discounts and company overprints are also available on bulk orders. Please contact GFMS at info@gfms.co.uk for further details.

The Ages of Gold:

Author: Timothy Green
ISBN 978-0-9555411-1-7
480 pages
Price £33 (+ postage)
Published on 14th November 2007



EVENTS

Toronto Launch of *Gold Survey 2007 - Update 2*

» 17th January, Toronto, Canada

The event

GFMS will be hosting the launch of its interim publication *Gold Survey 2007 - Update 2* in Toronto on 17th January 2008 at the Essex Ballroom, Sheraton Centre Toronto Hotel from 7:30am to 9:00am.

Philip Klapwijk, Executive Chairman, GFMS, will give a presentation during breakfast highlighting the main findings of *Update 2*.

About *Gold Survey 2007 - Update 2*

Update 2 to the annual *Gold Survey* provides flash estimates of global gold supply and demand during 2007, with analysis of the most

recent trends in every sector of the market. *Update 2* will also set out GFMS' views on the outlook for the main variables and the price in the first half of 2008 and identify the most important economic, socio-political and market-specific issues facing the industry in the short term.

Specifications

» 40 pages - Price: £215 / US\$395 / €325 (hard copy)

» Also available in pdf format (contact us at info@gfms.co.uk for prices)

GOLD SURVEY 2007 - UPDATE 2



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GFMS DIARY



Gold Survey - Update 2

17th January 2008

Gold Survey 2008

9th April 2008

Platinum and Palladium Survey 2008

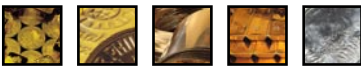
24th April 2008

World Silver Survey 2008

7th May 2008

GFMS Precious & Base Metals Seminar

17th September 2008



Rising Jewellery Demand the Backdrop to Launch of Chinese Edition of *Platinum and Palladium Survey 2007*

» by Philip Klapwijk, Executive Chairman, GFMS

On 23rd October GFMS launched the 4th Chinese language edition of its *Platinum and Palladium Survey* at an event in Shenzhen - the country's centre of jewellery manufacturing for the two PGMs. There was a good opportunity too in the days before and after the launch event for Philip Klapwijk and Veronica Han to visit with the trade in order to learn first hand how Chinese jewellery demand for the two metals is shaping up in 2007.

It was interesting to hear from several manufacturers that their platinum offtake over the first nine months had not only held-up well but also in several cases registered reasonable year-on-year growth. Such views were in line with what we had heard from retailers and were also backed by the official trade data showing good growth in mainland China's official bullion imports (though part of this is explained by growth in other areas of demand and, especially, a further shift away from unofficial to official imports). Key factors said to be supporting platinum jewellery consumption were the strength of the yuan (taking the edge off high US dollar prices), rapid growth in urban incomes (particularly for the already 'better off') and substantial stockmarket gains (the positive 'wealth effect' of which received much comment). However, expectations for platinum jewellery

demand in the fourth quarter were not so positive. Already in October higher prices and increased price volatility were manifestly impacting on consumption and manufacturers' offtake. It was felt that were such negative conditions to persist - and they have indeed done so - demand could weaken in the fourth quarter leaving the full year only marginally up on 2006's levels.

Fabricators' views on palladium demand in 2007 were more variable. Some manufacturers we spoke to had experienced very strong gains from the admittedly weak levels recorded in the first nine months of 2006. Others, however, painted a different picture and, in a couple of cases, had even ceased manufacturing palladium jewellery altogether. Market share changes were clearly an important part of the explanation for this lack of consensus. Taking these shifts into account and assessing the overall situation we would nevertheless conclude that over January-September there had been a significant rebound from 2006's major dip in palladium jewellery output, with this recovery largely continuing in the fourth quarter of this year. Our conclusion is strongly backed by an analysis of the Hong Kong trade data. (Most bullion fabricated into jewellery is sourced from the Special Administrative Region.) Although at first sight net

bullion imports would seem to have fallen sharply, the headline figures are misleading. This is because in 2006 there was an important build-up in loco-Hong Kong bullion stocks. Allowing for this, it is clear that the flow of bullion from Hong Kong to the mainland has actually risen strongly in 2007, supporting the information we have received from contacts in the field that points to a robust recovery in demand.

» **To order a copy of the *Chinese Edition of Platinum and Palladium Survey 2007*, please contact veronica.han@gfms.co.uk**



Philip Klapwijk is the Executive Chairman of GFMS. In his capacity as an analyst, he continues to cover the official sector, investment and fabrication demand in

North America, Latin America and much of Europe. Philip holds degrees in economics from the London School of Economics and a Master's degree from the College of Europe in Bruges. Philip was appointed Group Economist at CGF in 1987, where he was responsible for developing the group's economic scenarios as well as participating in the work for the annual Gold Survey. He has worked for GFMS as part of the gold research team since 1989.



MARKET COMMENTARY

News on Italian Gold Jewellery Less Gloomy

» by Neil Meader, Research Director, GFMS

At the time that the research was being carried out for September's *Update 1 to Gold Survey 2007*, it appeared that Italian gold jewellery fabrication was heading for a decline of at least 6% in 2007. However, following a recent field trip to the main producing centres, this now seems somewhat overdone and that a slip of just a couple of a percent, or even stability, seems the more likely.

The key driver of this change is that, during recent months when prices were rising fast, buying did not evaporate, with some wholesalers even noting a rush to place orders when gold moved over \$800 by clients fearful of the price soaring ahead to \$900. This sustained level of acquisition was in turn largely a function of the low level of stocks in the jewellery pipeline.

This meant that, in the run up to the all important Christmas (and Thanksgiving) season, distributors were obliged to buy, despite the price, if they wanted a respectable range to offer the public.

A word of warning needs to be made as regards the official statistics. The latest available (to end-August) show a year-on-year rise of around a fifth for the year-to-date total for both gold bullion imports and gold jewellery exports (in gross weight terms). However, various factors, such as a change in bullion routings and July/August 2006 being so weak, mean the official numbers at the moment considerably overstate the health of the jewellery sector.



Neil Meader holds the position of Research Director and is responsible for most of Europe, having previously covered the

Arabian Gulf countries. Prior to GFMS, Neil worked as an analyst in the energy industry and in soft commodity trading. He holds a degree in economic history from Exeter University.



The Fed Helps with Liquidity

» by Rhona O'Connell, Managing Director, GFMS Analytics

In a speech in late November, Dr. Bernanke said that the recent economic indicators released in the United States had been "mixed". The most recent figures from the US have been erring on the bearish side. The cut in the federal funds rate from the Federal Open Market Committee on 11th December had been widely expected, although the immediate market response was disappointment that the cut had not been 50 points. The statement accompanying the cut was more hawkish than of late, with the Committee noting "deterioration in financial conditions" and "strain in financial markets". The Committee cut the discount rate by just 25 basis points, which also disappointed the markets. The discount rate, which is the rate charged to banks when they borrow directly from the government, has been at a 50 basis point premium to the fed funds rate since August 2007, having previously been at a premium of 1% and some market participants had been hoping that the rate would be cut by 50 basis points in order to halve the differential. This did not happen, reports are circulating that the Fed is planning to take action in order to increase inter-bank lending activity. A further cut in the discount rate is one of the options, along with easier collateral rules for Fed loans and extended loans to money market dealers.

Meanwhile the tensions in the financial sector that have been generated by the problems in the sub prime market are of course well documented and the US Treasury has announced a plan that will extend the fixed-rate period in part of the sub prime sector. A considerable number of mortgages have been taken down in the past five years that commence with low "teaser" interest rates, and which are subsequently repriced a few years into repayment. Filings for foreclosure in October rose by 94% against October 2006, at 224,451 and sub prime mortgages that are due to reset next year on the expiry of their teaser rates amount to approximately \$362 billion. The Treasury plan intends to "fast-track" those sub prime borrowers with adjustable rate loans who can afford refinancing, while offering a freeze on rates for borrowers that cannot afford a rate rise.

The bond market continues to find investors' favour as a "safe haven" asset, with yields on the ten-year bond dipping towards 3.8% and that on the 30-year bond standing at 4.3%, compared with rates of 4.5% and 4.6% a year ago. The yield curve is steepening because of the Fed's activity with respect to the fed funds market, rather than longer-term economic considerations. Gold is holding above \$800/ounce as a partial result

of safe haven investment activity. In the immediate aftermath of the rate cut gold slipped as the dollar rallied, but this was short lived and, with physical interest starting to re-emerge in the market there are sound prospects for further price increases in the first quarter of next year.

» **This article is an extract from the October issue of GFMS Analytics' *Precious Metals Market Briefing*. To subscribe to this publication or to receive a free trial copy, please contact GFMS Analytics, info@gfmsanalytics.com**



Rhona O'Connell

is a recognised authority in the metals markets, with over 20 years' experience as an analyst in the metals

sector. Rhona is the managing director of GFMS Analytics and ROC Consultancy, an independent consultancy specialising in metals markets analysis and comment. The specialist areas constitute gold, silver, platinum and palladium, looking at the markets themselves in the context of the economic, political and financial environments while considering also the performance of other asset classes and related mining equities.



Silver's Annual Average Expected to Rise Some 16% in 2007

» by Sierra Highcloud Metals Analyst, GFMS

On 7th November 2007 at the annual New York dinner organised by the Silver Institute Philip Klapwijk presented GFMS' interim views on the silver market. The principal findings regarding supply, demand and the price are summarised below.

GFMS expects fabrication demand to rise by around 2% this year, with silver's substantial price increase since early 2000 having relatively little impact on this component of demand. Mine production is forecast to rise marginally in 2007, while scrap should record a small loss, despite silver's price run up. Investment demand, as in 2006, has again been the chief cause of the strength of the price, the white metal rising to peaks of well above \$15.50 in November.

The key points on market developments highlighted by GFMS in New York were:

Supply

Mine production is forecast to increase by just over 3% this year. The outlook for 2008 is for output to rise far more strongly, possibly by greater than 6% year-on-year.

Scrap supply is expected to decline this year. This is mainly due to a reduction in the quantity of silver recovered from photographic waste as this area of demand continues to fall.

Government sales are forecast to fall sharply, possibly by as much as 50% year-on-year. This is the

result of markedly lower sales from China and the absence of Indian government disposals this year.

Demand

Fabrication demand appears to be on track for an increase of around 2% in 2007, in spite of the surge in silver prices. Next year, however, demand is expected to suffer from a combination of still higher prices (and high price volatility) and a marked slowdown in global GDP and industrial production growth.

Industrial demand is currently forecast to expand by over 6% in 2007. Its core component of electrical and electronics end-uses has performed particularly strongly. Nevertheless, an expected setback in industrial demand next year may be compounded by weaker construction output and a potential cyclical downturn in the electronics industry.

Jewellery & Silverware fabrication is expected to gain around 2% in 2007. Demand in most countries has been little affected by the silver price rise (indeed silver has even benefited somewhat from higher gold prices). The key exception is the pivotal Indian market, where demand has also been negatively impacted by a secular shift in investment favouring silver bullion over high-carat jewellery.

Photographic use of silver in 2007 is declining again. This year a drop of 10% looks to be on the cards. A continued switch in most areas to digital technology, coupled with an

economisation in silver use in some photographic products has driven this year's decline in demand.

Investment

In 2007 investment has again featured solidly on the demand side of the equation and has been the essential driver of the rise in the silver price to an expected annual average of around \$13.40 this year, which would represent a gain of 16% on 2006's average.

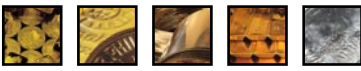
Most investors are forecast to remain firmly on the buy-side in 2008. Rising investment next year should be more than enough to offset the headwinds from higher mine production and an expected fall in fabrication demand. As a result, the average silver price is forecast to advance further in 2008 and to trade within an approximately \$13-\$17 range.



Sierra Highcloud holds a first degree in International Business from the Cracow University of Economics, and an MSc in International Finance from the University of

Westminster.

Sierra works within precious metals forecasting and also assists Peter Ryan in platinum/palladium demand. Prior to GFMS, Sierra worked in the investment management department of a corporate law firm in New York. He joined GFMS in August 2007.



Where Are We in the Supercycle?

» *By Neil Buxton, GFMS Metals Consulting*

The base metals cycle is looking slightly less "super" than earlier this year. For example, both nickel and zinc prices are more than 50% below their bull market peaks. Such volatility seems inevitable given the exceptionally inflated base. Trends in these markets reinforce how prices can fall dramatically on only a modest deterioration in the fundamentals; this has particularly been the case for the zinc market.

Forecasts revised and extended

In current issue of the Base Metals Market Briefing, we have revised our supply-demand balance and price forecasts. We have extended our quarterly supply-demand balance out to 2008. In terms of our average annual forecasts, we are predicting lower annual average prices in 2008 compared to this year for aluminium, copper, nickel and zinc and higher prices for cobalt, lead and tin.

As we have repeatedly noted in our analysis, a constant stream of bullish news is required to sustain the elevated price levels, when they are so far in excess of the marginal cost of production. Since the metals industry gathered in London for LME Week in early October, this news stream has not only dried up but has also turned negative. GFMS Metals Consulting's base metal index now stands at around 305 compared to the October high of close to 400.

Long-term the fundamentals are positive

Although many aspects of the supercycle remain relevant – delays in the commissioning of new capacity, increasing costs associated with bringing new projects on line, high utilization rates at mines and smelters, an increased number of labour disputes, the rise in resource nationalism, strong metals-intensive economic growth in China and India, a declining dollar and on-going interest from the investment community with a long side bias – in the short-term these factors are likely to continue to take a back seat.

Weak demand will be carried over to 2008

The base metals industry is increasingly reliant on strong demand from China to support the market. This will continue to be the case for the rest of the year (and into 2008) as demand weakens in most of the other markets. The latest key economic indicators – almost without exception – are pointing down. In addition, the anecdotal evidence that we receive also points to a weak demand environment, and importantly it is no longer restricted to the US construction sector. For example, the rebound in demand in the Euro-zone, after the summer slowdown, has yet to materialise. Offtake is also weak in Japan. Trends in physical premiums tend

to reinforce the lacklustre demand outlook. The decline in copper premiums has been the most extreme. In the US, they have more than halved from the early summer peaks to below \$100/tonne. This reflects both the resolution of earlier supply disruptions such as at CCR, as well as the weak demand conditions. Premiums in both Europe and Asia are also under pressure, but the decline is from a lower base. In other metals, we are also generally seeing lower premiums.

The Base Metals Market Briefing comprises an in-depth monthly report plus regular Updates during the course of the month which are distributed by e-mail.

Availability

» **In order to receive our latest report, which provides detailed supply-demand and price forecasts out to 2009 please contact:**
info@gfms-metalsconsulting.com



Imports Are Undermining EU Producers' Attempts to Lift Steel Prices

» *By Neil Buxton, Managing Director, GFMS Metals Consulting*

It had been our expectation that high freight rates would protect the EU market in Q4, allowing inventory to be run down, and to see an improvement in pricing in Q1 on the back of high demand. A couple of factors have undermined this and altered our view for 2008 slightly.

The inexorable rise of the euro in the last couple of months has pushed down euro-dominated prices even as dollar prices held elsewhere. This has resulted in a rash of import offers into the EU market in Q4 and forced local suppliers to respond with lower prices.

Of greater importance has been a weakening in the economic outlook for Europe in November and in early December. Forward-looking indicators have generally weakened and certain important markets such as Spanish construction and German engineering have therefore curtailed buying. Therefore domestic producers have been forced to abandon plans for a HR coil price hike in Q1 next year. For now, they are hoping to pass on increases in raw material costs in Q2, but it seems likely that any increase will just bring back prices to the €500/tonne level. Thus margins may come under pressure over 2008 and volumes could be lower-than-expected as imports continue to maintain their higher market share.

The short-term outlook is deteriorating with order books coming under pressure and some discounted deals available. Continental mills are now offering HR spot sales at around €480/tonne ex-mill, but are still finding few takers. CR coil has dropped to around €570/tonne with some sales at discounted rates. In dollar terms however, they are unchanged thanks to the rising value of the euro, thus seeing imports continue.

Inventories are rising

Distributors in general are lowering their inventory and working through stocks prior to the year-end and are themselves seeing orders fall away. The European Association of Steel Service Centres (EASSC) has stopped releasing its inventory data, so there is little hard evidence, but discussions with some distributors indicate that they consider themselves over-stocked given the current end-use demand, with HDG particularly weak.

Arcelor-Mittal skips planned increase

This inventory situation and weakening economic outlook forced price leader Arcelor-Mittal to forego its internally-planned Q1 hike and instead indicate that it planned to push prices up in Q2, once the prices of higher raw material prices of iron ore and coal are confirmed. It also

reflects the slowdown in demand over the last month or so and the unexpected variety of offers of steel coming into the EU over the final quarter of this year.

The strength of the euro continues to concern as it rises to new peaks against the dollar. US mills in particular remain competitive thanks to this weakness. Even with high freight rates, an fob price of \$600/tonne gives a delivered price of around \$660/tonne cif (€450/tonne) – well below current continental prices, while CR coil could be landed at around €540/tonne cif, although there is less availability of this product. Even plate is now being offered from North America despite continued high prices there at price levels in the region of around €650/tonne cif. Part of the reason for this is that Chinese plate offers are drying up as the EU Commission expects to consider AD duties against Chinese material. In addition, Chinese prices are rising to above €700/tonne delivered.

Availability

» **To receive regular analysis on all the main regional markets for flat-rolled steel and associated raw materials, which is contained in the Steel Market Forecast Briefing, please contact: info@gfms-metalsconsulting.com**

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