



Central Banks Are Net Buyers for the First Time Since 1988

by Philip Klapwijk, Executive Chairman

A central bank 'supply shock' was one of the key features of the market in the 1990s. This had obvious consequences for gold prices not only because of the additional volume of bullion that had to be digested but also because of the impact that these sales had on investor sentiment. Currently many are wondering if over the next decade we may not see in contrast a 'demand shock' from the official sector that would likely extend the gold bull market. Certainly, basis

GFMS' estimates, 2010 looks as if it will be the first year since 1988 that there will be net official sector purchases. Moreover, we expect net purchases to grow next year as IMF sales will be either zero or negligible, while we foresee ongoing, if moderate buy side interest.

Central banks and other official institutions in a number of developing countries with large foreign exchange reserves and/or with significant balance of payments

surpluses are more inclined these days to convert a small part of these into gold bullion. Gold's price performance, safe haven characteristics and usefulness as a means of portfolio diversification are recommending it to at least some countries where gold holdings as a percentage of overall foreign reserves are also very low. In addition, confidence in the major reserve currencies, the dollar, euro

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Hedges House
153-155 Regent Street
London, W1B 4JE, UK
tel: +44 (0)20 7478 1777
fax: +44 (0)20 7478 1779
email: info@gfms.co.uk
web: www.gfms.co.uk



and yen is sagging, especially in the light of such factors as ultra-low short term interest rates, exceptionally high bond prices, soaring government debt levels, Quantitative Easing and more than a whiff of competitive devaluation.

Nevertheless, due to a number of factors, including the smallish size of the gold market and political considerations, we are not convinced that the pendulum will swing all the way from heavy net selling to the large scale purchasing on a regular basis of gold in the open market by central banks and sovereign wealth funds. We would expect, instead, further discreet and modestly sized operations in the international market coupled with the purchase of local supply

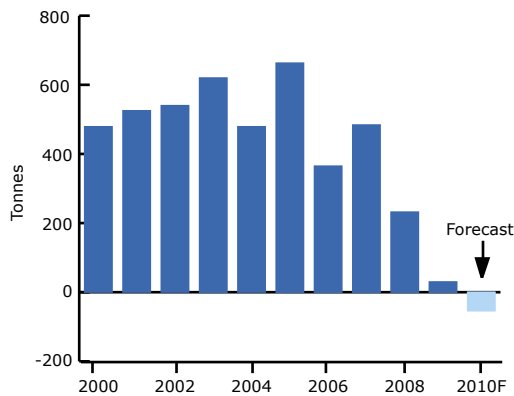
by certain countries where there is domestic mine production available. In time, this could be supplemented by off-market deals for potentially larger quantities if either the IMF or certain Central Bank Gold Agreement (CBGA) members were to make additional disposals. As regards the latter, the news that gold sales from CBGA signatories came to less than seven tonnes in the recently ended Agreement year confirms the lack of appetite to sell within the group. Although we think that eventually market conditions will change sufficiently to encourage strategic sales by some 'overweight' (in gold) members of the CBGA, it is probable that sales will remain modest while gold prices continue to advance and the sovereign debt crisis rumbles on in Europe.



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.

Net Official Sector Sales, 2000 - 10F



Source: GFMS





The Rise and Fall of the Gold Producer Hedge Book

by William Tankard, Senior Metals Analyst, & Oliver Heathman, Metals Analyst

With the recent fall of the last 'great' gold producer's hedge book, that of AngloGold Ashanti, now seems an appropriate time to briefly review the rise and fall of the practice of gold producer hedging. GFMS calculates that at end-June 2010 the global gold producer hedge book amounted to just 224 tonnes and by the end of 2010 may well fall to 110-120 tonnes, less than 4% of the hedge book volume when at its peak in 1999.

The emergence of gold producer hedging against substantial volumes of gold commenced in the 1980s. Forward sales were the initial mechanism, but they were soon joined, and effectively superseded, by the gold loan, generally put in place against projects as a means of establishing finance for mine development. The other theme of the late 1980s was the limited use of opportunistic forward selling in order to secure prices perceived as high relative to the cost of production. At the other end of the scale, some companies sold forward in order to secure cash flow in times of distress; at least one high cost South African miner managed to stay in business in the early 1980s as a result of such activity. Towards the end of the decade hedging intensity waned as the gold price pulled back and the pipeline of projects that required financing contracted, leaving the total hedge book standing at around 900 tonnes.

In the early 1990s the gold price trended gradually lower, but with volatility remaining low the book registered only steady growth. The

only exceptions came as a handful of larger projects vied for financing. However, from 1996 a renewed slide in the price reinforced the utility of hedging once again.

Firstly, entering into hedge positions became an increasingly necessary means of facilitating debt financing. This was further exacerbated by greater investor caution towards resources stocks in the wake of the Bre-X scandal.

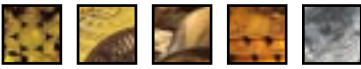
Secondly, the revenue enhancement that could be achieved versus the spot market was plain to see. Those that had the foresight, or luck, to embrace a major hedging strategy early on, such as Newcrest and Normandy (subsequently acquired by Newmont) were the stand-out winners, with Barrick Gold not far behind. By 1997 their earlier hedges were enabling these companies to beat the London average price for gold by \$100/oz or more, a premium of 30-40% compared with unhedged producers. As margins were progressively squeezed, the stark contrast between the 'haves and have-nots' served to further encourage more producers to hedge as companies vied for survival as an increasing number of producers' margins turned negative.

These factors were appreciated by company management, shareholders as well as the banks that structured and aggressively marketed lucrative products, triggering a hedging explosion. GFMS estimates that by mid-1999 the global hedge book had reached a peak of almost 3,300 tonnes.

The first Central Bank Gold Agreement was signed on 26th September 1999 in an effort to calm market fears about sporadic large-scale official sector sales. Possibly of more significance at the time, this froze the amount of gold out on loan. The consequential hedging crisis led to margin calls being made against several producers' positions and, in some cases, caused insolvency in late 1999. It certainly caught out one of the largest hedgers, Ashanti Goldfields, which was forced to hastily restructure its positions, leading to the sale of 50% of its major Geita asset to AngloGold and led ultimately the loss of the corporate identity in 2003 when it was acquired by AngloGold, forming AngloGold Ashanti.

In the wake of these dramatic events the next year, 2000 represented a period of apparent calm, or more appropriately, uncertainty, before the situation changed dramatically. After the gold price bottomed out, and subsequently enjoyed an almost continuous rally, producers have aggressively de-hedged in order to gain greater exposure to the rising price. Production cost inflation has broadly followed the gold price rise, leading hedged producers to suffer increasingly diminishing profits at the hands of price capped revenues. These factors, and occasionally the lack of transparency of hedging structures, have led to the now staunchly anti-hedging sentiment among gold equity investors and gold mining companies alike.

(Continued on next page)



As a result, over 3,000 tonnes of hedged gold have been eliminated since the peak, as producers not only delivered into hedges as they matured, but in several significant instances proactively bought back ahead of schedule. Meanwhile other significant hedges were restructured in the process of industry consolidation, or unwound by the administrators of failed enterprises.

Although a small handful of producers have recently engaged in project hedging and one diversified miner entered into a multi-year put/call option structure to secure the viability of its gold assets out to 2015, hedging remains firmly out of vogue with most key producers and their shareholders; the latest move by AngloGold Ashanti is a good example of this. It does lead one

to beg the question of whether we now find ourselves at the end of the hedging era, or whether this marks the bottom of a first cycle? Since the price will not always increase and a decent contango will likely return from the current low levels, it would be prudent not to completely disregard the prospect of a return to the practice of gold producer hedging at some future point.

NEW AT GFMS

GFMS' PGM Mine Economics Service - Now Live

by Mark Fellows, Managing Director

GFMS' web-based PGM Mine Economics service is now available to subscribers.

Based on a rigorous analytical approach it provides miners, financial institutions and other industry investors with detailed forward-looking insight into the underlying drivers of PGM mine profitability and value.

The web-based service comprises detailed mine-by-mine analysis of PGM mine production, operating costs and cash flows to 2030, with production costs broken down to \$/tonne mining, ore processing and on-site administration costs, smelting and refining costs, plus benchmarking of labour, fuel, power and other key inputs.

The service currently covers around thirty primary and by-product mines and projects, accounting for over 90% of global PGM mine production. Coverage will continue to grow in coming weeks, and is expected to

reach around 50 mines and projects by end-October.

The mine-by-mine analysis is based on published reports, dialogue with mining companies, plus insight gained from an extensive programme of mine visits; our analysts have visited ten PGM mines in the past nine months, with more visits scheduled in the coming weeks. The service aims to present "live" analysis, updated on a rolling basis as new information becomes available.

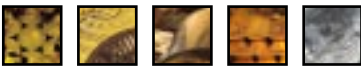
The service is a unique one in many regards, not least the stringency and consistency of the \$/oz cost analysis. In addition to the traditional 4E and 6E cost measures used in the industry, GFMS applies platinum and palladium equivalent (co-product costing) methodologies, to produce cost and margin curves which provide a truly consistent global comparative analysis.

(Continued on next page)



**Mark Fellows,
BSc (Hons)
MIMMM**

Mark began his twenty-two year career in the mining industry as an exploration geologist with De Beers. He went on to work for several junior explorers, prospecting for diamonds, gold, base metals and industrial minerals in Africa. In 1992 he joined Brook Hunt, a globally-renowned mineral economics consultancy, leaving in 2005 to establish an independent consulting practice.



We believe that this is essential, particularly in comparing mines and projects with very different PGM baskets and operating cost structures.

The service includes:

- Highly detailed technical descriptions and analyst comment for each mine, covering the geology, mining methods, equipment, ore processing and mine history and latest developments.

- GFMS analysts' commentary on the key issues and risk factors impacting each mine and company.
- Links to Google Maps.
- Company analysis – aggregating the mine-by-mine resource, production, cost and cash flow data into forward-looking corporate totals and averages.
- A flexing model which allows users to assess the future cost impact of their own assumptions regarding exchange rates and input cost inflation, including electricity and fuel cost changes, is under development.

The graphics below are screenshots from the website, showing a typical mine summary page, and a underground mine cost curve, with selected mines highlighted.

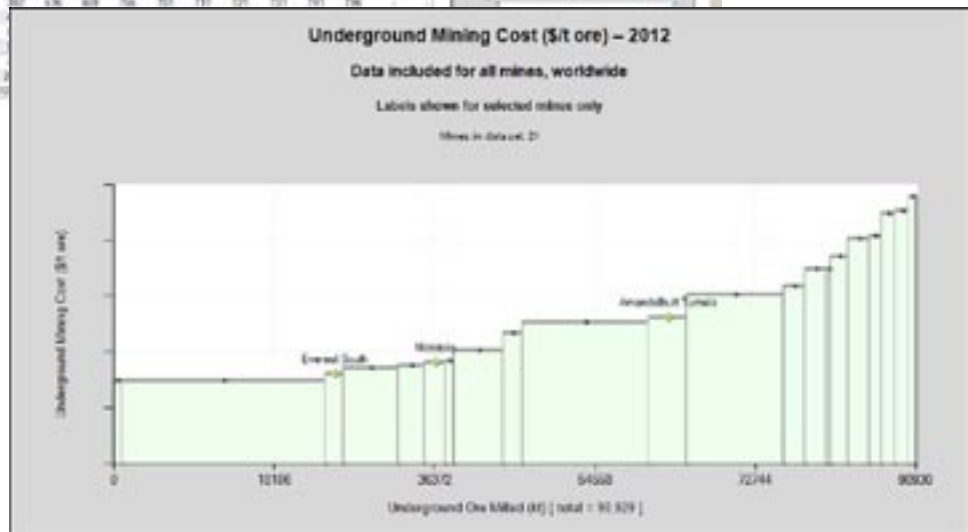
GFMS PGM MINE ECONOMICS SERVICE

Location: **Map | Coordinates:** South Africa [24 20'00" S 30 10'00" E](#)

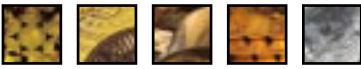
Ownership: **Assets:** Anglo Platinum 19.0%, Sibanye 37.0%, De Beers Group Investments 11.0%

Key Parameters Summary (Updated: 01 Aug 2010)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Reserves (M Contained)	Moz	2.9	2.8	2.8								
Resources (M Contained)	Moz	2.2	4.6	4.6								
Total Ore Reserves	Mt	1,802	1,802	2,248	2,419	2,409	2,400	2,408	2,408	2,408		
Head Grade - MPOE	g/t	4.33	4.86	4.12	4.38	4.33	4.33	4.33	4.33	4.33		
Plant/Service Pt Equip Production	koz	104.1	103.0	102.4	102.7	176.4	176.4	176.4	176.4	176.4		
Plant/Service Pt Production	koz	90.2	87.2	108.8	116.8	122.7	122.7	122.7	122.7	122.7		
Mine life Cash Cost (\$/oz)	\$/oz	40.90	48.96	48.36	53.36	51.62	52.23	53.07	53.71	54.47	56.11	
Total Cash Cost (\$/Eq)	\$/oz Pt Eq	300	636	608	764	757	733	733	733	733	733	
Total Production Cost (\$/Eq)	\$/oz Pt Eq											
All-in Cost (\$/Eq)	\$/oz Pt Eq											
Ongoing Capex	\$M											
Property/Exploration Capex	\$M											
Cash Flow (Pre-Tax)	\$M											



The PGM Mine Economics service is available now. For more information, please contact charles.demeester@gfms.co.uk or mark.fellows@gfms.co.uk.



NEWS FROM THE FIELD

South Korea: When Will Demand Return to Pre-Crisis Levels?

by Cameron Alexander, Senior Metals Analyst & Ayako Furuno, Metals Analyst.

From the gloom of last year's recession, a recent GFMS research trip to South Korea indicated that the outlook for silver and gold industrial demand in the East Asian country has brightened considerably. An improvement from 2009's dire outcome, however, is hardly surprising, and leads us quickly to the following question: when will demand return to pre-crisis levels?

For silver use in industrial fabrication, which is concentrated in electrical and electronics demand, a healthy rebound has been recorded in the year-to-date. Imports of silver powder, for example, used mainly for making silver pastes, have shown a gain of over 10% year-on-year (based on data for January to August). The re-stocking of much depleted pipelines also contributed to this result. Anecdotal evidence indicated that there has been a significant upturn in demand for televisions in particular, due to the revival of consumer confidence in the global economy, combined with the release of some pent-up demand.

That said, the rate of recovery so far has failed to achieve pre-crisis levels (seen in the first two quarters of 2008), and is unlikely to accelerate with the necessary pace to do so over the remainder of the year. Indeed, the consensus view amongst the key industry players that we met did not foresee a recovery to such levels until perhaps the latter stages of 2011, although this is of course heavily contingent on the strength of the global economy next year.

The gold bonding wire market may, however, prove to be different, as demand may have already reached, and in some cases surpassed, pre-crisis levels. This is largely due to the fact that demand from China, for which a large proportion of South Korean bonding wires is ultimately destined (often via Taiwan), has steadily risen. In addition, domestic demand has also proved lively.

Gold remains the most widely used metal used in bonding wire, owing to its technical qualities, and this has shown solid growth so far this year. In recent years, copper bonding wire has been gaining market presence, as it offers a far cheaper alternative to gold. The overall expansion of the electronics market has meant, however, that growth in copper bonding wire has yet to undermine growth for gold bonding wire. Moreover, current technical limitations mean that copper is unlikely to be able to usurp gold completely, particularly in high-end applications.

This year, however, we heard that palladium-coated copper wire has started to make inroads into the bonding wire market, as it achieves a middle ground between performance and cost. The threat to gold may, therefore, eventually come from this type of wire, rather than plain copper wire. The use of aluminium bonding wire presents another potential competitor to gold.

With regard to the jewellery market, the answer to the above question

depends on the metal. In 2009, silver demand remained flat from 2008, rather than falling, as it benefited from consumers shifting from gold to the cheaper white metal. This trend has continued so far this year, and a material year-on-year increase in fine ounces is expected. Once more, however, this comes at the expense of gold jewellery. Demand for the yellow metal, in contrast, is expected to struggle to return to pre-crisis levels in 2011, hampered by high gold prices and changing consumer purchasing attitudes.



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.



PUBLICATIONS AND PRODUCTS

Ten Year Outlook for Gold Service

Ten Year Outlook for Gold Service: The second edition of this bi-annual long term forecast report will be released in December 2010.

The Ten Year Outlook for Gold service complements our successful current series of forecasting monthlies and quarterlies on the precious metals markets, which have proved to be extremely popular within the precious metals market place.

The service offers a Base Case and two alternative scenarios for gold supply, demand and the price over the next 10 years, with each given

a weighted percentage probability and with a particular emphasis in the report on risks to the forecast, including those stemming from potential supply or demand 'shocks'.

Specifications

- Available in both hardcopy and electronic format. The service also includes a presentation or conference call with the authors of the report to discuss its findings.
- Annual Fees: £14,950 / US\$21,950 / 17,950 Euros.

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- Section 6:** Official Sector
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- Section 8:** Jewellery Consumption
- Section 9:** Other Fabrication

For more information or to purchase, please contact charles.demeester@gfms.co.uk.

PGM Mine Economics

This service provides miners, financial institutions, governments and other industry investors with detailed forward-looking insight into the underlying drivers of PGM mine economics. High quality independent support to investment/lending decisions, risk/reward analysis, peer group comparisons and asset benchmarking.

The GFMS PGM Mine Economics service identifies:

- Which mines are profitable under different market outcomes.

- The impact of different price outcomes and input cost scenarios on the future production profile.
- Breakeven commodity prices needed for projects to generate acceptable financial returns.
- Which mines and projects present the best growth and profit opportunities.

Analysis is based on highly detailed, rigorous mine-by-mine analysis of production costs, broken down to \$/tonne mining, ore processing and on-site administration costs,

smelting and refining costs, plus benchmarking of fuel, power, labour productivity and other key inputs. The study includes forecasts of PGM mine production, operating costs and cash flows to 2030.

The PGM Mine Economics service is available now. For more information or for a quotation, please contact charles.demeester@gfms.co.uk



EVENTS

GFMS Launches 7th Chinese Language Edition of the Annual Platinum & Palladium Survey

On 17th September GFMS, in association with China Gold News and the Beijing Gold Economic Development Center, launched the 7th Chinese language edition of its *Platinum & Palladium Survey* at an event in Shenzhen - the country's centre of jewellery manufacturing for the two PGMs.

Philip Klapwijk gave a presentation at the launch which focused on GFMS' latest views on platinum and palladium supply/demand developments and the likely future trajectory of PGM prices. This was complemented by presentations from senior figures in the Chinese precious metals markets.

The 2010 Chinese language version of the *Platinum & Palladium Survey* is kindly sponsored by Tanaka Kikinzoku Group and Lonmin Plc. GFMS would also like to thank the China Gold Association and the Shenzhen Jewellery Association for supporting this year's Chinese language version.

GFMS Launches Hindi & English Dual Language Editions of Their 2010 Gold, Silver and Platinum & Palladium Surveys

GFMS launched the dual language (Hindi and English) editions of the *Gold Survey*, *World Silver Survey* and *Platinum & Palladium Survey* 2010 at the 7th India International Gold Convention in Goa, India, on 27th August 2010. The event was attended by over 200 members of India's precious metals fraternity. At the launch, Paul Walker, CEO of GFMS, made several presentations on the global trends unfolding in each of these precious metals.

GFMS would like to thank the sponsors of the dual language editions of the surveys for their generous support.

Gold Survey 2010

Natixis Commodity Markets Limited
NYSE Liffe
Tanaka Kikinzoku Group

World Silver Survey 2010

Johnson Matthey
Natixis Commodity Markets Limited

Platinum & Palladium Survey 2010

A-1 Specialized Services & Supplies, Inc.
Lonmin Plc.
Tanaka Kikinzoku Group



Minex 2010 – Russia's Leading Mining Event of the Year

GFMS are participating in Minex 2010, the largest and most authoritative forum on mining in Russia and the CIS.

The 6th Russian and CIS MINEX Forum and Expo "Mining in Russia and CIS: efficiency, innovation, growth" is being held between 29th September and 1st October 2010 at the Radisson SAS Slavjanskaya Hotel in Moscow, Russia

MINEX (Mining & Exploration) is recognised as the largest and most authoritative international forum on prospecting, exploration and mining in Russia and CIS.

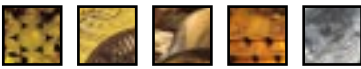
Established in 2005 by a group of leading Russian and international mining experts and engineers, MINEX leads the way by offering a diversified and unbiased platform for discussions, business networking, identifying new business and investment opportunities in Russia and CIS member states.

In the forthcoming years after the global financial crisis Russian and CIS mining businesses will be focusing on improving their efficiency, implementing innovative technologies to secure their sustainability and growth. The forum agenda offers extensive practical discussions and present

cutting edge solutions designed to address these issues in depth. The forum also offers numerous presentation, promotion, networking and learning opportunities for mining professionals, consultants, investors and service providers.

Over 500 CIS and international mining engineers, investors, consultants and mining professionals from gold, coal, iron ore, uranium and base metals companies are expected to attend the forum this year.

Full forum agenda is available on: www.minexrussia.com



MARKET COMMENTARY

The Zimbabwean Gold Mining Industry: a New Report from World Gold Analyst

by Paul Burton, Managing Director

Zimbabwe has a long history of gold production stretching back centuries. Figures from GFMS, showed that in 1999, the Zimbabwean gold mining industry produced 29.7 t of gold, a record for the country. However, since that time the economic woes of the country have decimated gold production and forced many mines to close in late 2008 and early 2009.

Since dollarisation of the economy in March 2009, which meant that the gold miners could be paid in US\$, producers have started to ramp up operations again, but they face many challenges to restore the industry to its former glory.

Full production has proved elusive because of serious problems with the supply of power from the state grid. The industry is probably working at only 40% of installed capacity.

Zimbabwe's gold mining industry is characterised by rich greenstone belts that support many small gold mines, many of which are underground, narrow vein mining operations which are often privately owned.

Future Prospects

In the short term, to reach its current potential, the industry needs modest investment in plant. In the longer term, it needs a radical rethink on its mining strategy and a substantial injection of capital to expand. The need for international funding is critical, therefore, in whatever timeframe and the availability of such funding will depend on investors' perception of the financial and political risk in the country. Thus the recovery of the economy, removal of uncertainty over the question of indigenisation and progress towards

a new constitution and democratic elections, are key factors that are being watched closely.

With modest investment the industry might possibly produce at its reported capacity of 20 t/y of gold from existing resources.

But with greater investment, private companies such as GAT Investments, Duration Gold and Metallon Gold Zimbabwe project that their output could soar. Toronto-listed New Dawn Mining also has growth plans and recently took a big step towards increasing its production by acquiring a majority and controlling interest in Central African Gold, a company with a number of mines currently on care-and-maintenance.



Details of the Report Contents

The aim of this study is to present the investment community with a comprehensive review of all the production and development activity being undertaken on a company-by-company basis and an analysis of the strengths and weaknesses of the industry.

Individual chapters include:-

- A brief introduction to the country of Zimbabwe through

statistics with a commentary on political developments leading up to and beyond the formation of the government of national unity in 2009, with analysis of where we stand today. This is followed by an assessment of the state of the economy and concludes with a discussion of the current situation with regard to mining law.

- A description of the geology of the country with special reference to the greenstone belts.
- The main characteristics of the gold mining industry before an investigation of the potential to develop the industry to a world scale which highlights some of the main challenges the industry faces to grow. The chapter concludes with an industry SWOT analysis.
- A comprehensive review of the principal gold mining companies and their development projects within the country. The review also reports the latest Chamber of Mines production figures.

The main sponsor of the report is the Chamber of Mines of Zimbabwe. Company sponsors were New Dawn Mining and GAT Investments.



Paul Burton

graduated as a mining engineer from the Camborne School of Mines in 1975 and spent almost twenty years working in the South African gold mining industry. He

has been editor of World Gold Analyst since early in 1996. He is an established speaker on the international conference scene and is Chairman of the FTSE Gold Mines Index Committee. He holds an MSc in Mineral Economics and an MBA from the University of the Witwatersrand. Recently Paul Burton took the position of Managing Director of newly established GFMS sister company - GFMS World Gold.



All Eyes on the Official Sector

by Rhona O'Connell, Managing Director

Sentiment in the metals markets has been focusing in recent weeks on official sector pronouncements in particular. This is in part because of quiet trading conditions that pertained during August, although it must be said that the reduced activity has allowed the metals to realign themselves in readiness for the end of the holiday season in Europe and North America.

United States; still trading cautiously

In the United States, the Federal Reserve has recently injected a small amount of fresh funding into the economy and Dr. Bernanke, following a cautious set of Minutes from the latest meeting of the Federal Open Market Committee (FOMC), has implied that there will be more such steps if necessary. The US economic picture is mixed.

A downward revision to June quarter GDP, to an annual rate of 1.6%, was released in late August, although the result was better than economists had been expecting. Growth in corporate profits slowed, but the general expectation is that the reporting season of the next few weeks will be better, and a number of strategists are looking for a bounce in the equities markets after a poor August.

Consumer sentiment has also improved. All this should in principle work against gold prices, but concerns over the longer-term implications of artificially low interest rates, plus the possibility of independent recovery in the euro against the dollar, suggest that we may be about to enter a period when gold and equities move in tandem rather than contrary to one another.

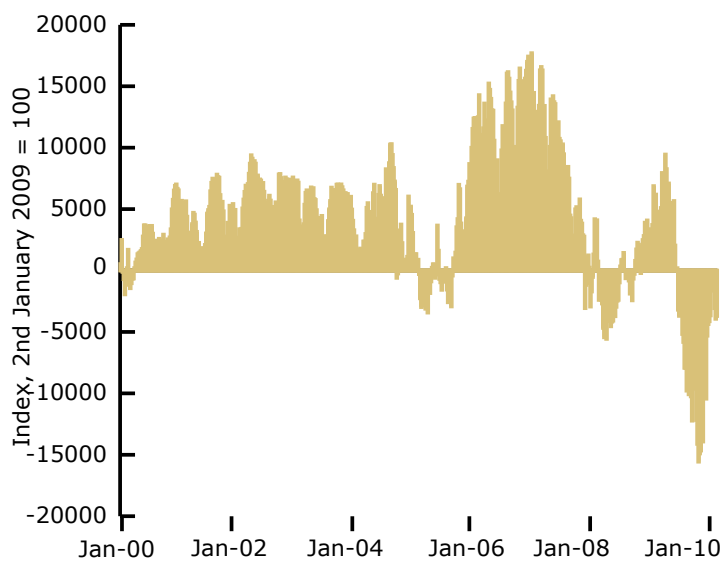
China; strengthening once more but Asia is patchy

In China, meanwhile, the latest figures have shown a stronger performance than the markets had been expecting, and the majority of local economists are expecting strong growth for the rest of the year, underpinned by reduced inventories and rising order rates.

This is being driven by domestic as well as export demand and these figures helped to maintain buoyant base metal sentiment, which was reflected also in the platinum group metals at end-August. (Silver, which has been strengthening its ties with gold in recent weeks after a number of months closely watching the base metals, suffered a brief dip in the wake of these numbers.)

(Continued on next page)

The net speculative Short Euro Position on the CME



Source: Thomson Reuters Ecowin

□
latest □

Portugal, Spain and Belgium still have difficulties.



Chinese industrial production grew by 13.9% year-on-year in August, up from 13.4% in July, while retail sales rose by 18.4% yoy and urban fix asset investment rose by 24.98% against August 2009. Inflation came in at 3.5%, but local economists believe that the government's target of 3% for the year is still attainable, as August's number was swollen by extreme weather conditions that affected food prices.

Indian economic activity is also strong, but other parts of Asia slowed during the middle of the year, largely reflecting the export-orientation of their economies.

The EU; uncertainty still prevailing

The latest statement from Mr. Trichet, President of the European Central Bank, following the early September meeting at which the ECB held the key benchmark interest rates unchanged, revolved around economic uncertainty. Recent EU economic performance has been stronger than expected but this was partly ascribed to temporary factors and a moderation in activity is expected for the second half of this year. [Certainly the poor recent performance of the auto sector, as foreshadowed some months ago

by senior officials within the auto industry, suggests that economic activity is moderating in the second half-year, even though the numbers have been distorted by the ending of the scrappage schemes].

European medium-term inflationary pressures remain "firmly anchored, in line with [a target of] rates below, but close to, 2%". The ECB is maintaining an accommodative policy stance, but the statement clearly implied that recent easing policies are temporary and that the ECB remains "firmly committed" to maintaining price stability over the medium to longer term.

The economic outlook has improved, but the assessment of the ECB Governing Council is that the risks to this outlook are slightly tilted to the downside with uncertainty prevailing.

Meanwhile the "Basel III" ruling on bank capital ratio was gentler than the markets had feared. The minimum reserve requirement is rising from 2% of assets to 7%, lower than expected and to be phased in over a long period of time. This eases some concerns over the banking sector and this takes a prop away from gold bull arguments - but only a small one.

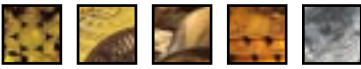


Rhona O'Connell

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.

This commentary is a modified extract from the September edition of GFMS Precious Metals One Year Forecast



Steel: The Billet Market Misses out on the Third Quarter Rally

by Neil Buxton, Managing Director

In GFMS' analysis on the base metals, we note the exceptional gains within the sector, which has seen the GFMS Base Metals index increase from a low of 231.84 in early June to a recent high of above 315 in late September. The cash price of the LME steel contract in contrast has been under pressure, with prices towards the end of the month at \$430/tonne compared to the recent high of just over \$500/tonne.

The weakness in the price has been driven by three key features; most important of which is the decline in scrap prices. Linked to this are attempts by steel mills, especially in China, to curb output in response to the government's move to greater energy efficiency. Finally, these developments are taking a place against a background of what is still weak underlying demand.

Steel prices have been driven by the scrap market

Scrap prices have eased from their earlier summer highs. However, during September they have not fallen as far as the billet quote on the LME. Therefore, we could see some more weakness in the scrap price during the early part of the final quarter. The high prices over the summer months have improved scrap availability, while the demand for scrap looks set to weaken as the recovery in crude steel production (post the summer shutdowns) is likely to be muted. According to the World Steel Association, global

output fell for the second month running in August, with surprisingly China contributing to the losses. Global steel output peaked at 118.76 million tonnes in June. By September, this figure had fallen by 5% to 112.87 million tonnes. Chinese production over this period fell by 4%.

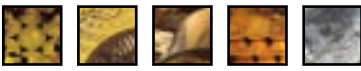
In contrast to many of the industrial commodities traded on the LME, the steel industry is characterised by over-capacity and hence relatively low utilisation rates. The latest figures from the World Steel Association (WSA) shows that global crude steel output in August was 4.2% higher year-on-year at 112.87mn tonnes. Monthly production in China was 1.1% down year-on-year.

Steel production is set to slow

The latest WSA figures highlight steps taken by the steel mills to try to align production with still relatively weak underlying demand conditions. Crude steel utilisation rates (for August) stand at 73.1% compared to a recent high of 82.3% in April and 74.5% a year earlier. Although part of the reduction in utilization rates is seasonal, some of the decline can be attributed to the relatively weak state of the fundamentals. In terms of the impact on billet demand, we tend to adopt a cautious approach. We believe that utilisation rates will remain relatively low over the next three to six months, thereby limiting the increase to billet demand. From a longer term basis (towards the

second half of 2011), we expect a rebound in offtake from the key construction sector that should support higher output and higher billet prices.

GFMS publishes regular reports on both the steel flat and long product sectors. To receive a copy of our latest analysis, which includes price forecasts on a monthly basis for the next year, please contact carmen.eleta@gfms.co.uk.



Tight Copper Market Helps Prices Breach \$8,000/Tonne Mark

by Nikos Kavalis, Senior Analyst

Contrasting the views of other data providers, GFMS had for the better part of 2010-to-date contended that the copper market has been in a small surplus, due to our understanding that the unreported stockpiling in China, that had been a major feature of the market last year, continued, albeit to a far more limited extent. In recent reports we had noted growing indications that this stockpiling was becoming more and more limited and we now feel that the market has finally moved into deficit.

Our assessment of trends in the Chinese copper market remains key to our analysis. For the last few months we noted that the "gap" between reported copper production (the sum of local production net imports and any changes in stocks) and semis fabrication had been at historically high levels, while scrap imports remained lower than the last few years' average, suggesting a tightening market. Moreover, given the current high prices, we would be surprised to see speculators or consumers in the country adding to stockpiles.

Elsewhere, LME inventories continue to trend downwards and as of 29th September stand at 375,000 tonnes, around 180,000 tonnes below their peak in February and 127,000 tonnes less than at end-2009. ICSG reports on inventories held by consumers suggest that they were also down, through to end-June, being the latest available data by the industry organisation at the time

of writing. A minor offset to these declines came from the marginal rise in producers' stocks.

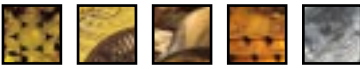
Developments in copper's supply/demand fundamentals are also supportive of our contention of a tighter market. Mine production is yet again looking likely to underachieve expectations, due to projects failing to meet targets, labour disputes, technical and operational difficulties. Although consumption in mature economies remains far below pre-Lehman levels, it has been increasing steadily, while China continues to grow at double-digit rates on a year-on-year basis.

Based on all the above, GFMS now estimate that the copper market saw a marginal deficit during the third quarter of the year. In the last three months, restocking by consumers in mature markets (which has yet to really take place) could prove to be the catalyst for a more noteworthy deficit to develop. Importantly, although a set-back may emerge in the first half of next year, as the restocking cycle winds down and a likely slow-down in the global economy hampers consumption growth briefly, we view these deficit conditions as structural and believe that they will likely remain in place in the foreseeable future.

Regarding the price of the red metal, copper's rally of the last 18 months has in large part been in line with the wider base metals sector. Nevertheless, copper's

clearly superior fundamentals to most of the rest of the group have undoubtedly contributed to the extent of its price gains, which have been the strongest among the six main LME metals (compared to the post-Lehman trough). On 29th September, copper peaked above \$8,000/tonne, for the first time since April this year.

To receive GFMS' latest analysis on the copper market, please contact
charles.demeester@gfms.co.uk
or carmen.eleta@gfms.co.uk.



The GFMS Team

Precious Metals

Philip Klapwijk

*Official Sector, Investment & Demand
China, Americas and Europe*
philip.klapwijk@gfms.co.uk

Philip Newman

*Supply and Demand
USA, Middle East, UK*
philip.newman@gfms.co.uk

Neil Meader

*Demand
Europe*
neil.meader@gfms.co.uk

Peter Ryan

*Senior Consultant
PGMs*
peter.ryan@gfms.co.uk

Paul Walker

*Supply and Demand
East Asia and Indian Sub-continent*
paul.walker@gfms.co.uk

Cameron Alexander

*Supply and Demand
East Asia, Australia, Middle East*
cameron.alexander@gfms.co.uk

Ayako Furuno

*Supply & Demand
Worldwide*
ayako.furuno@gfms.co.uk

Gargi Shah

Supply & Demand, India
gargi.shah@gfms.co.uk

Ross Strachan

Economic & Market Modelling
ross.strachan@gfms.co.uk

William Tankard

*Mine Production & Hedging
Worldwide*
william.tankard@gfms.co.uk

Matthew Piggott

*Mine Production & Hedging
Worldwide*
matthew.piggott@gfms.co.uk

Oliver Heathman

*Mine Production & Hedging
Worldwide*
oliver.heathman@gfms.co.uk

Junlu Liang

Official Sector, China
junlu.liang@gfms.co.uk

Base Metals & Steel

Neil Buxton

Managing Director
neil.buxton@gfms.co.uk

Shairaz Ahmed

Metals Analyst
shairaz.ahmed@gfms.co.uk

Robert Smith

Metals Analyst
robert.smith@gfms.co.uk

Nikos Kavalis

Metals Analyst
nikos.kavalis@gfms.co.uk

Yang Lu

Metals Analyst
yang.lu@gfms.co.uk

Equity Research and World Gold Analyst

Paul Burton

Managing Director
paul.burton@gfms.co.uk

Immediate Market Analysis

Rhona O'Connell

Managing Director
rhona.oconnell@gfms.co.uk

Mining & Exploration

Richard Napier

Managing Director
richard.napier@gfms.co.uk

Mine Cost Studies & Benchmarking

Mark Fellows

Managing Director
mark.fellows@gfms.co.uk

Paul Wheeler

Mining Analyst
paul.wheeler@gfms.co.uk

Nick Pickens

Mining Analyst
nick.pickens@gfms.co.uk

George Coles

Mining Analyst
george.coles@gfms.co.uk

Other Contacts

Emma Hastings

Office Manager / Sales & Marketing
emma.hastings@gfms.co.uk

Charles de Meester

Sales Director
charles.demeester@gfms.co.uk

Carmen Eleta

*Sales Director, Latin America, Southern
Europe, CIS, Japan and Steel Worldwide*
carmen.eleta@gfms.co.uk

Jacky Foster

Accounts
jacky.foster@gfms.co.uk

Vitaly Borisovich

Consultant, Russia

GFMS Limited

Hedges House
153-155 Regent Street
LONDON
W1B 4JE

Switchboard: +44 (0)20 478 1777
Sales: +44 (0)20 478 1750
Fax: +44 (0)20 478 1779
Email: info@gfms.co.uk
Web: www.gfms.co.uk

