

# JM&B Monthly Gold & Silver Report

## December 2010

<http://www.johnson-matthey.ch/>

### Introduction

The purpose of this report is to comment on developments in the gold and silver markets on a monthly basis. For more information about this report, please consult the Appendix. Johnson Matthey plc issues reports on platinum group metals:

[http://www.platinum.matthey.com/publications/price\\_reports.html](http://www.platinum.matthey.com/publications/price_reports.html)

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## 1. Commentary

Strong price action for both metals was observed in December 2010.

## 2. Gold

### 2.1 News and Fundamental Considerations

#### Selected News Items from the Month

**Beijing, 2nd December 2010, (Bloomberg)** – China's gold imports jumped almost fivefold in the first 10 months from the entire amount shipped in last year as concern about rising inflation increased its appeal as a store of value, said the Shanghai Gold Exchange.

Imports gained to 209 metric tons compared with 45 tons for all of 2009, Shen Xiangrong, chairman of the bourse, told a conference in Shanghai today. China, the world's largest producer and second-biggest user, doesn't regularly publish gold-trade figures and rarely comments on its reserves.

Bullion soared 27 percent this year as the dollar dropped on concern that the trillions of dollars governments are pumping into the global economy may debase the value of currencies. China

has pledged to use price controls and may raise interest rates a second time this year to slow inflation that has gained to the highest level since 2008.

“The central bank may now be approving all gold import” applications, Albert Cheng, managing director of the World Gold Council’s Far East department, said in an interview. “The government hasn’t officially said that China is encouraging private gold investments, but we in the industry suspect it. And you can see the big jump in the delivered gold imports through the exchange has to be approved by them.”

Gold demand in China gained in the first half as government measures to cool the property market and falling equities spurred investment, the gold exchange said July 7. About 70 percent to 80 percent of the imports in the first 10 months were made into mini-gold bars, which Chinese investors like to hold, the exchange’s Shen said.

### Inflation Expectations

“Given China is the world’s biggest gold producer, the sharp increase in its imports is a big surprise,” said Hiroyuki Kikukawa, general manager of research at IDO Securities Co. in Tokyo. “People there need to buy gold to hedge against inflation as the country’s tightening monetary policy drives investors from stocks and properties to gold.”

China’s consumer prices jumped 4.4 percent in October, the fastest pace in two years, and above the government’s full-year target of 3 percent. China’s central bank raised interest rates in October for the first time since 2007 and ordered banks on Nov. 10 and Nov. 19 to hold more money in reserve.

“The expectation for higher inflation has fueled great interest among investors to hold physical gold, which led to higher imports,” the gold exchange’s Shen said. The exchange traded 5,014.5 tons of gold in the first 10 months, up 43 percent from a year ago, Shen said.

### Investment Demand

Bullion for immediate delivery rose 0.3 percent to \$1,392.07 an ounce at 5:36 p.m. in Shanghai after yesterday touching \$1,397.50, the highest price since Nov. 12. The metal reached a record \$1,424.60 an ounce on Nov. 9 and is set for a 10th annual gain.

China’s investment gold demand may reach 150 tons this year, up from 105 tons last year, the World Gold Council’s Cheng said. That compares with 3 to 4 tons 10 years ago, Cheng said.

“The investment demand we estimate already reached 120 tons in the first three quarters, and it usually spikes in the fourth,” Cheng said. Global investment demand for gold of 1,901 tons last year exceeded jewelry consumption of 1,759 tons for the first time in three decades, according to London-based researcher GFMS Ltd.

China’s gold market may double in the next decade as retail investment and jewelry demand gain, the World Gold Council said Nov. 3. Consumption may climb to 800 tons to 900 tons in the next ten years, said Wang Lixin, the council’s Greater China general manager. China’s jewelry and investment gold demand was 428 tons in 2009, according to the council.

### Relaxed Rules

Sales of gold products such as bars by China National Gold Group Corp., owner of the country's largest deposit of the metal, jumped as much as 40 percent in the first half, Song Quanli, deputy party secretary at the company, said July 7.

China's central bank in August said that it would let more banks import and export gold and allow overseas companies more access to trading. Gold demand growth in China will likely be supported by rising disposable income levels and the country could surpass India as the world's biggest bullion consumer, Deutsche Bank AG said Aug. 6.

China's plans to relax gold-trading rules may boost demand and increase trading volumes on the Shanghai Gold Exchange, the bank said. Demand will continue to grow, making China one of the top importers together with India, IDO's Kikukawa said.

Gold imports this year by India have already exceeded 2009 levels as consumers boost jewelry purchases, the World Gold Council said Nov. 17. Imports totaled 624 tons by the end of the third quarter, compared with 559 tons in all of 2009, according to the council.

#### Output Grows

China's gold output may rise to 340 tons this year, from 314 tons last year, solidifying the nation's position as the world's largest producer, Zhang Fengkui, section chief of the raw materials department at the Ministry of Industry and Information Technology, said on Oct. 16.

The country should raise its gold holdings and its 1,054 tons of reserves are inadequate compared with the 8,133 tons held by the U.S. and 3,408 tons by Germany, Meng Qingfa, a researcher at the China Chamber of International Commerce, said on Oct. 27.

Gold accounts for 1.6 percent of the reserves held by the People's Bank of China, according to the World Gold Council. The country increased reserves by 454 tons to 1,054 tons since 2003, the State Administration of Foreign Exchange said last April.

**London, 3rd December 2010, (FT)** – The recent gold price rally is the first stage of a multi-year bull market that will drive the gold price to at least \$2,000 an ounce by 2015. A mixture of economic factors and innovations in how institutions can purchase the metal, have moved prices. But the biggest driver of gold prices is yet to come.

First, a recap of the factors that have taken gold prices to current levels.

The economic causes center on monetary policy and the risk of inflation. Some industrial countries are striving to devalue their currencies and will use monetary policy to support the goal. Japan recently spent \$24bn on unsterilized intervention trying to weaken the yen. The policy succeeded, albeit briefly. In 2003-04, Japan spent more than \$350bn on intervention and could easily do so again. This policy would increase dollar liquidity while nurturing more monetary growth in Japan itself.

The Federal Reserve has been dropping ever-bigger hints that it will embark on further quantitative easing. A significant policy move will trigger immediate selling of the dollar, and could set the stage for competitive devaluations elsewhere.

The gold price has also benefited from the introduction of exchange-traded funds five years ago. These funds allow investors to purchase gold bullion as effortlessly as a share of stock. In the second quarter of 2010, investors bought more than 274 tonnes of gold through ETFs. Their holdings now exceed 2,000 tonnes, and are the sixth largest in the world after the official stocks at the International Monetary Fund and the central banks of the US, Germany, France and Italy. At current growth rates, these ETFs could rank third by the end of 2012.

After a long period of selling gold, central banks are re-emerging as buyers. China revealed last year that it had purchased 450 tonnes. India bought 200 tonnes last October. Russia has bought 71 tonnes of gold this year while there have been small purchases by Mauritius, Thailand, Bangladesh and Sri Lanka. South Korea announced last week that it might use some of its \$290bn of foreign exchange reserves to buy gold. During the previous two decades, central banks sold nearly 4,500 tonnes.

But potentially the most important new factor in the gold market is China. China now has more than \$2,400bn of foreign exchange reserves, but only 1.7 per cent of this is invested in gold. The IMF is projecting that China will run a current account surplus of \$2,600bn during the next five years. If it does, its forex reserves could rise to the \$5,000bn-\$6,000bn range. Even if it keeps the gold share of its reserves constant, it will have to buy a further 1,000-1,500 tonnes. Yet the odds are high that China will want to expand the gold share of its reserves in order to lessen its vulnerability to dollar devaluations and strengthen the renminbi's status as a global currency.

As with the US 100 years ago, China will probably regard large gold holdings as a way to project financial power. In 1913, before the dollar had emerged as a global currency, the US had 2,293 tonnes of gold compared with 248 tonnes for Britain, 439 tonnes for Germany, 1,030 tonnes for France and 1,233 tonnes for Russia. The Americans' large gold reserves made the dollar a natural replacement for sterling when the first world war crippled Britain's financial position. The US is now running a fiscal policy that has parallels with Britain during wartime, which could undermine the dollar's global role at some point.

Some Chinese officials have publicly called for the central bank to purchase 10,000 tonnes of gold. The central bank has declined to comment on these proposals, but they will become increasingly attractive if the US pursues a policy of dollar devaluation while the renminbi emerges as a global currency.

It is also possible that the massive expansion of China's foreign exchange reserves could spawn faster monetary growth and increase China's inflation rate. If it does, there could be a sharp rise in Chinese private demand for gold.

China has deregulated its gold market since 2008 and private demand is increasing rapidly. It totalled 143 tonnes during the past 12 months compared with 73 tonnes in 2009 and 17 tonnes in 2008. It could easily rise to several hundred tonnes if investors perceive that China's monetary growth is going to produce higher inflation.

The US government has been critical of China's policy of pegging the renminbi to the dollar, but it would abandon this criticism if China pursued a policy of unsterilized currency intervention and allowed inflation to accelerate. The renminbi would then appreciate in real terms, and make Chinese goods less competitive.

There is no way to predict the timing of China's future gold purchases, but there can be little doubt they will create a demand for gold that will dwarf all other factors during the next quarter-century and guarantee large price gains irrespective of what happens to Federal Reserve policy.

**London, 22nd December 2010, (FT)** – The International Monetary Fund has said that it has completed its large programme of gold sales, removing one of the few bearish elements restraining the bullion market.

In a statement released on Tuesday night, the Washington-based IMF said that it had already sold the expected 403.3 tonnes of gold – equal to around 10 per cent of annual demand for bullion – partly through direct sales to central banks, including one large disposal to the central bank of India, and partly on the open market.

Gold prices were little changed after the announcement. In late trading in London, bullion traded at \$1,385 a troy ounce, up 0.1 per cent from Monday's last quote.

Gold prices have surged 26.5 per cent since January, hitting a nominal all-time high of \$1,430.95 an ounce earlier this month.

However, in real terms, adjusted by inflation, gold prices are far below the peak set in 1980 of more than \$2,300.

The completion of the disposals – around one-eighth of the IMF's total gold reserves – comes slightly ahead of initial expectations, but the IMF has accelerated its selling programme amid record high prices.

The conclusion also means that in 2011, barring a surprise sale by any European central banks, governments and other official institutions will be net buyers of gold for the second year in a row.

GFMS, the London-based precious metals consultancy, estimates that the official sector was a net buyer in 2010 for the first time in two decades in spite of the sales by the IMF. The shift marks a turnaround after heavy disposals by European central banks over the past 10 years, when gold was seen as a non-yielding unattractive asset. Monetary institutions then swapped their bullion for yielding sovereign debt.

The consultancy, which compiles benchmark statistics for gold supply and demand, said that central banks would buy about 15 tonnes of bullion on a net basis this year, a situation last seen in 1988.

The swing comes on the back of buying by Russia and several Asia-based central banks and the collapse of sales in Europe.

The IMF did not disclose how much money it raised, although noted that "all gold sales were at market prices, including direct sales to official holders." At current prices, the gold sold is worth around \$18bn, according to Financial Times calculations.

The IMF sold gold directly to the central banks of India – 200 tonnes; Sri Lanka – 10 tonnes; Bangladesh – another 10 tonnes and Mauritius – two tonnes.

## 2.2 Technical Comments

### Long Term Technical Comments

No change in the long-term trend:



### Daily/Weekly Technical Comments

London afternoon fix in USD/oz:

Open	High	Low	Close
1 <sup>st</sup> December	29 <sup>th</sup> December	16 <sup>th</sup> December	30 <sup>th</sup> December
1386	1423	1363	1406

London afternoon fix in €/oz:

Open	High	Low	Close
1 <sup>st</sup> December	29 <sup>th</sup> December	16 <sup>th</sup> December	30 <sup>th</sup> December
1056	1075	1031	1056



As in October and November, another new high for gold in December was followed by a correction and a period of price consolidation.

## 3. Silver

### 3.1 News and Fundamental Considerations

**London, 13th December 2010, (FT)** – JPMorgan has quietly reduced a large position in the US silver futures market which had been at the centre of a controversy about its impact on global prices for the precious metal.

The decision by JPMorgan was an attempt to deflect public criticism of the bank's dealings in silver, a person familiar with the matter said. The person added that the bank's position in silver would from now on be "materially smaller" than in the past.

A group of small precious metals investors has alleged that large short positions – or bets on lower prices – in silver futures held by several banks, including JPMorgan, are keeping prices artificially low.

The US regulator, the Commodity Futures Trading Commission, announced in September 2008 that it was investigating complaints of misconduct in the silver market, although it did not name specific entities.

However, JPMorgan said in a statement: "It is absolutely incorrect to say or imply that the Nymex, CFTC or any other exchange or regulator has instructed or asked us to reduce our position." The bank declined to comment on whether it had reduced its position in the silver market.

The price of silver has risen more than 70 per cent since mid-August to hit a 30-year high of \$30.68 a troy ounce last week on the back of a surge in investor buying and a rebound in industrial silver consumption.

In two previous reviews of the silver market, the CFTC has dismissed claims of manipulation. Most analysts say there is little reason to believe the price of silver is being systematically manipulated.

But Bart Chilton, a CFTC commissioner, said in October that he believed there had been "fraudulent efforts" to "deviously control" the silver price. He did not name any party.

Publicly available data on individual traders' positions are sketchy. In a speech last Wednesday, Mr Chilton said that "earlier this year, one trader held more than 40 per cent of the silver market". He declined to identify the trader.

The CFTC's Bank Participation Report shows that one or more US banks held a gross short silver futures position equal to 19.1 per cent of the total number of outstanding contracts in early December. In January the share was 30.2 per cent.

The CFTC only reports data for the US silver futures market, a small corner of the global derivatives market for the precious metal, which is centred in London and largely traded via private over-the-counter deals. The data also do not cover transactions in the physical market.

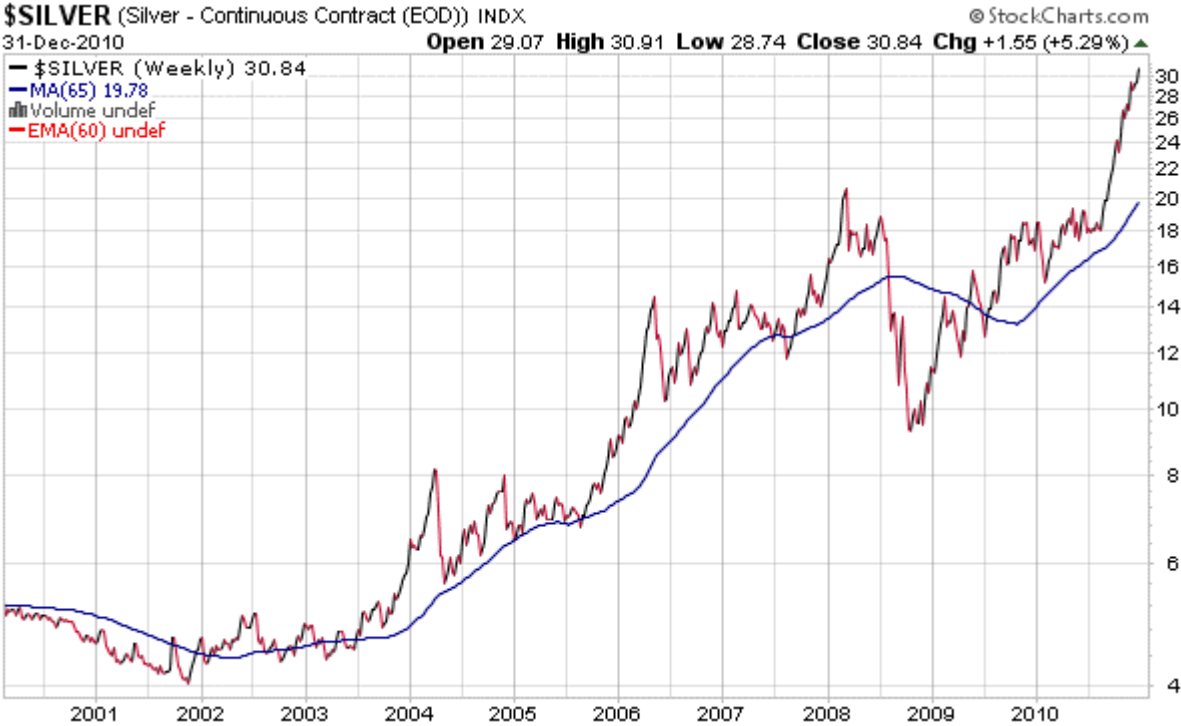
Analysts and traders said that JPMorgan's large short positions on New York's Comex exchange, a division of Nymex, were hedges for the bank's long positions in physical silver and London's over-the-counter market.

JPMorgan has invested nearly \$3bn over the past two years in its commodities business led by Blythe Masters.

### 3.2 Technical Comments

#### Long Term Technical Comments

Silver moved to new highs for the current bull market again in December:



#### Daily/Weekly Technical Comments

London fix in USD/oz:

Open	High	Low	Close
1 <sup>st</sup> December	30 <sup>th</sup> December	2 <sup>nd</sup> December	31 <sup>st</sup> December
28.74	30.70	20.50	30.63

London fix in €/oz:

Open	High	Low	Close
1 <sup>st</sup> December	30 <sup>th</sup> December	9 <sup>th</sup> December	31 <sup>st</sup> December
21.93	23.16	21.51	22.87



After meeting initial resistance at 30 USD/oz at the start of the month, silver consolidated and moved up through the 30 USD/oz barrier towards the end of the month.

John Fineron, 3<sup>rd</sup> January 2011.

## Appendix: More about this report

### Purpose of the Report

The purpose of this report is to comment on developments in the gold and silver markets on a monthly basis. Johnson Matthey plc issues reports on the platinum group metals:

[http://www.platinum.matthey.com/publications/price\\_reports.html](http://www.platinum.matthey.com/publications/price_reports.html)

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This report is prepared in the English language, as are the vast majority of contributions on precious metal markets.

### Structure of Report

The report comprises two sections:

#### Fundamental Considerations

This section addresses aspects of supply and demand in gold and silver, which typically affect the market over periods of **several years**. Over the long term, the price of a commodity will rise or fall until natural supply and demand reach equilibrium. Completion of this process, can take many years and is significantly influenced by hoarding and dis-hoarding. For example, dis-hoarding of stockpiles to compensate for supply shortages can proceed over decades and thereby delay movement to a true equilibrium price.

#### Technical Comments

This section describes aspects of technical analysis in gold and silver, which can be used to assist in buy and sell decisions over periods of **weeks to months**. Traders often use technical analysis to trade or profit from price movements up or down. Because large traders, e.g. hedge funds, often use the same signals, price-movements are often amplified and technical signals become self-fulfilling prophecies due to the herd-mentality.

Learn more about technical analysis:

<http://stockcharts.com/education>

and the terms used:

<http://stockcharts.com/education/GlossaryA.html>

Learn more about candle charts:

<http://www.litwick.com/about.html>

All charts used are courtesy of Stockcharts.com unless otherwise stated.

Find out more about the Elliot wave principle:

<http://www.prognosis.nl/principle/index.html>

Please note that our technical comments will be purely technical in nature and will not attempt to rationalise or second-guess the reasons for price movements.

### **Advice on buying and selling precious metals**

It is not the policy of Johnson Matthey & Brandenberger AG, to advise customers on specific buy or sell points. We are however prepared to assist customers in formulating views on precious metal markets and preparing strategies suited to their individual buying and selling needs.

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