Gold, silver and the rand

March 2010

As a company, Harmony is exposed to the gold price as well as the R/US$ exchange rate. The rand strength or weakness is therefore critical to our company, with most of our operations being in South Africa. The silver component relates to our Hidden Valley operation which is producing both gold and silver and, as a precious metal, silver has an intimate relationship with gold.

We have engaged the services of VM Group to provide us with the contents of this newsletter. We hope that this newsletter provides you with both insight and value.

Gold suffered a few blows in February 2010 and almost got knocked down, but by the end of the month had managed to recover. The price fixed on 25 February 2010 at $1 094.50/oz was slightly higher than its last fix in January 2010 of $1 078.50/oz and up from the low reached on 5 February 2010 of $1 058.00/oz.

Gold

The first punch delivered to gold was a stronger dollar. Over the course of the month the greenback gained 2.6% against the euro, 2.4% against the rand and 1.7% on its index of major currencies. This is the continuation of gains seen since the dollar bottomed out in November 2009. It is now 7% higher against the rand, 11% against the euro, and 9% on its index compared with those lows. This rise has been for a number of reasons – the simplest reason being that other currencies are weaker. The euro in particular, has been hit by fears that Greece cannot cover its huge budget deficit, with yields on Greece's existing debt rising sharply. While Greece's problems are relatively small compared to the size of the eurozone economy, other larger countries such as Spain and Italy have similar, if less serious, problems. At the same time, the US economy has also shown some signs of normalisation, with recovery in the financial system, allowing the Federal Reserve to raise its discount rate (the money it charges banks for emergency lending) for the first time since 2004.

The next blow was the announcement by the International Monetary Fund (IMF) on 17 February 2010 that it would shortly commence the sale of 191.3t of gold on the open market. This is the balance of the total 403.3t it has long earmarked for selling; the other 212t was sold late 2009 to the central banks of India (200t), Mauritius (10t), and Sri Lanka (2t). It was not so much the news of the sales that was moderately bearish but more the fact that it suggests it could find no other central bank to buy the gold. A few months ago this would have raised no eyebrows, but the purchase by India had raised hopes that central banks, particularly those in Asia with huge forex reserves, might be a force on the buy-side for the first time in decades.

US dollar index (1973 = 100)

Gold price, $/oz

Gold price, ZAR/kg

Gold *cont.*

These bearish aspects should not be overplayed, however. As gold managed to gain over the month, despite the rising dollar, this means that in other currencies it performed strongly. On 19 February 2010 gold fixed at 824.198/oz, an all-time high in that currency – when gold peaked at $1 212.50/oz in December 2010, the euro price then was just 804/oz.

The IMF news also needs to be put into context. The hope that central banks would be larger purchasers of gold was always optimistic, given the other obstacles, not the least of which would be the enormous amounts of bullion such central banks would need to purchase in order to raise gold to a meaningful share of their reserves. In addition, China – the country with the largest forex reserves – has hinted that it prefers to accumulate gold from local mine production.

Central banks have also undergone some reconsideration of the merits of gold reserves. The IMF aside, at present there are almost no other official sector gold sellers. This is shown most clearly by the European central banks that make up the Central Bank Gold Agreement (CBGA), and which sold nearly 1 900t in the years 1999-2009. Since the third CBGA began in late September 2009, we estimate that as of 19 February 2010, they sold just 1.18 tonnes. If sales had been on course to reach the maximum permitted 400t/year they should now be at 158t. It is quite possible that full year CBGA sales will be fewer than 10t, with just Germany's 6.5t (and even that is not certain) contributing to the bulk.

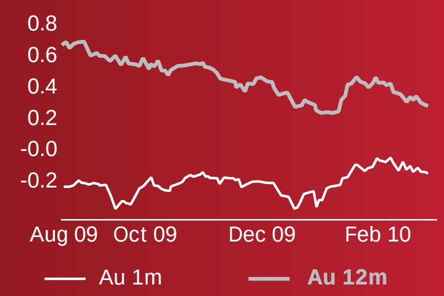
CBGA tonnes, sales

Year one sales so far	**Tonnes**
Germany	(0.87)
Malta	(0.29)
Luxembourg	(0.02)
Total under CBGA III	(1.18)

Given this, the IMF could sell all of its 191.3t in this CBGA year and still comfortably see the total fit under the maximum 400t/year by which it has agreed to abide (although it is not a signatory to the CBGA). Even so, this is unlikely, as the pace of these sales would probably be too high, given the IMF's ultra-cautious approach to not disrupting the market. Instead we expect IMF sales of about 10-15t/month over the next 12–18 months.

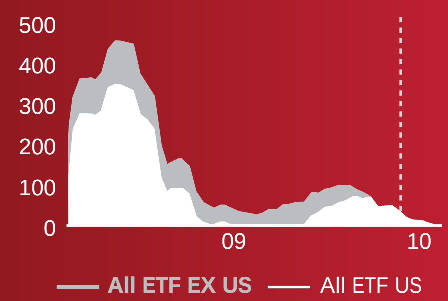
Gold has therefore survived a tricky first quarter reasonably well so far. Investment demand, at least measured by the exchange-traded funds, has been a negative 30t compared with 326t in the same period in 2009. This is a huge swing, yet the price is considerably higher than it was in February 2009 in both dollars and euros (but not, of course, in rand). Clearly, demand is coming from somewhere – and one source is particularly welcome - stronger physical demand in India, where gold imports in February 2010 are estimated at 30-35t as of 25 February 2010, four times higher than in February 2009.

Lease rates, % per annum

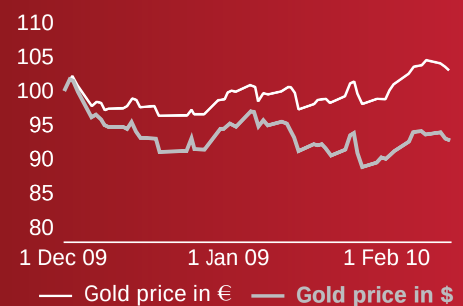


Note: LBMA indicative rates not dealer rates.

ETF rolling 12wk change, tonnes



Gold in dollars and euros,
1 Dec 2009 = 100



Monthly gold data

Prices	**US$/oz**	**Euro/oz**	**Rand/kg**	**ETFs**	**Tonnes**	**Change**	**Lease rates**	**1m**	**3m**	**6m**	**12m**	**Option volatility**	**(%)**
Average	1 096	803	269 698	US (3)	1 195.0	(5.9)	**Average**	0.05	0.05	0.13	0.43	**1-month**	19.70
High	1 119	822	277 078	UK (2)	228.7	(4.7)	**High**	0.10	0.08	0.16	0.50	**3-month**	22.05
Low	1 058	774	259 864	Swiss	211.3	1.1	**Low**	0.01	0.00	0.09	0.38	**6-month**	24.90
				S. Africa	52.7	–						**12-month**	27.95
				German	37.0	1.0						**24-month**	29.85
				Australia	15.3	_							
				Others	9.5	–							

Silver suffered a major tumble in February 2010 as the dollar strengthened, falling from $16.79/oz on 3 February 2010 to $15.17/oz by 5 February 2010.

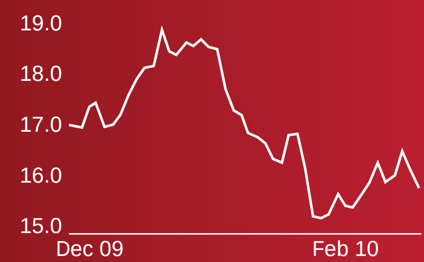
Silver

Speculators shed their positions quite aggressively, with the non-commercial net long position on Comex, a traditional measure of speculative activity, falling to 3 634t on 9 February 2010, down from 4 802t the week before, the largest one-week fall since July 2008. Moreover, this followed two weeks of heavy selloffs, making silver the largest fall seen over a three-week period since 2005.

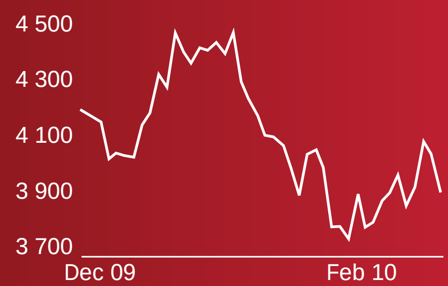
Silver's performance contrasts with the base metals which enjoyed a strong rally in February 2010; the London Metal Exchange (LME) index (a basket of base metal prices) rising 5.5% over the month as copper, in particular, staged a recovery.

Silver investors' liquidation has probably now run its course – the Comex net long increased modestly in the week to 16 February 2010 – and the silver price managed modest gains in the second half of the month, fixing at $15.92/oz on 25 February 2010, just 2.3% lower than at the end of January 2010.

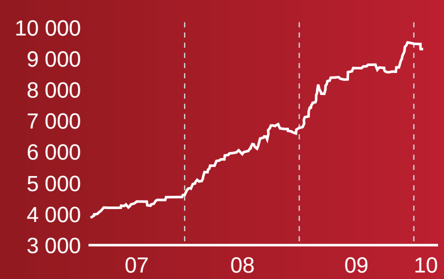
Silver price, $/oz



Silver price, ZAR/kg



BGI silver ETF holdings, tonnes



Monthly silver data

Prices	US$/oz	Euro/oz	Rand/oz	ETFs	Tonnes	Change
Average	15.84	11.59	121	US	9 704.0	70.7
High	16.79	12.09	127	UK	794.0	57.4
Low	15.14	11.02	116	Swiss	1 955.0	79.4

Lease rates	1m	3m	6m	12m	Option volatility	(%)
Average	(0.35)	(0.33)	(0.20)	0.26	1-month	32.00
High	(0.31)	(0.30)	(0.17)	0.29	3-month	33.25
Low	(0.38)	(0.36)	(0.22)	0.22	6-month	34.25
					12-month	35.50

Rand

In common with most other currencies, commodities and 'risky' assets, the rand fell sharply against the US dollar at the start of February 2010, from 7.44 on 1 February 2010 to 7.75 by 8 February 2010. It then made a limited recovery, before fading away again towards the end of month, reaching a low of 7.89 in intra-day trading on 25 February 2010, its lowest since early November.

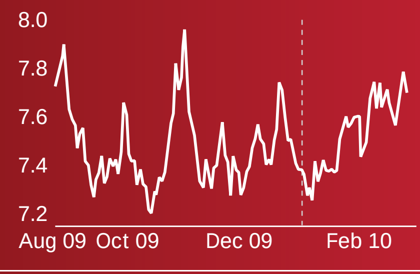
Much of this move downwards was related to a stronger dollar, rather than a particularly weak rand, with the US currency gaining against almost all currencies over February 2010. Domestic issues also had an impact towards the end of the month as better-than-expected inflation numbers and lower proposed electricity price increases raised hopes that the South African Reserve Bank's key interest rate, the repo rate, would soon be cut from its current 7.0%. January's inflation was recorded at 6.2% year-on-year, better than the expected 6.4% on weak food prices, while the energy regulator rejected state power utility Eskom's proposal for a 35% annual increase in electricity costs in 2010, 2011 and 2012 and instead granted average increases of 25% per year.

Prices and financial data

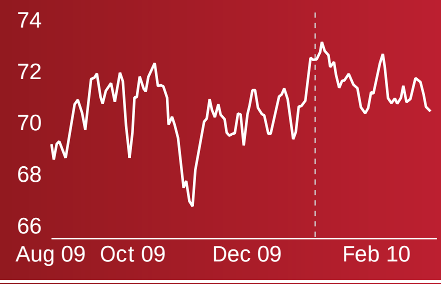
Prices	25-Feb	W%	M%	Y%	Equities	25-Feb	W%	M%	Y%
Gold, pm fix	1 103.00	(1)	2	12	FTSE 250	9 359	0	1	59
Silver, fix	15.76	(3)	(9)	10	DJI	10 374	1	2	45
					SSE	3 061	1	1	29
					Nikkei 255	10 102	(2)	(2)	40
WTI oil	78.09	3	7	105	Hang Seng	12 400	0	1	57
GSCI	518.76	1	3	64	S&P 500	3 953	1	1	51
DJ-AIG	353.44	0	0	47	NASDAQ	2 236	0	1	60
Bonds, %	**25-Feb**	**W%**	**M%**	**Y%**	**Ex. rates**	**25-Feb**	**W%**	**M%**	**Y%**
US 10yr	3.69	1	2	32	$/GBP	1.54	(2)	(5)	6
US 3m	0.12	24	129	(62)	$/EUR	1.35	(1)	(4)	5
Euro 10yr	3.20	0	(3)	5	$/JPY	90.20	(1)	0	(7)
Japan 10yr	1.34	1	(2)	0	$/Rand	7.70	1	2	(22)
Other					$/Yuan	6.83	0	0	0
VIX	21.37	(4)	(20)	(55)	$/SDR	0.65	1	2	(3)
Markitt 10yr	109.13	(5)	(2)	(35)	$/INR	46.27	0	0	(7)

Notes: W% = change in % on week, M% = change in % on month. Prices in US dollars, equity indices in local currency. Bonds refer to yields in %. VIX – volatility index showing expectations of 30d volatility on S&P 500. Markitt 10yr is spread over treasuries.

Dollar/rand



Rand index (2000=100)



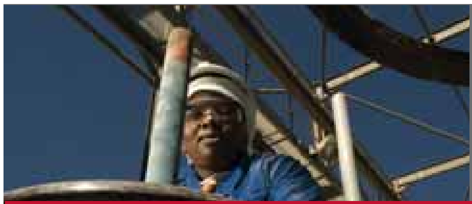
Ratios

Gold/silver ratio

Gold/WTI oil ratio

Gold/DJIA ratio

Copper/silver ratio



Harmony investors' diary

2010

10 May	Quarterly results presentation
16 August	Year-end results presentation
1 November	Quarterly results presentation
24 November	Harmony AGM

VM GROUP

100 Ashmill Street
London NW1 6RA
Telephone: +44 (0) 207 569 5930
Fax: +44 (0) 207 569 5931
Email: info@virtualmetals.co.uk
Website: www.virtualmetals.co.uk