

25. June 2008

Erste Bank Research: “In gold we trust”

- Strongly increased investor interest in 2008 and beyond
- Gold is rising due to a structural supply/demand deficit
- Central banks will want to achieve a higher degree of diversification of their dollar holdings
- First target price 1,200; long term target: inflation-adjusted all-time-high of USD 2,300

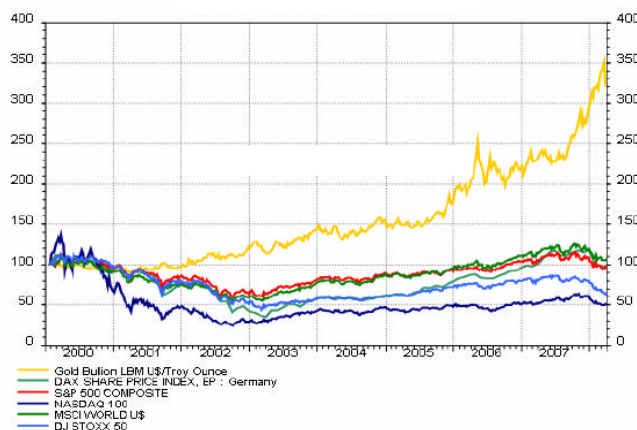
Gold passed nominal all-time-high - next target: inflation adjusted high of USD 2,300

Gold reached an all-time nominal high of USD 1,034 on March 17 this year, exceeding the previous high of USD 850 per ounce in 1980. The price has corrected considerably, but from a long-term perspective this has been an overdue and technically necessary correction within a secular bull market. However, at USD 2,300 per ounce the inflation-adjusted high is still a long way off. The current gold rush is based on a number of factors. One of the most important ones is the falling confidence in the American economy. The chronically weak dollar, the credit crisis originating in America and concerns over strongly rising inflation and the exploding growth of the money supply caused investors to feel uneasy and channel billions of funds into precious metals. *“Additionally, the strong increase in jewellery demand from India and the Middle East, falling volumes sold by central banks and the continued decrease in mining output – to name just some of them - are responsible for the gold bull market”*, states Ronald-Peter Stöferle, international equities analyst at Erste Bank.

Positive setting for gold investments to be prolonged

While equities outperformed commodities for 20 years, this situation has reversed since 2000. The current turbulences on the stock exchanges have lent support to this paradigm: While the established global indices have largely lost value since 2000, gold has been gradually booming.

Stock indices vs. gold since 2000

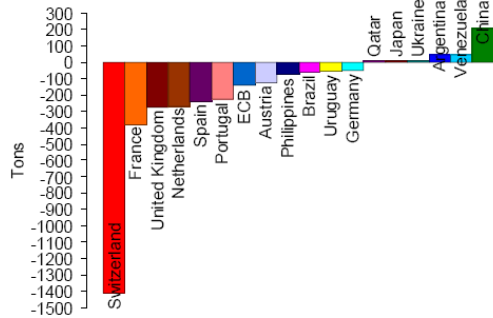


Gap between supply and demand can only be compensated by price increases

Total annual demand for gold is around 3,600 tonnes, but only close to 2,450 tonnes (i.e. the lowest amount since 1996) are produced by mines each year. The shortfall is compensated by central bank sales and recycling (so-called scrap gold). While central banks used the high gold price in the second half of 2007 to sell some of their holdings, the increased supply was eaten up by the continued fall in mining output and the lower supply of recycled gold. The demand side was stronger than in the previous year across the board, which means that the gap between supply and demand widened in 2007. On the demand side, speculative demand increased sharply last year: *“While the robust jewellery demand as well as industrial demand might come down a bit in 2008, the central banks in Russia, China,*

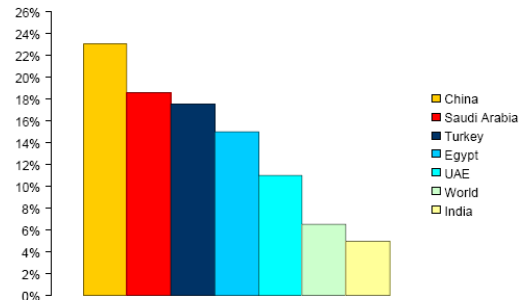
and the Arabic region will want to decrease their dependence on dollars. Even if only a small percentage of the (petro) dollars gets funnelled into gold investments, this will trigger another price leap. All in all, we expect the gold price to rise further”, continues Stöferle.

Changes in central bank holdings 2000-2007 in tons



Source: AMF, www.gold.org, central bank information

Jewellery demand change YoY



Quelle: GFMS, own estimates

Gold has several specific characteristics:

- It is both, a monetary asset and commodity,
- It protects against inflation, it acts as a dollar hedge instrument,
- It is a commodity investment
- It is a good instrument for diversification, as its sources are limited and as gold has low correlation to other asset classes it represents the highest form of payment in the world.

Alan Greenspan underlined in his "Gold and Economic Freedom" speech: *"The USA should hold on to its gold reserves. (...) Gold still represents the highest form of payment in the world. During the war in 1944, Germany could only buy materials with gold. Paper money, in extremis, will not be accepted by anyone – gold on the other hand will always be accepted."*

Secular bull market still intact, opportunities outweigh risks

The positive fundamental outlook will presumably not change. Currently only massive interest rate hikes could weaken the gold price in the long term. But in contrast to the situation in 1980, this seems unlikely. At the end of the 1970s the period of high inflation in the USA could only be remedied through massive interest rate hikes by then-chairman of the Fed, Paul Volcker. Nominal interest rates were at 20%, while real rates were at 8%. The USA was net creditor and had a positive trade balance in 1980, but the situation has reversed dramatically in the meantime. Private household debt and public debt have reached alarming levels. Therefore an imminent rate increase under the current chairman seems unlikely – a scenario that should lay a solid foundation for future gold price increases. *"We would seize the current opportunity of general profit taking to buy as soon as the short-term downward trend is over. We regard the current consolidation as a good buying opportunity and envisage higher gold prices in the medium to long term. The infamous USD 1,000 per ounce threshold should be clearly passed again in 2008, and positive seasonals should lend further support to the price from the third and fourth quarter. We believe that gold investors will encounter a highly attractive opportunity / risk profile in 2008 and beyond. Passing USD 1,200 is the first target, and in the long run the price may well pass the inflation-adjusted all-time-high of USD 2,300"*, believes Ronald-Peter Stöferle, International equities analyst at Erste Bank.

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