

## II. INTERNATIONAL FOREIGN EXCHANGE AND GOLD MARKETS

The international foreign exchange markets were marked in 2007 by strong depreciation of the US dollar against the euro, losing almost 9.3% of its value over the year. The dollar also depreciated against the other main international currencies, by 6.2% against the yen and 6.7% against the Swiss franc for example. Against the pound sterling, overall depreciation of the dollar held to just 1% for the year, thanks to a drop in the British currency at the end of the year. The dollar was affected by the slower pace of growth in the US economy, amplified by the subprime crisis and by losses at major American banks. This led to a liquidity and credit crisis, obliging the Fed to ease monetary policy by reducing key rates by 100 base points for Fed Fund rate and by 150 base points for the discount rate over the period September-December 2007, bringing the federal fund rate down from 5.25% to 4.25% and the discount rate from 6.25% to 4.75%. Inversely, the ECB was confident about the potential of European growth and remained determined to keep down inflationary pressure, raising its main key rate twice by 25 base points to 4% at the end of the year. The dollar was thus penalised by diverging objectives between the US and European central banks. The expected differential in interest rates between the two currencies, which had previously favoured the dollar, continued to narrow throughout 2007.

### THE EXTENT OF VARIATION IN THE MAIN EXCHANGE RATES IN 2007

EXCHANGE RATE	OPENING	LOWEST	HIGHEST	CLOSING
EUR/USD	\$1.3236	\$1.2864 (12/01/07)	\$1.4966 (23/11/07)	\$1.4589
EUR/JPY	¥157.17	¥149.24 (17/08/07)	¥168.96 (13/07/07)	¥162.53
USD/JPY	¥118.74	¥107.20 (26/11/07)	¥124.16 (22/06/07)	¥111.33

Growth in emerging countries turned out to be more robust than expected in almost all countries, thanks to vigorous domestic demand and dynamic foreign trade. Such economic performance favoured appreciation of currencies in most of these countries, supported by an overall drop in the US dollar. And gold continued in 2007 the upward trend prevailing since 2001, benefiting from speculative and hedging purchases as the dollar fell sharply and fears of inflation grew along with energy prices.

### A. FOREIGN EXCHANGE MARKETS

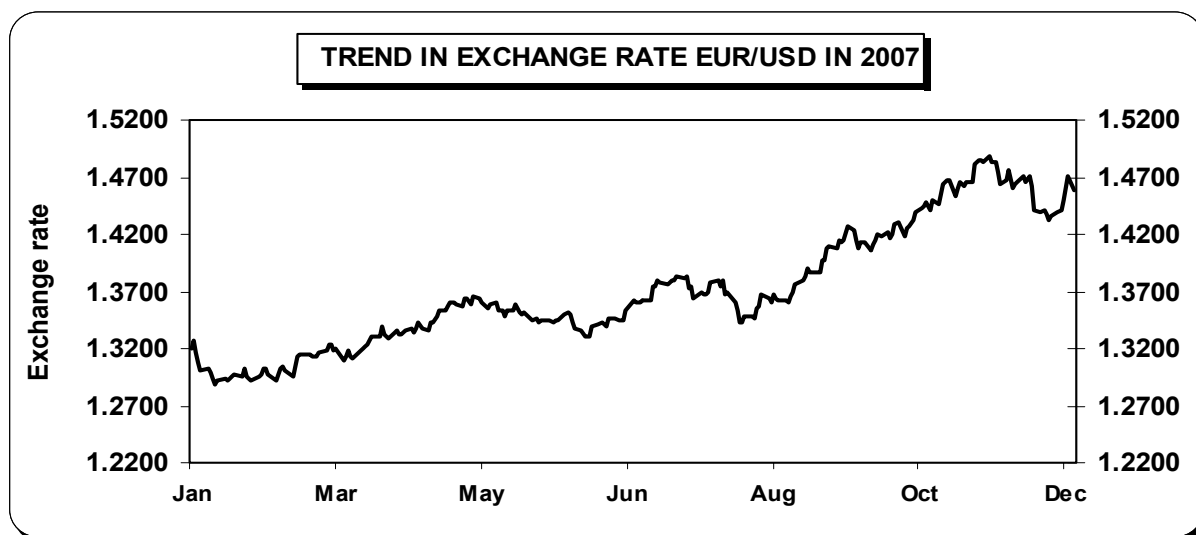
#### 1. INDUSTRIALISED COUNTRIES

Overall, international foreign exchange markets were marked in 2007 by an ongoing drop in the US dollar against the main international currencies. The greenback was affected mainly by expectations of slowing growth in the US and narrowing of the interest rate differential (which has long been in its favour), mainly linked to the consequences of the subprime crisis, especially its unforeseen impact on banking liquidity and solvency in the financial system. This environment led to a fresh outbreak of aversion to risk, one consequence being appreciation of the yen against the dollar following an end to the carry trade positions that have long penalised Japan's currency.

## a- TRENDS IN THE EUR/USD AND USD/JPY

Aside from slight appreciation of 2.3% over the first two weeks of the year, the dollar steadily depreciated against the euro throughout the first quarter of 2007. The dollar was initially sustained by encouraging economic statistics at the beginning of the year, which calmed fears of lower Fed key rates, notably, industrial orders, job figures, retail sales for December, and a drop in oil prices linked to an exceptionally mild winter. The dollar thus posted 1.2864 to the euro on 12 January, compared to 1.3236 at the opening of the year.

The dollar started to depreciate in mid January, attributable mainly to diverging expectations about growth in the United States and the euro zone. In effect, doubts arose about prospects for growth in the US, with the announcement of disappointing economic figures (foreign trade, manufacturing sector, industrial production, capital flows and industrial orders in January, and retail sales in February), along with concerns linked to the high-risk real estate loan market. Inversely, encouraging economic indicators in the euro zone, notably good performance on the job market in February along with higher investor confidence and a better business environment in March, encouraged investors to expect ongoing growth in Europe. The euro was also boosted by expectations that the rate differential would evolve in favour of the euro zone, supported by the first monetary tightening of the year in Europe on 8 March, bringing the ECB key rate from 3.5% to 3.75%. The dollar closed for the quarter at 1.3355 to the euro, its lowest level since March 2005.

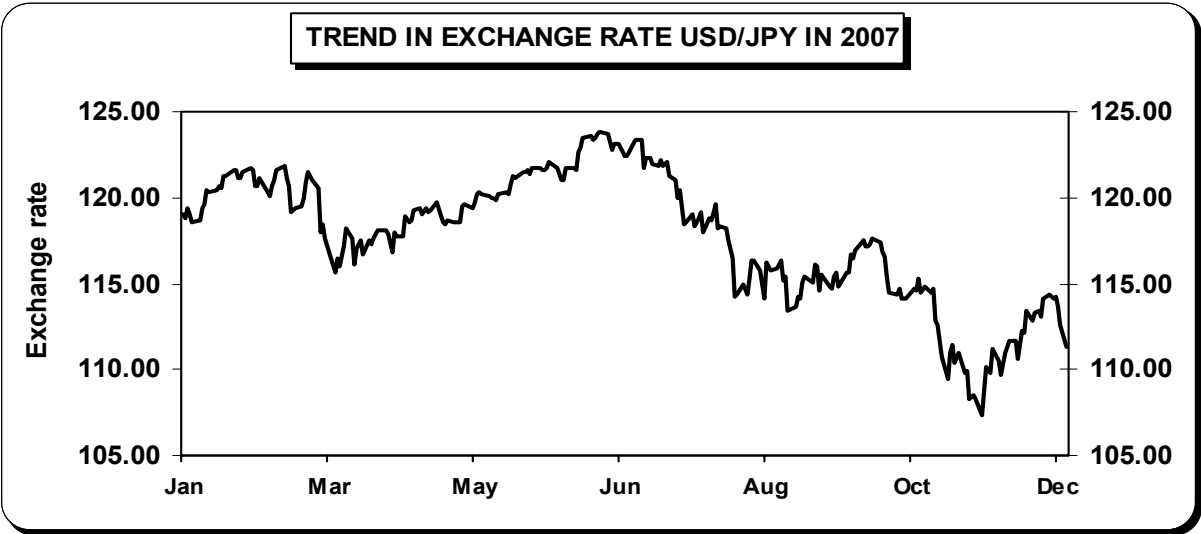


In the second quarter, aside from appreciation in May, the dollar's downward trend against the euro was pursued, moving from 1.3373 at the beginning of April to 1.3541 at the end of June. In April, projections for economic growth in the United States and in the euro zone continued to differ, bringing about a drop in the dollar of almost 2% against the euro, passing from 1.3373 to 1.3645. In the United States, difficulties in the real estate sector and slower growth in industrial production in March led investors to revise their short term growth estimates and to expect more flexible monetary policy from the Fed. In the euro zone, encouraging figures for industrial production and a better business environment in March and April along with gains on the job market in February and March contributed to better prospects for growth, leading investors to expect further monetary tightening by the ECB. On

27 April, the dollar traded at 1.3682, its lowest level against the euro since the single currency was introduced in 1999, following publication of GDP figures confirming slower growth in the US economy. At the beginning of May, the market began to revise downward the likelihood of recession in the US economy, and anticipation of further easing of US monetary policy gradually diminished. This revaluation of risk linked to growth is attributable mainly to upward revision of projections for GDP growth for the second quarter along with better job creation figures in May and enhanced manufacturing activity in April. The dollar then went up against the euro, moving from 1.3640 in early May to 1.3387 on 15 June, appreciating by 1.9% despite a new 25 base point increase in ECB rates on 6 June, bringing the refinancing rate to 4%.

Starting mid June, the dollar reverted to sliding against the euro, with expectation that the differential in interest rates would once again favour the single currency, while trouble in the subprime loan market and uncertainty about possible ensuing losses began to darken economic and financial prospects for the United States. The dollar closed for the quarter at 1.3541 to the euro.

As for dollar/yen parity, the differential in projected interest rates between the United States and Japan also influenced the yen over the first two months of the year. It depreciated by 1.6% against the dollar in January, evolving from 118.74 to the dollar at the beginning of the year to 120.65 on 31 January. The drop in the yen was tied to inflation that was lower than expected in Japan, caused by the Bank of Japan's monetary policy status quo, keeping its main key rate unchanged at 0.25% on 19 January, which was disappointing for investors. This trend continued until the end of February, despite a quarter point increase to 0.5% (21 February) in key rates in Japan, accentuated by strong national investor demand for foreign assets. Starting at the end of February, the yen began to appreciate against the dollar, taking advantage of both uncertainty concerning growth prospects in the United States and concerns about risky real estate loans in the US, which led speculators to close short positions in yen tied to carry trade transactions. This trend held until mid March, when dollar/yen parity stabilized around 117 yen to the dollar. Japan's currency closed for the quarter at 117.8.



The dollar steadily appreciated against the Japanese yen throughout the second quarter of 2007, the drop in the yen being attributable to a combination of several factors, notably expectation of a continuing status quo for Japan's monetary policy, ongoing demand from Japanese investors for foreign assets, and recovery in carry trade transactions. On 22 June, the yen posted 124.16, its lowest level against the dollar in two years. USD/JPY parity closed for the quarter at 123.14.

From the beginning of the third quarter until the first week of August, the dollar remained under pressure from both the euro and the yen, this period being marked by downward adjustment of US growth forecasts, crossing the bar of 1.38 against the euro and 118 against the yen. From 9 to 16 August, the dollar appreciated sharply against most currencies, except for the yen. Against the euro, it went from 1.3793 to 1.3423, a gain of more than 2.7%. Appreciation of the dollar during this period was due to greater aversion to risk and investor preference for safer US bonds that are easily turned into cash, with the subprime crisis spreading throughout the financial system and bringing about a banking liquidity crisis. Banks, eager to cover their own positions on risky assets, reduced their loans to other financial institutions. This led to drying up of liquidity and a sharp increase in interest rates. Decreased willingness to take risks was also evident in the rapid increase in the Japanese yen against most currencies, influenced by closing of carry trade transactions. The yen appreciated by 4.7% against the dollar over the period under review, from 119.63 to 114.24.

On 17 August the dollar once again took off on a downturn, following the Fed's decision to reduce its discount rate by 50 base points to 5.75%, while maintaining that of federal funds unchanged at 5.25%. The Fed justified this action by reference to deteriorating conditions on financial markets and by the growing risk of economic slowdown in the United States. The market interpreted the drop in the Fed's discount rate and its communiqué on risks threatening growth as preparing the ground for a drop in the federal fund rate. Expectation of monetary easing grew stronger following contraction of the job market, with 4000 jobs lost in August and downward projection of new jobs in July.

The pace of falling value for the dollar picked up starting 18 September, when the Fed for the first time in 2007 reduced the federal fund rate by 50 base points to 4.75% and for the second time the discount rate by 50 additional base points to 5.25%. The extent of this drop surprised the market and fed negative feeling about the US dollar, which closed for the quarter at 1.4271 to the euro. But the dollar changed very little against the yen, given greater willingness to accept risk following intervention by the Fed, leading to recovery in carry trade transactions on Japan's currency. Dollar/yen parity closed for the quarter at 114.8.

From the beginning of the fourth quarter until the end of November, the dollar depreciated by 3.2% against the euro and by 4.3% against the yen. Weakening of the dollar over this period reflected in particular greater concern about growth and stability in the US financial system. Indeed, balance sheets at banks seemed to be under pressure because of depreciation of assets, notably real estate claims and major provisions for consumer loans. This pressure led to a credit crunch, aggravating market pessimism about prospects for economic growth.

Over this period, Japanese indicators reflected a slight improvement in the Japanese economy, while those in the euro zone continued to project strong economic prospects. On

23 November the dollar posted 1.4966, its lowest level of the year against the euro, and on 26 November its lowest level of the year against the Japanese yen : 107.20.

In the area of monetary policy, the Federal Reserve reduced its main key rate by 25 base points for the second time on 31 October 2007, bringing it to 4.50%, and for the third time its discount rate to 5%, while the ECB held to the monetary status quo on 8 November by keeping its refinancing rate unchanged at 4%. On 11 December, the Federal Reserve proceeded with its last operation of the year to ease monetary policy by a 25 base point drop in the Fed Funds rate to 4.25% and the discount rate to 4.75%. The Fed's decision was based on its commitment to counter tougher loan conditions and fallout from the subprime crisis. In December, despite monetary easing by the Fed, the dollar rose against most of the main currencies, gaining more than 1% against the euro and the yen. Such strengthening of the dollar was due largely to rebalancing of global securities portfolios, closing of short positions on the dollar as the end of the year approached, and repatriation of profits earned abroad by US multinationals. The dollar closed for the year at 1.4589 against the euro and 111.33 against the yen, drops of 9.3% and 6.2% respectively for the year as a whole.

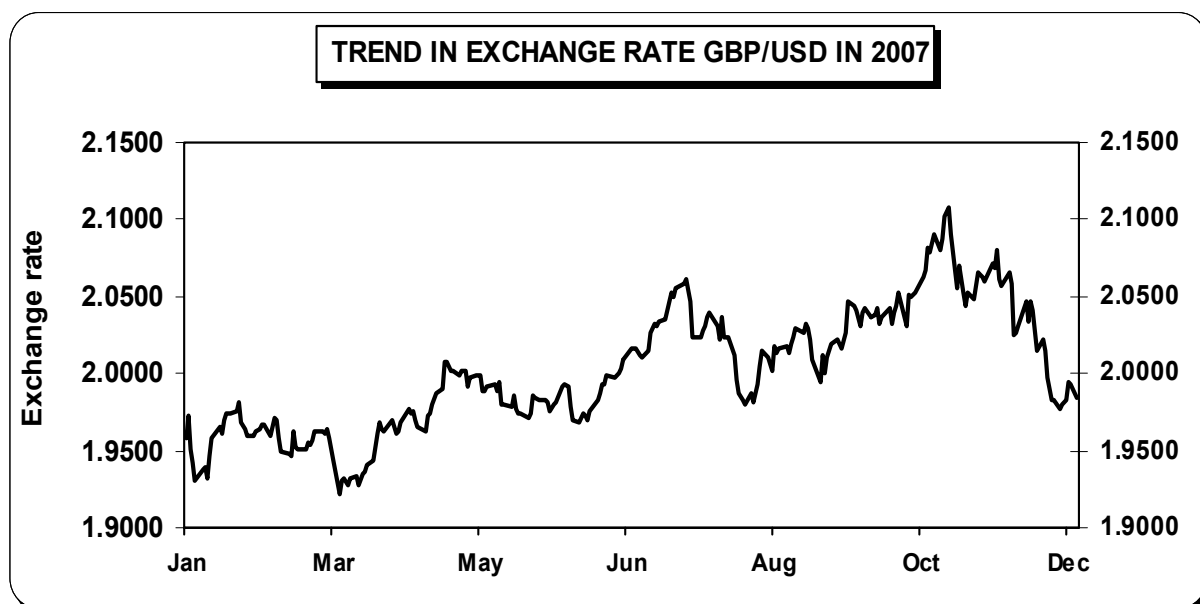
#### b. TRENDS IN GBP/USD

A weak US dollar throughout 2007 was advantageous to the pound sterling, which for the most part gained value until the first week of November, with the pound moving from 1.9646 USD at the beginning of the year to 2.1076 USD on 8 November, a gain of more than 7%. It then fell against the dollar to close for the year at 1.9847.

Upward movement for the pound sterling over the first quarter was due mainly to sustained growth in GDP in Great Britain. The risk of inflation grew over this period, causing the Bank of England to raise its main key rate by 25 base points to 5.25% on 11 January, neutralising the differential in interest rates between Great Britain and the United States. But there was a short period when the pound depreciated, over the first 10 days of March, linked to market disappointment about the decision taken by the BoE's monetary policy committee to keep its key rate unchanged, given uncertainty about consumer expenditure and the job market. The pound posted 1.9217 USD on 5 March, its lowest level of the year against the US dollar. But the pound then quickly recovered, and even gained ground at a faster pace starting in April, following announcement of an inflation rate of 3.1% in March, the highest level in 10 years, raising expectations of further monetary tightening by the BoE. This did indeed transpire, with two 25 base point increases in the main key rate on 10 May and 5 July, bringing it to 5.75%, the highest level since April 2001.

The trend reversed toward the end of July, with the pound briefly losing ground against the dollar, until the third week of August, moving from 2.0540 on 26 July to 1.9810 on 21 August, a drop of 3.6%. This weakening of the pound was linked to greater aversion to risk, following turbulence on the financial market after settlement of carry trade speculative positions that had benefited the pound due to high yield.

Starting the last week of August, the pound started gaining once again against the dollar, until the first week of November. The British currency reached its highest level of the year on 8 November (2.1117 USD) before a final period of depreciation that lasted until the end of the year.



According to analysts, weakening of the pound was likely linked to anticipation of slowing growth in the British economy, in reaction to successive increases in UK interest rates. Higher rates seem to have slowed down consumption and investment, due to concern about the extent of Great Britain's current deficit, along with the higher cost of external financing of this deficit linked to tighter credit in the wake of the subprime crisis. Slowing economic growth and efforts to keep inflation down to about 2% since the beginning of the fourth quarter led the Bank of England to ease monetary policy for the first time in more than two years, reducing its main key rate by 25 base points on 6 December to 5.5%. Britain's currency closed for the year at 1.9847, an overall increase of just 1% compared to the start of 2007.

## 2. EMERGING COUNTRIES

Again in 2007, economic performance in emerging countries, mainly in Asia, was well above projections, with GDP growth higher than expected in almost all countries, thanks to strong domestic demand and dynamic foreign trade. This favoured appreciation of currencies in most of these countries, some reaching record levels. Despite worsening world conditions (due in particular to the subprime crisis), Asian countries continued to do well, thanks in particular to dynamic economic performance in China and India. As in the past few years, China's economy continued to expand, growing at a rate of 11.4% in 2007, up from 11.1% in 2006, despite active intervention by the authorities to cool it down. China's trade surplus further rose by almost 47.7% in 2007, reaching a record level of 262.2 billion dollars, vs. 177.5 billion in 2006. Furthermore, net inflows of FDI were up by more than 56% in 2007. Such massive inflows of foreign currency, along with faster loss of value for the dollar against the main international currencies, pushed the yuan up to 7.3036 CNY to the dollar at the end of 2007, compared to 7.8135 CNY at the beginning of the year, appreciation of almost 7%.

#### RANGE OF VARIATION FOR THE MAIN CURRENCIES OF EMERGING COUNTRIES IN 2007

Exchange rate	Opening	Closing	Variation* In %
USD/CNY	7.81	7.30	7.0
USD/INR	44.11	39.38	12.0
USD/MYR	3.53	3.31	6.6
USD/THB	35.35	29.90	18.2
USD/KRW	926.80	935.70	-1.0
USD/PLN	2.90	2.47	17.4
USD/HUF	190.12	172.83	10.0
USD/CZK	20.82	18.17	14.6
USD/RUB	26.32	24.60	7.0
USD/TRY	1.41	1.17	20.5
USD/MAD	8.39	7.77	8.0
USD/EGP	5.70	5.52	3.3

(\*) Variation of the local currency against the dollar.

Similarly, the Indian rupee gained value against the US dollar in 2007, moving from 44.11 INR to 39.38 INR, appreciation of some 12%. Strengthening of India's currency was due to faster growth in industry and services and higher net flows of FDI, the main source of foreign currency for this economy. The surplus in capital transactions, estimated at 5% of GDP, was more than enough to cover the trade deficit, estimated at 2.1% of GDP in 2007.

As for the other Asian countries, most of the currencies of the region held firm against the dollar, except for the Korean won. Strengthening of Asian currencies was due mainly to the higher increase in foreign exchange reserves, which reached record levels in 2007.

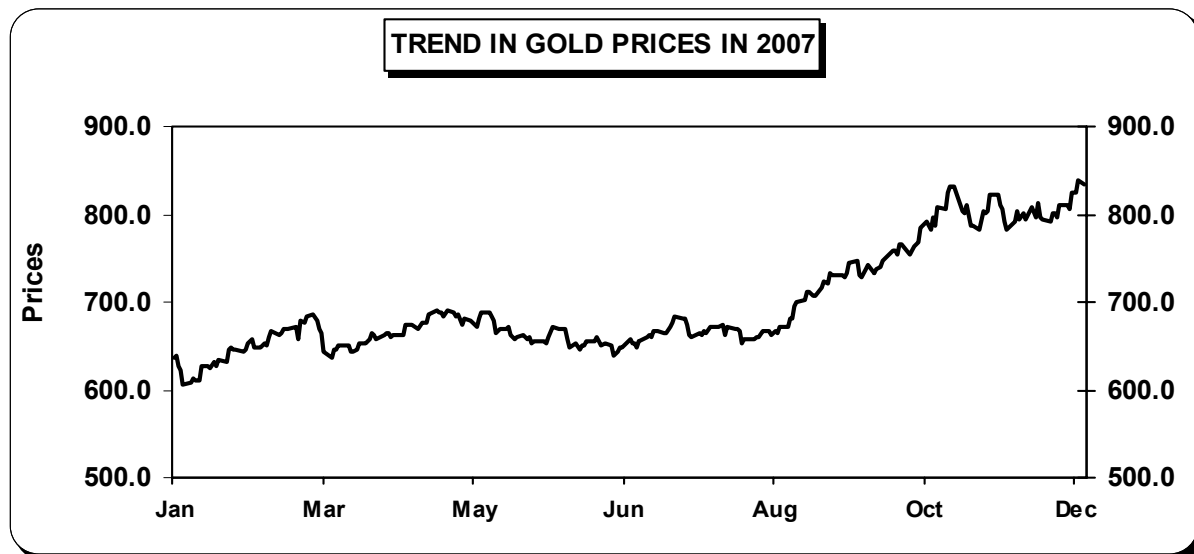
Despite the stir on world financial markets caused by the subprime crisis in the United States, economies in eastern Europe continued to perform well, supported by major inflows of capital thanks in particular to rigorous economic policies. As for foreign exchange, a favourable business environment along with a weakening dollar against Europe's single currency favoured appreciation of currencies in most of the countries of the region against the greenback.

In Russia, the growth rate climbed to 8.1% in 2007, up from 7.4% in 2006, helped by sound domestic demand, soaring prices for oil, and high growth in investments. Furthermore, trade and current balances remained quite positive, favouring a record of uninterrupted growth since 1999 for the Russian rouble, which came to 24.60 RUB to the dollar at the end of 2007, having started the year at 26.32 RUB, appreciation of almost 7%.

#### **B. THE GOLD MARKET**

Gold price rose sharply in 2007, mainly over the second half, recording an increase of 30% for the year after opening at 636 USD/oz. The dollar gained value in early January, oil prices dropped, geopolitical tension slackened, and overall investor optimism led to liquidation of gold positions by speculative funds, pushing prices down to 602 USD/oz on 5 January, its lowest level of the year. This downward phase did not last for long. Low gold prices encouraged sales of physical gold, mainly from Asia (especially Thailand, India and the Middle East), with jewellers and investors taking advantage of the opportunity to build up stocks. Analysts also reported reconstitution of positions by speculative funds, against a

background of rising prices for oil and the drop in the US dollar. The price of gold thus gradually bounced back to 689 USD/oz at the end of February.



The sharp drop in the Chinese stock market at the end of February brought about a wave of liquidation on the markets dealing in various categories of assets. Gold price dropped in the wake of profit taking, meant in particular to raise funds to meet margin calls linked to losses on stock markets. Gold fell to 633 USD/oz on 6 March, which turned out to be a good level of support, and for the rest of the month gold continued to recover lost ground. Rising geopolitical tension in the Near East, the high cost of oil, and disappointing US economic indicators weakened the dollar and pushed up the price of gold. Furthermore, gold was boosted by data confirming a drop in gold production, the announcement by Germany that it would not sell its quota of gold in 2007, and sale of gold by institutional traders, notably the central banks of eastern Europe. Gold price continued to climb in April, reaching 693 USD/oz on the 23rd. But they did not cross the psychological threshold of 700 USD and this triggered a wave of profit taking that weighed on prices, with gold evolving on a weak note until July. Appreciation of the dollar over the period May-early June on the strength of good news about the US economy, improvement on stock markets around the world, and higher bond yields all contributed to the greater cost of holding onto gold. Sale of gold by the Spanish central bank (40 tonnes in March and April and 28 tonnes in May) and by the ECB (28 tonnes in May) and lower geopolitical tension were other factors pushing the price of gold down. Initial signs of the subprime crisis and the drop in stock markets, paradoxically, were not initially favourable to gold, due to liquidation of speculative positions in the overall context of aversion to risk. Thus gold price fell to 638 USD/oz on 27 June.

It was at the beginning of July that gold prices started going up again, with investors seeming to take advantage of the better conditions for buying this precious metal. Gold traded at 687 USD/oz on 24 July. August was another month of high volatility for gold, which was unable to take off despite a weaker dollar and unrest on financial markets, posing questions about the diminished attraction of gold as a safe investment. But closer analysis shows that gold (and raw materials in general) suffered during the subprime crisis, since it is a liquid asset, easy to sell to raise cash, which is exactly what many funds in difficulty did. These

negative factors were at times offset by strong demand on the part of Asian investors or jewellers eager to build up their inventory as well as take advantage of low prices for gold and a weak dollar. Thus gold prices fell to 641 USD/oz on 16 August, before embarking on a period of strong appreciation that lasted until the end of the year. And once it crossed the psychological barrier of 700 dollars, gold rallied, influenced by concern about the state of financial markets, fears of a credit crunch (given the growing difficulties encountered by the biggest international banks), the sharp increase in oil prices (causing fears of renewed inflationary pressure), and the dollar's downward spiral, so that gold once again played its role of safe investment. Gold reached its highest value of the year (845 USD/oz) on 7 November, then consolidated its gains over the remainder of the year, closing at 833 USD/oz.