

Executive Summary

Polished Prices Rise

- Average prices of certified polished diamonds rose 1.6 percent in January 2011.
- Prices were 11.7 percent above levels seen a year ago.
- Trade was driven by Far East demand in advance of the Chinese New Year, which started February 3, and some cautious restocking by U.S. wholesalers and retailers.
- Shortages persisted in popular categories.

Strong Rough Demand

- De Beers Diamond Trading Company (DTC) kept prices relatively stable.
- Premiums on DTC boxes increased to double digits.
- Strong demand was fueled by shortages and expectations of future price increases.
- Indian manufacturers anticipated final Kimberley Process (KP) approval for exports from Zimbabwe's Marange mine.

High Retail Expectations

- Caution lingered in the U.S. despite strong Holiday sales.
- Sales forecasts are positive for Valentine's Day.
- Expectations are high for the Chinese New Year period.

Conclusion

Polished trading was stable-to-positive in January and the uptrend in demand is expected to continue at a moderate pace in the coming months. Cutters are expected to ramp up manufacturing in an attempt to alleviate shortages in the market.

Their ability to do so will largely depend on the availability of rough supply and their assessment as to whether the margins gained on the resulting polished are sustainable. Demand for rough is expected to heat up prior to the next DTC sight, which begins February 21, with a price hike expected by the De Beers sales and distribution unit.

The industry will be watching the Chinese New Year retail season closely as demand in the Far East is expected to continue to drive market growth. In addition, the industry will be looking at U.S. Valentine's Day sales to assess whether the positive Christmas period was a flash in the pan or a signal that a real consumer recovery has begun.

Polished Markets

Average prices of certified polished diamonds rose 1.6 percent in January, continuing the uptrend seen toward the end of 2010. Increases were most apparent in 1-carat sizes, where the average price rose 3.1 percent during the month (Figure 1).

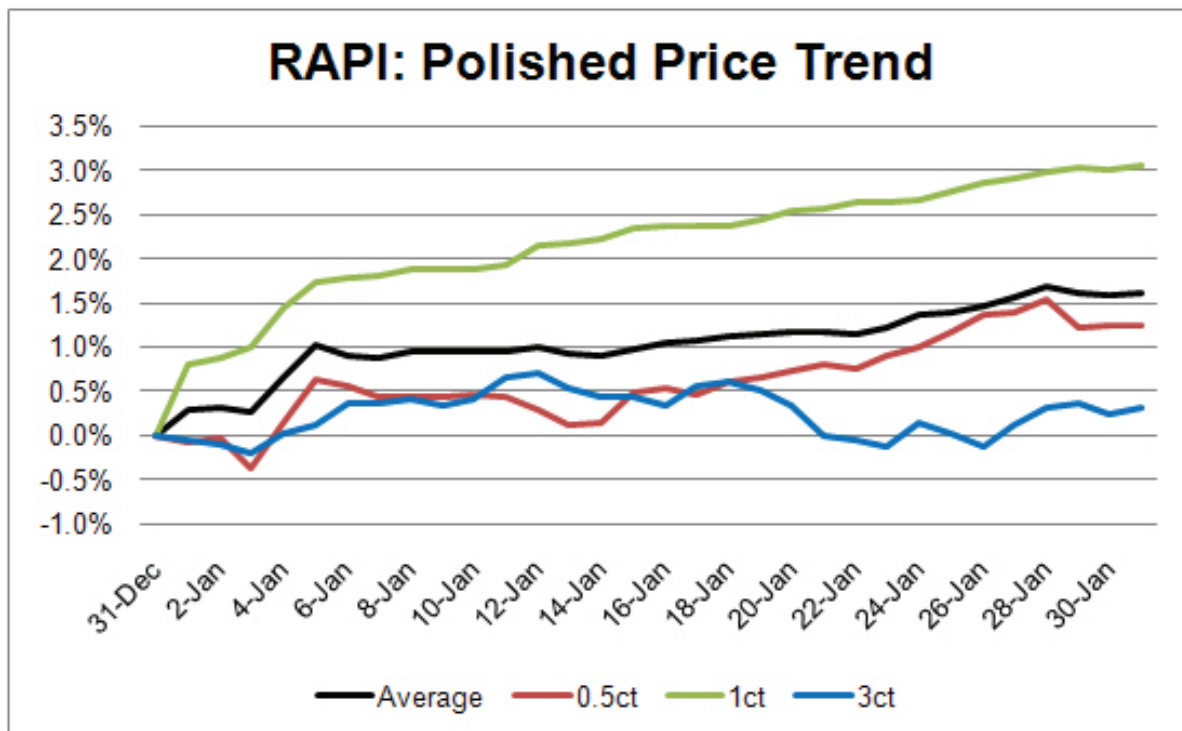


Figure 1

RapNet Asking Price Index (RAPI) is the average RapNet best asking price for D-H, IF-VS2, VG+ diamonds. Rapaport Spec 2, Round, D-H, IF, X, X-VG, GIA-HRD-AGS

The pace of growth in average polished prices gained momentum in January from December (Figure 2). The increases were spurred by strong demand for 1-carat stones during the month, whereas 3-carat stones weakened. Average prices at the end of January were 11.7 percent higher than a year ago.

RAPI: Certified Polished Diamond Price Changes			
Categories	Jan '11	Dec '10	Y2Y Changes
Average	1.6%	0.8%	11.7%
0.5 carat	1.3%	0.7%	5.4%
1 carat	3.1%	0.1%	14.9%
3 carat	0.3%	3.2%	25.3%

Figure 2

RapNet Asking Price Index (RAPI) is the average RapNet best asking price for D-H, IF-VS2, VG+ diamonds. Rapaport Spec 2, Round, D-H, IF, X, X-VG, GIA-HRD-AGS.

There were consistent reports of shortages in the market across all trading centers. Indian demand was strongest for stars and smalls up to 0.5 carats in all categories, and 1-carat, H-J, VS-SI goods. Traders in other centers — Israel, Belgium and the U.S. — noted shortages in a broader size range, from 0.75-carat to 3.00-carat, VS-SI goods.

There are indications that U.S. wholesaler stocks were depleted during the Christmas season and that some level of restocking will occur during the first quarter. Price gaps remain between the U.S. and the manufacturing centers because U.S. buyers have not fully accepted the new prices. Still, buyer price resistance is less than that experienced in 2010. In addition, sellers appear willing to hold out on closing transactions if they do not get the price they are looking for, as they anticipate future price increases.

Rough Market

Demand for rough was strong in January, with the DTC sight valued at an estimated \$650 million, making it the largest site in just over two years (Figure 3).

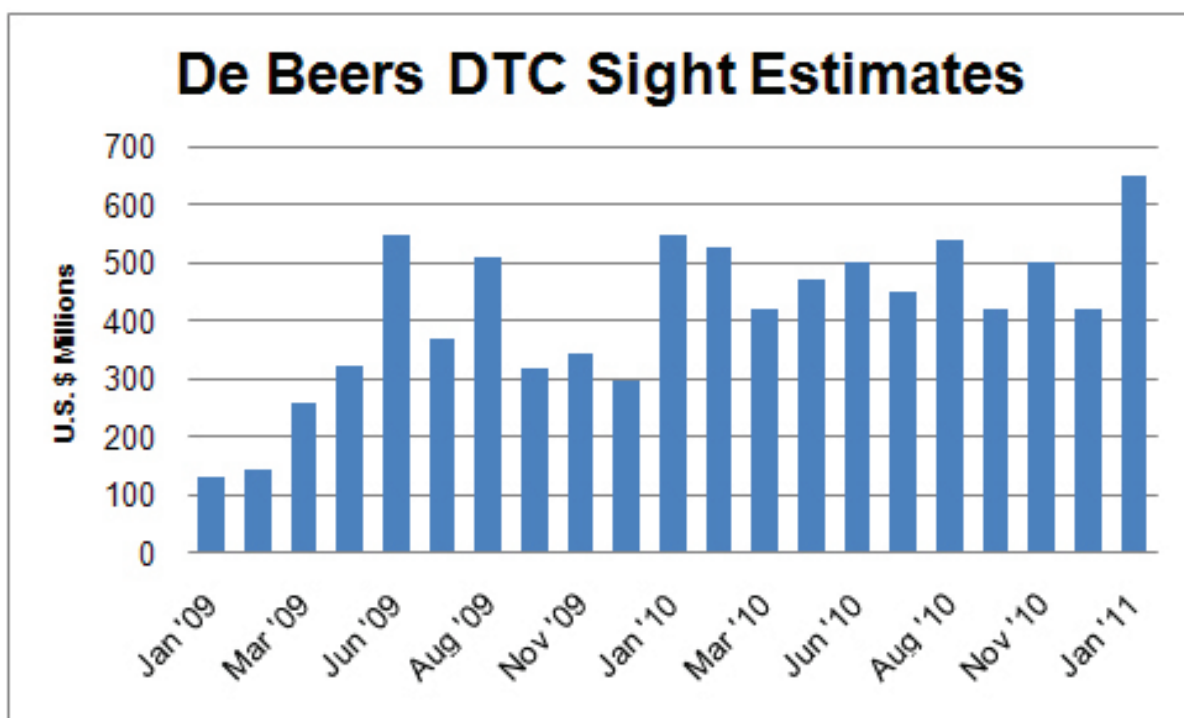


Figure 3

Source: Rapaport Estimates

DTC kept prices relatively stable, which spurred strong trading in the secondary market and pushed premiums on DTC boxes up to an estimated average of 10 percent. The mid-tier mining companies — notably Petra Diamonds and Gem Diamonds — were bullish in their assessments of the rough market, based on the fact that prices at their respective tenders continue to strengthen.

There is some anticipation that DTC will raise prices at its February site, after De Beers has published its full-year results and more fully analyzed both Far East demand from the Chinese New Year and the actual strength of the U.S. Christmas season.

Strong rough prices have been encouraged by shortages of supply in the market. Manufacturers, particularly in India, are hoping that the pending access to stock from the Marange mines in Zimbabwe will help alleviate the shortages. Members of the Kimberley Process Certification

Scheme (KPCS) reached a written consensus to allow the exports, but they still must receive formal approval from Zimbabwe and the KP chair. Rapaport estimates that several million carats of Marange goods are awaiting final clearance.

Retail Market

January is generally a quieter period for U.S. retail following the busy Christmas season. Retailers spent the month taking stock and preparing for Valentine's Day on February 14. Research and trade groups, including IBISWorld and the National Retail Federation (NRF), expect jewelry sales on Valentine's Day to grow by strong double-digit percentages over 2010.

More significant for this time of the year is the Chinese New Year, which is a busy shopping and gift-giving season, and a popular time for Chinese couples to get married. These factors have fed expectations that Chinese retail sales will continue to grow in the coming months.

Economic Factors

- U.S. gross domestic product (GDP) rose 3.2 percent in the fourth quarter 2010, led by a 4.4 percent rise in consumer spending, according to the "advance" estimate released by the Bureau of Economic Analysis (BEA).
- The Federal Reserve maintained its lending rates at a record low of zero percent to 0.25 percent. The Fed noted that "the economic recovery is continuing, though at a rate that has been insufficient to bring about a significant improvement in labor market conditions."
- China's GDP grew 9.8 percent in the fourth quarter, despite government efforts to slow the property market and restrict bank lending. The Chinese economy grew 10.3 percent in 2010, according to National Bureau of Statistics of China.
- Spot gold price rose 6.3 percent in January to close the month at \$1,337.5 per ounce. The U.S. dollar depreciated by 2.2 percent in January to close the month at a rate of \$1 = 0.7303 euros.

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