

RARE ELEMENT RESOURCES LTD.
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2006
Containing information up to, and including February 27, 2007

Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the consolidated financial statements of Rare Element Resources Ltd. ("Rare Element" or the "Company"). The information provided herein should be read in conjunction with the Company's consolidated financial statements and notes for the six months ended December 31, 2006.

Management is responsible for the preparation and integrity of the consolidated financial statements, including the maintenance of appropriate information systems, procedures and internal controls. Management also ensures that information used internally or disclosed externally, including the consolidated financial statements and MD&A, is complete and reliable.

The Company's board of directors follows recommended corporate-governance guidelines for public companies to ensure transparency and accountability to shareholders. The board's audit committee meets with management regularly to review the consolidated financial statements, including the MD&A, and to discuss other financial, operating and internal-control matters.

The reader is encouraged to review the Company's statutory filings on www.sedar.com.

All currency amounts are expressed in US dollars unless otherwise noted.

Overall Performance

The Company's principal activity is the acquisition and exploration of mineral properties.

The Company was incorporated in the province of British Columbia on June 3, 1999 and acquired Paso Rico Resources Ltd. ("Paso Rico") in 2003. Paso Rico owns the Bear Lodge Property in Wyoming, USA, through its wholly owned subsidiary, Paso Rico (USA), Inc.

In April 2006, the Company acquired 26 claims totaling approximately 58.9 hectares in Quebec by staking. The property is located about 90 km northwest of North Bay, Ontario.

During the six months ended December 31, 2006, the Company closed non-brokered private placement for the gross proceeds of \$897,917 (\$1,000,021 CDN). Proceeds from the offering increased working capital to approximately \$1.1 million and provided funding for exploration of the Company's Bear Lodge, Wyoming, rare-earth property and funding for potential strategic-metals project acquisitions.

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Exploration expenditures on resource properties:

	Balance June 30, 2005	Expenditures for the year	Balance June 30, 2006	Expenditures for the six months	Balance December 31, 2006
Bear Lodge Property					
Property acquisition costs	\$ 17,721	\$ -	\$ 17,721	\$ -	\$ 17,721
Exploration expenditures					
Assays	3,528	4,109	7,637	-	7,637
Assessments and taxes	12,541	7,563	20,104	-	20,104
Drilling	132,013	118,396	250,409	-	250,409
Geological consulting	60,567	61,416	121,983	9,973	131,956
Geophysical	-	300	300	-	300
Metallurgical testing	-	-	-	38,530	38,530
Overhead expenses	7,684	805	8,489	540	9,029
Staking	816	17,133	17,949	-	17,949
Survey	34,338	-	34,338	-	34,338
Travel expenses	23,935	-	23,935	-	23,935
Wages	99,734	-	99,734	-	99,734
Total exploration expenditures on Bear Lodge property	392,877	209,722	602,599	49,043	651,642
Kipawa Property					
Exploration expenditures					
Geological consulting	-	4,949	4,949	-	4,949
Staking	-	1,308	1,308	-	1,308
Total exploration expenditures on Kipawa property	-	6,257	6,257	-	6,257
TOTAL EXPLORATION EXPENDITURES	\$ 392,877	\$ 215,979	\$ 608,856	\$ 49,043	\$ 657,899

Bear Lodge Property

Paso Rico holds a 100% interest in a group of unpatented mineral claims, the Bear Lodge Project property. The property is situated in the Bear Lodge Mountains of northeast Wyoming. These claims were, in part, acquired from Phelps Dodge Exploration Company ("Phelps Dodge") by way of a "Mineral Lease and Option for Deed". Some of the claims and a portion of a defined area of influence surrounding the claims are subject to a production royalty of 2% of Net Smelter Returns ("NSR") payable to Phelps Dodge. Paso Rico owns a portion of the claim group outright and those claims are not subject to the NSR.

The Company staked 20 additional claims at the property in 2005. The property now comprises 90 federal unpatented mineral claims and a 640-acre Wyoming state lease for a total of approximately 2,100 acres. All claims are located on federal lands and are subject to a \$125 per year annual maintenance fee payable to the United States Bureau of Land Management, which are now and will continued to be paid by Newmont for the term of Newmont Agreement (see below).

The Bear Lodge Project has indications of precious metals and "rare-earth elements" ("REE"). Rare-earth elements are used in hybrid-electric-vehicle (HEV) batteries and motor/generators, consumer nickel-metal-hydride (Ni-MH) batteries, fuel cells, magnetic refrigeration technologies, and numerous other modern specialty technologies.

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The mineral claims that comprise the Bear Lodge Project have been extensively explored for the rare-earth elements, as well as precious metals and base metals, by a number of major mining companies at various periods over the past 50 years. These various exploration campaigns have identified a number of rare-earth and precious metals indications that the Company believes warrant further exploration and evaluation.

The Company began exploration of the Bear Lodge Project properties in late 2004. Two drill holes targeted previously known rare-earth-bearing carbonatite dikes. These holes were successful in intersecting good grades of rare-earth mineralization and in confirming previous data. A third hole was unsuccessful in testing one interpretation of data that appears to predict a larger carbonatite intrusion. Data from this hole will, however, be helpful in further evaluating this and other targets in the area.

In October of 2005 Rare Element Resources drilled two core holes, RES05-1 and RES05-2 totaling 2,174 feet, in the Bull Hill area. The holes were drilled to test the rare-earth-element (REE) content and continuity of a dike-swarm, which was identified by Hecla Mining Company (“Hecla”) during the period from 1987 through 1991. Drill-hole RES05-2 was collared at the site of Hecla drill-hole WP-6 and tested the down-dip extension of the dike-swarm. It intersected a series of REE-mineralized iron-manganese, silicocarbonatite, and carbonatite veins, dikes, and stockworks, which were contained within the heterolithic intrusive breccia body of the Bull Hill area. Drill-hole RES05-1 was designed to test the northwesterly strike extension of the REE-mineralized dike-swarm; however, it remained in intrusive breccia with only minor intersections of iron manganese, silicocarbonatite dikes and veins.

The compilation of data and the resulting quality of the targets, which were generated, confirm the exceptional rare-earth-element exploration potential of the Bear Lodge property. Based on this compilation of data, the Company announced a 2006 exploration program, which will feature drilling and metallurgical work to confirm the historical tonnage estimate, which was the result of Hecla’s work on the Bull Hill dike-swarm. The goal of this work is to produce a current NI 43-101-compliant REE resource. Toward this goal, the Company has started preliminary metallurgical tests on the rare earths mineralized materials to determine how these materials could be concentrated and eventually produced in the most economical way. New drilling, as laid out in the 2006 exploration program will begin in the spring of 2007. Further information about past drilling results can be found in past news releases posted on the Company’s Sedar site (www.sedar.com).

On June 1, 2006, the Company’s wholly owned subsidiary, Paso Rico (USA) Inc. and Newmont North America Exploration Limited (“Newmont”), a subsidiary of Newmont Mining Corporation, signed an agreement to establish a gold exploration venture on the Company’s Bear Lodge, Wyoming property (“Venture”). Under the term sheet, Newmont has the right to earn a 65% participating interest in the Bear Lodge property, excluding any rights to the rare-earth elements and uranium, but including rights to gold and other metals if Newmont spends \$5 million in property exploration by 2011.

Newmont also has the right to earn an additional 15% participating interest by completing a positive feasibility study. If the Company’s interest is reduced to 20% for any reason, the Company shall have a financing option by which it may elect for Newmont to carry the Company’s share of Venture expenditures, without further dilution to the Company, until commencement of mining on the property. The funds advanced by Newmont under the financing option, plus interest at LIBOR plus 3%, shall be recouped from 90% of the Company’s portion of the proceeds from production.

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Newmont has staked an additional 116 Federal lode mineral claims and included them as part of the Venture's property. Newmont is the operator of the Venture's gold-exploration program, which is underway. The Company will continue to operate its rare-earth-element exploration program; however, if the two exploration programs conflict, the Venture, under Newmont, may operate both programs.

In the fiscal 2007, the Company incurred \$49,043 in exploration expenditures on its properties. As at December 31, 2006, the Company had incurred a total of \$651,642 (June 30, 2006 - \$602,599) on exploration work at Bear Lodge.

In October 2006, Newmont completed nine reverse-circulation drill holes (1,687 metres of reverse-circulation drilling) and two core holes (535 metres of core drilling). Six trenches have been constructed for a total length of 945 metres of trenching. The trenches were mapped, sampled and geophysically surveyed for radiometric and magnetic susceptibility. Cores and chip samples from the drilling program were split, sampled and assayed. The results demonstrate significant potential for the definition of surface gold deposits, as well as potential for deeper higher-grade gold occurrences. Further information about drilling results can be found in www.sedar.com, October 12, 2006 and January 18, 2007 news releases.

The second-year program of the gold-exploration venture agreement calls for Newmont expenditures of \$700,000 (total Newmont expenditures through the end of the second year would then be \$1,200,000). It will include project planning, further drilling and geological field studies. Field work will begin in spring of 2007.

Kipawa Property

In April 2006, the Company acquired 26 claims by staking in Quebec, Canada,, totaling approximately 1531 hectares. The property is located about 90 km northwest of North Bay, Ontario. As of December 31, 2006, the Company had spent \$6,257 (June 30, 2006 - \$6,257) on this property. The Company is looking to acquire further properties in this area before any exploration work is to begin.

Selected Annual Information

	Year ended June 30, 2006	Year ended June 30, 2005	Year ended June 30, 2004
	\$	\$	\$
Total revenues	Nil	Nil	Nil
General and administrative expenses	458,407	145,082	192,473
Write-off of resource-property costs	Nil	Nil	Nil
Loss for the year	(458,407)	(145,082)	(192,473)
Loss per share – basic and diluted	(0.03)	(0.01)	(0.00)
Total assets	1,094,740	521,392	401,103
Total long-term financial liabilities	Nil	Nil	Nil
Cash dividends declared – per share	Nil	Nil	Nil

The increase in total assets from 2005 to 2006 reflected an increase in cash as a result of the \$196,928 private placement completed and the proceeds of \$764,085 received from the exercise of warrants and options during 2006. Of the cash received from the issuance of common shares, \$211,641 was used in the exploration of the Bear Lodge property. In 2006, the Company's general and administrative expenses also increased as a result of an increase in the Company's activity level, which resulted in higher investor-relations, management, legal and stock-based-compensation costs.

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Summary of Quarterly Results

Expressed In \$	Dec 06 Quarter	Sep 06 Quarter	June 06 Quarter	Mar 06 Quarter	Dec 05 Quarter	Sep 05 Quarter	Jun 05 Quarter	Mar 05 Quarter
Total Revenue	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Loss	(309,821)	(227,358)	(58,581)	(150,168)	(105,851)	(143,807)	(29,749)	(27,896)
Loss Per Share	(0.02)	(0.01)	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.00)
Total Assets	1,911,495	1,907,636	1,094,740	1,127,231	634,418	476,604	521,392	543,301
Total Long-term Liabilities	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Cash Dividends Declared	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil

Results of Operations for the three months ended December 31, 2006 compared to the three months ended December 31, 2005.

The results of operations for the second quarter of fiscal 2007 totaled \$309,821 compared to \$105,851 in the same period of 2006. The increase of \$203,970 in operating expenses was mainly due to the non-cash increases of \$95,232 in stock-based compensation expenses and \$46,757 in foreign-exchange losses on the conversion of the Canadian operation into US currency. The total increase in other administrative expenditures was \$61,981. The new investor relation program on European and Canadian investors resulted in an increase of \$40,632 in investor relations and travel expenditures. The closing of the September 2006 private placement and the exercise of the Company's warrants resulted in increase of \$7,453 in transfer and listing fees. The management and professional fees also increased by \$7,242 in the second quarter of 2007 as the result of the increase in the Company's activities.

The loss per share for the second quarter of 2007 and 2006 was comparable and equal to \$0.01.

Results of Operations for the six months ended December 31, 2006 compared to the six months ended December 31, 2005.

The results of operations for the six months of fiscal 2007 reflected the increase in administrative and financing activity level compared to the same period in fiscal 2006. In the six months ended December 31, 2006, the Company's net loss totaled \$537,179 (loss per share of \$0.03) compared to a net loss of \$249,658 (loss per share of \$0.02) in the same period of fiscal 2006. The Company had no operating revenue in either period. A loss on foreign exchange totaled \$52,752 in the first six months of fiscal 2007, compared to \$1,094 in 2006 as a result of a strong Canadian dollar compared to the US dollar.

The increase of \$287,521 in operating expenses in the six months ended December 31, 2006 compared to the same period last year was due to increases of \$83,805 in investor relations expenditures, \$9,122 in accounting and administrative fees, \$13,411 in office and miscellaneous, and \$11,553 in transfer and listing fees. These increases in operating expenses in the two quarters of 2007 were a result of the increased general and administrative activities of the management, who took more aggressive approach to investor awareness and to set new development strategies for the Company. The Company implemented a shareholder and investor relations program in Europe and participated in European and Canadian trade shows to give presentations to potential investors. Additional administrative expenditures were incurred on the closing of the September 2006 offering. The increase of \$100,677 in stock-based compensation expense was due to the increased amount of options vested during the six months of 2007 compared to 2006.

Liquidity

As at December 31, 2006, cash totaled \$1,217,911, an increase of \$789,644 from \$428,267 as at June 30, 2006. The Company's working capital as at December 31, 2006 was \$1,220,326 (June 30, 2006 - \$443,003).

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The increase of working capital and cash was due to the funds received pursuant to the private placement (\$897,917 (\$1,000,021 CDN)), the exercise of warrants (\$252,118 (\$284,280 CDN)), and the exercise of options (\$19,332 (\$22,250 CDN)). This increase in cash was offset by deferred exploration costs of \$49,043, the purchase of computer equipment of \$868, and the increase in general and administration expenses of \$329,812 (see "Results of Operations for the six months ended December 31, 2006"). The Company has sufficient funds to complete programs planned for the upcoming calendar year; however, the Company is searching for additional property acquisitions and acquisition budgets normally require significant additional funding. In the event that the Company acquires a property, it will most likely fund the acquisition through the sale of equity.

Capital Resources

The authorized share capital of the Company consists of an unlimited number of common shares without par value.

	No. of Common Shares Issued	Share Capital Amount
June 30, 2006	18,273,425	\$ 3,463,293
December 31, 2006	20,972,723	\$ 4,653,842
February 27, 2007	20,972,723	\$ 4,653,842

During the six months ended December 31, 2006, the Company closed a non-brokered private placement of 1,666,698 units at \$0.60 CDN per unit for gross proceeds of \$897,917 (\$1,000,021 CDN). Each unit comprises one common share and one-half of a non-transferable share purchase warrant. A whole warrant may be exercised to purchase one additional common share of the Company, at \$0.75 CDN per share until March 22, 2008. These funds are to be spent on the Bear Lodge Rare Earths exploration, including the drilling to be done early in 2007, on new property acquisitions and on general working capital. With the exception of ongoing administration costs, as of the date hereof, most of these funds are still on hand pending beginning of the exploration season at Bear Lodge.

As at December 31, 2006, the Company had 2,495,000 stock options outstanding with exercise prices ranging from \$0.20 CDN to \$0.55 CDN expiring from October 31, 2008 to April 28, 2011. If all the remaining outstanding options were exercised, the Company's available cash would increase by \$936,750 CDN.

As at December 31, 2006, the Company had 833,349 warrants outstanding issued in connection with the September 2006 private placement at a price of \$0.75 CDN. If the warrants outstanding were exercised, the Company's available cash would increase by \$625,012 CDN.

On July 17, 2006, the remaining 350,400 shares held in escrow were released, resulting in no more escrowed shares as at December 31, 2006.

Contributed surplus was \$290,379 as at December 31, 2006 (June 30, 2006 - \$116,579). The increase in contributed surplus represents the fair value of vested stock options granted to officers, directors, and consultants of the Company during the period ended December 31, 2006, less the fair value of the stock options exercised during the first six months of fiscal 2007.

The deficit was \$3,055,192 as at December 31, 2006 (June 30, 2006 - \$2,518,013). The increase is the result of the loss of \$537,179 for the six months ended December 31, 2006.

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Potential environmental contingency

The Company's mining and exploration activities are subject to various federal, provincial and state laws and regulations governing the protection of the environment. These laws and regulations are continually changing and generally becoming more restrictive. The Company conducts its operations so as to protect public health and the environment and believes its operations are materially in compliance with all applicable laws and regulations. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations. The ultimate amount of reclamation and other future site restoration costs to be incurred for existing mining interests is uncertain.

The Company maintains a website at www.rareelementresources.com.

Transactions with Related Parties

During the six months ended December 31, 2006, \$37,193 (2005 - \$30,307) was charged for management fees by a private company controlled by the president. As at December 31, 2006, \$6,367 (June 30, 2006 - \$Nil) was owed to this private company.

During the six months ended December 31, 2006, \$49,729 (2005 - \$40,410) was charged by a private company controlled by one of the directors for accounting, administrative fees and rent. As at December 31, 2006, \$6,053 (June 30, 2006 - \$9,556) was owed to this private company.

During the six months ended December 31, 2006, \$Nil (2005 - \$1,724) was capitalized in deferred exploration costs for geological consulting work performed by a director. As at December 31, 2006, \$Nil (June 30, 2006 - \$Nil) was owed to this director.

The amounts bear no interest and are unsecured with no repayment terms.

Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to permit timely decisions regarding public disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of November 30, 2006. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to ensure that information required to be disclosed in reports that are filed or submitted under Canadian securities legislation are recorded, processed, summarized and reported within the time period specified in those rules.

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Risks and Uncertainties

The Company's financial success will be dependent upon the extent to which it can discover mineralization or acquire mineral properties and the economic viability of exploring its properties.

The Company competes with many companies possessing greater financial resources and technical facilities than itself. The market price of minerals and/or metals is volatile and cannot be controlled. There is no assurance that the Company's mineral-exploration activities will be successful. The development of mineral resources involves many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome.

The exploration of mineral resources on federal lands in the United States is subject to a comprehensive review, approval and permitting process that involved various federal, state and local agencies. There can be no assurance given that the required approvals and permits for a mining project, if technically and economically warranted, on the Company's claims can be obtained in a timely or cost-effective manner.

All of the Company's short- to medium-term operating and exploration cash flow must be derived from external financing. Actual funding may vary from what is planned due to a number of factors including the progress of exploration on its current properties. Should changes in equity-market conditions prevent the Company from obtaining additional external financing, the Company will need to review its exploration-property holdings to prioritize project expenditures based on funding availability.

The Company competes with larger and better-financed companies for exploration personnel, contractors and equipment. Increased exploration activity has increased demand for equipment and services. There can be no assurance that the Company can obtain required equipment and services in a timely or cost-effective manner.

The Company's operations in the United States and financing activities in Canada make it subject to foreign-currency fluctuations and such fluctuations may materially affect its financial position and results.

Outlook

The Company commenced the 2006 rare-earth exploration program for the Bear Lodge Project in October of 2006 and outlined four targets for its coming 2007 exploration programs. Drilling will target suspected deep carbonatite bodies and will further define past drilling results. In addition, the Company continues to examine the high-tech commodities industry for opportunities to participate in the growing markets for rare-earth elements and other strategic metals. The Company intends to acquire additional mineral properties or join in ventures that explore other properties or aspects of these metals' markets. The Company believes that rare-earth-element deposits have potential economic importance as various modern-day technologies become more widely commercialized.

Other metals occur on the Company's Bear Lodge property. Previous gold exploration has identified numerous geochemical gold anomalies and occurrences in intrusive breccia bodies. The Company intends to take advantage of the exploration potential for gold and other metals through the option/joint venture Agreement presently in effect with Newmont. The Newmont gold-exploration venture provides the Company with further options to build a strong company and to advance its programs to evaluate both the gold and rare-earth elements of the Bear Lodge property.

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Disclaimer

The information provided in this document is not intended to be a comprehensive review of all matters concerning the Company. The users of this information, including but not limited to investors and prospective investors, should read it in conjunction with all other disclosure documents provided including but not limited to all documents file in SEDAR (www.SEDAR.com). No securities commission or regulatory authority has reviewed the accuracy or adequacy of the information presented herein.

Forward Looking Statements

Except for statements of historical fact, certain information contained herein constitutes forward-looking statements. Forward looking statements are usually identified by our use of certain terminology, including “will”, “believes”, “may”, “expects”, “should”, “seeks”, “anticipates” or “intends” or by discussions of strategy or intentions. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results or achievements to be materially different from any future results or achievements expressed or implied by such forward-looking statements. Forward-looking statements are statements that are not historical facts, and include but are not limited to, estimates and their underlying assumptions; statements regarding plans, objectives and expectations with respect to the effectiveness of the Company’s business model; future operations, products and services; the impact of regulatory initiatives on the Company’s operations; the size of and opportunities related to the market for the Company’s products; general industry and macroeconomic growth rates; expectations related to possible joint and/or strategic ventures and statements regarding future performance.

Forward-looking statements used in this discussion are subject to various risks and uncertainties, most of which are difficult to predict and generally beyond the control of the Company. If risks or uncertainties materialize, or if underlying assumptions prove incorrect, our actual results may vary materially from those expected, estimated or projected. Forward-looking statements in this document are not a prediction of future events or circumstances, and those future events or circumstances may not occur. Given these uncertainties, users of the information included herein, including investors and prospective investors are cautioned not to place undue reliance on such forward-looking statements.