China, western central banks out of sync on gold

By John Embry

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The theatre of the absurd has continued to unfold in the gold and silver markets, with the anti-gold cartel (western governments, their central banks and selected bullion banks) abandoning any hint of subtlety in their price-suppression efforts.

This is not terribly surprising, given the intractable nature of the financial and economic problems, but it tends to draw unwanted attention to the degree of manipulation in all markets (stocks, bonds, currencies and commodities).

Gold and silver fell 13 per cent and 17 per cent respectively from their late February highs, ostensibly because there was less demand for both as safe havens, due to stock-market rallies around the world and better commodity prices across the board.

The improvement in both stocks and commodities followed sharply oversold positions and was, in our view, the direct result of the staggering amount of fiscal and monetary stimulus being injected into the world economy, which may or may not ultimately have a salutary impact on economic activity.

Gold and silver, the two assets which should have benefited most from this development, fell in price despite ongoing, demonstrable tightness in their physical markets, illustrated by the large premiums being paid for coins and small bars.

More importantly, particularly in the instance of gold, just as the price was falling, demand in the very important eastern markets (India, China, Vietnam, et al.) was reviving noticeably following a very slow start to the year.

Thus, we view any suggestion that the price decline could be attributed to weakening physical demand as totally invalid. What the world once again witnessed was just another vicious takedown in the paper markets, designed to protect the fatally flawed U.S. dollar and to delude the investing public with respect to the true state of affairs.

As part of this initiative, there was a renewed cry for the International Monetary Fund to disgorge the 403 tonnes of gold it controls that is readily disposable. This request has been trotted out so many times in the past to threaten the gold market that it is absolutely laughable to me that anyone would take this seriously. Four hundred and three tonnes of gold is worth in the neighborhood of US$12 billion at current prices. The U.S.'s unfunded daily financial requirements are roughly $7 billion at the moment, so the proposed gold sale is a rounding error in the total scheme of things.

One of the leading proponents of IMF gold sales for the last 10 years has been none other than Gordon Brown, England's justifiably beleaguered prime minister. In 1999, in his previous role as Chancellor of the Exchequer, his initial call for dumping IMF gold was rejected and this triggered the British gold auctions, which subsequently cost the treasury billions of pounds. Gold rose 60 per cent in price in the succeeding six years before he once again unsuccessfully lobbied the IMF to part with its gold in 2005. This was followed by a 70 per cent increase in the price of the yellow metal, sparking yet another request by Brown in 2007 that was blocked by the U.S. government. Gold then rose nearly 50 per cent in less than a year and broke the US$1,000-an-ounce price ceiling for the first time in early 2008. Does anyone sense a pattern developing here?

He was back at it during the recent G20 confab, and if recent history is any guide, it probably guarantees another sharp upward move in price in the reasonably near future. I strongly doubt that any of this is coincidence. Brown, who I believe is being hypocritical in his approach, has called for IMF gold sales at the very times that the gold market is desperately short of physical metal. To date, this has turned out to be an utterly futile attempt to stave off a sharp escalation in the price.

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Adding further intrigue this time is that India and China were reported to have subsequently suggested that the IMF sell its entire alleged stash of 3,217 tonnes, not just the 431 tonnes that are readily available. While the veracity of this report has been called into question, the central issue is still relevant. Both countries have a huge natural appetite for gold and an excess of U.S. dollars, thus providing the wherewithal to absorb all of the IMF's gold easily. That will never happen because the true state of the gold market would then be revealed for all to see, essentially infinite demand contrasted with increasingly limited supply. However, the whole incident has shone a very welcome light on the true irrelevance of IMF gold sales.

The Chinese, who are continuing to take shots at the U.S. dollar as the sole reserve currency, didn't stop there, following up with an announcement that they had added 454 tonnes of gold to their existing reserves of 600 tonnes in a purchase program in effect since 2003. While some anti-gold commentators tried to downplay the significance of this, I believe they are mistaken. I see this action as a forceful demonstration that the Chinese are prepared to buy more gold. With their gold position in relation to their total reserves still at a minuscule level compared with many other central banks, it suggests that their purchases could accelerate in the future.

The Chinese gold revelation also calls into question the misguided decision by numerous western central banks to part with their bullion in a rising price environment for the past eight years. If China, arguably the world's most successful economic entity this decade, is adding, other central banks appear foolish if they have been giving away their gold at bargain prices. Central bankers are human and, I strongly believe, don't like to be embarrassed. This move by the Chinese could represent a major watershed in all central bankers' approach to gold.

Returning to the subject of whether the frantic reflation efforts currently being undertaken worldwide will work, it is worth considering the wisdom of Bill Buckler, publisher of the prestigious Australian market letter *The Privateer*. In a recent issue, he cited three immutable historic economic principles that apply to what is occurring today. To paraphrase him, he observed the following:

- No nation has advanced its real economy by means of

monetary inflation, i.e., the indiscriminate printing of money;

• No nation has advanced its real economy by holding the market rate of interest below the natural, real rate of interest, i.e., driving administered rates well below where they should be and;

• No nation has advanced its economy by aggressive deficit spending.

Buckler then pointed out that three of the four most important economies in the world, the U.S., Japan and China are engaging in all three activities simultaneously. I would add that the only reason the European authorities haven't fully gone this route yet is because the Germans remember only too well the hyperinflation that such policies caused in their domestic economy in the post-First World War era.

This approach has obviously never been tried globally before, but if anyone really believes that piling more financial excess on top of all that which went before is sound policy, they would clearly flunk Austrian Economics 101 badly. Economists of an Austrian persuasion would argue that this will simply compound the eventual unwind. The sad truth is that it is virtually guaranteed that any economic recovery sparked by further indebtedness will be unsustainable and will ultimately be accompanied by escalating inflation.

Under the worst outcome, the economic response will be negligible, but currency debasement will create rampant inflation. In that instance, all financial assets (stocks, bonds and money-market instruments) will, at least initially, be impacted negatively. Fortunately, precious metals represent a safe haven that should offset this potential risk.

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