

More on gold manipulation

Complication: when East's central bank buying outstrips West's selling

By John Embry

If one looks solely at the gold price, rather than the machinations behind the scene, it would be very easy to become discouraged amid the recent price weakness.

In the face of a U.S. dollar rally of nine per cent on a trade-weighted basis

against other paper currencies, gold has declined over nine per cent from its early December peak of US\$455 per ounce, despite the fact that demand for physical gold has, if anything, intensified. I have alluded to robust physical demand on several occasions recently and current data only reinforce this impression.

One has only to look at imports into Turkey (300 tonnes annualized, based on the last two months' inflow); the continuing historically high levels of ex-duty premiums into the world's most important market, India; the sharp rise in the premium over world gold prices on the Shanghai Gold Exchange and the inability of gold refineries around the world to keep up with demand.

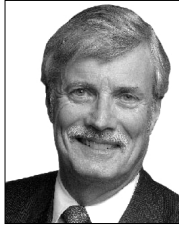
Furthermore, this gold demand is certainly not being met by rising mine supply as Goldfield Mineral Services recently estimated 2004 gold production to have been down four per cent from the previous year.

Before getting too exercised over the short-term volatility in gold and what appears to be somewhat irrational weakness in the price, it might be worth considering the comments of three senior central bankers in recent years.

In 1998, the Maestro Alan Greenspan, chairman of the U.S. Federal Reserve, stated the following while testifying before Congress about over-the-counter derivative markets:

"Nor can private counter-parties restrict supplies of gold, another commodity whose derivatives are traded over-the-counter, where central banks stand ready to lease gold, in increasing quantities, should the price rise."

Despite the classic doublespeak for which Mr. Greenspan is renowned, I would interpret him as having said that, although our bullion-bank cronies are suppressing the price by using derivatives, central banks will be there to bail them out in the event of natural demand taking the gold price higher. That certainly proved to be the case af-



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ter his remarks.

Then, after the Washington Agreement in September 1999, which limited the sales and leasing activities of European central banks and sent the gold price up sharply, Eddie George, the governor of the Bank of England was quoted in a conversation with the CEO of Lonmin, a British organization with interests in gold mining. The following quote was included in evidence put forth in a suit lodged in a U.S. Federal Court. Mr. George allegedly said:

"We looked into the abyss if the gold price rose further. A further rise would have taken down one or several trading houses, which might have taken down all the rest in their wake. Therefore, at any price, at any cost, the central banks had to quell the gold price, manage it. It was very difficult to get the gold price under control but we have now succeeded. The U.S. Fed was very active in getting the gold price down. So was the U.K."

This comment clearly needs no further interpretation.

The third quote is perhaps the most germane today and I included it in a previous article. Nevertheless, I think it is worth repeating. This came from the recent memoirs of Paul Volker, the former U.S. Fed chairman, and related to a revaluation of the yen and the European currencies in the 1970's. Volker stated that:

"Joint intervention in gold sales that was needed to prevent a steep rise in the gold price, however, was not undertaken. That was a mistake. Through March, the price of gold rose rapidly and that knocked the psychological props out from under the dollar."

So, despite what others might say, it is abundantly clear to me that central bankers and their bullion-bank associates manipulate the price of gold. The U.S. dollar is currently experiencing a technical rally, and the weak gold price is part of the contrived scenario, but the longer-term outlook for the dollar is unquestionably more bleak than at any time since it assumed its role as the world's reserve currency.

This distresses central bankers and, along the lines of Mr. Volker's remark, they are doing their best this time to make sure that gold

doesn't emerge as the monetary alternative of choice.

To offer a little psychological support, the U.K. Chancellor of the Exchequer Gordon Brown trotted out the old refrain of selling IMF gold to provide debt relief for impoverished Third World countries. That would be a noble gesture but for the fact that a lot of those same countries are gold producers that would be disadvantaged by just such a program.

However, a little hypocrisy in the cause of gold price suppression has never embarrassed Mr. Brown. He is the same guy who called for IMF gold sales six years ago and, when that ploy failed, dumped half of the Bank of England's gold at two-thirds of today's price in the infamous British auctions.

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With the U.S. and Canada already expressing objections to his latest suggestion, there is very little chance that any sale will occur this time either, but the accompanying furore created an environment in which it was easy to knock the gold price down.

For investors worried about the longer-term outlook for gold due to the central banks' negative attitudes towards it, I can only offer up the experience of the 1970s, when the central banks dumped over 100 million ounces of gold into the market to hold the price at US\$35 per ounce between 1968 and 1971. When this policy failed and the true fundamentals asserted themselves, gold moved up more than 20-fold during the decade of the 1970s.

This time, a new group of central bankers, equally as myopic as their predecessors, are at it again with considerably greater gusto and infinitely more subterfuge. They are doing it covertly in an allegedly free market by leasing their gold into the market through their bullion-bank associates.

They may have pumped about 500 million ounces into the market over the past 10 to 12 years, in an attempt to manage the gold price. Thus their reserves are now severely depleted, particularly in comparison to their position in the '70s.

But their problem is bigger than that. A new complication on this front is that the eastern central banks (Russia, China, etc.) may have a much different game plan, stuffed as they are with U.S. dollars and holding a minimal amount of gold in their reserves.

As a result they will ultimately be buying gold, if they aren't already. They are not under the hegemony of the U.S. as the European, Japanese, Canadian and Latin American central banks seem to be and will do what they deem appropriate for their own interests. The central banks are currently the most important factor in the gold equation, but the day is rapidly approaching when that will change.

When eastern central-bank buying outstrips western central-bank selling, and it will in the not-too-distant future, the other remarkably bullish fundamentals for gold will take over and drive the gold price to levels that most people can scarcely imagine today.

Junior gold stocks are being ignored to the extent that even minimal selling pressure has resulted in prices that provide considerable opportunity.

Two that have been particularly trashed are **African Gold Group** (\$0.86 AGG-TSX/VEN) and **Aurelian Resources** (\$0.55 ARU-TSX/VEN), both of which are trading at prices close to the amount of cash in their respective treasuries, thus attributing minimal value to their properties.

Both have sound management and very prospective land positions in geologically attractive areas. African Gold Group has extensive exposure in Ghana and Aurelian has a large land package in Ecuador, a country which is heating up as the result of the recent Iamgold discovery.

They are both thin traders in the current environment and have the potential for dramatic appreciation when things pick up in the gold sector.

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