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Largest gold swap ever almost escapes notice

By John Embry

Gold once again has been taken to the woodshed by the anti-gold cartel during the quiet summer months. When gold burst above US\$1,250 an ounce in late June, achieving an all-time high and clearing all overhead resistance, the telltale warning signs of an impending cartel attack were apparent.

They succeeded in driving gold down roughly US\$100 an ounce in the following month, for absolutely no apparent fundamental reason. The U.S. dollar was falling, commodities were rising and physical gold demand remained robust. This had the effect of turning the short-term technical outlook from resolutely bullish in late June to uncertain or worse by late July.

However, I am not the least bit concerned because this is just another example of their winning a skirmish in a war that they are most assuredly losing, as gold continues to make new high after new high in the aftermath of their attacks. I fully expect exactly the same outcome this time.

It wasn't at all surprising to me that immediately after the market cleansing was complete, the president of the St. Louis Federal Reserve bank, James Bullard, warned that current U.S. policy could lead to Japanese-style deflation and that another round of



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quantitative easing may be necessary.

If gold hadn't been smashed prior to the acknowledgment of this reality, it would have been headed to US\$1,500 an ounce instead of having to regroup to make an assault on the June all-time high of US\$1,260. This has been standard practice for the cartel throughout the entire 10-year bull market and has resulted in gold being many hundreds of dollars below where it should be today.

380 tonnes

While this market activity was unfolding, it was reported that the Bank of International Settlements, the so-called central banks' central banker, had undertaken the largest gold swap in history (380 tonnes worth roughly \$14 billion) with a group of commercial banks, sometime before March 31st of this year.

Any attempts to interpret this development negatively were undermined by the fact that it was discovered by an eagle-eyed analyst who was studying the Bank's March year-end statement, suggesting that the bank preferred that the public not be aware of the swap. If it could have been spun negatively for the gold market by the BIS, you can rest assured that they would have made a great spectacle of it, proudly announcing the swap with great fanfare.

There have been numerous in-

terpretations of what it all means. Initially, there was the suggestion that the commercial banks (bullion banks, in reality) were merely an intermediary for a cash-strapped European government (Portugal was the obvious candidate since it allegedly has 382 tonnes of gold and was obviously in need of financial assistance).

Then, well respected gold analyst James Turk opined that it might have indicated that the BIS needed to replenish its gold supplies. This organization has been intimately involved in the gold price suppression scheme from the outset and might have been getting a little short of physical supplies to maintain its activities.

Yet another point of view was revealed in an article in the *Financial Times* that stated that the gold came mainly from investor deposit accounts at European commercial banks and not from a central bank at all. In other words, it came from the unallocated accounts at the banks and, in my mind, this serves as yet another warning to avoid these types of gold products because whatever gold backing that does exist is being mobilized and isn't physically available to the holder.

Perhaps the most plausible analysis of this particularly opaque undertaking of the BIS was provided by Adrian Douglas, an individual who has done some remarkable work on the whole gold scene. His take was that the commercial banks involved had made a swap with a central bank

(or central banks, as the case may be) and obtained real physical bullion in exchange for \$14 billion.

He further postulated that the bullion banks then made a swap with the BIS who gave them the \$14 billion back but, instead of receiving the physical gold, settled for a paper promise crediting them with a ledger entry of gold in the Bank's unallocated gold account.

This resonates with me because it represents further evidence of the degree to which paper gold has permeated the system.

Jeff Christian of CPM Group let the cat out of the bag at the CRTC hearings in March when he blithely acknowledged that there were 100 ounces of gold trading on the London Bullion Market for every ounce represented by a London good delivery bar. Douglas himself has estimated that there is only a single ounce of gold backing every 45 ounces of paper gold in existence.

Investors and institutions are just beginning to realize that "unallocated gold" is not gold at all but merely an unsecured promise for gold. This may help to explain why bullion-bank spokesmen and commentators, representing organizations that have dealt extensively in paper-gold products, are relentlessly negative on the prospects for the gold price.

As those who hold paper-gold instruments begin to demand real, physical gold in its stead, the upward pressure on the gold price is going to reach

the boiling point. In any case, all this may tend to explain why the BIS and the bullion banks entered into this swap arrangement which essentially gave the bullion banks enough ammunition to stave off the inevitable for a little while longer.

I take the whole exercise to be extraordinarily bullish for gold because, whether the bankers admit it or not, it represents clear evidence of the reintroduction of gold into the world's monetary structure. This is a reality that the western central banks have been trying to distance themselves from for decades.

The IMF has continued to sell gold monthly (17.5 tonnes in June) at a rate that will totally deplete their readily available supply by yearend.

This is happening under the auspices of the European Central Bank Agreement and is essentially substituting for the virtual absence of any sales by European central banks. This is a far cry from the big bad IMF threatening to swamp the market with gold for the past decade and, in my estimation, demonstrates the extent to which official supplies of gold

are dwindling. It is becoming ever more apparent that the western central banks' available gold is no longer sufficient to fill the yawning gap between sharply rising physical demand and sluggish mine supply. The price implications of this will become very apparent shortly.

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To conclude, The Economist magazine recently published an article contending that the gold price has probably topped. This is standard fare for the publication, which like its associate, The Financial Times, articulates the financial establishment's preferred stance on important issues like gold. The fascinating aspect about this particular essay

was that if you read between the lines, you could just as easily have reached a very positive conclusion on where the gold price was headed.

The underlying flaw in all the negative gold rhetoric currently is the notion that the world economy is going to return to normal in the reasonably near future. Then, in a world where growth is restored and inflation remains under control, the need for gold will be diminished and investment demand for it will drop off precipitously, putting considerable downward pressure on the price. I think the probability of that happening in this debt bloated world is about as close to zero as humanly possible.

The true picture may have been conveyed by the widely differentiated views of Jean Claude Trichet, the President of the European Central Bank and the aforementioned James Bullard of the St. Louis Fed. Trichet wrote an impassioned plea in mid-July on the Financial Times op-ed page calling for the European governments, and by extension the U.S., to rein in their insane budget deficits and reduce their stimulus

programs because ultimately they will do more harm than good.

Bullard countered less than two weeks later by stating the U.S. stance that any noticeable flagging in growth and tendency towards deflation should be met with a renewed bout of quantitative easing, thus implying that the removal of stimulus at this time is not on the table.

In my opinion, what these two diametrically opposed views represent is an acknowledgment that the achievement of a satisfactory economic outcome in the foreseeable future is highly unlikely, if not impossible. Trichet's remedy would lead the world into a deflationary spiral while Bullard's would ultimately result in an acceleration of inflation that could easily get out of control. In effect, the middle ground appears to have been lost and this virtually ensures growing investment demand for gold as far as the eye can see and much, much higher prices in the relatively near future.

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