Gold by Montresor

Tucker, Anthony warns of shakeout

A reliable forecaster's evidence, and how the 'Siena scenario' for remonetization fits in.

Tucker, Anthony Day's gold and credit markets analyst August F. Arace warns that a few large financial institutions may "try to reshape the gold market for their own purposes," by pushing the price down below the $400 mark.

Arace, who has one of Wall Street's best track records in forecasting gold-market price turns, told *EIR* he fears that large private holders may "shake the ribbon merchants out of the market," and then accumulate a large volume of gold at a very low price.

The Tucker, Anthony analyst uses an index of U.S. foreign and domestic liabilities to calculate an implicit gold price, assuming that U.S. gold stocks should roughly cover half of total liabilities. During the past five years, he notes, this "gold correlation ratio" has stayed in line with the gold market price. In a Feb. 26 memo to clients, Arace noted, "The lowest gold price reached on London fixings in early 1981 was approximately $483 per ounce. That is about 85 percent of the 'ratio price,' and represents an 'oversold' price for gold, *although not as 'oversold' as we prefer.*"

The London gold fixing on March 3 was only $463, confirming Arace's warning that "the probabilities favor a decline in gold to below $480 an ounce. Continued credit restriction by the Federal Reserve, high relative-dollar interest rates, and a firm dollar relative to other currencies are likely to impart a continued negative bias to the activities of gold traders."

The behavior of the gold price indicates that the "Siena scenario" (see page 4) is in operation. The Siena proposal to return to the gold standard should not be read at face value, but in terms of its economic and financial implications. With foreign official liabilities in excess of $160 billion and gross foreign private liabilities around $1 trillion, U.S. monetary gold, worth about $120 billion at the current price, cannot possibly back up the dollar, with the United States in a sharply worse trade-deficit position.

A return to the gold standard could be accomplished only in one of two ways: either through a massive rise in American exports to provide real value to the dollar, or through the liquidation of large amounts of foreign liabilities. The Siena scenario implies a shakeout on the Eurodollar market in which the U.S. would go through a sort of Chapter 11 bankruptcy proceeding. This is the implication of last week's conference of the Securities Group's International Monetary Advisory Board.

If the trend continues, it would match the developments that gold analyst Arace is warning about. A continued squeeze on the credit markets both in the dollar and West German mark sectors would force the liquidation of gold by many marginal holders, faced with high interest-carrying costs and liquidity difficulties. The gold price would then soar upward, in the context of gold remonetization. Then, according to *EIR*'s estimate, the minimum price for remonetized gold would be in the $500 to $600 range for cost-of-production reasons.

Otherwise, the post-remonetization price of gold is a political question under this gloomy scenario, reflecting the terms of bankruptcy the U.S. would presumably negotiate with its foreign creditors.

In any event, Arace believes that "the gold price will trend toward the mid-to-lower $400s." The political assumption this implies is an uninterrupted deflationary policy on the part of the Federal Reserve.

Before the April meeting between West German Chancellor Schmidt and President Reagan, it is too early to say whether the deflationary trap will spring according to plan. Schmidt will present to Reagan a plan for coordinated reduction in interest rates including Europe, Japan, and the United States, a plan which represents Reagan's own best chance of avoiding a depression and the political collapse of his administration.

It is interesting that the European financial elite that created the Siena Group is taking an increasing gold portfolio position, betting on their own scenario. The one-fortieth to one-fiftieth of all wealth still held as gold, in Robert Mundell's estimate, is heavily distributed on the side of Europe's old financial families. According to one authoritative estimate, the Society of Jesus—the Catholic order that educated Mundell, Triffin, and other leading "Siena" economists—is the single largest gold holder outside of the central banks themselves, with about 30 tons of the metal.