Click here for Full Issue of EIR Volume 10, Number 10, March 15, 1983

Gold and world liquidity

Ironies in the market price of gold, including its important and puzzling relationship to international oil prices

Suppose that you had your savings and paid your creditors in blue chips, but that at an undisclosed time in the future, blue chips would be made valueless in favor of red chips; red chips could be had now at the market price, but if you ran out of blue chips in the meantime, you would be bankrupt, and would lose your hoard of red chips in any case. What would then be the market price of red chips?

This inane little example describes a paradox in the recent gold price movements, of which I warned most recently in this column on Feb. 22. Does the drop of the gold price from the $500 range of January and February to barely over $400 in recent trading days indicate less motivation to purchase gold? On the contrary, the same hoarders who have liquidated physical metal during the past two weeks, such as large Kuwaiti and other Middle Eastern investors, are less confident about the future than almost anyone else.

Simply speaking, the house of cards known as the Eurodollar market has drawn sustenance from the deposits made by the OPEC nations, whose total foreign assets are estimated at about $340 billion; of those, perhaps $100 billion or more is deposits in the international banks. A reduction in the price of oil, welcome as it be in some quarters, is not good news to the inhabitants of the house of cards. The prospects for its total demolition are increased.

As for the major private gold investors—the old *fondi* [family fortunes—ed.] in Zürich, Munich, Paris, and London—the conviction is growing in such circles that the monetary situation is insoluble: This opinion my friends at the Swiss National Bank will trumpet to any stray listener.

Why, then, should the gold price fall? Apart from the apparent technical (or manipulative) factors in the New York futures, as opposed to the European physical market, the simplest answer is the one most subscribed to among informed circles: there is a world liquidity crisis which forces some major holders, starting with some Arabs, to sell off their holdings. No matter that Eurodollar bank deposits might, indeed, become worthless at some point in the near future; bank deposits pay one's current obligations, and without liquidity, one may not survive to enjoy the benefits of having hoarded gold.

The paradox is that the same factors which impel the price of gold, oil, and other commodities downward, argue for investment in gold. That is why short-term investment in gold is such a grim trap for the unwary. Investors can make money by holding gold only if they do not need the money they have invested in the metal.

Where can the price reasonably be expected to stabilize? Although the $400 level is held during the present round, it is easy to conceive of circumstances under which the price might decline much further. A mere oil price decline to $27 has been taken into consideration by the markets; the price might fall further. A sharp rise in interest rates might have the same effect. Perversely, the first effect of a major national default, might be to tighten the availability of credit and compel distress liquidations of gold holdings, among other assets.

For a variety of reasons it is difficult to see a price lower than $300, if only because the central banks would have an enormous incentive to convert dollar assets into gold at that price. Central bankers, commented one economist of my acquaintance possessing a long association with the Bank for International Settlements, hate to lose money; they will not buy at $400, but might well buy at $300.

More is at work here than simple asset preference or expectations of price appreciation. Since the former central banker of the Netherlands, Jelle Zjilstra, told an International Monetary Fund group in September 1981 that gold must be part of the reformulation of the world monetary system, it has become more or less received wisdom in central banking circles that gold reserves have a special importance. It is ironic to see Prof. Robert Triffin, long one of the most egregious and vocal proponents of international paper against the use of gold, admitting that gold must anchor his international monetary devices.

At what price could this occur? There is now $5 trillion of debt in the U.S. economy and $1.5 billion of dollar-denominated debt in the international markets. At what price of gold would the United States have sufficient reserves to make gold a credible factor in international transactions, covering, among other things, all or a portion of the American current account balance? Arbitrary calculations are often used to claim that the price must be $2,000 per ounce or higher. It would be simpler to say that gold at less than $500 an ounce is a sensible investment, under present conditions, over the long term.

© 1983 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.