

Gold by Montresor

Ignore the supply and demand data

Much more gold is coming to market internationally than has been reported.

In a world in which \$100 billion of world payments are lost in the accounting procedures of national governments, why should it be assumed that the supply and demand projections for gold are accurate?

Quite the contrary, both supply and demand in the gold market are much higher than the usual estimates, e.g., the annual tally published by Consolidated Gold Fields, would otherwise suggest. Including such new mechanisms as gold lending, encouraged by the London and Swiss gold pool operators, as well as gold swaps, the turnover of world gold stockpiles is even larger.

The principal element of disingenuity in this affair is the underreporting of central bank gold transactions. It is, for example, well known that France has relinquished \$3 or \$4 billion of its gold reserves in return for foreign exchange to defend the franc, and that without such pledges of gold, France's external credit would have collapsed.

It is also known that Portugal sold off 30 tons, or most of its gold reserve, last month in order to repay a \$300 million loan to the Bank for International Settlements, and that Brazil, bankrupt since late last year, has sold off almost its entire \$1.1 billion stock of gold.

However, many more cases are not officially reported, partly through absolute fraud, partly through the semi-fraudulent practice of "gold lending."

In this case, gold is physically transferred from a central bank's vaults to the vaults of a private bank, and a loan is made to the central bank at something resembling market rates.

Even apart from central bank gold sales, much more gold is coming onto the private market than official numbers would suggest.

Brazil is a case in point. Although the country's central bank maintains reasonably efficient exchange controls, the open border with Paraguay offers smugglers a convenient means to obtain dollars through other than official channels. In the case of coffee, smuggling of Brazilian coffee has made Paraguay the world's fourth-largest coffee exporter, with close to \$250 million annual sales, although Paraguay does not grow any coffee itself. Gold leaves Brazil in approximately the same fashion. Brazil's statistics on internal gold production are problematic, since so much of the metal is garnered through primitive panning methods by thousands of prospectors spread along the Amazon. Currency speculators buy gold dust with cruzeiros and smuggle the metal out of the country, to be sold on the world market free from exchange controls.

Another major provider of unofficial gold to the world market is the Soviet Union. Gold is the basic medium exchange in the vast Soviet black market, the largest black market in the

world. The late Dr. Giovanni Leone of the Monte dei Paschi Bank estimated the size of the gold-based black market ten years ago at 20 billion rubles, and other sources suggest that it has doubled since then.

Because the black market pervades the entire official establishment, and, indeed, provides the KGB with an efficient method of maintaining its state-within-the-state, the permeability of the Soviet Union's borders to gold traffic is much greater than most Western observers might suspect. Some gold leaves through emigrants, who make deposits in Austrian or Italian banks on behalf of Soviet citizens; some is exported directly to finance illegal Soviet political operations through the untraceable, fungible metal; some is exported in excess of the reported figures for economic reasons.

In all, central bank forced sales and black market sources of supply bring between 400 and 600 tons of gold to market this year in excess of the standard projections (in the range of 1,200 tons or so).

Why has the gold market not collapsed? Because a significant portion of the market believes that gold is cheap at the price, and will buy whatever comes to market at the \$400-\$450 range. We speak here of old money that invests not for next year's profit, but for the succeeding generation's benefit, and is capable of sitting on a large hoard in dragon fashion for an indefinite period of time.

Of course, a change in world monetary conditions will change the price at which the old *fondi* will buy whatever comes to market. Under conditions of threatened default in South America, the price will rise. The dissolution of the spurious American recovery will tend to depress the price. But the principle remains the same.