Gold by Montresor

The reality principle

Mr. Paul Volcker's failure in Europe may have something to do with the rise in the gold price.

After more than a year of quiescence, the gold price rose to $394 on Aug. 11, well above the $350 or so range of the preceding months. Its price on Aug. 15 had fallen slightly, to $388, but the change in trading range appears to have been established.

Considering how much cheaper gold is now to holders of German marks or Japanese yen, the event was no cause for cheer outside of the Reserve Bank of South Africa, where it was hailed as a symbol of the strategic power of that nation's mines.

Nonetheless, the significant rise in the gold price sounds a danger alarm for the American dollar, whose exchange-rate against the German currency draws perilously near to DM 2.00 (see p. 11). It is one of those little turning points which precedes a monetary crisis as heralds.

This writer cannot help associate Monday, Aug. 11's events on the gold markets with the previous day's burial of Dr. Otmar Emminger, the late president of the Deutsche Bundesbank. I did not count Dr. Emminger among my friends, although I had frequent occasion to speak with him, and was received by him courteously when in Frankfurt. Although his health as well as his influence had waned in recent years, Dr. Emminger remained a personal symbol of the once-unshakeable Atlantic view of the Frankfurt banking community. He was not, in my judgment, a good central banker, but he frowned upon the *Mitteleuropäische* delusions of grandeur that since infected the Munich-to-Venice financial axis.

Appropriately, it was at Dr. Emminger's final resting place that his former colleague, Federal Reserve Chairman Paul Volcker, was told that West Germany is far less concerned about the disintegration of the American dollar than Volcker is. It appears that a great deal of vain expectation attended Mr. Volcker's trip to West Germany; the next morning, the *Wall Street Journal* published a prominent article predicting (incorrectly) that West Germany, as well as Japan, would undertake to reflate their economies, in response to American demands to that effect.

This same charade has been played out before every international forum since the May meetings of the International Monetary Fund in Washington, and each time the West German and Japanese response has been the same: "Why should we debase our currency in order to rescue American banks from their sordid problems?" The dollar had briefly rallied against the mark and the yen before Volcker's trip. The rally broke afterwards, and the U.S. currency remains in the neighborhood of DM 2.06 and yen 153.

To the best of my knowledge—and one must always hesitate to estimate what goes on in the mirror-house of the gold markets—the sudden rise in gold, as well as platinum, prices, began in Switzerland. Most interesting are indications that German buyers, under the cloak of Swiss bank secrecy, were responsible for this buying.

As noted, South Africa is a major beneficiary of this speculation; its annual export earnings will rise about $1 billion on the strength of the early August events. There are circulating the usual complement of inaccurate market rumors, e.g., that the South African response to sanctions would be to embargo export of platinum, essential for automobile catalytic converters. South Africa supplies more than 80% of the Western world's platinum. That is to be taken with a grain of salt.

There has emerged discussion of "anticipated world inflation." A correspondent in London argues that the price increases, at least as far as timing is concerned, "have nothing to do with activities in South Africa; otherwise you would have seen this several weeks ago around the Commonwealth Games. It's linked to the recent ending of the U.S. stock market bubble. Hot money is looking for every chance to make a major killing. Platinum is just very easy to kick it off, by the nature of the market."

However, the phrase, "inflationary fears," does not adequately characterize a situation in which raw materials prices are, in general, 30% below their long-run average, according to a calculation recently published by Amex Bank of London. Indeed, the continuing weakening of physical production throughout the industrial world suggests a continuing price deflation.

Gold, however, is not a commodity that responds to the general price level, but rather, the means of settling payments of last resort. Gold buyers foresee a monetary inflation, coinciding with price deflation, and anticipate that the world will have no other resort at some unspecified but close future date.