Gold falls below $400

The continual drain internationally on liquidity implies a lower gold price, only the advance signal of a broader crisis.

Although the eccentric means through which Mr. David Saxon of Bullion Reserve chose to end his life argue against any suggestion of foul play, the new interest in the underside of the gold markets among regulators is suggestive. While the collapse of the gold price below $400 may, in the short-term, be related to the panic among the many investors whose link to the gold market is a toll-free number in Fort Lauderdale, nonetheless the price move tells us something broader.

When the central banks of the major industrial nations gathered for their monthly discussions at the Bank for International Settlements in Basel in mid-September, a basic change in policy occurred. The Federal Reserve did not change its monetary stance after last June, reducing the per annum rate of reserve-creation from 12 percent during the first half of the year to about 2 percent during the third quarter, but the European central banks belatedly shifted to a tight monetary posture.

This turn was announced, first, in the German Bundesbank's monthly report for September under the headline, "Against Too Much International Liquidity," and later by the statement of M. Jacques de Larosière of the International Monetary Fund at the IMF meeting Sept. 27 in Washington.

The effect was felt immediately on both the currency markets and the gold market. The dollar is now worth more than 2.6 deutschemarks for the first time since June, after tipping above 2.7 marks in August. This is apparently the result of a marked turnaround in Bundesbank policy, which had been inordinately expansive earlier in the year as the government of Helmut Kohl sought to buy an economic recovery. The credibility of this effort has since faded, and the Bundesbank has reverted to the outlook of the Swiss National Bank, to the consternation of some in the Frankfurt banking community.

Although there is considerable talk about a "correction" of the dollar's excessive price and lower American interest rates, the gold market development suggests an entirely different view. While gold may become attractive at points of crisis, the grinding pressure of illiquidity in the international system forces many holders to sell in order to raise cash.

Earlier in the year, the exhaustion of developing nations' (as well as Portuguese and perhaps French) gold stocks depressed the gold price, and it is possible that additional sales from those quarters will continue to do so. However, the selling is much broader; Italian gold exports to the Mideast show a drastic decline this year, reflecting the deficit position of the oil-producing group, and the position of American small investors has deteriorated just as some brokerage firms have run into trouble.

Despite the somewhat forced official enthusiasm of the South Africans for gold investments at this time, many gold-market specialists are speaking of a major decline in the price from present levels. It is useless to speculate about when, and how deeply, such a price collapse may occur; it is nonetheless evident that the stage-setting provided by the central banks is conducive to such a development.

All this might change in a moment, e.g., the central banks might panic at the resiliency of South American nationalism and reverse the harsh policy they maintained at the last Bank for International Settlements meeting. The Federal Reserve might be forced to bail out American banks *en masse*, causing a run from the dollar into gold.

Nonetheless, the world banking community is still contemplating its own liquidation, and the insurance premium of many investors, i.e., their gold holdings, will be the first casualty.

It is no longer possible to pinpoint a special area of weakness in the market. The Bundesbank's turnabout puts the rest of Western Europe into roughly the same position as Brazil or Argentina, since nothing but West German monetary largesse permitted the austerity programs of Belgium or Denmark to sustain their currencies during the past several months. With the strain upon the weaker OECD countries come strains upon their banking systems, and the clients of those banking systems.

In this atmosphere, relatively small shocks to the gold market, such as those introduced by American regulators, may have far-reaching impact. No such scandals are ever accidents; it is when the general liquidity environment tightens that the embezzlers and cheats are inevitably exposed.

Mr. Saxon will not be the last casualty of this process, and the decline of the gold market may be the advanced signal of a much broader problem.

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