Market Force Analysis™

PROOF OF GOLD PRICE SUPPRESSION
Gold & the US Dollar

By Adrian Douglas

I have written several articles recently discussing that the suppression of the gold price is a consequence of "fractional reserve" bullion banking (see "Price suppression follows inevitably from fractional-reserve gold banking". "Fractional reserve" is another way of saying "selling something that you don't have". In this article I will demonstrate the devastating effect it has on market prices and how the US Dollar itself is the canary in the coal mine as to the extent of the gold price suppression.

The principle of price suppression can be very easily demonstrated. Let's imagine an investor wants to buy wine for storing in his cellar with a view to selling it in the future for a profit when it has matured and is highly sought after. There are two wine merchants A & B. They are both selling wine at $10 per bottle. Merchant A proposes to the investor a package of 2 bottles for only $15. The investor accepts what seems like a smoking deal. But the merchant is a crook. He delivers one good bottle of wine and the other wine bottle he has filled with water. The investor has paid $7.50/bottle but the bottle of water is worthless so in effect he has paid $15 for his good bottle of wine. Merchant B finds out about the crooked scheme from an employee working with Merchant A and decides to play the same game. Merchant B proposes to the investor 2 bottles for $10. The investor accepts and he again unwittingly receives one bottle of wine and one bottle of water. The price per bottle has now declined to $5 but as the second bottle is worthless the investor has in effect paid $10 for the one good bottle. The Merchants continue to cheat the investor offering packages of 3 bottles (1 good bottle of wine with two bottles of water) and then 5 bottles (1 good bottle of wine with 4 bottles of water). After many months the investor is offered a package of 10 bottles which actually consist of 1 good bottle of wine and 9 bottles of water for a price of $10. This equates to just $1/bottle but the investor has still paid an effective price of $10 for the good bottle of wine because unbeknown to him the other nine bottles are worthless. At this point the investor despairs of his investment ever appreciating as planned and he sells his entire cellar back to the merchants at $1/bottle and consequently the scam is never discovered. But many other investors who have genuinely good bottles of wine also despair of the market price and so dishoard their wine from their cellars begging the merchants to buy the wine for just $1/bottle. The merchants buy all the good wine for just $1/bottle and are thus ready to continue their scam with another investor. The key is that the per bottle price is the average price of what purports to be wine (wine and water) which dropped from $10 per bottle to $1/bottle yet the true price of real wine varied only from $15/bottle to $10/bottle, but the investor never knew this as he was unaware of the fake bottles of wine.

Imagine that the investor didn't have a wine cellar and he requested instead that the wine merchants store his wine for him. They would not need to manufacture the fake wine they could invoke a "fractional reserve" operation. In our last example of selling 10 bottles of wine they would have one in stock and the remaining nine would be just a ledger entry – an "I.O.U. wine" or what we could call "paper wine". The merchant is now operating a wine business that is backed by only 10% of the wine is that has been sold to customers. The "paper wine" is valued on the books at $1/bottle but it is worthless because it doesn't exist. This values the one real bottle at $10. The 90% drop in apparent market price of wine from $10 to just $1 devastates the wine investors and of course devastates the wine producers who are obliged to sell their produce for just $1/bottle. The true price of wine is the price that would exist in the absence of the dilution caused by the "paper wine". The true price (TP) is the market price (MP) divided by the fractional reserve ratio (FRR).

TP=MP/FRR

In this case $1.0/0.1 =$10.

How can the investors break the scam? Simply by asking for their physical bottles of wine to be delivered. The fractional reserve ratio would be forced upwards toward 100% as settlements would be made in cash or defaulted upon thus eliminating all "paper wine" rendering the market price to be the price of real physical wine, which in this example is $10/bottle.

The gold price is suppressed in the same manner. Because real gold and worthless "I.O.U. gold" or "paper gold" are sold in an almost indistinguishable fashion and supposedly stored for the investor the "gold price" is actually the average price of real gold and paper gold (non-existent gold).

Let's call POG (Price of Gold) the average market price for all gold, that is to say paper gold and real physical gold which is the price quoted as the "gold price" each day. If there is, let's say, only one ounce of physical gold backing each 45 ounces of "gold" that are sold in the market through the selling of unallocated gold then the price will be suppressed. Forty five ounces will cost $54,000 at POG=$1200/oz. But if this is made up of 44 ounces of worthless paper promises for gold and one real physical ounce then the effective price paid for the real ounce is $54,000/oz. If the investor never takes delivery he doesn't realize his investment is backed by just one ounce not 45 ounces.

Let's estimate what the fractional reserve ratio of the gold market is. The supply of physical gold is limited by the output of gold mines at roughly 2200t per year. A temporary increase in dishoarding is possible but in practice this is likely to be a steady amount over time. So the only real scope for a dramatic increase in supply that could massively suppress the gold price is to increase the supply of paper gold. In the gold market there will be a ratio of real physical gold to total gold that prevails on average in the market.

The LBMA reports that trading by its member bullion banks has recently been averaging around 20 Mozs of gold traded on a net basis each day. The London market is considered to trade about 90% of the global volume so the total market is approximately 22.2 Mozs per day which on an annual basis gives 180,555t.

Real physical gold supply is estimated at 4000t per year (mine + scrap +dishoarding). The ratio of total gold traded to real physical gold traded is

180,555/4,000=45

This means that there are indeed on average about 45 ounces of "gold" traded in the market of which only one is a real physical ounce. In other words the trading of gold is backed on average by only 2.2% of real physical metal. Just like in our wine example if we consider that paper gold is worthless then real gold is worth 54,000/oz.

To be rigorous, what we calculated was not the fractional reserve ratio of the gold market but the fractional net trading ratio. However, with such a desperately leveraged trading based on 2.2% backing the fractional reserve ratio will be necessarily very similar. There is a smoking gun that confirms this. It is the US Dollar.

It is true that the dollar can be "created out of thin air" but it is not true to state that it is "backed by nothing". It is in fact backed by the US Treasury gold. However, in 1971 president Nixon "temporarily suspended" the convertibility of the US dollar into gold (39 years later this temporary suspension is still in force!).

This did not however change the backing of the dollar by gold; it just prevented redeeming dollars into gold by the central bank. For example, ExxonMobil shares are backed by the oil assets of the company but there is no ability for any shareholder to convert XOM shares into barrels of oil. This doesn't mean that XOM shares are worthless; they are worth the per share valuation of the oil assets.
There has been no new official definition of the dollar since 1971. Statements that the dollar is backed by confidence or backed by all the goods and services in the economy are false. The dollar is backed by the gold of the US Treasury and redeemability was temporarily suspended in 1971.

We can use the fact that the dollar is still backed by gold to derive some useful relationships between the USD and the gold price.

Definitions:

RPG= Real Physical Gold held by the US Treasury (claimed to be 261.5 Mozs)
M3= broadest measure of dollar money supply
TG= Total Gold the Treasury is accredited with due to the market price of "gold"
PFG= Promises for Gold
POG= Market Price of Gold determined from the supply of all gold (real AND paper gold)
TPOPG= True Price of Physical Gold
FRR= Fractional Reserve Ratio of the gold backing the US dollar

The total gold that the US Treasury holds is the real physical gold and the implied promises for gold.

TG=RPG+PFG……….(1)

According to the market the total gold that the treasury is accredited with holding is:
TG=M3/POG……….(2)

The fractional reserve ratio is the ratio of the amount of physical gold held to the total gold that the market implies should be held:

FRR=RPG/TG…………(3)

Rearranging

RPG=TGxFRR

Substituting for TG from eq 2

RPG= (M3/POG)*FRR

FRR= RPG*POG/M3….(4)

Using current values

RPG= 261.5 Mozs M3= 13,789,000M$ POG=$1200

FRR=0.023 or 2.3% (or one real physical ounce for 44 ounces)

What does this tell us? Let's go back to our wine example. If the value of our wine cellar is $10 but the price of "wine" is $1/bottle the market price tells us that we should have 10 bottles of wine but our annual physical audit report says that there is only one bottle. This means that the price is manipulated. To make the books balance we would have to invoke nine “paper bottles of wine” and value all 10 bottles at the market price of $1. The way that this phony market price of $1/bottle was achieved was by selling one good bottle with nine “paper bottles of wine”.

Let us apply the same reasoning for gold. The market price is phony because it is the average price of gold and paper gold combined. The value of all issued dollars (M3) is 13.789 trillion dollars. The market price of gold (POG) of $1200 tells us that the US Treasury should have 11.5 billion ozs of gold when in fact the US Treasury only declares 261.5 million ozs. As a result one has to infer the US treasury has 11.229 billion ozs of “paper gold” or non-existent gold for the accounts to balance.

The ratio of real gold to total implied gold held at the treasury is 2.3% (FRR). Not too surprisingly this is the same ratio that is the ratio of real gold to total gold traded on a net basis in the market place.
If we apply the same logic as we did with the wine example we can say that all unbacked paper gold is worthless then this would value the true price of physical gold (TPOPG) at 13,789,000/261.5= $52,831/oz which is very close to the $54,000/oz we found above (note this is the same as true price=POG/FRR).

Inferences
The suppression of the gold price is inescapably demonstrated by the over estimation of ounces of gold the US Treasury should be holding when using M3 and dividing by the suppressed “gold price”. The reserve ratio of actual gold to the implied holding is almost identical to the dilution being used in the gold market.

If we look at the equation (4) again for FRR

FRR= RPG*POG/M3

We would expect FRR to be almost constant because RPG is constant (the US Treasury reports it to have been 261.5 Mozs since 1971). As M3 is increased we would expect the gold price to increase so the ratio of POG/M3 should be reasonably constant. In figure 1 FRR is charted since 1971. We see that it is anything but constant and has a dynamic range of 0.9% to 8.5%...a factor of 10 variation!

GOLD FRACTIONAL RESERVE RATIO OF US DOLLAR (FRR)

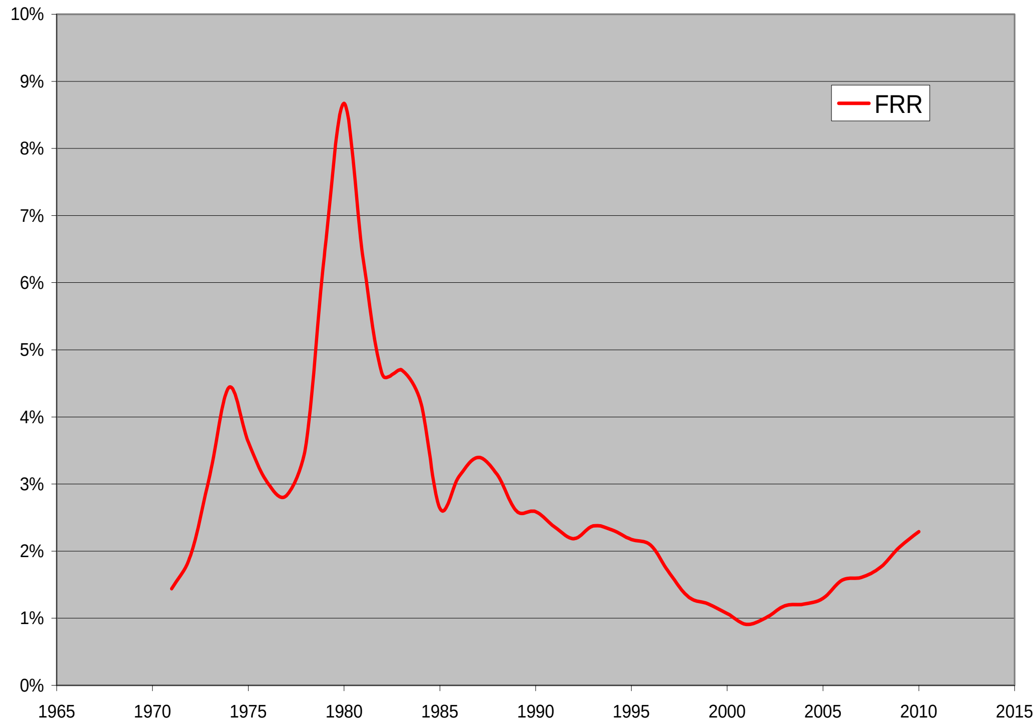

Figure 1

Many market analysts have noted that the “gold price hasn’t kept pace with inflation” since 1995. How can that be because as we have shown the dollar is still backed by a fixed amount of real gold so a dilution of the claims to that gold through an increase in M3 must translate to a corresponding increase in the gold price? The fact that it doesn’t keep pace infers that the gold price is suppressed.

That suppression comes from trading on a net basis 45 ounces of gold for every ounce of real gold. In other words 44 ounces of paper gold are traded for each ounce of physical gold. This bogus increase in gold supply distorts the price such that it does not move in lock step with M3 but instead it moves in lock step with the amount of paper gold that is created out of thin air.

The most effective way for the gold price to rise is for there to be a trend away from paper gold toward real gold (this is already happening and accelerating). Each 44 ozs of paper gold are only backed by 1 oz of real gold but if holders of paper gold demand real gold then each 44 ozs of paper gold will need to be met with 44 ozs of physical gold and not just with one ounce; this will cause a run on the bullion banks. The price will increase and its final limit will be the price related to only real physical gold i.e. at the limit all paper substitutes are rejected and discounted toward zero.

TPOPG=POG/FRR

Currently this would value the true price of physical gold (TPOPG) at \$1200/0.023= \$52,174/oz

Observations on Hyperinflation

We can use this discussion of dollar valuation to explain two ways in which hyperinflation could occur.

If TG=RPG+PFG then:

1) If an audit revealed that the US had sold all its gold then RPG=0 but if physical gold is found to be zero ounces then the dollar would fall and total gold accredited by the market would have to be zero so

PFG=0=M3/POG

If M3 is positive and large then POG must tend to infinity to make PFG tend to zero. An infinite gold price would mean the destruction of the dollar. One can see why the FED doesn't want an audit or to tell GATA about its gold swaps!

2) Alternatively if the Fed prints so much money that M3 becomes very, very large, this would bring with it a total distrust of everything paper such that only real physical gold would be acceptable to investors; then at the limit we would expect that TG→RPG that is to say PFG →0; For PFG to approach zero when M3 is very large then POG would tend to infinity implying total dollar destruction.

It is interesting to note that if the treasury is shown to have no gold or it and the Fed create masses of dollars the result will be an infinite gold price or in other words the dollar would lose all of its purchasing power.

If on the other hand a rejection of paper gold caused a run on the bullion banks then in theory this would not cause a hyperinflationary collapse of the dollar although gold would reach a very high price. In practice I imagine that the contractual clauses that allow cash settlement for holders of paper gold would require that the FED bail out the bullion banks leading to a massive increase of M3 so that the gold price would tend toward infinity and result in hyperinflation also.

Conclusions

The inescapable conclusions are

- the gold price is suppressed through fractional reserve bullion banking
- the gold market is selling on average 45 ounces of gold for every one ounce of real physical gold via "unallocated gold" (fractional reserve bullion banking). In other words the gold market is backed by only 2.3% gold
- The true price of physical gold is currently around \$54,000/oz if fractional reserve bullion banking did not exist. In the presence of fractional reserve

banking with 2.3% gold backing the market price of “gold” is reduced to $1200/oz
- The US dollar has a purchasing power that is 45 times over valued
- The way to end gold price suppression is for investors to ensure they have allocated physical bullion preferably held outside of the bullion banking system

The Trade of the Century

The sick joke of the Gold cartel is that whether you hold dollars or unallocated gold you only have 2.3% of gold backing! However, the trade of the century is to buy actual physical metal with your dollars, or if you have unallocated gold to demand physical delivery. In this way you can trade something with 2.3% gold backing for an investment that is 100% gold.

More and more large investors and funds are waking up to the fraud of fractional reserve bullion banking and how it suppresses the price of the very asset they have invested in. As a result there is a growing trend away from unallocated bullion toward allocated bullion and storing it with entities who are not affiliated with the bullion banks. This is creating a short squeeze of the physical market. Such things are hushed up by the bullion banks but there are the tell tale signs. The IMF has been surreptitiously selling large tonnages of gold each month since February to undisclosed recipients. The recent massive gold swap of 380 tonnes of gold between the BIS and commercial banks is without a doubt an attempt to address a lack of physical gold liquidity (see “Mysterious BIS gold swaps are likely a bullion bank bailout”). This gold swap involves more gold than the Bank of England sold, it involves more gold than the IMF has so far sold out of its earmarked 400 tonnes. The fact that it was “discovered” in a footnote of the BIS quarterly report is evidence that this news is being hushed up.

Goldman Sachs is recommending that gold mining companies hedge their gold production! This would be the worst trade of the century. Why would anyone bet that the US dollar that only has 2.3% gold backing could be more valuable than mine output that is 100% gold? Hedging would be betting that the Gold Cartel can ramp up their selling of paper gold even more so that the market price is suppressed even more. All indications are that the opposite is true. Look at figure 1. Clearly FRR has been in an increasing trend since 2001; this means that there is a trend that less paper gold is being sold or that physical gold sales are increasing, or both. The increasing fractional reserve ratio suggests the price suppression game is coming to an end. The last thing a mining company should do is to hedge production. But when has Goldman Sachs made recommendations in their clients’ best interests?

The writing is on the wall that physical demand is so strong it is straining the system. If you own unallocated bullion you likely only own about 2.3% of what you think you own. The window of opportunity to get your investment to be 100% bullion is closing rapidly.

Adrian Douglas
Editor of Market Force Analysis
Board Member of GATA

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