
# GOLD DERIVATIVE BANKING CRISIS

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# Gold Derivative Banking Crisis Summary

# GOLD DERIVATIVE BANKING CRISIS

**Extensive research has led the Gold Anti-Trust Action Committee (GATA) to the conclusion that the gold market is being recklessly manipulated and now poses a serious risk to the international financial system.**

* Annual gold demand, currently at record levels, exceeds mine and scrap gold supply by more than 1,500 tonnes. In the Washington Agreement of Sept. 26, 1999, 15 European central banks announced that they were capping their lending of gold and would limit their official sales of gold to 400 tonnes per year for the next five years. Some major gold producers have reduced their forward sales, and speculators have reduced their borrowed gold selling. Commodity prices and wages are rising. Yet the price of gold has declined steadily. With demand so much greater than supply, the price of gold should be rising sharply.

* According to the Office of the Controller of the Currency, the notional value of the off-balance-sheet gold derivatives on the books of U.S commercial banks exceeds $87 billion, which is greater than total U.S. official gold reserves of approximately 8,140 metric tonnes.

* Gold derivatives surged from $63.4 billion in the third quarter of 1999 to $87.6 billion in the fourth quarter, after the Washington Agreement was announced. The notional amount of off-balance-sheet gold derivative contracts on the books of Morgan Guaranty Trust Co. went from **$18.36 billion to $38.1 billion in the last six months of 1999.**

* Veneroso Associates estimates that the private and official-sector gold loans stood at 9,000 to 10,000 tonnes at the end of 1999. Most of these loans represent gold that has been sold in the form of jewelry and cannot be retrieved. Mine supply of gold for all of 1999, according to trade sources, was only 2,579 tonnes. Thus the gold loans are far too big too be repaid back in a short time. The swift $84 rise in the gold price following the Washington Agreement caused a panic among bullion bankers. But that was only a warning of what is to come.

* Federal Reserve Chairman Alan Greenspan and Treasury Secretary Lawrence Summers, responding to GATA's inquiries through members of Congress, have denied any direct involvement in the gold market by the Fed and the Treasury Department. But they have declined to address whether the Exchange Stabilization Fund, which is under the control of the treasury secretary, is being used to manipulate the price of gold.

* Several prominent New York bullion banks, particularly Goldman Sachs, from which the immediate past treasury secretary, Robert Rubin, came to the Treasury Department, have moved to suppress the price of gold every time it has rallied over the last year.

* The Gold Anti-Trust Action Committee believes that U.S. government officials and these bullion banks have induced other governments to add gold supply to the physical market in recent years to suppress the price. Britain's National Accounting Office is now investigating the Bank of England's decision to sell off more than half its gold. Contrary to proper accounting practice, reductions in gold in the earmarked accounts of foreign governments at the New York Federal Reserve Bank are being

listed by the Commerce Department as the export of non-monetary gold. These "exports" from the Fed occur upon rallies in the gold price.

*Why would anyone want to suppress the price of gold?

1) Suppressing the price of gold has made it a cheap source of capital for New York bullion banks, which borrow it for as little as 1 percent of its value per year. Gold is borrowed from central banks and sold, and the proceeds are invested in the financial markets in securities that have much greater rates of return. As long as the price of gold remains low, this "gold carry trade" is a financial bonanza to a privileged few at the expense of the many, including the gold-producing countries, most of which are poor. If the price of gold was allowed to rise, the effective interest rate on gold loans would become prohibitive. 2) Suppressing the price of gold gives a false impression of the U.S. dollar's strength as an international reserve asset and a false reading of inflation in the United States.

*Too much gold is being consumed at too cheap a price. Massive amounts of derivatives are being used to suppress the gold price. If this situation is not corrected soon, there will be a gold derivative credit and default crisis of epic proportions that will threaten the solvency of the largest international banks and the world standing of the dollar.

**The Gold Anti-Trust Action Committee requests that a full and complete investigation be launched into this matter as soon as possible. The longer the gold price is artificially held down, the bigger the eventual banking crisis.**

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# Delegation Biographies

**Gold Anti-Trust Action Committee Delegation**
**Meeting with members of Congress**
**May 10, 2000**
**Biographies of the Delegation:**

* **William J. Murphy III** is the Chairman of the Gold Anti-Trust Action Committee and owner of www.LeMetropoleCafe.com. A graduate of the School of Hotel Administration at Cornell University in 1968, he went on to become the starting wide receiver with the Boston Patriots of the American Football League. Mr. Murphy, who now resides in Dallas, Texas, spent much of his business career in the Futures Industry with such firms as Drexel Burnham and Shearson Hayden Stone. Today, he writes gold market commentary for this financial web site that features the precious metals markets and contrarian economic analysis.

* **Chris Powell** is the Secretary/Treasurer of the Gold Anti-Trust Action Committee and has been managing editor of the Journal Inquirer, a daily newspaper in Manchester, Connecticut, for 26 years. He is immediate and past president of the Connecticut Associated Press Managing Editors Association and a director for the Center for First Amendment Rights Inc. He writes a weekly column about Connecticut issues that is published in a dozen other newspapers in the state and frequently appears on Connecticut television and radio public-affairs programs.

* **Reginald H. Howe**, proprietor of **The Golden Sextant**, is an author and private investor. A graduate of Harvard College, Harvard Law School and the Bologna (Italy) Center of the Johns Hopkins School for Advanced International Studies, he began his business career in 1964 as a financial analyst with the international division of The Kendall Company. From 1976 to 1984, Mr. Howe was a partner in the Boston law firm of Palmer & Dodge, where he specialized in civil litigation and was a member of the firm's investment committee. He was an associate at the same firm from 1970 to 1976. In 1983, Mr. Howe organized Golden Sextant Associates, a general partnership for investing in developing North American gold mining companies, and he served as its managing general partner until its profitable dissolution in 1987. For a few years thereafter, he continued as a sole legal practitioner and served as a registered investment adviser to private clients.

*** Mr. Veneroso** is currently the head of Veneroso Associates. Formerly he was a partner of Omega Advisors, where he was responsible for investment policy formulation. Prior to this, acting through his own firm, Mr. Veneroso has been an economic consultant and investment strategy advisor to governments, international agencies, financial institutions, and corporations around the world. He acted as an economic policy advisor to international agencies and governments in the areas of money and banking, financial instability and crisis, privatization, and the development and globalization of emerging securities markets. His clients have included the World Bank, the International Finance Corporation, and the Organization of American States. He has been an advisor to the governments of Bahrain, Brazil, Chile, Ecuador, Korea, Mexico, Portugal, Thailand, Venezuela, and the United Arab Emeritus. Mr. Veneroso graduated cum laude from Harvard University and has authored several articles on subjects in international finance.

# - III -

# Case for Recent Large Undisclosed Official Selling of Gold

# <u>A Case for Recent Large Undisclosed Official Selling of Gold</u>

***Prepared For***

## *The Gold Anti Trust Action Committee Presentation to*

## *The Congress of the United States*

***May 10, 2000***

***By***


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# A Case for Recent Large Undisclosed Official Selling of Gold

1) In today's gold market, where there is minimal Western investment interest, gold behaves as a commodity, not as an asset. Its price is determined by annual flows of demand for jewelry, electronics, etc., and supply from mines, scrap and the liquidation of the official sector's above ground holdings. The latter occurs through both outright sales and loans. These liquidations comprise the market's "commodity deficit". Today, investor inflation expectations are not greatly influencing the gold price, but central bank disposals are greatly depressing the gold price.

2) According to the consensus Gold Fields Mineral Services, Ltd. (GFMS) gold market supply/demand framework, in the 1990s annual demand has been on the order of 3500 tonnes. Supply from mine and scrap has been roughly 3000 tonnes. Annual official sales have averaged roughly 300 tonnes and annual loans have been slightly higher than 200 tonnes. All these figures have trended up and the average of these several items has been somewhat higher in recent years.

3) According to Veneroso Associates, these consensus figures have understated gold demand and supply, chiefly from gold lending. In the mid 1990s annual demand averaged roughly 4000 tonnes, mine and scrap supply were 3000 tonnes, official sales averaged 300 tonnes and gold loans averaged 700 tonnes.

4) Gold demand increases as global income rises and as the real gold price declines. The gold price has fallen since 1996. With the recent recovery in the economies of Asia, global income has risen as well. By late 1999, the above demand and supply figures were much higher, with annualized demand at perhaps 5000 tonnes, mine and scrap supply at perhaps 3200 tonnes, and the difference between the two (the market deficit) at perhaps 1800 tonnes.

5) For the mid 1990s, higher than consensus levels of gold loan supply can be attributed to large underestimates of gold loans to speculators, smaller underestimates of gold loans to producers, and a complete neglect of gold loans to fabricators and refiners.

6) In September of 1999 fifteen European central banks with almost half the world's official gold decided to cease all net new gold lending and limit their sales to 400 tonnes annually. The IMF and US say they do not lend or sell gold. If so, that would imply that central banks with perhaps only 5000 tonnes (roughly 15% of the world's official gold) account for more than 1000 tonnes annually of undisclosed supplies. Yet sales announced by this group of countries have been minimal.

7) The Washington Accord created the largest short term percentage rise in the price of gold in almost twenty years. It raised perceptions of risk by all private market participants who had heretofore been selling short (i.e. borrowing) gold. Therefore, they moved to cease or reverse their borrowing. At a minimum, one cannot attribute recent large implied supplies to those private parties who had been suppliers of borrowed gold in the past. In fact, it is more likely that speculators have reduced shorts, implying offsetting undisclosed official sales in excess of those supplies needed to meet the market's deficit.

8) These developments on the supply and demand side of the gold market point to a huge undisclosed seller in the gold market in recent quarters. The Europeans with almost half the world's official gold have removed themselves as lenders and as possible sellers of such a magnitude. The US and IMF account for roughly another one third of global official holdings. All other countries account for perhaps only 15% of all official gold, and consensus estimates suggest that perhaps half has already been lent. A process of elimination points to the US and/or IMF as possible undisclosed sellers and/or lenders of gold.

9) The above thesis rests on Veneroso Associates alternative gold market supply/demand framework. Their framework incorporates data from a demand survey done by the World Gold Council. The Council has far more resources to research demand than GFMS. The Council's data unequivocally points to levels of global gold demand that are much higher than GFMS estimates.

10) On the supply side, Veneroso Associates has found eleven independent sets of evidence and lines of reasoning that point to higher levels of gold lending than are reflected in the GFMS historical supply/demand balances. Other recent estimates of total gold loans (and implied annual gold lending) have corroborated the estimates of Veneroso Associates.

11) Data on the at-risk OTC gold derivative positions of some US bullion banks are regularly published by the OCC. These positions probably correspond in large part to their gold lending books plus the face value of counter-party client options they must hedge. In the second half of 1999 the Washington Accord encouraged private market participants to reduce short positions. Reduced short positions imply a contraction in dealer books.

12) Understandably, the combined OTC derivative positions of all US bullion dealers who report to the OCC except for Morgan Guaranty and Citibank underwent a significant reduction. However, the same positions of Morgan and Citibank almost doubled. There is nothing about their commercial activities that readily explains this unprecedented increase. Such a massive change concentrated in only two banks appears anomalous and may correspond to an intervention by only one or two official sector parties with special relations with US dealers.

# A Case for Recent Large Undisclosed Official Selling of Gold

## *Documentation and Recommendations*

Documentation for points 3) and 5) are presented in chapters 1 through 3 in the Gold Book Annual 1998. It is available from Jefferson Financial[1] . In what follows we present documentation of most of the other points listed below, largely through reproductions of research analyses by Veneroso Associates that are now in the public domain.

The case for large scale undisclosed official gold lending can be readily proved or disproved from data on the positions and operations of the world's principal bullion bankers. This data now exists. There should be no difficulty in obtaining it. If the activities of the world's bullion bankers have been straight forward, there should be no opposition to its disclosure.

In introducing our documentation of each point, wherever appropriate, recommendations are made for obtaining information that would confirm or disconfirm each thesis

1 Jefferson Financial, 2400 Jefferson Highway, Suite 600 Jefferson, LA 70121, Phone 800-877-8847.

## Point 4

### Chapter 2 Thesis

Gold demand increases as global income rises and as the real gold price declines. The gold price has fallen since 1996. With the recent recovery in the economies of Asia, global income has risen as well. By late 1999, the above demand and supply figures were much higher, with annualized demand at perhaps 5000 tonnes, mine and scrap supply at perhaps 3200 tonnes, and the difference between the two (the market deficit) at perhaps 1800 tonnes.

### Commentary:

In early 1997 the gold price fell significantly under selling pressure from central banks, producers and speculators. As global income was still expanding, global gold demand increased to new highs. In the second half of 1997, the Asian crisis began. It depressed gold demand in the all important Far East and curbed demand in the gold intensive Middle East where incomes fell with the price of oil. Financial crisis in the Far East led to dishoarding by distressed holders, which added appreciably to supply. These adverse supply and demand shocks deepened the decline in the gold price.

By the third quarter of 1998 the Asian crisis began to pass. Incomes in Asia have recovered strongly. Commodity prices have rebounded, with the price of oil reaching a ten year high. Middle East incomes have consequently recovered. The US and Europe have been in strong cyclical expansions. Global gold demand should have recovered strongly. Asian distress scrap supply has disappeared. At current low gold prices mine supply has stagnated. The gold market deficit has widened greatly since mid 1998, requiring a large increase in the liquidation of above ground official stocks.

There is a difference between the World Gold Council and consensus Gold Fields Mineral Services (GFMS) demand data on the extent of the recovery in global gold demand and the consequent trend in the gold market deficit. Veneroso Associates follows the World Gold Council in this regard, as their estimates are in keeping with historical income and price elasticities of gold demand. Their estimates point to a massive gold market deficit by late 1999.

For details, see the supporting documents to points 7 and 9.

## Point 6

**Chapter 3 Thesis**

> ***In September of 1999 fifteen European central banks with almost half the world's official gold decided to cease all net new gold lending and limit their sales to 400 tonnes annually. The IMF and US say they do not lend or sell gold. If so, that would imply that central banks with perhaps only 5000 tonnes (roughly 15% of the world's official gold) account for more than 1000 tonnes annually of undisclosed supplies. Yet sales announced by this group of countries have been minimal.***

## Commentary:

It is possible that, since September of 1999 several official institutions other than the central banks of Europe, the US and the IMF have moved in concert to sell significant quantities of reserve gold and have not disclosed their sales. However, this alternative, though possible, is unlikely.

There are only a handful of official institutions outside Europe, the US and the IMF with gold holdings large enough to constitute a possible source of significant supply. These few official institutions may be willing to disclose to the appropriate authorities the status of their gold reserve holdings over the last several quarters.

# The Mystery of Recent Undisclosed Gold Sales

Candidates for Large Scale Undisclosed Official Sales

***Chapter 4***

***Chapter 5 Executive Summary***

*There is more official and quasi-official gold out there than most gold market observers realize. We see no special reason why these holders should have recently become sellers, especially after the announcement of the Washington Accord. Nonetheless, the sale of official gold by Malaysia late last year opens up the possibility of deep disaffection by official holders which may have led to simultaneous sales by such holders along the lines suggested by Gold Fields in their recent January 2000 interim report. It is possible that multiple undisclosed official sales of gold explain recent selling in the gold market. However, the odds are not great that such sales alone can explain the overall large volumes that we infer from our supply/demand work.*

*In any case, if large undisclosed sales from official bodies such as those discussed above account for recent selling pressures in the gold market, they cannot be sustained at such levels for long. We would expect them to abate or end soon. Only deliberate intervention by the official sector is likely to keep the gold price depressed given the positive and improving supply/demand framework of the market.*

## The Case for Undisclosed Gold Sales

We have argued again and again and again that all aspects of the gold supply/demand framework point to the existence of one or several large undisclosed official sector sellers since late 1998 and especially since the announcement of the Washington Accord at the end of September 1999. Because of the Washington Accord, official selling out of Europe will be limited to the Netherlands, Switzerland, and the UK and is not supposed to exceed 400 tonnes per annum. This accord prohibits the sale of forwards and options, so it seems to be binding. US Congressional action has prohibited outright gold sales by the IMF. Therefore, to posit large undisclosed official sales requires significant sales by either the US or the rest of the world excluding Europe and the IMF.

There are less than 33,000 tonnes of official sector gold holdings reported to the IMF. The US, the IMF, and the signatories to the Washington Accord account for about 26,000 tonnes. Because the holdings of gold by central banks outside North America, Europe and the IMF are so limited, the US has become a candidate for the role of recent large-scale official seller by a process of elimination. The predominant role of Goldman Sachs in the gold market, with close ties to the current administration, has fueled rumors of US intervention. Because of Fed and Treasury denials that US physical bullion has been sold, it is presumed by those who point the finger at the US that such selling has been done with derivatives. Such finger pointers note that the US Treasury and Fed under this administration have encouraged the growth of OTC derivatives markets and have fought against CFTC regulation of, and FASB disclosure requirements for, these markets.

## Undisclosed Official Gold Holdings

We know there have been huge undisclosed official sales in the gold market but we do not know their origin. However, we do realize that there are larger official holdings outside North America, Europe, and the IMF than the available statistics on official gold holdings would indicate. Therefore, there is a greater possibility than most people realize that official holdings from countries outside North America, Europe and the IMF are the source of recent undisclosed official sales. We will review in this note some of these undisclosed official gold holdings.

**Saudi Arabia**: Approximately a decade ago we received reports that Saudi Arabia held in excess of 1000 tonnes of official gold. This gold was supposedly bought in the very late 1970s or early 1980s. Roughly 200 tonnes were thought to have been sold in early 1990 to pay for the purchase of British aircraft. The Saudi central bank, the Saudi Arabia Monetary Authority (SAMA), reports a holding of roughly 100 tonnes to the IMF. However, the line between holdings of the Saudi royal family and the Saudi monetary authority may not be clearly drawn. We know from several sources that many of the dominant families of Saudi Arabia purchased large gold positions in the late 1970s and early 1980s that they still hold today. It is possible that Saudi Arabia never accumulated such a large official or quasi official gold position. They may have acquired such a position but sold part or all of it earlier in the 1990s. But, it is equally possible that Saudi Arabia has "quasi" official holdings that are close to 1000 tonnes in excess of what they report to the IMF.

**The Vatican:** We have received one report that, as of roughly a decade ago, the Vatican was a large gold holder, with gold reserves roughly equivalent to those of a second tier European country. We presume that this implies gold holdings comparable to those of Portugal or Spain, which are in the 500 to 600 tonne range.

**China:** China has reported official gold reserves to the IMF of 400 tonnes for a very long time. However, it is widely believed that China accumulated considerable additional gold holdings in the 1990s. Such purchases are implied by the Gold Fields Mineral Services (GFMS) reports of the 1990s, which make frequent references to undisclosed official purchases in those years. In early 1997 Mr. Fritz Plass, senior gold trader at Deutsche bank, stated at a meeting in New York that China's gold reserves exceeded 1000 tonnes and may have been 1000 tonnes higher than their official reserve position of 400 tonnes.

**Taiwan**: Taiwan holds 406 tonnes of reserve gold. As it is not part of the IMF, its gold reserves are not included in compilations of official reserves recorded with the IMF.

**Others:** It is widely believed that several countries such as Brunei have gold holdings that are not recorded with the IMF. We presume that any such holdings are much less than those of Saudi Arabia, China, the Vatican, or Taiwan. We also believe that some gold producing countries, notably Brazil and Venezuela, have accumulated significant domestic mine supply that is not disclosed.

## Are These Gold Holdings Under Liquidation?

Reviewing the above, we can see that there may be 3000 tonnes of official or quasi official gold holdings that are not reported to the IMF which could be the source of recent undisclosed sales. In its January interim report, GFMS claimed to know about such sales; they stated that there were two large official sales in Q4 1999 that would never be disclosed. The GFMS text suggests that each of these sales were on the order of 100 tonnes. It is our strong conviction that, though GFMS is in a strong position to obtain information about official sector gold activities, they have tended to bias their estimates of flows downward to fit into an overall supply/demand framework that suffers from severe underestimation.

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There is one reason above all for doubting that such gold holdings are the source of recent undisclosed official selling: the Washington Accord was agreed upon by the European governments involved in order it improve gold market sentiment and the gold price. This accord was well advertised. Central Banks all around the world are well aware of the Accord and its implications. The Accord and its price aftermath have profoundly reversed the prior bearish expectations of private bullion banks, funds, and gold mining companies. The same should apply to official holders.

That said, let us consider the individual candidates for such sales discussed above.

**Saudi Arabia:** Recent contacts with Saudi families who hold gold have indicated a deep dissatisfaction with their barren gold holdings but no haste to sell at recent depressed prices. With the dramatic recovery in the oil price, the fiscal position of the Saudi government is in better shape than it was earlier in the decade; therefore, there is little financial motivation for such sales at the present time.

**The Vatican:** We know nothing about Vatican gold holdings, if they exist.

**China:** China was a frequently reported gold buyer on price declines throughout most of the 1990s. This was consistent with statements made by some Chinese authorities that China should diversify its vast official reserves out of dollars and possibly purchase more gold. However, beginning in late 1997, such reports of Chinese purchases have given way to reports of sales. This is reflected to some degree in Gold Fields' discussion of official activity in recent years. Gold Fields has reported that China turned seller in 1998. Also, in its interim report this January on the gold market in 1999, it made no reference to undisclosed official purchases in that year. This is unusual since in virtually all prior years in the 1990s it obtained information regarding undisclosed official purchases.

Malaysia sold half its official gold reserve in the fourth quarter of 1999. The nation's political leader, Dr. Mohammed Mahathir, is no friend of the US. The fact that Malaysia appears to be jettisoning its gold reserve indicates that countries that are less than positively disposed to the US and hold mostly dollars in their official reserves may be inclined to sell their official gold holdings nonetheless.

**<u>Taiwan</u>:** We believe that the sale of official gold has been considered by the Taiwan authorities, but that no action has been taken. However, despite an official denial last year, a sale of official gold by Taiwan is not inconsistent with our overall information. If such a sale occurred we presume it would be disclosed. However, that may occur with a lag, as Taiwan is not a member of the IMF.

**<u>Others</u>**: We understand that there are problems with the management of the assets of the Brunei Monetary Authority but have no indication that these problems have any implication for any gold holdings. We have received reports that both Venezuela and Brazil have recently sold unreported accumulated mine output. In fact, there is one rumor being circulated that Brazil has sold all of its official gold, both its disclosed reserves as well as any undisclosed holdings from domestic mine production. ◆

## Point 7

### Thesis:

The Washington Accord created the largest short term percentage rise in the price of gold in almost twenty years. It raised perceptions of risk by all private market participants who had heretofore been selling short (i.e. borrowing) gold. Therefore, they moved to cease or reverse their borrowing. At a minimum, one cannot attribute recent large implied supplies to those private parties who had been suppliers of borrowed gold in the past. In fact, it is more likely that speculators have reduced shorts, implying offsetting undisclosed official sales in excess of those supplies needed to meet the market's deficit.

### Commentary:

> From evidence available at the end of the fourth quarter of 1999, it appears that all prior private sector borrowers of gold ceased net new lending in the fourth quarter of that year. In fact, evidence from the CFTC and other sources suggests that speculators covered short positions. This would imply huge official selling to both cover an ongoing physical market deficit and offset short covering by speculators. We append an early account of this process and its implications for undisclosed sales. There has since been additional corroborating evidence for this thesis.

Adequate survey data on the short positions of mining companies exists. The CFTC provides data on the short positions of a subset of speculators (managed futures funds). However, owing to very restrictive futures market position limits, this data encompasses only a part of the overall positions of these funds.

It should be possible for the authorities to obtain full disclosure of the overall positions of any managed futures funds that report to the CFTC at past relevant benchmark dates. As the CFTC has some responsibility for surveillance of these futures market participants, review of their overall balance sheets should fall under the purview of the CFTC. Publicly owned banks and broker dealers take short positions in gold in proprietary trading accounts and through mismatches in bullion banking asset and liability positions. Disclosure of these positions at past benchmark dates should fall under the authority of the US banking authorities and the SEC. Many of the world's principal hedge funds lie outside the authority of such regulatory bodies. However, many of the large hedge funds have suspended or curtailed operations in recent years. They may be willing to provide the appropriate authorities with historical data on their past gold trading positions.

From benchmark dates over the past year or so, it should be possible to ascertain whether speculators have reduced short positions, thereby implying undisclosed official sales in excess of those needed to cover the implied physical deficit in the gold market.

# Gold Watch
## Veneroso Associates
**December 23, 1999** **Issue 12.03**

# Unidentified Gold Supplies and the Borrowed Gold Debate

***Summary***

*The odds are that the end of distress liquidations of gold in Asia has reduced gold scrap supplies this year by 500 tonnes or more. We believe that there were significant undisclosed EMU related sales in 1997 and 1998 that probably ended before the beginning of 1999. We also believe that there were large flows of borrowed gold associated with additions to speculative short positions in 1997 and 1998. Again, these flows probably abated and may well have reversed in 1999 owing to financial constraints on these speculators. These flows had to be replaced in 1999 to keep the gold price depressed. We have argued repeatedly over the last year that, with global gold demand strongly on the rise, a sustained low gold price required yet further large flows of gold to keep the gold price in the $290 range of the prior year. The recent World Gold Council third quarter survey of gold demand which showed a 22% year-over-year increase strongly supports this thesis.*

*From published information it appears that the UK decision to sell its gold panicked producers, leading to record hedge selling. This record producer hedging explains most of the requisite huge supplies that depressed the gold price in the third quarter of this year. However, it confirms our thesis that the gold market deficit has been very large and commensurately large flows of gold from official stocks were needed to maintain a depressed gold price in the prior quarters. However, from published information it is not possible to account for such large gold supplies.*

*On the recent rally the three classes of market participants that had delivered borrowed gold to the market in 1999 and 1998---funds, bullion banks, and producers---probably all moved to cover short positions. Though physical demand abated short term on the rally, the market could not have gone into a significant cumulative surplus. Again, one must posit some source of selling to offset this likely short covering. Yet, once again, such a source cannot be identified from published information.*

Again, on the recent precipitous gold price decline those market participants that were major sellers of borrowed gold experienced a change in risk perceptions after the gold price spike of late September/early October. They were, therefore, less inclined to sell short and many have sought to cover shorts. We have reports of small quantities sold recently by some central banks such as the Netherlands and possibly Russia, but these are not sufficient to explain how this aggregate short covering was absorbed.

This precipitous decline again requires a major seller who can not yet be identified. Therefore, it is necessary to review the basis for the above assertions and the case for such undisclosed supplies throughout this year.

# Unidentified Gold Supplies and the Borrowed Gold Debate

## Gold Supply Demand Frameworks and the Existence of "Mysterious" Gold Supplies

On this issue, everything depends on one's supply/demand balances. If one accepts the Gold Fields Mineral Services (GFMS) balances, there is little reason to posit large undisclosed supplies. However, we have become convinced that global gold demand, the gold market deficit, and official supplies have been greatly understated for a decade or so. In a report written on July 29th, entitled, *Gold Deposits and Swaps, Gold Demand and the Gold Market Deficit: Close to Raising Our Estimates*, we set forth nine independent reasons for our position.

We continue to pursue research into this area. We understand that Jessica Cross has been conducting a gold lending survey for the World Gold Council and has found 6000 tonnes of official lending. Andy Smith of Mitsui has made a similar estimate at a conference in Paris this past week. We understand that Jessica Cross has not been able to get data on the lending of all official and quasi-official entities. Cross' findings may be getting into circulation, putting a new and higher floor on the range of such estimates. To this 6000 tonnes plus we must add at least several hundred tonnes of private gold deposits. This would place total gold lending at roughly 6500 tonnes. That would be 2500 tonnes or so below our best estimate, but it would be more than 3500 tonnes higher than the cumulative gold lending in the GFMS balances since 1984[2]. Since annual gold loan flows were only beginning fourteen years ago and since everyone agrees that such flows have been rising progressively over the last decade or so, Jessica Cross' survey would suggest that GFMS estimates of global gold demand, the gold market deficit, and borrowed gold flows have been underestimated by perhaps 400 tonnes annually in recent years.

We have identified three possible new sources of support for our overall position on gold lending. They all lie with the official sector, but adequate disclosure may be possible. None would provide a comprehensive account of global official lending. Each would provide a 'window' on a different aspect of the overall phenomenon of gold lending. Judging from first pass evaluations, two of these could possibly "blow" the debate wide open in our favor. We fear the research involved will take considerable time. We will report our findings as they become available.

The explosive nature of the late September-early October rally made swirling rumors of larger than consensus short positions by bullion banks, funds, and producers credible. In our opinion most market participants now believe that there was a "mountain" of borrowed gold out there and that bullion bank and central bank secrecy on this issue was done deliberately to conceal the true magnitude of gold lending. Clearly,

2 The cumulative gold lending in GFMS supply/demand balances is far less than their current estimate of the outstanding stock of borrowed gold. They seem to be unaware of this important discrepancy between their stock and flow estimates.

some of the large bullion banks appear to have been operating in "bad faith". These banks will disclose their consumer loan books, their corporate loans books, and their mortgage loan books but they will not reveal the size of their bullion banking books. To a man they have denied that they had any unhedged speculative short positions or carry trades. Some made estimates for total global gold lending that even Gold Fields came to discard[3] and that they surely must have known were too low. It is now generally recognized that the bullion banks have been deliberately misleading market participants on the extent of their bullion banking operations.

When they consider the existence of large gold lending aggregates, most market participants focus on the potential for short covering which would, of course, lead to a gold price rally. However, the most relevant implication of the existence of a larger than consensus stock of gold loans is on the flow variables in the supply/demand equation. If outstanding gold loans are perhaps 6000 tonnes higher than the cumulative flows in the GFMS balances (more than 9000 tonnes official and private versus perhaps 3000 tonnes in the GFMS balances), then the Gold Fields supply/demand balances are greatly in error. Because annual gold lending has been on a rising trend, these flows have been understated by 600 tonnes or more per annum in recent years. This means that the commodity equilibrium price of gold in the absence of all net official sales and loans must be much higher than is generally thought. In the first Gold Book Annual we estimated that in 1998 this "commodity" equilibrium price would be on the order of $600 give a full Asian recovery.

Gold Fields estimated global gold demand at 4123 tonnes in 1998. If the new consensus estimate of outstanding gold borrowings of 6500 tonnes is correct, global demand was perhaps 4500 tonnes. If our estimate of total gold loans outstanding of 9000 tonnes plus is correct, then demand last year may have been more than 4700 tonnes. The determinants of global gold demand turned positive in second half 1998 and have been strengthening progressively. The WGC gold demand survey reflects this with estimates of substantial increases in demand this year versus last year, even when allowance is made for Asian distress scrap liquidations which reduced their measures of demand in first half 1998. Consequently, it is our guess that global gold demand was running above 1998's level in the first half of this year. Based on the WGC third quarter demand survey, it may have been running at a 20% higher rate versus third quarter 1998. If demand was 4500 tonnes last year, it was probably higher in the first half of this year and could well have been at a 5000 tonne rate in the third quarter. If our estimates of demand are correct, demand was close to a 5000 tonne rate in the first half and was probably well in excess of a 5000 tonne annual rate by the third quarter.

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3 GFMS "slipped in" an upward revision to their estimate of global gold lending in their 1998 annual report without pointing this out to their readers. We hear that they will now further revise this total upward toward Jessica Cross' estimate. This will create a yet greater inconsistency between their estimate of the outstanding stock of borrowed gold and the cumulative flow of borrowed gold in their historical supply/demand balances.

Both GFMS and Veneroso Associates estimate mine and scrap supply in 1999 at 3200 tonnes. If the first of the above estimates of demand are correct, there was a market deficit at perhaps a 1500 tonne annual rate in the first half and an 1800 tonne rate in the third quarter. If the second of the above estimates is correct, the deficit was higher yet by perhaps 200 hundred tonnes or more annually.

In effect, demand rose by many hundreds of tonnes at an annual rate and scrap supplies fell by more than 500 tonnes at an annual rate. In addition, both GFMS and ourselves believe there were undisclosed official sales in 1998 that resulted in net official flows for the year of roughly 400 tonnes. By contrast in the first half of 1998 there were almost no reported net official flows and reports to date for the third quarter (UK, Malaysia, Jordan) only bring the reported total to perhaps 100 tonnes over nine months---hundreds of tonnes below 1998's annual rate. On a combined basis these improvements in the above supply and demand variables constitute a swing in the gold supply demand balance of well in excess of a thousand tonnes annually year-over-year. This swing is greater during the third quarter. The implied deficit is huge, at a 1700 tonne rate by the second quarter and at almost a 2000 tonne rate by the third quarter.

How was such a large deficit met? As we discussed in a companion report ("More Price Weakness Than We Expected", Dec. 6th.) producer hedging may be a sufficient explanation for the third quarter but not for the first and second quarters. It was trivial in the first quarter. It was large in the second quarter, on the order of 200 tonnes net. However, that is roughly only half of the likely market deficit.

In the Gold Fields balances, the average rate of borrowed gold supplies over the last several years from market participants other than hedging producers---speculators, bullion dealers, fabricators, and central bank option writers---is on the order of only 100-200 tonnes. We believe this flow was in fact very large, perhaps on the order of 600 tonnes or more. When global gold demand and supply trends began to turn favorable in Q3 1998, the gold price should have risen. It did not. Our initial inclination was to assume that this very substantial past rate of selling of borrowed gold by funds and bullion banks had increased. However, the more Asian demand strengthened and scrap flows abated, the less plausible this explanation became. Other factors made it increasingly implausible as well. First, losses and redemptions at hedge funds made it likely that the flows of borrowed gold due to <u>increases</u> in their short positions contracted rather than expanded. In fact, their overall financial positions were so debilitated these flows might have gone negative. Second, starting in September of 1998, it is widely reported that Goldman Sachs became the featured seller in the market. If bullion banks were largely responsible for increased borrowed gold flows, they would have acted on their own behalf and not through Goldman Sachs. Therefore, a large and unidentifiable source of gold supply appears to have emerged in late 1998 and appears to have grown over time.

## Unidentified Selling Reversed the Recent Short Covering Rally

The violent rally in the gold price in September was set off proximally by the decision of fifteen European central banks to cease all net new gold lending. For most market participants, a short covering rally, though it may be violent, tends to be a transitory event. Once the shorts cover, the buying dries up and the price falls back. That is true of an ordinary market. But the gold market is not an ordinary market. We have explained in a recent report entitled "The Prison of the Shorts", that there is a net short position in the gold market that is equivalent to the outstanding stock of borrowed gold. This net short position is unique since it corresponds to a "physical" short position. This short position resulted from a flow of physical gold bars from central banks which had to be refined, reworked and absorbed as fabricated demand. This process of physical absorption was constrained by the level of physical demand and the existence of competing supply from mines and scrap. As a consequence it took years and years for this process to result in today's large stock of outstanding gold loans. The covering of this net short position is similarly constrained by the physical flows that make up the gold supply/demand balance. To reduce this net short position requires a gold price high enough to generate a market surplus, and, even when a surplus occurs, it takes a long time to return enough bullion bars to the lending central banks to make a noticeable dent in this outstanding short position. For this reason, if the various classes of gold shorts attempt to reverse their positions in unison, the gold market should rise explosively and on a sustained basis.

On the late September-early October rally, trend following Comex shorts covered and went long. From all indications, OTC oriented funds, already suffering financial debilitation, tried to cover as well. We hear that Tiger covered a large short position. The margin call crises at Ashanti and Cambior generated shareholder pressures on all gold producers to cover shorts. Several large producer buy backs have been announced. More must have occurred. We have learned that some producers have been delivering against hedges which they have not renewed. Bullion bankers were also caught with short positions in the form of carry trades, gold-dollar mismatches, and option exposures. Losses have been suffered. Key personnel have been dismissed. More dismissals are rumored. The value at risk models employed by these bullion banks now call for lower risk positions since historical volatilities are now higher. It seems unlikely that bullion banks, now reviewing and reassessing their risk exposure, are adding to their short positions. All of the previous market participants responsible for past flows of borrowed gold have been trying to reduce, not increase, their short positions. Therefore, these market participants, taken in the aggregate, should have covered a significant volume of gold short positions.

The totality of all gold forward shorts is offset by a combination of pure "paper" longs and bullion dealer "paper" longs which are underpinned by offsetting physical gold short positions. (See our report, "The Prison of the Shorts"). The latter corresponds to the stock of outstanding gold loans which we refer to as the net short position in the gold market. Physical demand for gold abates over the short run on all price spikes. No doubt it did on the October spike, but this abatement was probably not enough to throw the market into a surplus.  In any case, the period involved was brief, so, even if a transitory surplus was achieved, the quantity of physical bars made available from mine and scrap supplies to reduce the stock of gold borrowings would have been insignificant and the stock of outstanding gold loans could not have been appreciably reduced.

It is possible that the sharp rise in the gold price induced some "paper" longs to sell to corresponding gold forward shorts.  But even this hypothesis is questionable. There are many trend following speculators in the gold market.  The October price rise no doubt encouraged them to go long.  It is likely that any fundamental longs in the forward market who were inclined to sell to the shorts on the recent rally were offset by new speculative forward longs entering the market.  For these reasons we conclude that, short or massive official selling, the aggregate short position in the gold market could not have been covered and, therefore, has not been covered.  This poses the all-important question, how did many market participants who were short manage to cover and why was the explosive rally reversed?

The answer is simple: either someone else took those short positions onto their books or there was offsetting physical sales.  Given the large magnitude of the likely flows, only the official sector could have done either.  Over the past year unidentifiable supplies have met the gold market.  These could have been attributed in part to undisclosed selling by traditional short side market participants: funds, bullion banks, producers, etc.  However, on the October rally these participants were covering shorts. Huge selling must have offset their short covering.  Such selling must have been official in origin.  The Dutch have announced a small sale (15 tonnes plus) recently.  There is some evidence of a Russian sale for 80 tonnes, but it is not conclusive.  In any case, these two sales do not provide the supply we need to offset short covering and a possible ongoing deficit.  Substantially more as yet undisclosed official selling must be assumed.

## Conclusion

As the consensus estimate of outstanding gold lending rises, it becomes clear that the Gold Fields estimates for global gold demand and the gold market deficit are too low. We are confident our estimates are correct and the market will eventually converge on our estimates that are 600 or more tonnes annually than those posited by GFMS.

Because the determinants of gold demand turned positive this year, we are sure that a market deficit at a 1500-2000 tonne annual rate was prevailing this year prior to the recent sharp rise in the gold price. Based on all the information available on the actions of all classes of market participants, it is not possible to identify all the supplies that were needed to keep the gold price depressed. Therefore, we assume there had been intense unidentified official sector selling of some nature at various times over the last year.

On the recent price rise, the gold market deficit no doubt fell on a transitory basis. However, all classes of borrowers of gold moved to reduce their gold short positions. This implies negative flows of borrowed gold. What, then, stopped and reversed the rally. Once again, we must posit large scale unidentified official selling. ◆

## Point 9

## Thesis:

The above thesis rests on Veneroso Associates alternative gold market supply/demand framework. Their framework incorporates data from a demand survey done by the World Gold Council. The Council has far more resources to research demand than GFMS. The Council's data unequivocally points to levels of global gold demand that are much higher than GFMS estimates.

## Commentary

> Though neither the World Gold Council, Gold Fields Mineral Services, or market analysts highlight the wide difference in their estimates of global gold demand, in fact simple analysis shows unequivocally a huge implied difference in these estimates.

The authorities should encourage research into the implications of the World Gold Council demand data and its "quality" relative to consensus GFMS estimates.

# Gold Watch
## Veneroso Associates
**March 8, 2000** **Issue 03.01**

# *The World Gold Council Demand Trends Data Survey*

## *Does It Point To A Large Undisclosed Official Seller?*

### *Executive Summary*

The World Gold Council estimates its survey encompasses 80% to 85% of all global demands for physical gold as estimated by Gold Fields Mineral Services. The Council surveys only jewelry, bar, and official coin demands. It does not survey demands for electronics, dental, decorative, industrial and medallions.

We pose the question, does the 80% to 85% global coverage of the World Gold Council (WGC) demand survey refer to just jewelry, bar and official coin demands or does it refer to all gold uses? The WGC assumes the latter. However, if that were so, the WGC 1999 survey would cover roughly 96% of global demands for jewelry, bar, and coin.

Gold Fields Mineral Services has provided estimates of jewelry consumption in 1998 for only seven of the many, many countries the WGC does not survey. Jewelry consumption in these seven countries alone, according to GFMS, is equal to more than 8% of their estimate for total jewelry fabrication demand worldwide. These GFMS estimates make it clear that the WGC survey encompasses much less than 96% of global jewelry demand.

If one compares the aggregate incomes of the countries the WGC surveys versus the aggregate incomes of those countries it does not survey, it would seem that the WGC survey may encompass less than 80% of the global markets it surveys---jewelry, bar, and official coin.

We "gross up" the WGC survey data from an assumed 83.2% coverage of the jewelry, bar and official coin markets to a full 100% coverage. We then add GFMS' estimates of demand for those gold markets or uses the WGC does not survey. We also make small additional adjustments for WGC under-estimates of Chinese demands, Gold Fields underestimates of dental and other demands, and positive inventory demands at the fabrication and wholesale levels. This procedure argues that GFMS global gold demand estimates were

500 to 600 tonnes too low in the 1994-1996 period. It indicates that GFMS global gold demand estimates were 800 to 900 tonnes too low in 1999.

The above analysis suggests that the WGC demand data, with possibly 80% or less coverage of the global markets it covers, might need to be grossed up by more than 25%---not just 20%---to arrive at an estimate for global gold demands for jewelry, bar, and official coin. This procedure points to total global demands and a gold market deficit that was 1000 tonnes or more higher in 1999 than the GFMS estimate.

If the GFMS demand data is correct, one may need to assume only a small level (200 tonnes or so) of undisclosed official selling in 1999. If we (and the WGC, though it does not realize this) are correct about global demand, there was absolutely huge undisclosed official selling in 1999.

## *The World Gold Council Demand Trends Data Survey*
### ***Does It Point To A Large Undisclosed Official Seller?***

**Introduction**

World Gold Council demand surveys have indicated a large rebound in end user demand for gold worldwide as well as a sharp decline in liquidations of gold by parties in financial distress in emerging Asia (which are classified as scrap by Gold Fields Mineral Services). At the same time, the Washington Accord in September 1999 and the subsequent gold price explosion has changed risk perceptions by market participants. Trend following funds have covered short positions and have gone long. Mining companies have started to reduce their aggregate hedge position. Bullion bankers using value at risk and other trading disciplines have probably started to reduce net short positions. Improvement in supply/demand fundamentals and a move by market participants who were formerly short sellers of gold to cover short positions should have had a dramatic positive impact on the gold price. Instead, the gold price explosion of September/October was almost completely reversed in late 1999 and the recent rally has met with stiff resistance and has effectively been reversed. The failure of the gold price to rally despite improved supply/demand fundamentals and short covering by former short sellers points to a large undisclosed official seller.

The strength of the above argument depends upon one's assumptions about the underlying gold market supply/demand structure. If one assumes the GFMS framework, there has been virtually no recent growth in global gold demand and the gold market deficit was modest in Q4 1999. We have turned to the World Gold Council's estimates of gold demand for 1999 to argue that gold demand has rebounded strongly from the Asian crisis lows of 1998 and that there was a large gold market deficit in the fourth quarter of last year. Therefore, our case for an implied large undisclosed official seller in that quarter depends upon our interpretation of the World Gold Council's recent demand surveys. In this report we will defend our interpretation of the WGC demand estimates and our contention that there has been a very large undisclosed official seller since September of last year.

**The Level of Demand and the Gold Market Deficit**

The World Gold Council does a quarterly survey of gold demand in those countries where it has an active presence. It surveys demands for jewelry, bar and official coin. It no longer surveys dental demands. It has never surveyed gold demand for electronic, decorative and other industrial uses as well as medallions. The Council estimates that its surveys comprise 80% to 85% of all global demand for physical gold as estimated by Gold Fields Mineral Services.

In the *Gold Book Annual 1998* we assumed that the World Gold Council's (WGC) coverage (roughly 80% at that time) applied to only those markets or uses that it surveyed. Applied to the current juncture, we would interpret this to mean that the WGC estimate of global gold demand of 3278 tonnes of gold in 1999 encompassed 80% to 85% of global demands for gold in jewelry, bar and official coin only and not for dental, electronics, decorative and industrial uses and for medallions. Employing this assumption, we have "grossed" up the most recent WGC demand estimates by roughly one fifth (from 83.2% to 100%) to obtain an estimate of global gold demand for just jewelry, bar and official coin.

In the *Gold Book Annual* we added Gold Fields Mineral Services' estimates of demands for gold in dental, electronics, decorative, industrial and medallions to arrive at a complete global gold demand estimate. Our analysis indicated that further adjustments had to be made for underestimates of Chinese demand by the WGC, for underestimates of dental, electronics, and other demands by Gold Fields, and for inventory demands by fabricators and wholesalers.

Of greatest importance is the question, "Have we been correct in assuming that the World Gold Council survey comprises 80% to 85% of global gold demand for only jewelry, bar and official coin uses?" Our position calls for a justification since the World Gold Council has argued that its demand survey encompasses 80% to 85% of all global markets for gold including dental, electronics, decorative, industrial, and medallions.

Why did Veneroso Associates assume in the *Gold Book Annual* that the World Gold Council survey encompassed (at the time) roughly 80% of only those markets the Council surveys and not all markets for gold use? We came to this interpretation by looking at the incomes of the countries that the WGC surveys and comparing their aggregate incomes to the aggregate incomes of those countries it does not survey. We compared these incomes along regional lines, as different regions exhibit different "intensities of gold use". Such comparisons argued conclusively that the WGC survey covered 80% of global gold demand only for those markets it surveyed---not all world markets for gold.

In April of 1999 Gold Fields Mineral Services provided some estimates of jewelry consumption in a handful of countries the World Gold Council does not cover in its survey work. These GFMS estimates of gold end use greatly support the interpretation of the *Gold Book Annual* regarding the extent of the coverage of WGC surveys.

Let us explain in more detail the above thesis. In January of this year, GFMS announced a preliminary estimate of global demand for gold in fabrication and bar hoarding of 3875 tonnes. We can exclude their estimate of Western investment demand of 203 tonnes, as that largely referred to short covering by funds and has no counterpart in the WGC survey. To make the GFMS data more comparable to the WGC data, we should subtract from their estimate of total fabrication and bar hoarding demands their estimate of 464 tonnes of dental, electronics, etc. demands which the WGC does not survey. This provides a GFMS estimate of global fabrication and bar hoarding demands for those uses for gold that the WGC does survey of 3411 tonnes in 1998. The World Gold Council's estimate of comparable demands "by the trade" is 3278. The WGC estimate is equal to 96% of the Gold Fields' global subtotal for such demands. The difference between the two estimates of 133 tonnes is equal to less than 4% of GFMS' estimate of such demands for the whole world and is equal or less than such demands in many individual countries.

It is often argued that estimates of world gold demand by the WGC seem high relative to estimates by GFMS because the WGC estimates demands by retailers (the "trade") whereas GFMS estimates demands by fabricators. To be sure, inventory change at the level of fabricators and wholesalers causes a disparity from time to time between these two measures of demand. However, such inventory demands should be on balance positive; therefore, they should tend to make the GFMS estimates higher, not lower, relative to those of the Council. (See chapters one and four of the *Gold Book Annual 1998*). For the time being, let us provisionally assume the inventory issue is not material. We can then pose the question, "Does the World Gold Council survey capture 96% of all global demands for gold for jewelry, bar and official coin or does it capture only 80% to 85% of such demands?" We can definitely conclude that the latter is the case. To explain our unqualified answer to this question, let us briefly consider the various regions of the world in which the WGC conducts its surveys.

**Europe:** The World Gold Council surveys Germany, France, Italy and the UK only. It does not survey Greece, Portugal, Spain, Austria, Switzerland, Belgium, Netherlands, Denmark, Sweden, Norway, Finland, Ireland and the smaller European principalities. Gold demand for jewelry, bar and official coin was estimated at 274 tonnes in 1999 for the four countries the WGC surveyed. Gold Fields estimates jewelry consumption alone for Greece, Portugal, and Spain was 107 tonnes in 1998. Therefore, jewelry consumption alone in just three countries accounts for almost the entire difference between the WGC and GFMS estimates of demand for those gold markets---jewelry, bar and official coin---which the WGC surveys. The combined income of all the other European countries which the WGC does not survey---Austria, Switzerland, Belgium, Netherlands, Denmark, Sweden, Norway, Finland and Ireland---equals or exceeds the incomes of every country in Europe except Germany. This would suggest that these countries taken together may consume almost 60 tonnes or more of gold in jewelry, bar, and official coin. These considerations suggest that demands for gold for jewelry, bar and official coin in all those countries in Europe that the WGC survey does not cover may have approached 170 tonnes in 1999. This one region alone accounts for more than the entire difference between the WGC and GFMS estimates of demand for gold for jewelry, bar, and official coin.

**The Near East: The** World Gold Council does not survey demand in Iran, Iraq, Israel, Lebanon, Jordan and Syria. Gold Fields Mineral Services estimates that jewelry demands in Iran and Syria alone were 72 tonnes in 1998. The odds are that total demands in these six countries for jewelry, bar, and official coin might have been well in excess of 100 tonnes in 1999.

**Latin America:** **The** World Gold Council makes estimates for gold demand in only two Latin American countries: Brazil and Mexico. These two countries had an average gold demand of 63 tonnes in 1999. All the remaining counties of Latin America---Argentina, Uruguay, Paraguay, Chile, Peru, Bolivia, Ecuador, Columbia, Venezuela, Guyana, Suriname and French Guyana---are not covered. Neither are the small countries of Central America or the island countries of the Caribbean. Gold Fields estimates that jewelry demand in Colombia alone was 20 tonnes in 1998. Columbia's national income is less than 5% of all of Latin America and less than 10% of that of Brazil and Mexico combined. The combined incomes of the countries that the WGC neglects are almost equal to the combined incomes of the two that are surveyed, which, according to the WGC, consume 126 tonnes of gold. Conceivably the demands for gold in jewelry, bar and official coin of these counties not surveyed could be on the order of 100 tonnes.

**The Indian Subcontinent: WGC** does not survey Sri Lanka, Bangladesh, Nepal, Bhutan, Mauritius, and Afghanistan. Their combined incomes approach that of Pakistan, which consumed 122 tonnes of gold in 1999.

**Far East Asia: The** WGC does not survey Myanmar, Laos, Cambodia, Philippines, North Korea, Mongolia and the small Pacific island nations. Based on income and ethnicity these countries combined may generate gold demand equal to one medium-sized country in the region, which might be somewhat less than 100 tonnes.

**The Former East Bloc:** This region is not surveyed by WGC. Gold Fields estimates that jewelry demand in the former Soviet Union was 43 tonnes in 1998. Income levels in East Europe and the former USSR would point to much higher levels of demand for jewelry, bar and official coin---possibly on the order of 100 tonnes overall.

**The Anglo Saxon Countries:** Canada, Australia and New Zealand are not surveyed by the WGC. GFMS' estimates Canadian jewelry demand at 24 tonnes in 1998. Comparison with US and UK income levels would point to total demands for jewelry, bar and official coin in these three countries of almost 50 tonnes.

**Africa:** This region is the most intriguing. Only Egypt is surveyed by the WGC. GFMS provides no consumption estimates for the countries of Africa other than Egypt. The World Bank estimates that the income of Egypt is only roughly one tenth of that of all of Africa. The cultures of many African countries suggest a generally high gold intensity of use. Egypt consumes 125 tonnes of jewelry, bar and official coin. Surely the rest of Africa's demands are not nine time those of Egypt, but they could be two or three times that of Egypt's. Two times Egypt's demand would be 250 tonnes.

## **Conclusion**

From such country by country considerations it is clear that the countries surveyed by the World Gold Council do not comprise all but 4% of global demand. Gold Fields Mineral Services' estimates of 1998 jewelry demand alone in only seven countries---Greece, Portugal, Spain, the former USSR, Iran, Columbia, and Canada---total 268 tonnes, equal to more than 8% of GFMS' estimates for such demands globally. We have looked at eight different sets of countries the WGC survey does not encompass. The average likely level of demand of each of these sets may approximate the 133 tonne difference between the WGC demand total and the GFMS total for these same demands. Our assumption that the GFMS survey encompasses 83.2% of global demand for the gold uses that it surveys assumes that all the other countries of the world have such demands totaling 650 tonnes. The above country comparisons indicate that assumption is reasonable. If anything it would suggest a higher, not a lower, demand total for the combined countries not surveyed by the WGC.

In a recent Gold Watch we argued that, if the WGC demand surveys encompass 83.2% of total global demands for jewelry, bar, and official coin, the WGC demand estimate for the fourth quarter of 1999 of 806 tonnes would project total global demands of almost 1100 tonnes at a minimum and possibly 1200 tonnes. Mine and scrap supply in that quarter was slightly more than 800 tonnes, suggesting a Q4 1999 deficit of almost 300 to 400 tonnes. The above analysis suggests that this recent estimate of the fourth quarter deficit may have been too low.

We believe that prior short sellers of gold---funds, producers and bullion banks---reduced their shorts in the fourth quarter of last year by at least several hundred tonnes on a combined basis and probably more. A quarterly market deficit of 300-400 tonnes plus short covering of a comparable or greater magnitude had to be offset by an equal volume of selling. With private market participants covering short positions, selling on such a scale could only have emanated from the official sector. Yet only roughly 100 tonnes of official selling has been announced for the fourth quarter. Therefore, we argued that there must have been undisclosed official selling of many hundreds of tonnes and possibly even 1000 tonnes or more in that quarter. The analysis presented in this report suggests that, if anything, our earlier estimates of the fourth quarter 1999 gold market deficits and their implied undisclosed official selling may be too low.

Let us consider the implications of the WGC demand survey for global gold demand on an annual basis. If we gross up the WGC 1999 total assuming a market coverage of 83.2%, total demands for gold in jewelry, bar and official coin by the trade were 3934 in 1999. To this we must add 464 tonnes of gold absorbed by fabrication of electronics, dental, decorative, and industrial products plus medallions for a larger total demand figure of 4398 tonnes. We would add an additional 400 tonnes for a WGC underestimate of Chinese demand, an underestimate of dental, electronic and other demands by GFMS, and positive inventory demands at the fabrication and wholesaler level not captured by the WGC survey (See Chapter one, *Gold Book Annual 1998*). This generates a new global demand total of 4798 tonnes. If the suggested demands for the eight sets of countries not surveyed by the WGC are in the ballpark, total global demand for gold in 1999 was well in excess of 5000 tonnes. It follows that the GFMS estimate of global gold demand and the gold market deficit could be too low by 1200 tonnes or more. ◆

# Point 10

## Thesis:

On the supply side, Veneroso Associates has found eleven independent sets of evidence and lines of reasoning that point to higher levels of gold lending than are reflected in the GFMS historical supply/demand balances. Other recent estimates of total gold loans (and implied annual gold lending) have corroborated the estimates of Veneroso Associates.

## Commentary:

The evidence that total outstanding gold loans exceed those implied by consensus Gold Fields Mineral Services supply/demand balances is overwhelming. First, GFMS' own data on gold loans outstanding implies higher levels of gold lending than does their annual flow accounts. Second, there are many information sources pointing to much higher gold loan stocks and flows in the 1990s. Third, there is a growing awareness that these stocks and flows are much higher than GFMS estimates as information has disseminated. We append two summary pieces on this topic.

The important point to grasp is that, if historical gold loan flows were higher than GFMS estimates prior to 1999, the gold market deficit was higher. After the Washington Accord, gold borrowing by private market participants ceased. In fact, their borrowing probably reversed, creating new demands. Further, gold lending by European central banks with half the world's gold reserves ceased. With an abrupt abatement in supplies, the gold price should have risen. It did not. This implies a large new source of selling, which has not been disclosed.

There are roughly 40 bullion banks worldwide that take deposits or engage in swaps with official and private lenders. These deposits and swaps are the basis for all gold lending. Each bullion bank has precise accounts on its present and past deposit and swap positions. Banks and broker dealers readily disclose their positions in other lines of business. There is no reason why they should not disclose fully their bullion banking positions.

The appropriate US regulatory bodies should obtain data on the official gold deposits, off balance sheet swaps, and private deposits of all those bullion banks they have authority over. The Bank of England has done surveys of official gold deposits and swaps of some of the principal bullion banks operating in London. This data should be requested. Simple checks of a few French, German, Japanese and Swiss banks by their authorities would complete a survey of global gold lending.

Even a partial achievement of this overall objective would probably settle the debate over the size of global gold lending, since a global total could be projected from a subset of the world's bullion banks.

# Gold Watch

## Veneroso Associates

**March 23, 2000** **Issue 03.03**

## *Eleven Reasons Why There Is A Mountain of Borrowed Gold*

### *Support for the Existence of Large Scale Undisclosed Official Gold Sales*

We have argued that global gold demand and the gold market deficit have greatly exceeded consensus Gold Fields Mineral Services (GFMS) estimates. Demand must equal supply in every time period; therefore, one must posit higher than consensus supplies. We believe we have identified such supplies: they have been flows of borrowed gold delivered to the market by market participants who were selling short---funds, bullion banks, producers, fabricators and refineries. These flows of borrowed gold, which have been severely underestimated by GFMS, provide most but not all of the unrecorded supplies that correspond to underestimated demands in the period 1990-1998. In addition, there has probably been net physical disinvestment by Western investors in the 1990s---not positive physical investment, as is implied by the GFMS balances for the 1990s. Also, there were significant official sector sales not reflected in the GFMS balances in the early 1990s (See Appendix I of the *Gold Book Annual 1998*).

We have found eleven good reasons for assuming that such flows of borrowed gold have vastly exceeded those implied by the GFMS supply/demand balances. We set forth eight of these reasons in a Gold Watch issued on 7/29/99 (attached). Since then we have encountered three more pieces of evidence in support of our contention. They are:

1) The explosive rise in the gold price immediately triggered by the September accord on a Sunday evening suggests a dealer, not a fund response. It certainly was not a producer response. The cessation of all net new lending by the European central banks would have been extremely bullish only to market participants who clearly recognized the gold market's dependence on massive flows of borrowed gold.

2) Reports of large losses by bullion bankers, presumably on short positions. These large losses imply large bullion dealer short positions which GFMS does not recognize but which we have long included in our compilation of aggregate outstanding gold borrowings.

3) New higher estimates of official sector gold loan aggregates by Jessica Cross (reportedly 6000 tonnes) and Dinsa Mehta of Chase (reportedly 6500 tonnes, to be

disclosed at the forthcoming conference of the Australian Gold Council). From what we know about their work, neither has included every possible lender or borrower of gold.

In 1999, the Washington Accord and the subsequent gold price explosion altered the perceptions of risk and reward of private participants in the gold market. Since then private market participants have probably been repaying their gold loans on a net basis. This should have withdrawn gold from the market, thereby adding to the forces acting to lift the gold price. At the same time, the announced rate of official selling has not increased. Also, based on trends in global income, demand should be rising rapidly relative to stagnant mine supply. From this we infer there has been huge official selling that has prevented the gold price from rising in the face of short covering and improving supply/demand fundamentals. ◆

# Gold Watch
## Veneroso Associates
**July 29, 1999** **Issue 7.04**


## ***Chapter 6 Gold Deposits and Swaps, Gold Dem and and the Gold Market Deficit***

### Close to Raising Our Estimates

***Someday there will be an explosive bull market in gold that virtually no one today can imagine…***

With the gold price at $254, we should be concerned that the very bullish long term outlook we have for gold, as laid out in the Gold Book annual 1998, might be wrong. Surely, it is argued, current weak gold prices suggest that the gold supply/demand fundamentals are not as constructive as we thought. In fact, we are quite concerned about our framework and long run forecasts. So we have increased our research into the basis for this framework and these forecasts. To our surprise, our most recent inputs suggest that gold demand and the gold market deficit, as well as aggregate gold borrowings and annual gold loan flows, may exceed our former estimates.

We present eight reasons why we believe that global gold demand, the gold market deficit and the flow and stock of gold loans greatly exceeds consensus (Gold Fields Mineral Services) estimates.

1) World Gold Council gold demand surveys indicate higher levels of gold demand. This implies a higher deficit and a higher flow of gold loan supplies. (Chapter 1, *Gold Book Annual*).

2) Since George Milling-Stanley stopped compiling the Gold Fields data, a large disparity in the trend in growth in demand in the two data series has developed. For the years 1991-1996, the World Gold Council data is consistent with the historical trend based on the price and income determinants of gold demand. The Gold Fields data, on the other hand, is not consistent with this historical trend. Neither is the Gold Fields data consistent with Gold Fields' own scrap data series since 1991. (Chapter 6, *Gold Book Annual*).

3) Results from Bank of England surveys in 1994 and 1995 as reported by Mr. Terry Smeeton, coupled with a conservative interpretation of his comments on these surveys, point to gold loan aggregates two times Gold Fields estimates circa mid 1995 and annual gold loan flows in 1994-95 that were perhaps three times those contained in the GFMS balances. (Chapter 2, *Gold Book Annual*).

4) Inconsistencies within the GFMS' data point to higher levels of gold demand, the gold market deficit and gold loan flows for several reasons.

   a) GFMS estimates of 4700 tonnes of official, quasi official, and private gold deposits and swaps plus their assertions of physical gold disinvestment in the 1990's imply higher levels of demand and the deficit.

   b) GFMS concedes the existence of fabricator and refinery borrowings and OTC short sales, yet there are no line items in their balances for these flows, implying higher levels of demand and the deficit

   c) GFMS' estimates of mobilizations in 1998 imply a level of gold lending and thereby demand and the deficit that far exceeds the level implied by their balances. (See Gold Watch, GFMS 1999, 1/12/98).

5) By way of third parties we have slowly compiled the official deposit and swap positions of many bullion dealers. The results are astonishing. This partial window on the world of gold lending indicates a global total of official deposits and swaps outstanding that exceeds, perhaps by a large margin, our current estimate of 7500-8000 tonnes for year-end 1998.

6) During the period 1989-1993 unreported official sales exceeded GFMS estimates by a large margin. These include Russian, Abu Dhabian, Saudi, Iraqi and Libyan sales. This implies higher levels of demand and the deficit for those years which, when carried forward, require much higher levels of gold borrowings. (See Appendices to Chapter 1, *Gold Book Annual*) The Bank of England surveys clearly indicated such higher levels for the two subsequent years 1994-1995.

7) It is widely believed that large OTC speculative short positions have built up in the gold market over the last decade. The texts of the Gold Fields reports over the last decade suggest on balance physical disinvestment. Therefore, these balances cannot even accommodate visible Comex short selling. They certainly make no allowances for the buildup of a large OTC speculative short position over this longer term and can account for only a small position over the last several years.

8) If one regards the official gold positions held in custody at the NY Fed and the annual flows out of the NY Fed as representative of overall global official positions and flows, NY Fed outflows suggest higher levels of overall sales and mobilizations from official and quasi official portfolios than are implied by GFMS balances.

The above constitutes a large multi faceted body of supportive information. We have no doubt our published estimates for gold deposits and swaps outstanding (7000-7500 tonnes official and quasi-official, 500-1000 tonnes private at year-end 1997) are valid. The issue now is, are they too conservative? As we said, our most recent inputs suggest they are.

First, we have received new reports on bullion dealer official sector deposit and swap positions. They continue to exceed our earlier expectations which we based on both guesstimates by competitors and our overall 7000-7500 tonne 1997 aggregate ceiling. Of the last nine reports received, one was slightly below our expectations, two were more or less right on, and six were significantly to very far above our initial guesstimates. Unless bullion dealers are very wrong about the relative position of the players in this market, our aggregate estimates in the *Gold Book Annual* are too low.

Second, based on recent events and research which we cannot discuss in detail, we are reassessing our overall assessments of the disclosures in 1994 and 1995 of Mr. Terry Smeeton regarding Bank of England surveys on the gold deposit and swap market. Discussions with Terry Smeeton gave rise to two interpretations. One pointed to a possible official and quasi-official gold deposit position at year-end 1995 of perhaps 10,000 tonnes. The other pointed to a possible position of 5000-6000 tonnes. We chose the higher end of the latter lower range. We did this for three reasons.

1) We chose to be conservative.

2) Mr. Smeeton made it clear that even the latter estimate was, in his estimation, too high (even though his comments on his survey results possibly pointed to much higher numbers).

3) It did not seem plausible that so high a total---more than 6000 tonnes---could have been accumulated in the brief history of so young a market.

We are now re-appraising our estimates based on Mr. Smeeton's disclosures.

> First, a series of events (which we prefer not to discuss in detail) since mid 1996 now inclines us to accept the interpretation of the Bank's survey (discussed earlier) that pointed to the higher (perhaps 10,000 tonne) estimate for 1995.

> Second, it has been drawn to our attention that most bullion dealers, when queried, are likely to exclude swaps from the reports of their positions, since these are off balance sheet items. Our first foray into this issue confirms this tendency for reports of deposit and swap positions by dealers to systematically err in the direction of underreporting for this reason.

> Third, we now have reports on deposit and swap positions held with bullion dealers at earlier benchmark dates (1985,1990, 1991). These reports suggest that gold deposits and swaps were much larger than we thought at these earlier dates. This makes an aggregate total for year-end 1995 of more than 6000 tonnes seem far more possible than we originally believed.

## Conclusion

The preceding research seems academic to many. From a long run perspective, it is anything but. Officially, we are sticking with the Gold Book Annual 1998 estimates, but it now seems possible that total gold deposits and swaps---official, quasi official (e.g. Brunei, Arab potentates, the Vatican, etc., etc.), and private---may now exceed 10,000 tonnes, and by a significant margin. If this is so, global gold demand and the gold market deficit are understated systematically by Gold Fields Mineral Services by not 500-600 tonnes, as we have thought, but by perhaps 800 or 900 tonnes.

It is our guess, based on our new information, including reports on bullion banker positions at earlier benchmark dates, that Milling-Stanley was already underestimating global gold demand, the gold market deficit, borrowed gold flows and physical disinvestment by several hundred tonnes when he was compiling the GFMS data in the late 1980's. We thought that the official sales not included in GFMS' balances in 1989-1993 referred to above might have been offset by more undisclosed official purchases than GFMS has made allowance for, with no implications for the historical supply/demand balances. However, indications from a recent trip to Asia suggest otherwise. Such underestimated official sales in the transition years between Milling-Stanley's work at GFMS and the new regime there also suggest that gold demand and the gold market deficit were more seriously understated by then.

Furthermore, the growing disparity between the WGC and Gold Fields gold demand data between 1991 and 1996 suggests that this underestimate may have increased by 400 tonnes at an annual rate in that period. Together, an overall underestimate of demand and the deficit of 800 to 900 tonnes in recent years now seems possible to us.

Historical trends and GFMS' provisional 1999 forecasts indicate that scrap supplies of only 550 tonnes at $300 gold are sustainable. Therefore scrap supply should be down by 550 tonnes or more this year from last year's estimated 1100 tonne level. World Gold Council demand data points to an increase in global gold demand of perhaps 400 tonnes. Extrapolating 1998 GFMS data forward projects a deficit of 1200 tonnes. Our most recent work may suggest a deficit this year of 2000 tonnes or more. If the US, IMF, Germany, France and Italy do not sell their gold and place limits on their lending, a 2000 tonne per annum deficit does not seem to be sustainable.

If the gold price stays below $300, we expect mine supply to fall gradually but significantly. Asia will continue to recover. With a near record current account deficit, the worlds' largest net debtor nation---the United States---is on an unsustainable explosive external debt path. Global recovery and a lower dollar will lift gold demand as mine supply falls. The gold market deficit, which is statistically leveraged to these supply/demand variables, will explode and become totally unsustainable. Once this becomes clear---and eventually it will---speculators will want to buy gold and cover shorts and pessimistic attitudes by official players will change***. Someday there will be an explosive bull market in gold that virtually no one today can imagine***. ♦

# Point 11

## Thesis:

Data on the at-risk OTC gold derivative positions of some US bullion banks are regularly published by the OCC. These positions probably correspond in large part to their gold lending books plus the face value of counter-party client options they must hedge. In the second half of 1999 the Washington Accord encouraged private market participants to reduce short positions. Reduced short positions imply a contraction in dealer books. Understandably, the combined OTC derivative positions of all US bullion dealers who report to the OCC except for Morgan Guaranty and Citibank underwent a significant reduction. However, the same positions of Morgan and Citibank almost doubled. There is nothing about their commercial activities that readily explains this unprecedented increase. Such a massive change concentrated in only two banks appears anomalous may correspond to an intervention by only one or two official sector parties with special relations with US dealers.

## Commentary:

We have only one possible clue to the nature of the implied large scale undisclosed official gold selling that must have occurred since late 1999 and possibly earlier. The Office of the Controller of the Currency publishes the summary balance sheet accounts of some US reporting banks. There is a section on OTC gold derivatives subject to risk capital adequacy requirements. The reporting banks involved constitute only a minority of the aggregate book of all the world's bullion banks. We cannot be sure what these accounts refer to. Veneroso Associates has reason to believe that they correspond for the most part to the loan and option "books" of these bullion banks, with some "inflation" due to a degree of "double counting".

These OCC reports present one glaring anomaly: while private market short sellers in aggregate were moving to reduce their loans in late 1999, and while all other reporting bullion banks in aggregate seem to have been reducing their books in a corresponding fashion, two US bullion banks were increasing their position at a virtually unprecedented rate. In six months their implied book was almost doubling and in the case of Morgan Guaranty their derivative book increased by more than the entire outstanding book of Chase, one of the world's largest, which took well over a decade to build.

The authorities should obtain in detail the overall bullion banking books of those banks now reporting to the OCC to obtain a full understanding of this apparent anomaly. Some major US bullion banks do not report to the OCC since they are broker dealers or insurance companies. However, as publicly owned companies they fall under the authority of the SEC. Similar information should be obtained from bullion banks that do not report to the OCC to see if similar anomalies exist. There should be no objection to such an inquiry; under FASB 133 such publicly owned bullion banks will soon be required to make disclosures to the SEC similar to those made by banks reporting to the OCC.

# Gold Watch
## Veneroso Associates

**May 6, 2000** **Issue 05.01**

# The OCC Gold Derivative Disclosures
## *Ever More Confirmation of Our Basic Assessment of the Gold Market*

**Executive Summary**


- *The latest Scotia survey data on producer hedging suggests no increase in Q4 hedging and a likely total for producer hedging related gold borrowings in excess of 4000 tonnes. This exceeds GFMS estimates, which should be less than 3000 tonnes.*
- *Flows of official gold out of the New York Fed have increased substantially since September of last year. These large flows cannot be accounted for by identifiable net new gold borrowing and reported official sales.*
- *OCC data on gold derivatives at US banks indicate a large increase in at risk OTC gold derivatives. Trends in such derivatives should correspond to changes in dealer books. These books should have declined if net borrowing ceased or contracted. In fact, it appears that dealer positions in the aggregate did stabilize or contract except for a huge and anomalous rise in the gold derivative position of Morgan Bank.*


The following developments support our assessment that there is a large and growing deficit in the gold market and that this implies a very large undisclosed official seller.

### Surveys of Producer Hedging Show No Net New Hedging Since the Washington Accord

We have received the Scotia Capital producer hedge survey by Ted Reeve. Ted's work shows virtually no increase in hedging in Q41999; in fact, Barrick's purchase of calls may have led to a reduction in overall producer hedges including the delta on options.

Ted believes his survey data does not capture the hedging activity of all producers. Therefore, he estimates that, at year-end 1999, the total value of all producer forwards and in the money producer options exceeded his data compilations and was on the order of 3600 to 3800 tonnes. We presume that, in addition to this estimate there is a considerable quantity of <u>out of the money</u> options with a sizable delta. Ted's data on such options may be too low, since many of the out of the money calls, which "sweeten" structured derivatives, are not broken out and disclosed. The "delta" on out of the money options should raise the total producer hedge to well in excess of 4000 tonnes.

Gold Fields estimates that total official gold lending was 4700 tonnes at year-end 1999. Judging from earlier GFMS texts, a few hundred tonnes of private gold lending should be added. Ted Reeve's implied estimate for total gold lending resulting from producer hedging including out of the money options is almost equal to Gold Fields Mineral Services' (GFMS) total estimated gold loans. However, GFMS concedes that, in addition to producer hedges, there are several other sources of gold lending: there is a delta hedge against central bank calls, there are gold loans to fabricators and refiners, and there are gold loans that support speculative shorts. If Ted Reeve is right, there is insufficient room in the GFMS estimate of outstanding gold loans for such loans to borrowers other than producers. If one looks at the GFMS historical supply/demand balances,it appears that total producer hedging estimated by GFMS has been less than 3000 tonnes. Ted Reeve's estimate of producer hedging is therefore more than 1000 tonnes or so in excess of producer related hedges in the GFMS historical supply/demand balances.

We believe that loans for uses other than producer hedging are on the order of several thousands of tonnes, at a minimum. In fact GFMS is not too far from our estimates; they estimate that, over the last ten years, producer hedging has resulted in only 2100 tonnes of gold lending and other borrowers have accounted for 1600 tonnes of lending. Given the existence of such lending prior to 1990, their implied total for all gold loans to borrowers other than producers could easily be in the 2000 to 2500 range. If Ted Reeve's work suggests that producer-related gold lending exceeds 4000 tonnes, a total for all gold lending of 6500 tonnes or more would seem very plausible. This is not out of line with Dinsa Mehta's estimate of 7000 tonnes of official lending and more than 7000 tonnes if one includes private deposits. Since we believe that loans to fabricators, refiners, and speculators and the delta on official options significantly exceeds 2000-2500 tonnes, we conclude that total gold lending is on the order of 9000 to 10,000 tonnes.

## <u>**All Short Selling in the Aggregate Has Ceased**</u>

Normandy has announced that it has been delivering mine production against its hedges. The evidence of a net reduction in gold hedges in the first quarter of 2000 grows. We have received an input from John Hathaway that some bullion dealers have been forced by their value at risk disciplines to reduce net short positions. We have reported the same from other sources. CFTC position of trader reports, changes in hedge fund strategies that are less negative toward commodities, and the closing of several large funds that were once short gold suggests that aggregate fund shorts have been reduced. The evidence grows that the various short sellers of the past have not delivered large supplies of borrowed gold to the market as they had been doing prior to September 1999.

## Yet Flows of Official Gold Are Up Significantly

The US trade data shows more than $1.6 billion in gold exports for January and February, roughly four times the volume of such exports in Jan-Feb of last year. The US consumes roughly as much gold as it produces. There is a small export of US mine output that is offset by some imports from mine production abroad, but these volumes are small. Almost all recorded US exports of gold are shipments of official gold held in custody at the New York Fed.

We present US gold exports by month in dollars in the following table. On average, over the last year, $1 billion in exports approximates 100 tonnes of gold. We can see that US gold exports have risen from perhaps 25 tonnes a month in early 1999 to 80 tonnes a month beginning in September.

| US Exports of Gold (in millions of dollars) | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jan** | **Feb** | **Mar** | **Apr** | **May** | **June** | **July** | **Aug** | **Sept** | **Oct** | **Nov** | **Dec** |
| **1999** | 225 | 223 | 240 | 336 | 168 | 326 | 146 | 399 | 976 | 400 | 1008 | 783 |
| **2000** | 727 | 921 | | | | | | | | | | |

> The 80 tonne monthly outflow starting in September is very large. It is roughly three times the average of the past decade and more than two times the flow of recent years. It confirms a large flow of official gold into the market that is not being disclosed.
>
> The official gold held in the New York Fed accounts for roughly one quarter of all official gold. It is possible that the gold leaving the New York Fed is being transferred to another official depository. However, we believe that many official institutions seek to maintain a geographical diversification of their gold holdings. Therefore, when central banks sell or lend, the often do so from several of the depositories they use. We believe that outflows of official gold from the New York Fed indicate similar drawdowns are likely from other official depositories. For extended periods, the overall rate of official drawdowns is probably much higher than the visible outflow from the New York Fed.

## The Gross OTC Gold Derivative Book of Morgan Bank Has Risen Hugely

We reproduce below the outstanding gross OTC gold derivatives subject to risk capital adequacy requirements of three large US banks as reported to the Office of the Controller of the Currency.

| Outstanding Gross OTC Gold Derivatives* (in billions of dollars) (encompasses 439 US institutions) | | | | |
|---|---|---|---|---|
| | Dec. 1998 | June 1999 | Sept. 1999 | Dec. 1999 |
| **Citibank** | 6.6 | 7.2 | 10.7 | 11.7 |
| **Chase Manhattan** | 24.0 | 20.5 | 22.6 | 22.0 |
| **Morgan Guaranty** | 16.7 | 18.4 | 30.4 | 38.0 |
| **Total** | 68.4 | 61.4 | 83.4 | 87.6 |
| * Excludes futures contracts, written options, basis swaps, and any contracts not subject to risk based capital requirements. | | | | |

We do not know exactly what these totals refer to. However, they are risk positions and do not include riskless hedges like basis swaps. They also do not include futures positions. We believe they reflect to some degree two bullion bank operations: 1) gold lending operations in which deposited gold is sold in the spot market and hedged with a forward long position, and, 2) the face value of the gold option positions of clients which dealers as a counter party must hedge in some fashion. In addition, there must be some “double counting” in such positions that “inflates” these statistics.

These positions are not marked to market. Given their maturities we would guess that the combined positions of the three bullion banks with the largest positions (out of roughly forty bullion banks worldwide) is perhaps 7000 tonnes. Their percentage changes in terms of physical units (tonnes) probably corresponds to percent changes in their dollar value.

It is very odd that almost the entire increase in this gold derivative position is accounted for by Morgan Bank. We hear that Morgan Bank has reduced its New York staff, is less active in the producer business than it once was, and is less of a presence in the market than many other bullion banks. We presume they still are a major recipient of central bank deposits but they are apparently not that active with producers and funds who account for most of the forwards and options on bullion bank books. If the producers, bullion banks, and speculators did not increase their outstanding shorts in the fourth quarter of 1999, why did the gross value of the gold derivatives of Morgan Bank increase by so large an amount? ◆

# - IV -

# From the 'Golden Sextant'

## MATERIALS FOR INCLUSION IN
## GATA'S PRESENTATION TO MEMBERS OF CONGRESS

FROM THE GOLDEN SEXTANT
www.goldensextant.com, Reginald H. Howe,* Proprietor

## MATERIALS FOR INCLUSION IN GATA'S PRESENTATION TO MEMBERS OF CONGRESS

Note: Pursuant to a request from Bill Murphy, chairman of GATA, for material of relevance to GATA's planned presentation to Members of Congress interested in recent activities relating to gold and the gold market, I have selected the following four articles written by me and posted at my website, www.goldensextant.com. The last article selected concludes with a reference and URL to a "charticle" on a relevant matter that I plan to address in my next commentary at The Golden Sextant, and therefore I have suggested that the charticle be included as well. Other articles of interest may be found at my website and questions may be submitted to me by e-mail at row@ix.netcom.com. The articles are reproduced in original form, but before each I have inserted a brief explanation of the reasons for its inclusion.

First Article. This article provides an overview of the gold market from 1995 to the beginning of 2000, focusing on the possibility: (1) that official manipulation of the gold market began in 1995 as part of a coordinated international effort led by the central banks of the industrial nations to prevent economic meltdown in Japan spreading to the rest of the industrial world; (2) that the Europeans participated in part to assure reasonably stable international monetary conditions for the planned launch of the euro in January 1999; (3) that the announcement of British gold sales in May 1999 reflected pressures in the gold market arising from withdrawal of European support for continued gold price control in light of: (a) the successful introduction of the euro; (b) increasing doubts about the continued efficacy of Japan's zero interest rate policy; (c) rising worries over derivatives generally after the Long Term Capital Management fiasco in October 1998; and (d) quite specific concern that gold derivatives and the net short gold position had grown too large, posing a systemic risk, and leading to the Washington Agreement announced by European central banks in September 1999 to restrict their official gold sales and gold lending activities. The article begins with a discussion of the possible roles of the Exchange Stabilization Fund and the Federal Reserve in carrying out the U.S. part of the gold price control scheme, and ends with some comments on their difficult situation after the Washington Agreement.

February 1, 2000. **Two Bills: Scandal and Opportunity in Gold?**

Last week the world's movers and shakers held their annual confab in Davos, Switzerland. Bill C. and Bill G. were there. No doubt the scandal enveloping Helmut Kohl, Europe's greatest statesman since Churchill and De Gaulle, provided much grist for gossip. But here at home, some began to glimpse the outline of a possible new Clinton scandal -- one that could ultimately eclipse Watergate or Teapot Dome.

Evidence is accumulating that the administration of Bill Clinton may have turned the Exchange Stabilization Fund (the "ESF") into a political slush fund to make itself look good and simultaneously profit some of its closest Wall Street friends and supporters. Specifically, the known facts support credible allegations that the Clinton administration has effectively capped the gold price by using the ESF to backstop the selling of gold futures and other gold derivative products by politically well-connected bullion banks. Such interference in the free market price of gold would undermine its traditional role as a leading indicator of inflation. And it would do so at the same time that the administration's many adjustments to the CPI have rendered that lagging indicator of inflation also suspect. Among the bullion banks most heavily involved in selling gold futures and purveying gold loans, forward sales and other derivatives that undercut its price is Goldman Sachs, former Treasury Secretary Robert Rubin's old firm.

These are serious allegations, but the current administration scarcely merits much benefit of the doubt. If these allegations are incorrect, Treasury Secretary Summers can deny them in unequivocal language as Fed Chairman Alan Greenspan did two weeks ago with regard to similar allegations of gold price manipulation by the Fed. Indeed, in a formal letter to Senator Lieberman (Dem., Conn.) (reprinted at www.egroups.com/group/gata/346.html), the Fed chairman not only denied that the Fed had intervened in the gold or gold derivatives markets, but also added: "Most importantly, the Federal Reserve is in complete agreement with the proposition that any such transactions on our part, aimed at manipulating the price of gold or otherwise interfering in the free trade of gold, would be *wholly inappropriate*." [Emphasis supplied.]

The odd behavior of the gold price over the past five years, including massive gold leasing and heavy bouts of futures selling apparently timed to abort threatened rallies, has generated considerable speculation regarding intentional manipulation by governmental authorities. What has made weakness in the gold price all the more perplexing are mounting shortfalls of new mine production relative to annual demand. Because most nations deal in gold through their central banks, they are prime suspects. Clarifying remarks that he made to Congress in 1998, Mr. Greenspan confirmed in his letter to Senator Lieberman that some central banks other than the Fed do in fact lease gold on occasion for the express purpose of trying to contain its price. Gold leased by central banks to bullion banks is typically sold by them into the market in connection with arranging forward sales by gold mining companies or making gold loans to mining companies or others. The attraction of gold loans is their typically low interest rates (known in the trade as "lease rates") of around 2%.

The Fed and the ESF are the only arms of the U.S. government with broad statutory authority "to deal in gold" and thus by reasonable extension in gold futures and derivatives. Were the Fed to engage in such activities, it would of necessity have to do so subject to all the institutional safeguards that govern its more important functions. Unlike the Fed, the ESF is virtually without institutional structure or safeguards. It is under the exclusive control of the Secretary of the Treasury, subject only to the approval of the

President. Indeed, direct control and custody of the ESF must rest at all times with the President and the Secretary. The statute further provides (31 U.S.C. s. 5302(a)(2)): "Decisions of the Secretary are final and may not be reviewed by another officer or employee of the Government."

Originally funded out of the profits from the 1934 gold confiscation, the little known ESF is available for intervention in the foreign exchange markets. In the absence of a Congressional appropriation, the Clinton administration used funds from the ESF to finance the 1995 U.S. bailout of Mexico. However, accepting the Greenspan dictum that it "would be wholly inappropriate" for the Fed ever to intervene in the gold market to manipulate the price, it is hard to imagine any situation in which such intervention would be appropriate by the ESF, never mind one involving large profits for the former investment bank of the Secretary himself.

Last week, in response to an inquiry from Bridge News, Secretary Summers "categorically denied" that the Treasury was selling gold. With all due respect to the Secretary, this is not the allegation that knowledgeable gold market participants and observers are making. Their allegation is that the ESF -- by writing gold call options or otherwise -- is making sufficient gold cover available to certain bullion banks to allow them safely to take large short positions in gold, thereby putting downward pressure on the price and in the process making huge profits for themselves.

Two devices that have put the most pressure on the gold price in recent years are sales of gold futures contracts on certain public exchanges, the COMEX in New York being the largest and most important, and sales of leased gold in connection with gold loans and forward selling by miners. Bullion banks that engage in these activities must of necessity take short positions in gold. While these positions can result in large profits for them when the gold price declines, they can -- if unhedged -- also result in large losses should the gold price rise.

The most common tactic used by bullion banks to hedge against such losses is the purchase of gold call options, usually from gold producers, other large holders of physical gold, or entities with sufficient financial resources to guarantee cash settlement. In the absence of such protection, bullion banks leasing gold or selling large amounts of gold futures contracts for their own account (or the accounts of any but the strongest gold credits) would be forced to assume risky net short positions on which they could sustain huge losses in the event of an upward spike in the gold price. At the same time, sellers (often called "writers") of gold call options also assume risk, for they will be called upon to provide gold (or equivalent cash settlement) to the bullion banks in the event that the gold price rises above the strike prices of the options.

Given its own resources of something like $40 billion and its connection to the U.S. Treasury, which controls the nation's official gold reserves of about 8150 metric tonnes, the ESF has the ability to write gold call options in circumstances where private parties would not. Should it do so, it can effectively permit favored bullion banks to engage in gold futures selling and gold leasing under conditions where they would otherwise be forced to curtail these activities as perceptions of increasing risk rendered call options from private sources either too expensive or even unavailable. What is more, the ESF can write these options clandestinely so as to camouflage the true source of what otherwise appears as inexplicable downward pressure on gold, thereby creating market uncertainty that itself augments bearish sentiment and increases the profits of bullion banks privy to the scheme.

With the Fed's announcement that it, unlike some other central banks, does not operate in the gold or gold derivatives markets, the focus of suspicion naturally shifted to the ESF. But to understand fully why gold market participants and observers increasingly sense market manipulation originating somewhere in the U.S. government, it is necessary to recount and highlight some recent history of the gold market, particularly for those not fully conversant with it. And even for those who are, Fed Chairman Greenspan's recent letter requires reassessment of working hypotheses involving assumptions of gold price manipulation by the Fed. More detail on much of what follows can be found in earlier essays and commentaries here at The Golden Sextant, together with various links to supporting or explanatory information.

The story begins in 1995. Gold is slumbering as it has for some time around US$375/oz. Japan's economic situation is worsening, and in mid-1995 the Japanese cut interest rates sharply. Gold begins to stir, jumping over $400 in early 1996, propelled in part by Japanese interest rates so low that they force yen denominated gold futures on the TOCOM into backwardation (i.e., when prices for future delivery are lower than spot). The yen is falling; gold lease rates are rising. From the U.S. perspective, an economic collapse in Japan threatens to exacerbate the U.S. trade deficit and possibly trigger massive dishoarding of Japan's large holdings of dollar denominated debt, including U.S. Treasuries.

From the European perspective, there is concern not only about the obvious economic effects of a Japanese collapse, but also that it might cause sufficient disruption in the existing international payments system to complicate severely or even prevent the planned introduction of the euro in 1999. An accelerating gold price responding to world financial turmoil is hardly a propitious environment for the introduction of a new and untested currency.

The G-7 central banks and finance ministers cobble together a plan to support Japan, including a strategy for controlling the gold price through anti-gold propaganda backed by small but highly publicized official gold sales augmented by leasing of official gold in large quantities at concessionary rates. For Belgium and the Netherlands, the largest European sellers, gold sales also help to meet the Maastricht Treaty's criteria for the euro. Gold analysts, who at the beginning of 1996 were almost unanimous in predicting a new bull market for gold, are blind-sided. Virtually none foresaw such a coordinated official attack on gold, and many are slow to recognize its broad scope. The gold price steadily declines from over $400 in early 1996 to well under $300 in early 1998, and stays under $300 for most of 1998 and into early 1999. Every time gold looks to rally, it is slammed on the LBMA or COMEX by the same small group of well-connected bullion banks.

Particularly notable in these attacks are Goldman Sachs, Chase and Mitsui, which regularly runs by far the largest net short position on the TOCOM.
Scared by falling prices and encouraged to do so by their bullion bankers who are also their lenders, many gold mining companies respond by increasing their hedging activities, expanding forward sales and buying more gold put options. The forward sales, generally made with gold leased from central banks through bullion banks, add to the downward pressure on gold and provide fees to the bullion banks, augmented by further windfall profits on the loaned gold as the price continues to fall. The bullion banks earn further fees by selling put options to the mining companies, who frequently are forced to finance buying shorted-dated puts from the bullion banks by selling them long-dated calls.

Trading around $280 in April 1999, gold is below the total cost of production for many mines and not far above the cash costs of quite a few. What is more, annual gold demand is now almost 4000 tonnes, exceeding annual new mine production of 2500 tonnes by almost 1500 tonnes. This deficit, building over several years, is largely filled by sales of gold leased from central banks by the bullion banks. Analysts trying to calculate the net short gold position of the bullion banks in early 1999 are coming up with some astonishing figures, some as high as 10,000 tonnes, equivalent to four full years of production.

Since much of this leased gold is sold into the Asian jewelry market, particularly to India which regularly absorbs 25% to 30% of annual world production, many question where all the gold necessary for repayment will be found. But at the beginning of 1999, some is expected to come from the proposed sale of over 300 tonnes by the IMF to raise funds for aid to heavily indebted poor countries, an initiative strongly supported by the U.S. and Britain.

On May 6, 1999, gold again nears $290 and is threatening to explode above $300 due in part to increasing doubts that the proposed IMF gold sales will be approved. Short positions are in grave peril. Then comes a wholly unexpected bombshell which will have even more unexpected consequences.

On May 7, 1999, the British announce that the Bank of England on behalf of the British Treasury will sell 415 tonnes of gold in a series of public auctions ostensibly to diversify its international monetary reserves. The manner of the British sales -- periodic public auctions instead of hidden sales through the BIS -- belie any effort to get top dollar and smack of intentional downward manipulation of the gold price. All indications are that these sales were ordered by the British government over the objection of BOE officials. Palpably spurious and inconsistent reasons for the sales are offered, but no persuasive ones. There is only one logical conclusion: the gold sales were directly ordered by the Prime Minister for unknown political or other reasons. What is more, his reasons are unlikely to have been frivolous. As leading supporters of the proposed IMF gold sales, the British clumsily put themselves in the position of front-running them, and ultimately the British sales are an important catalyst in forcing the IMF to change tack.

For most knowledgeable gold market participants and observers, the British announcement is the smoking gun -- proof positive that the world gold market is being manipulated with official connivance and support. But what none yet suspects is that the BIS, the ECB and the central banks of the EMU countries are having serious second thoughts about the gold manipulation scheme.

The British announcement quickly sends the gold price into near free fall toward $250. Gold mining companies panic. Urged on by the bullion banks, led again by Goldman Sachs, the miners add to their hedge positions. The very dangerous practice of financing short-dated puts with long-dated calls expands exponentially as financially strapped mining companies, threatened with reduction or loss of credit lines by their bullion bankers, are often left with little other choice. Then comes a second and even larger bombshell that takes the bullion bankers and their customers completely by surprise. Indeed, it is likely a watershed event for the entire world financial system, comparable only to the closing of the gold window in 1971.

On September 26, 1999, 15 European central banks, led by the ECB, announce that they will limit their total combined gold sales over the next five years to 2000 tonnes, not to exceed 400 tonnes in any one year, and will not increase their gold lending or other gold derivatives activities . Besides the ECB and the 11 members of the EMU, Britain, Switzerland and Sweden are parties. The 2000 tonnes include the remaining 365 tonnes of British sales and 1300 tonnes of previously proposed Swiss sales, leaving only 335 tonnes of possible new sales. The announcement, made in Washington following the IMF/World Bank annual meeting, is ironically christened the "Washington Agreement" although the government in Washington played no role. However, the BIS, IMF, U.S. and Japan are all expected to abide by it, and the BIS is expected to monitor it.

The effect in the gold market is quick and dramatic. Within days, as some gold shorts rush to cover, the gold price jumps from around $265 to almost $330 and gold lease rates spike to over 9%. By late October gold retreats back under $300, and a month later lease rates are almost back to normal levels. But the hugely over-extended net short position in the gold market is clearly revealed and far from being resolved. Two heavily hedged gold mining companies, Ashanti and Cambior, are virtually bankrupt and in negotiations with their bullion bankers. Indeed, soon the entire rationale of hedging is under comprehensive review throughout the gold mining industry as shareholders rebel at practices that take away the upside of their gold investments.

As the details of Ashanti's and Cambior's hedge books are disclosed, the recklessness of gold hedging strategies foisted onto to them by their bullion bankers becomes all too apparent. Ashanti's lead bullion banker, Goldman Sachs, is the subject of scathing comment, including allegations of serious conflicts of interest. See, e.g., L. Barber & G. O'Connor, "How Goldman Sachs Helped Ruin and then Dismember Ashanti Gold," Financial Times (London), Dec. 2, 1999, reprinted at www.egroups.com/group/gata/299.html. Clearly the most aggressive bullion bankers have been caught completely wrong-footed and totally unawares by the Washington Agreement. Significantly, rumor is that the agreement was hammered out secretly among the members of the EMU, the BIS and Switzerland, that the British were given a chance to sign on after the fact, and that the U.S. was not informed until just before the Sunday announcement. For references to European press commentary on the genesis of the agreement, see W. Smith, "Operation Dollar Storm," www.gold-eagle.com/editorials_99/wsmith111099.html.

Besides the three provisions relating directly to central bank activities in the gold market and one calling for review after five years, the Washington Agreement contains this statement: "Gold will remain an important element of global monetary reserves." The ECB and 11 EMU nations hold collectively around 12,500 tonnes of gold reserves (almost 1.4 ounces per citizen), making the EMU as a whole by far the world's largest official holder of gold. What is more, unlike the U.S. which values its gold stock of about 8150 tonnes (under 1 ounce per citizen) at an unrealistic $42.22/oz., the EMU marks its gold reserves to market quarterly.

The notion, shared by many, that the EMU would forever acquiesce in the trashing of its gold reserves by bullion banks operating in the largely paper gold markets of London, New York and Tokyo appears in retrospect to have been incredibly naive. Indeed, a careful reading of the 69th annual report of the BIS issued in June 1999 suggests that European central bankers were already questioning the effectiveness and sustainability of Japan's low interest rate policy, and were very concerned about the implications of the LTCM incident for the world payments system. With the euro successfully launched, they quickly lost reason to continue capping the gold price and became much more concerned about the increasingly parlous state of the gold banking system to which they were lending.

Often referred to as the central banks' central bank, the BIS is not only the principal forum for discussion and cooperation among the world's central bankers but also the world's top gold bank. Established under international treaty in 1930 to facilitate payment of German war reparations, the BIS from its founding has kept its financial accounts in Swiss gold francs, making conversions at designated or market rates as appropriate. It holds approximately 200 tonnes of gold for its own account and records on its balance sheet separate gold deposit and gold liability accounts in connection with the banking services it provides to central banks and other international financial institutions. That the BIS in early 1999 was not as aware as gold analysts in the private sector of the bullion banks' dangerously leveraged condition is almost inconceivable.

Fed Chairman Greenspan's letter to Senator Lieberman is highly significant in that it tends to negate the impression many had, including myself, that a rift had developed between the Anglo-American central banks and those of the EMU over gold. Rather, the Fed's position as expressed in the letter, together with the BOE's position that the decision to sell British gold came from Her Majesty's Treasury, implies a rift not among the major central banks, but between them and the British and American governments operating through their Treasury departments. In this connection, the Fed and the BOE labor under a handicap that does not affect the Europeans, for whereas the central banks of the EMU have direct legal responsibility for their nations' gold reserves, in both Britain and the U.S. this responsibility rest with their Treasury departments.

What is more, a quite plausible scenario now appears to explain the British gold sales. Whether it is true or not, only a very few high officials in the British and American governments and their bullion bankers are in a position to know for sure. But on known and reasonably inferred facts, the following hypothesis can be constructed.

The ESF was writing gold call options for certain bullion bankers, principally those most active in selling futures and arranging forward sales: Goldman Sachs, Chase, et al. As of April 30, 1999, it had outstanding a sizable position at strike prices in the $300 area. For writing these options in a generally falling market, it had net earnings from premiums but these were not in context large amounts, at most a very few dollars per ounce. In the ESF's monthly financial reports required to be filed with the Senate and House Banking Committees, these amounts were listed as miscellaneous income.

When gold threatened to explode over $300 in early May, and with IMF's proposed gold sales in trouble, the ESF found itself in much the same position as that of Ashanti and Cambior after announcement of the Washington Agreement. Gold call options previously sold for a few dollars an ounce threatened to cause losses many multiples of these amounts if the gold price jumped by $50 to $75. If settled in cash, exploding volatility premiums would add hugely to the loss, putting the effective strike price far above the nominal one. On the other hand, if settled in gold at the strike price, the ESF would have to deliver gold from U.S. reserves or go into the market to cover, adding more upward pressure to the gold price.

Worse, unlike the modest premium income from sales of options, huge losses could not be hidden from Congress in the monthly financial reports to the House and Senate Banking Committees. Not to panic. The ESF, being under the direct control of the Secretary and the President, has an option not available to others. Call the British Prime Minister and arrange for a very public official gold sale designed to kill the incipient gold price rally. And for God's sake don't let the BOE or the Fed know what is really afoot. If some of their inflation hawks knew the real situation in the gold market, they might be more inclined to raise interest rates.

The plan worked, sort of. The immediate crisis was bridged. By now, depending on the maturity schedule of its options, the ESF may have substantially worked off its position. Indeed, a reduction in call options available from the ESF after the BOE's announcement may be what pushed the bullion banks to be so aggressive in trying to secure similar options from mining companies in the hedging panic that ensued. But if that was the strategy, the Washington Agreement undid it and left the bullion banks in dire peril. For an excellent discussion of their continuing exposure, see John Hathaway's latest essay, "Rich on Paper," at www.tocqueville.com/brainstorms/brainstorm0055.shtml.
If the foregoing hypothesis is correct, there will be time enough at a later date to analyze the full implications of a scandal of such magnitude. To do so now would be to get too

far ahead of the story. Probably only an investigation by the U.S. Congress or possibly the British House of Commons could really uncover the truth.

But whether the hypothesis about manipulation of the gold price by the ESF is correct or not, the incredible over-extension of the bullion banks is a fact that ultimately will have to be faced. Currently the European central banks through the BIS and within the limits of the Washington Agreement are engaged in a tightly controlled feed of modest amounts of gold into the market. Of the 335 remaining tonnes under the Washington Agreement, 300 tonnes at a rate of 100 tonnes annually over the next three years were allocated to the Dutch on December 6, of which 65 tonnes have already been sold. Where this gold is going and to whom is unknown, but most assume it is being used in large measure to alleviate critical shortages among the bullion banks. Some of these banks are divisions of very large and important commercial or investment banks, and thus may enjoy "too big to fail" protection.

Plainly too, the American and British governments have put pressure on friendly gold holding countries outside the Washington Agreement to supply gold to the market. Kuwait, for example, publicly announced that it was making its entire official reserve of 79 tonnes available to the BOE for lease into the market. Soon afterwards further new U.S. military aid to the country was disclosed. With regard to the Kuwaiti announcement, a top BIS official observed that it was so far outside normal practice as to permit only one conclusion: someone was trying to manipulate the gold market.

The bottom line is that whether as the result of greed, stupidity, breach of public trust, or some combination thereof, the fate of the bullion banks and the gold banking system itself has passed outside not only the bankers' control but also the power of the American and British governments. They are all hostages now: hostages to the continued goodwill of the European central banks, who could bury the exposed bullion banks tomorrow should they choose to do so; and hostages to events over which they have no control, whether as major as a stock market crash or as minor as a blockbuster bid at the next British auction.

Given a sharp spike to $370/oz. or thereabouts, many believe the gold banking crisis would spiral out of control. Each periodic British auction is for 25 tonnes (803,750 ounces). At $370/oz., an entire auction could be had for less than $300 million, a trifling sum in modern finance. That may seem like a large premium to current prices of around $280-$290, but many gold analysts peg the true equilibrium price of gold today at between $500 and $600. Add in rumors of difficulty finding physical gold in size, and 25 tonnes of deliverable physical gold at $370 could almost look like a bargain.

In any event, anyone -- friend or foe -- with a spare $300 million who cares to bid $370/oz. for the full amount of the next British auction could more than likely crash the gold banking system with consequences far more serious than those threatened by the failure of LTCM. Not long ago Marc Faber publicly suggested to Bill Gates the investment merits of switching his almost $100 billion of Microsoft shares into gold. M. Faber, "An Investment Tip for Bill G.," Forbes, Nov. 29, 1999, p. 248, also

www.forbes.com/forbesglobal/99/1115/0223099a.htm. My advice to Bill G. would be a little different: Start buying gold, leak that you are doing so, watch the price rise and governments sweat, bid early and high at the next British auction, and wait for a settlement offer you really like. No reason not to have both Microsoft shares and gold. Since the government likes free, unfettered markets, give them one -- in gold.
The next auction is March 21, 2000, a date perhaps uncomfortably close to the ides of March for bullion bankers and would-be Caesars.

**Second Article.** This article discusses the continuing role of gold in the international financial system and the current vulnerability of the dollar to any loss of confidence in U.S. capital markets as a refuge for dollars accumulated by foreigners as a consequence of U.S. trade deficits. Because the dollar price of gold is an indicator not only of U.S. inflation but also of the international health of the dollar, any gold price manipulation can send false signals about both. The emergence of the euro as a potential alternative reserve currency to the dollar makes misleading gold price signals even more dangerous, particularly given that the euro area collectively commands greater gold reserves than the U.S.

March 26, 2000. **It's the Dollar, Stupid**

The Fed increased interest rates by the widely expected 25 basis points, and the stock market responded not just with relief but with exuberance. What is more, **as The Wall Street Journal** observed ("Why the Fed Hasn't Fazed Big Borrowers," March 22, 2000, p. C1): "It isn't only the stock market that is defying the Federal Reserve. So are (get ready for a big list) the bond market, the mortgage market, the corporate-loan market. In short, a lot of what has to do with borrowing." Asked about the Fed's action, Treasury Secretary Summers chimed: "With these sound fundamentals, supported by fiscal discipline, I believe this expansion has a long way to run." Were the fundamentals really as sound as Mr. Summers suggests, he would have made an unqualified denial of any intervention by the Exchange Stabilization Fund in the gold market. Instead, last week the Treasury Department produced answers to GATA's questions in the form of two letters, one from an acting assistant secretary for legislative affairs and the other from its inspector general.

As will be elucidated more fully in my next commentary, neither letter read carefully directly addresses possible intervention in the gold market by the ESF -- a sui generis body under the exclusive, unreviewable control of the Secretary of the Treasury and the President. Coming more than two months after Alan Greenspan's personal letter to Senator Dodd responding for the Fed to GATA's questions, these letters from lower level Treasury functionaries bear every indication of an exercise in Clintonese.

Last week too, the Commerce Department reported that the January trade deficit hit a record $28 billion, with $34.7 billion of net goods imports offset by $6.7 billion of net services exports. Regional balances included a negative $5.6 billion with Japan, $6 billion with China, $3.6 billion with Western Europe, and $2.5 billion with the so-called NICs (newly industrialized countries of South Korea, Taiwan, Hong Kong and

Singapore). A department undersecretary commented (**The Wall Street Journal**, March 22, 2000, p. A2): "So long as the U.S. has a very healthy rate of return on investments in U.S. enterprises, we'll continue to attract the financing we need to carry the trade deficit." His observation comes much closer to the truth than anything said by Mr. Greenspan or Mr. Summers.

The following table of international monetary reserves is taken from the IMF, **International Financial Statistics**, March 2000 (figures mostly as of December 1999/January 2000), and World Gold Council calculations based thereon (www.gold.org/Gra/Statistics/Reserves.pdf), with corrections for Dutch and British gold sales through March 2000. All figures except metric tonnes of gold are in US$ billions, with gold converted at US$295/oz. and SDRs translated at a rate of SDR1 to US$1.37. Although foreign exchange reserves are stated in dollars, their composition while predominantly dollars also includes other hard currencies (e.g., euros, yen, pounds). Other reserves are primarily IMF Special Drawing Rights (SDRs) and IMF reserve positions.

| Country/ Area/Org. | Gold (Tonnes) | Gold @ US$295/oz. | Foreign Exch. | Other Res. | Percent in Gold |
|---|---|---|---|---|---|
| Euro Area | 12457 | 118 | 225 | 25.5 | 32.1 |
| Germany | 3469 | 32.9 | 51.5 | 8.1 | 35.6 |
| France | 3025 | 28.7 | 33.8 | 5.7 | 42.1 |
| Italy | 2452 | 23.3 | 18.3 | 3.6 | 51.5 |
| Netherlands | 912 | 8.6 | 6.2 | 3.4 | 47.5 |
| Portugal | 607 | 5.8 | 8.1 | .4 | 40.4 |
| Spain | 524 | 5 | 32.1 | 1.9 | 12.7 |
| Austria | 408 | 3.9 | 13.9 | 1.1 | 20.5 |
| Belgium | 258 | 2.4 | 8.4 | 2.5 | 18.3 |
| Fin.,Ire.& Lux. | 55 | 0.5 | 11.1 | 2.3 | 3.7 |
| ECB | 747 | 7.1 | 41.6 | (3.5) | 15 |
| Switzerland | 2590 | 24.6 | 30.2 | 2 | 43.3 |
| United Kingdom | 590 | 5.6 | 24.5 | 5.7 | 15.6 |
| Swe.,Den.,Greece | 384 | 3.6 | 51 | 3 | 6.3 |
| Japan | 754 | 7.2 | 283 | 8.9 | 2.4 |
| China | 395 | 3.7 | 155 | 3 | 2.3 |
| Hong Kong | 2.1 | 0 | 96 | 0 | 0 |
| Taiwan | 435 | 4.1 | 107 | 0 | 3.7 |
| India | 358 | 3.4 | 32 | 0.7 | 9.4 |
| Russia | 415 | 3.9 | 8.5 | 0 | 31.7 |
| So. Korea | 13.6 | 0.1 | 77 | 0 | 0.2 |
| Indo.,Malay.,Sing. | 134 | 1.3 | 134 | 1 | 1.0 |
| | ------- | ----- | ------ | ----- | ---- |
| Sub-Totals | 18527 | 176 | 1223 | 50 | 12.1 |

| | | | | | |
|---|---|---|---|---|---|
| United States | 8139 | 77.2 | 32.2 | 28.3 | 56.1 |
| IMF | 3217 | 30.5 | | | |
| BIS | 203 | 1.9 | | | |
| All Others | 2821 | 26.7 | 451 | 22 | 5.4 |
| | ------- | ----- | ------ | ----- | ---- |
| Totals | 32907 | 312 | 1706 | 100 | 14.7 |

There are a number of points about this table worth noting. Among the more salient are: (1) long continued U.S. trade imbalances have caused huge dollar reserves to build up in a relatively few surplus nations; (2) virtually all these nations continue to run large trade surpluses with the U.S. as evidenced by the most recent trade figures; (3) the Euro Area, given its large gold reserves and continuing substantial trade surpluses, has some $200 billion in unneeded foreign exchange reserves; (4) gold reserves outside Europe and the U.S. are relatively tiny; (5) at US$295/oz., gold provides less than 15% of official world liquidity, but gold remains the next largest single component of international monetary reserves after the dollar; and (6) despite its position as a chronic deficit country, the U.S. declines even during periods of dollar strength to expend dollars to build up its foreign exchange reserves.

Two points deserve special mention. First, official monetary institutions hold a little less than one-third of the above-ground gold supply. At US$295/oz., all the gold in the world equals around $1 trillion, or less than the total combined current market capitalization of Microsoft and Intel. This comparison against the market cap of just two companies is an indication of not only current stock market madness, but also the egregious relative undervaluation of gold versus dollars.

Second, the overhang of dollars is highly concentrated in a few central banks. Accordingly, a rush to exit dollars by just one large holder could easily produce a stampede. So too, a major move into gold by one of the large Asian holders of dollars could rapidly evolve into a gold buying panic.

Not shown in the foregoing table is the dramatic slowdown in the growth of world foreign exchange reserves. The following table shows total foreign exchange reserves as reported by the IMF for all member countries from 1992 through 1999. The figures, reported in SDRs, are given in US$ billions for the end of each period translated at the appropriate end of period rates.

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|---|---|
| Total Foreign Exchange Reserves | 926 | 1030 | 1184 | 1385 | 1561 | 1610 | 1636 | 1708 |
| Increase from Prior Year | | 104 | 154 | 201 | 176 | 49 | 26 | 72 |
| Percentage Increase From Prior Year | | 11.2 | 15 | 17 | 12.7 | 3.1 | 1.6 | 4.4 |

The IMF's statistics cover only official monetary reserves. They do not include private investment flows. The following table is taken from the **Federal Reserve Bulletin**, March 2000 and November 1997, Tables 3.15, 3.24 and 3.25. All amounts are in US$ billions; 1999 figures are as of Nov. 30 or for the first 11 months.

| Category | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|
| U.S. Liabilities to Foreign Official Institutions | 631 | 759 | 777 | 760 | 781 |
| Net Foreign Purchases of U.S. Treasury Bonds | 134 | 245 | 184 | 49 | -15 |
| Net Foreign Purchases of U.S. Stocks | 11 | 12 | 70 | 50 | 99 |
| Net Foreign Purchases of U.S. Bonds | 87 | 128 | 134 | 179 | 236 |
| Net U.S. Purchases of Foreign Securities | -99 | -106 | -89 | -11 | 9 |

Taken together, these two tables suggest that the current dollar-based international financial system is on the cusp of dramatic breakdown. Official international liquidity has almost ceased to grow as official monetary institutions refuse to continue to add to their dollar reserves. The international dollar liquidity created by U.S. trade deficits now shows up not in official reserves but as private investment in the U.S. financial markets. At the same time, private U.S.investors have largely exhausted their exodus from foreign financial markets.

The importance of capital and investment flows, and particularly cross-border equity investments, in determining current exchange rate movements is the subject of a recent article in **The Economist** ("Test-driving a new model," March 18, 2000, p. 75). Noting that the "the new correlation between stock markets and exchange rates may be fickle," The Economist nevertheless opines (p. 76): "The key to the dollar's future almost certainly lies in Wall Street; a bursting of stockmarket euphoria would drive down the dollar sharply." In the meantime, the more the U.S. buys from foreigners, the more dollars return for recycling into stocks at ever higher valuations. What's really new about today's American economy is not its technology. It's America's ability, courtesy of foreigners, to buy itself rich.

None of the tables above includes much in the way of non-interest bearing currency, which official monetary institutions and private investors hold only in small amounts. Steve Hanke, the leading advocate of currency boards, estimates that 70% of U.S. currency circulates outside the country, as do 35% of German marks. See S. Hanke, "How to Abolish Currency Crises," **Forbes** (March 20, 2000, p. 145) (www.forbes.com/columnists/hanke). Of course, U.S. currency circulating overseas also represents dollars that could flood into official monetary authorities in a dollar crisis. Currency boards linked to the dollar are a means of sopping up dollars outside the U.S. It is perhaps not coincidental that Congress, as Mr. Hanke points out, is now considering legislation which would authorize the Fed to share seigniorage with countries using dollar-based currency boards. With all due respect to Mr. Hanke, small nations contemplating this route should tread very carefully, and he should include in his advice a full analysis of the longer term prospects for the dollar. More to the point, the first table shows that smaller, less-developed countries generally hold a very small proportion of their total reserves in gold, and thus will be among those most devastated by any dollar collapse.

Flight by foreign investors from falling U.S. financial markets is the Fed's doomsday scenario. Nor do foreign monetary authorities, already choking on excess dollars, want to be buried in an avalanche of rapidly depreciating greenbacks. Against this picture, current runaway U.S. financial markets -- bad as they undoubtedly are -- appear almost benign. Fear of a cascading dollar collapse explains the Fed's unwillingness to apply strong monetary medicine, the Secretary of the Treasury's covert efforts to contain the gold price through the ESF, and foreign reluctance to rock the shaky dollar boat.

What the foregoing tables cannot reveal is the trigger or the timing. No financial minister or central banker wants to be blamed for launching the world into a monetary black hole. Most would probably prefer that the crisis be precipitated by a geopolitical event extrinsic to the international financial system. But make no mistake, while none can know for certain how events will play out, all will act in what they consider the best financial interests of their nations when the crisis hits.

All these tables and figures point to one inescapable fact: when the dollar goes, gold will regain its glory. In 1971, the only viable alternative to Bretton Woods was floating rates centering around the dollar. No other currency had the size or depth to perform all the necessary functions of international settlement, let alone to do so over the objections of the U.S. and with the Cold War underway. But with the end of the Cold War and the birth of the euro, the major industrial nations of Continental Europe are no longer willing to be the monetary vassals of America. Having retained the bulk of their historic gold reserves, they are prepared to proceed on a more traditional monetary path in which gold -- not the U.S. dollar -- is the international monetary numeraire. They may not want to rock the boat, but they are quite prepared for the storm.

**Third Article**. This article examines the financial reports of the Exchange Stabilization Fund since 1981. Since 1995, a period during which there was little official U.S. intervention in the foreign exchange markets, the ESF's reports show an unusual amount of trading activity, often incurring much larger losses than in earlier periods, and apparently related particularly in the last two years to gold prices.

April 9, 2000. **The ESF and Gold: Past as Prologue?**

The recently released March 2000 **Treasury Bulletin** (www.fms.treas.gov/bulletin/b10esf.pdf) contains the Exchange Stabilization Fund's balance sheet and profit and loss statement for the quarter and fiscal year ending September

30, 1999. Prior quarterly statements, in mildly varying formats but similarly limited levels of detail, are available in earlier bulletins. These are summarized for five-year intervals from 1935 to 1995 in tables 1 and 2 contained in A. J. Schwartz, "From Obscurity to Notoriety: A Biography of the Exchange Stabilization Fund," **Journal of Money, Credit, and Banking** (Vol. 29, No. 2, May 1997), pp. 135-153. Although the ESF's current balance sheet shows total assets of about $41 billion, this number must be reduced by at least the $8.2 million of liabilities for SDR certificates to arrive at total resources available to the ESF. For more discussion of the intricacies of the ESF's balance sheet, including "monetizing" SDRs and "warehousing" foreign currencies with the Fed, see W. P. Osterberg et al., "The Exchange Stabilization Fund: How It Works," Federal Reserve Bank of Cleveland, Dec. 1999 (www.clev.frb.org/research/com99/1201.htm).

Created by the Gold Reserve Act of 1934, the ESF began operations in April 1934, financed by $2 billion of the profits realized from the New Deal's gold confiscation and subsequent devaluation. However, only $200 million was made available to the ESF as working capital, of which $20 million was soon invested in gold, held mostly at the U.S. Assay Office, and $30 million in silver. The other $1.8 billion remained in the Treasury's gold account, and ultimately was used to fund part of the original U.S. subscription to the IMF. All SDRs allocated to or otherwise acquired by the U.S. are turned over to the ESF.

A review of the ESF's past quarterly statements, together with other quarterly international financial statistics contained in the same bulletins, reveals some interesting facts: (1) until April 1989, the Treasury's gold stock and the total U.S. gold stock, which also included gold held by the ESF, were reported separately in table IFS-1; (2) from 1974 to April 1989 these two numbers were the same, implying that the ESF held no gold during those years; (3) in 1973 and prior years, the ESF reported gold holdings of varying amounts. According to Schwartz (p. 148), this gold was held in a special ESF account at the New York Fed, and in 1974 was consolidated with the Treasury's other gold in anticipation of its 1975 and 1978-79 gold auctions. Schwartz also reports (p. 138, fn. 6) that at the 1977 IMF gold auctions, the Treasury purchased gold which it sold to the ESF, and that this gold appeared on its balance sheet for the first three quarters of 1977 but not thereafter. Why the ESF purchased this gold and what it did with it remains unclear.

Of more relevance for present purposes is the ESF's income statement, and particularly the first line: "Profit (+) or loss (-) on: Foreign Exchange." In the statement for December 31, 1977, this account read: "Profits on transactions in: Gold and exchange (including profits from handling charges on gold)." Similar language appeared in prior statements, so that until the end of 1977 profits or losses on gold and foreign exchange were lumped together in a single line item. In the statement for September 30, 1978, the language was similar, but there were separate line items for gold and foreign exchange. However, only the line for foreign exchange showed activity during the year. In the statement for December 31, 1978, the separate line item for gold was eliminated, and the current format of a single line item for foreign exchange with no specific reference to gold was adopted. Accordingly, if the ESF has resumed trading in gold or gold derivatives, historical practice indicates that the profits or losses on these activities should be reflected in this line item absent creation of new line item for gold.

The following table shows the ESF's profits or losses (-) on foreign exchange by quarter and fiscal year from fiscal 1981, the first year of the Reagan administration, through fiscal 1999, the most recent data. All amounts are in US$ millions.

| Fiscal Year | Oct./ Dec. | Jan./ Mar. | Apr./ Jun. | Jul./ Sep. | Total FY |
|---|---|---|---|---|---|
| 1999 | 1699 | -817 | -500* | 1257 | 1637 |
| 1998 | -754 | -333 | -135 | 576 | -646 |
| 1997 (Korea/ Asia) | -383 | -1093 | 402 | -538 | -1613 |
| 1996 | -449 | -547 | -419 | -214 | -1629 |
| 1995 (Mexico) | -38 | 2623 | 276 | -2054 | 808 |
| 1994 | -1116 | 1388 | 883 | 102 | 1257 |
| 1993 | -1700 | 965 | 412 | 437 | 114 |
| 1992 | 1264 | -1267 | 1495 | 1191 | 2683 |
| 1991 | 1020 | -1357 | -421 | 739 | -19 |
| 1990 | 327 | -722 | 944 | 1752 | 2301 |
| 1989 | 545 | -555 | -501 | 471 | -39 |
| 1988 | 994 | -236 | -414 | -133 | 212 |
| 1987 (Louvre) | 96 | 589 | -51 | -15 | 618 |
| 1986 | 456 | 488 | 478 | 504 | 1926 |
| 1985 (Plaza) | -57 | 50 | 43 | 441 | 477 |
| 1984 | -26 | 107 | -165 | -162 | -246 |
| 1983 | 524 | -64 | 41 | 112 | 613 |
| 1982 | 439 | -475 | -95 | 99 | -32 |
| 1981 | -217 | -390 | -806 | 241 | -1172 |

* Income of $36 million for "Commissions" reported as separate line item this quarter; no similar entry before or since.

Because the ESF is self-funding, its earnings on gold and foreign exchange trading (as well as its interest income on investments held) are accumulated in the fund, and it has incentive to operate profitably. As these reports make clear, the ESF does not confine its foreign exchange trading to interventions for purposes of currency stabilization. Indeed, the Treasury has reported to Congress that the ESF did not conduct any "interventions" in 1998 or 1999, yet its activities nevertheless generated foreign exchange profits or losses, as they did in prior years when interventions for the purpose of currency stabilization were few or none. However, since the ESF is sometimes used as a vehicle for providing aid to other countries, e.g., Mexico in 1995-1996, Korea possibly in 1997, some losses in certain years may be attributable to these activities, which really are undertaken to stabilize not the dollar but the currencies of other nations.

For 14 years, from 1982 (the second year of the Reagan administration) through 1995 (the third year of the Clinton administration), the ESF's foreign exchange trading was generally quite profitable, suffering small losses in only three years (1982, 1989 and 1991) and a moderate loss in just one (1984). This creditable record began to fall apart in 1996, with by far the largest loss on foreign exchange trading in the ESF's history, followed by another similarly large loss in 1997, and a significant loss in 1998. Good results in the first quarter of 1999 were halved by losses in the second quarter, and further reduced by a smaller but sizable loss in the third, which is also the quarter in which the British gold sales were announced.

Another noteworthy feature of this quarter is the appearance on the ESF's income account of a separate line item for "commissions." No such entry has appeared before or since. The closest historical analogue are the "handling charges on gold" included in the profits line prior to 1978.

While an examination of the ESF's skeletal financial reports cannot possibly prove that it has engaged in efforts to "stabilize" the gold price in recent years, there is nothing in these reports to suggest that it has not. What is more, there is much to arouse suspicion.

As I have suggested in earlier commentaries, official efforts to cap the gold price probably began in late 1995 or early 1996 as the gold price challenged $400/oz. with the deepening of Japan's economic crisis. These dates also coincide with the ESF's transition from profits to losses. Generally speaking, official bodies like the ESF ought to make profits on foreign exchange trading when profits rather than currency stabilization are their objective since they are likely to have relevant information and intelligence unavailable to others. On the other hand, when they intervene to stabilize a currency in opposition to fundamental market forces, experience suggests that large losses are likely to occur. Accordingly, particularly during 1998 and 1999 when the Clinton administration denies making any interventions and when there were no other obvious activities of the ESF that might explain losses on foreign exchange trading, the losses themselves -- especially large ones -- raise questions.

They become even more suspicious when plotted against gold prices over the past two years, where on a quarterly basis and allowing for shorts lags in realizing profits or losses, firm or rising gold prices tend to correspond with ESF losses and falling prices with ESF profits. This relationship does not hold true for the last calendar quarter of 1997 (first quarter of fiscal 1998 for the ESF), but then declining gold prices reflected concern about lower demand and even dishoarding as a result of the Asian financial crisis, which may have impacted the ESF's results adversely as well. Thereafter, rising gold prices in the first four months of 1998 correspond with ESF losses in the second and third fiscal quarters, and falling gold prices to September with a small recovery that month with ESF profits. From October 1998 through the end of the year gold prices remained weak and in declining mode, and the ESF had one of its most profitable quarters.

For the first two months of 1999, gold remained firm at around 290, spiking upward toward $300 in early March. This rally was contained despite apparently good fundamentals for gold, and the price receded to around $280 by the beginning of April. Then another rally began, pushing the price back above $290 at the end of the month, largely powered by increasing doubts that the proposed IMF gold sales would be approved. In the second fiscal quarter (first calendar quarter) of 1999, the ESF lost almost half of its profits from the prior quarter, and its losses continued into the next quarter on a scale that if continued would have pushed it into a loss position for an unheard of fourth straight year.

In early May, just as gold was threatening a sharp rally that many expected would carry it over $300 and perhaps to much higher levels, the British announced their gold sales. For many knowledgeable about gold, this otherwise inexplicable action was the smoking gun, proof that some official scheme was afoot to cap the gold price. In its wake, the gold price declined within two months to under $260, and stayed at these low levels until announcement of the Washington Agreement at the end of September. At the same time, the ESF had another very profitable quarter, closing out fiscal 1999 with a large profit for both the last quarter and the year.

All these events may be coincidence, but they are also consistent with an ESF program of trying to cap the gold price through a program of selling call options or backstopping calls sold by others. Gold loans and short selling by bullion banks are largely responsible for the weak gold prices of recent years. Both activities require access to a deep, liquid and financially credible market where call options on gold can be purchased. See, e.g., The New Dimension: Running for Cover. Absent such a market or its functional equivalent, these activities simply become too risky, especially for prudent, sophisticated players, because they have no means to hedge their risk. At the same time, as the net short gold position grows, writing or selling calls becomes more risky, and premiums tend to rise, eventually choking off both gold loans and short selling. At that point, gold prices should rally, relieving some of the pressure.

However, given its rather large resources relative to the gold market, the ESF could have enabled gold loans and bullion bank short selling to continue past their normal limits by selling or backstopping calls at reasonable premiums when private parties declined to do so in sufficient quantities or at all. A program of this sort would generally, although perhaps with a slight lag for their actual realization, tend to show losses on rising gold prices and profits on falling ones. Nor would it necessarily require access to official U.S. gold reserves, either for sale or leasing. At first, relatively deep pockets and a high tolerance for risk probably would be sufficient.

But ultimately, as the net short position grew and perceptions of risk increased, central banks and others who loan gold would begin to step back. No central bank wants to be caught with a defaulted gold loan. Then the program to cap the gold price would break down without access of some sort to physical gold, such as a friendly central bank willing to step into the breach -- either with bullion for sale or with a willingness to lease notwithstanding the risk. The British gold sales and Kuwaiti gold loan -- both otherwise without apparent rational basis -- fit this pattern.

Given its long-standing culture of secrecy, any ESF scheme to cap the gold price would almost certainly be carried out without notice to Congress, and quite possibly without notice to the Fed either. As to mechanics, a hidden relationship with one or a very few bullion banks would be sufficient. This relationship would give the favored bullion banks an enormous edge in their own gold trading operations, and one that no Chinese wall could likely neutralize.

From the outset, the constitutionality of the ESF has been open to doubt. Its self-funding operations largely immune from effective congressional oversight seem to contravene both the separation of powers and the exclusive control over appropriations vested in Congress. But any scheme by the ESF today to control the gold price would face further legal and constitutional hurdles.

At the same time that it established the ESF, Congress put the gold value of the dollar at $35/oz. and generally prohibited gold ownership by American citizens. Accordingly, Congress set the gold price for the ESF to target, not the Secretary of the Treasury. What is more, by outlawing most private gold ownership, Congress effectively foreclosed trading of gold. Thus there was little likelihood that the ESF would come into conflict with private investors trading gold or gold futures in New York or anywhere else in the country.

Today, of course, the situation is wholly different. Although Congress has left standing an anachronistic official gold price of $42.22/oz., there is no reasonable argument that this figure remains a legitimate target for ESF stabilization efforts. Congress has also repealed the ban on gold ownership. Substantial trading of gold, including bullion and coins, and gold derivatives, including futures and options, now takes place daily in private transactions, over-the-counter financial markets and public commodities exchanges.

Any act by the executive branch -- through the ESF or otherwise -- to set the dollar gold price today, under these circumstances, would be patently illegal and unconstitutional. The public commodities exchanges are regulated under the authority of Congress precisely to assure that they function honestly and fairly for all participants. Congress has effectively declared by its actions that gold contracts on these exchanges should trade in a free market, not one subject to manipulation by the ESF, the Fed or anyone else, including the bullion banks.

The monetary provisions of the Constitution grant to Congress sole and exclusive power to determine the gold value of the dollar. The Supreme Court, to its everlasting shame, has refused to decide whether Congress may constitutionally sever any meaningful link between the dollar and gold or silver. But if there is to be a link, the Constitution vests in Congress exclusive power to define it.

Were I counsel to a bullion bank, my advice would be to avoid like the plague involvement, or even suspicion of involvement, in any ESF scheme to affect gold prices. Activities of this sort could potentially violate a wide array of federal and state statutes, many of which also confer rights of private action on injured parties. Indeed, the blatant unconstitutionality of any such scheme could well deprive participating government officials of a range of defenses ordinarily available when they perform authorized duties in good faith. But many defenses available to the government or its officials would not be available to the bullion banks. In short, if the scheme blew up, their financial exposure could be enormous.

Fourth Article. This article focuses on the danger that gold derivatives pose to the U.S. banking system. These derivatives are concentrated in three large money center banks, Morgan Guaranty Trust Co. of New York, Chase Manhattan Bank and Citicorp N.A. Their total notional value at the end of March exceeded $87 billion, which converted at market prices exceeds total U.S. official gold reserves of around 8140 metric tonnes.

May 3, 2000. **House of Morgan: From Gold Bugs to Paper Hangers**

No bank is more intertwined in the great events of U.S. financial history than the House of Morgan. More than once, J. Pierpont Morgan rode almost single-handedly to the rescue of the U.S. financial system. Never were the stakes higher, nor the outcome more uncertain, than on February 5, 1895. The U.S. Treasury faced imminent default on its gold obligations. In Morgan's view, widely shared on Wall Street and in London, default threatened a complete collapse of the national credit and the dollar. In a last minute effort to avert catastrophe, the great financier met with President Cleveland to try to salvage a plan for the issue of government gold bonds through a syndicate led by his bank. Based on an obscure Civil War statute, Morgan's plan faced heavy political opposition. But in a tense White House meeting, Morgan carried the day. Not until the deal was done did the President notice that the cigar which Morgan had pulled from his pocket upon arrival lay in brown dust on his lap. It would be more than century before another cigar played as famous a role in a White House rendezvous.

No one fought harder for restoration and maintenance of the gold standard after the Civil War than J. Pierpont Morgan. "Gold is money," he thundered. "That's it." Today the House of Morgan appears considerably more ambivalent on the subject. Its participation in GoldAvenue.com suggests some optimism about gold. On the other hand, the derivatives business of Morgan Guaranty Trust Co. of New York (hereinafter "Morgan"), a wholly-owned subsidiary of J. P. Morgan & Co., gives quite another picture.
Recent figures from the Office of the Comptroller of the Currency on the off balance sheet derivatives contracts of U.S. commercial banks show that Morgan continues to play an outsized role on the U.S. financial scene, particularly as regards gold. But there is a difference. When a Morgan ran Morgan, the dollar was as good as gold and the bank aimed to keep it that way. Today's managers at Morgan seem to have placed a huge bet against gold and on the paper dollar.
The following table is taken from the quarterly OCC Bank Derivatives Reports, which can be accessed at www.occ.treas.gov/deriv/deriv.htm. Since these reports cover only commercial banks, investment firms like Goldman Sachs and Merrill Lynch are not included. Neither, of course, are foreign banks. Data on individual banks is reported only

for the seven banks having the largest total notional amounts of off balance sheet derivatives. Of these seven, only Morgan, Chase Manhattan Bank and Citibank NA reported any gold derivatives at the end of 1999. The table gives the total notional amounts of all gold derivatives for all reporting banks in US$ billions from March 31, 1995, together with Morgan's share in both dollars and percent from June 30, 1998.

| | Maturity | | | | Tonnes @ | Gold* | Tonnes @ |
|---|---|---|---|---|---|---|---|
| Quarter | <1 yr | 1-5 | >5 yrs | Total | Gold Pr. | Price | $327/oz.** |
| 1999/4 | 46.5 | 27.8 | 13.3 | 87.6 | 9388 | 290 | 8333 |
| Morgan | 20.9 | 11.3 | 5.8 | 38.1 | 4082 | | 3623 |
| % | 45% | 41% | 44% | 43% | | | |
| 1999/3 | 52.3 | 22.4 | 8.7 | 83.4 | 8676 | 299 | 7933 |
| Morgan | 21.0 | 7.6 | 1.8 | 30.5 | 3171 | 2899 | |
| % | 40% | 34% | 21% | 37% | | | |
| 1999/2 | 36.9 | 20.9 | 3.6 | 61.4 | 7317 | 261 | |
| Morgan | 13.8 | 3.8 | 0.8 | 18.4 | 2188 | | |
| % | 37% | 18% | 21% | 30% | | | |
| 1999/1 | 34.8 | 21.5 | 8.5 | 64.8 | 7213 | 279 | |
| Morgan | 10.7 | 3.8 | 0.6 | 15.1 | 1677 | | |
| % | 31% | 17% | 7% | 23% | | | |
| 1998/4 | 36.0 | 23.2 | 9.2 | 68.4 | 7392 | 288 | |
| Morgan | 10.4 | 5.3 | 1.1 | 16.8 | 1811 | | |
| % | 29% | 23% | 12% | 25% | | | |
| 1998/3 | 40.6 | 24.3 | 9.2 | 74.1 | 7844 | 294 | |
| Morgan | 13.5 | 5.8 | 0.9 | 20.3 | 2148 | | |
| % | 33% | 24% | 10% | 27% | | | |
| 1998/2 | 37.0 | 23.5 | 9.1 | 69.6 | 7306 | 296 | |
| Morgan | 13.4 | 4.9 | 0.9 | 19.3 | 2026 | | |
| % | 36% | 21% | 10% | 28% | | | |
| 1998/1 | 39.7 | 17.7 | 4.9 | 62.3 | 6438 | 301 | |
| 1997/4 | 42.6 | 15.4 | 4.2 | 62.2 | 6667 | 290 | |
| 1997/3 | 44.1 | 13.6 | 3.1 | 60.8 | 5694 | 332 | |
| 1997/2 | 35.0 | 14.3 | 2.5 | 51.8 | 4816 | 335 | |
| 1997/1 | 34.2 | 22.9 | 2.4 | 59.5 | 5317 | 348 | |
| 1996/4 | 39.4 | 17.4 | 2.0 | 58.8 | 4953 | 369 | |
| 1996/3 | 46.8 | 15.6 | 1.7 | 64.1 | 5261 | 379 | |
| 1996/2 | 36.5 | 15.6 | 1.7 | 53.8 | 4381 | 382 | |
| 1996/1 | 38.8 | 16.4 | 2.4 | 57.6 | 4520 | 396 | |
| 1995/4 | 35.9 | 16.1 | 1.9 | 53.9 | 4335 | 387 | |
| 1995/3 | 28.4 | 10.6 | 1.3 | 40.3 | 3264 | 384 | |
| 1995/2 | 22.8 | 9.5 | 1.4 | 33.7 | 2708 | 387 | |
| 1995/1 | 20.4 | 9.4 | 1.2 | 31.0 | 2515 | 383 | |

* End of period, London, IMF International Financial Statistics.
** Average of Barrick's strike prices: $319 in 2000; $335 in 2001.

This table shows a pattern of generally rising gold derivatives against generally falling gold prices. At the beginning of 1995, the total notional amount of gold derivatives converted to tonnes at market prices equaled just slightly more than annual new mine production of around 2275 tonnes. Currently new mine production is running at about 2500 tonnes, but total gold derivatives have increased to considerably more than 3 times this amount whether converted at market prices or the average price of Barrick's calls. Morgan's position alone equals some one and one-half years of total world gold production. Coincidentally or not, the total position now exceeds total official U.S. gold reserves of around 8140 tonnes.

Especially striking are the increases in the last half of 1999, and particularly in the last quarter. The British gold sales were announced on May 7, 1999, and the Washington Agreement on September 26, 1999. Both events, one presumably bearish for gold and the other bullish, were followed by large increases in total gold derivatives. In the third quarter, these increases were most pronounced in the under one year maturities. However, in the fourth there were large increases in the longer maturities, with the over five years category rising by more than 50%.

But even more extraordinary than the increases in total gold derivatives in the last half of 1999 were their increasing concentration in one bank: Morgan. Prior to 1999, Morgan had never held more than about $20 billion in total gold derivatives, nor more than 28% of the total outstanding for all banks. But beginning in the second quarter of 1999, Morgan took on a much larger role in the under one year maturities, possibly presaging the the British gold sales. Then, during the last half of 1999, Morgan more than doubled its total gold derivatives, taking them from $18.4 billion to $38.1 billion, amounting to 43% of the total for all banks. What is more, Morgan's over 40% dominance stretched across all maturities. In the fourth quarter alone, it increased its gold derivatives with maturities over one year by more than 80% to $17.1 billion from $9.4 billion, which may well answer the question of who sold Barrick the calls.

Typically financial rescue operations carried out by banks involve a sharing of the load and risk more or less in proportion to exposure. Indeed, normally banks strongly object to taking on more than their fair share of a problem, or to giving another bank -- not to mention a major rival -- a free ride. Until Morgan passed it in the third quarter of 1999, Chase was the largest provider of gold derivatives. Its total gold derivatives were $23.7 billion on March 31, 1999, falling to $20.5 billion by June 30. Thereafter they rose just slightly to $22.6 billion on September 30, falling back to $22.1 billion at the end of the year. This huge change in the relative positions of Morgan and Chase during a period of extreme turbulence in the gold market seems quite unusual unless Morgan acted with some sort of official approbation.

Notional amounts are generally the underlying contractual amounts from which derivative payments are determined. They are not typically the amounts at risk. Assessment of risk requires assumptions or estimates about the magnitude, timing and volatility of underlying price movements, the liquidity of the relevant markets, especially as regards the availability of appropriate hedge positions, and the creditworthiness of counterparties. Particularly for over-the-counter derivatives, which constitute over 90% of the total, risk assessment also requires knowledge of the details of the relevant contracts.

For example, Barrick's calls on 6.8 million ounces (211.5 tonnes) of gold at an average price of $327/oz. have a notional value of around $2.2 billion. However, this amount could not really be deemed at risk unless one assumed a doubling of the gold price to $654 before any of the calls expired and with no opportunity to put protective hedges in place. What is more, a provision making the calls dischargeable in dollars rather than bullion would further affect the risk calculation under certain conditions.

Total notional amounts of all off balance sheet derivatives for all reporting banks at the end of 1999 were $34.5 trillion, of which Chase accounted for $12.7 trillion and Morgan for $8.7 trillion. Approximately 80% of the total represents interest rate contracts, 17% foreign exchange, and 3% equities, commodities and credit derivatives.

Obviously gold derivatives are a tiny proportion of the total, about 0.25%. However, not only do they exceed annual new gold production by well over 3 times, but also they are of significant size relative to bank capital. At the end of 1999, Morgan reported total risk-based capital of $12.1 billion, or $12.9 billion for parent J. P. Morgan & Co. as a whole. The parent's total market capitalization is around $22 billion (at $135/share); total stockholders' equity at year end was $11.4 billion. Against these numbers, Morgan's total gold derivatives of over $38 billion, equivalent to roughly 3600 to 4000 tonnes of gold, are scarcely trivial.

How dangerous are these gold derivatives? Apart from dwarfing annual new mine production, they must also be viewed against: (1) reasonable estimates of a current equilibrium gold price on a commodity basis of $500 to $600/oz.; (2) a total net short gold derivatives position estimated at anywhere between 7000 and 14,000 tonnes; and (3) the possibility of a surge in western investment demand for gold caused by stock market declines or other outside events. In these circumstances, a swift upmove to $600/oz., with little or no retracement, cannot be discounted. Assuming that Morgan's book is equally divided between longs and shorts, a move of this size could well create actual liabilities equal to around 50% of the notional value of its gold derivatives. Failure of 20% of its counterparties to perform would imply losses to Morgan equal to approximately 10% of the notional value or $3.8 billion, which is nearly one-third of its total capital.

Of course, the actual situation could be much worse. To the extent Morgan or its counterparties had to deliver physical bullion, it might not be available at all, or only at much higher prices. The known facts already point to a real possibility that in the wake of the Washington Agreement, Morgan may have served to warehouse short gold positions of others, thereby keeping those who wanted or needed to cover out of the physical market and cutting short a potentially huge rally toward equilibrium prices. In this event, Morgan's book is likely far more short than long, and difficulties in securing physical bullion have already manifested themselves. But as dangerous as Morgan's gold derivatives may appear, it is very unlikely that Morgan took on this position without the full knowledge of the Fed.

Why did Morgan do so? What was the Fed's involvement? Is there any connection between the gold derivatives positions of the big U.S. banks and the Swiss gold sales? What are the possible end games for Morgan and the other U.S. banks? Before tackling these intriguing questions, it is first necessary to look at U.S. gold exports and reductions in foreign earmarked gold at the N.Y. Fed. This interesting subject will be the subject of my next commentary. In the meantime, I recommend study of the chart found at the following link: http://www.geocities.com/goldtango/analysis1.htm.

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**Deutsche Bank: Sabotaging the Washington Agreement?**

In a prior commentary, I suggested that the Swiss gold sales of 1300 tonnes over the next four and one-half years are likely aimed at covering gold loans made by European central banks, and that the quid pro quo for the Swiss is effective inclusion within the Euro Area even though Switzerland is not a formal member. Suspecting that Swiss gold sales might also be intended to cover gold loans to Swiss banks, especially from the Bundesbank, which is reported to have loaned out 10% of its total reserves of almost 3500 tonnes, I made an online search for further information on the gold derivatives of both the Swiss and the German banks. WOW!

UBS, of course, has been a leading bullion bank for years. With a total notional value at year-end 1999 of around US$74 billion, its derivatives position in precious metals is huge, approaching the $87 billion in gold derivatives of all U.S. commercial banks combined. But the gold derivatives position of Deutsche Bank is just plain stunning in the speed and magnitude of its growth, from almost nothing in 1996 to a total notional value of over US$50 billion, or nearly 5000 tonnes, at the end of 1999. Even more amazing are the lengthening maturities and accelerating growth in these derivatives during the last part of 1999, making it appear that Deutsche Bank is allied with Morgan in the same cabal to control the gold price.

Information on the precious metals derivatives of the Swiss banks is available at the website of the Swiss National Bank (www.snb.ch) in a publication entitled Les Banque Suisse (also available in German) at schedule 34. The great bulk of this business is done by UBS, and can be tracked in note 27 to its 1999 annual report and note 28 to its 1998 annual report, both of which are available at its website (www.ubs.ch). Credit Suisse does a much smaller business in precious metals derivatives, on which it also provides information in its annual reports, available online (www.de.credit-suisse.ch).

All these derivatives reports provide figures on notional amounts comparable to those in the OCC reports for U.S. commercial banks. However, the Swiss reports also use another measure: positive replacement value ("PRV") and negative replacement value (NRV). PRV, as described by UBS, "represents the cost ... of replacing all transactions with a receivable amount if all ... counterparties were to default." It is an asset on the bank's balance sheet. NRV, which is a liability on the balance sheet, "is the cost to the [bank's] counterparties of replacing all the [bank's] transactions ... if [the bank] were to default." The difference between the two is net market value, positive or negative. Generally the net difference is quite small, and to simplify the table below, PRV and NRV are averaged to make a single entry, which is given in Swiss franc billions. Not being notional amounts, these figures do not add to the total notional amounts stated. However, since PRV and NRV are the only figures given by maturity and line of business, I have used an average of the two to show the general distribution of the business.

The following table, compiled from these sources, shows the precious metals derivatives activities of the Swiss banks, of which more than 90% is almost certainly gold. Annual totals for UBS and Credit Suisse are slightly higher than the sums of their figures for over-the-counter forward contracts and options because both banks additionally report very small amounts of exchange-traded futures and options (almost all options). Additionally, the figures reported by the SNB do not reconcile completely with the UBS and Credit Suisse figures, but the apparent discrepancies are quite minor and probably due to some netting or other form of consolidation. Conversions to U.S. dollars and tonnes are at end of period rates and gold prices as shown in IMF, International Financial Statistics. Conversions to tonnes are discounted by 10% to exclude precious metals derivatives that are not gold.

| | Maturity | | | | Total | Total | Tonnes | @ |
|---|---|---|---|---|---|---|---|---|
| | <3mos | 3-12mos | 1-5yrs | > 5 yrs | | Notional | Notional | Gold Pr. |
| Gold | | | | | | | | |
| Year | (average of PRV and NRV) | | | | SwF bil. | US$ bil. | Notional | Pr. |
| 1999 UBS OTC | | | | | | | | |
| Forwards | 1.08 | . 06 | .07 | 0 | 30.0 | 18.8 | 1809 | 290 |
| Options | .25 | .53 | 1.12 | .12 | 82.9 | 51.8 | 4998 | |
| Total | 1.33 | .59 | 1.19 | .12 | 118.6 | 74.1 | 7151 | |
| 1998 UBS OTC | | | | | | | | |
| Forwards | 4.59 | .26 | .07 | .01 | 47.7 | 34.7 | 3371 | 288 |
| Options | 2.88 | .01 | .0 | .0 | 56.2 | 40.8 | 3971 | |
| Total | 7.47 | .28 | .09 | .01 | 110.2 | 80.1 | 7787 | |
| 1999 Credit Suisse OTC | | | | | | | | |
| Forwards | | | | | 17.5 | 10.9 | 1055 | 290 |
| Options | | | | | 11.2 | 7.0 | 675 | |
| Total | | | | | 28.8 | 18.0 | 1736 | |
| 1998 Credit Suisse OTC | | | | | | | | |
| Forwards | | | | | 18.8 | 13.7 | 1328 | 288 |
| Options | | | | | 15.4 | 11.2 | 1088 | |
| Total | | | | | 34.8 | 25.3 | 2459 | |
| 1997 Credit Suisse OTC | | | | | | | | |
| Forwards | | | | | 26.3 | 18.1 | 1758 | 290 |
| Options | | | | | 8.6 | 5.9 | 575 | |
| Total | | | | | 36.7 | 25.2 | 2453 | |
| All Banks | | | | | | | | |
| 1999 | | | | | not yet available | | | 290 |
| 1998 - Total | | | | | 133.7 | 97.2 | 9450 | 288 |
| Forward Contracts | | | | | 59.9 | 43.5 | 4232 | |
| Options | | | | | 65.5 | 47.6 | 4631 | |
| 1997 - Total | | | | | 144.8 | 99.5 | 9676 | 290 |
| Forward Contracts | | | | | 74.1 | 50.9 | 4954 | |
| Options | | | | | 60.3 | 41.5 | 4032 | |

Several important points emerge from this table. First, of course, is the huge size of UBS's business, dwarfing that of Credit Suisse. Second, the size of both banks' business has remained relatively stable over the past three years, Credit Suisse showing small declines and UBS a slight increase as measured in Swiss francs. More interesting, however, is the shift in the mix between forward contracts and options, with the former declining and the latter rising. This trend, apparent for Credit Suisse in 1998, is very pronounced for UBS in 1999. Finally, from the average PRV and NRV figures, which are the only figures that UBS provides by maturity, one can detect a shift in options in 1999 from shorter to longer maturities, mostly from under 3 months to over 1 year.
Deutsche Bank acquired Banker's Trust in June 1999. Deutsche Bank's annual reports from 1996 through 1999 are available in English at its website (http://public.deutsche-bank.de), and give detailed information about its off balance sheet derivatives, including precious metals, of which again more than 90% must be gold. Dresdner Bank's 1998 and 1999 annual reports are also available online (www.dresdner-bank.com). The following table is drawn from all these reports. Except as noted, conversions to U.S. dollars and tonnes are at end of period rates and gold prices as shown in IMF, International Financial Statistics. Conversions to tonnes are discounted by 10% to exclude precious metals derivatives that are not gold.

| | Maturity | | | | | | |
|---|---|---|---|---|---|---|---|
| Year | <1 yr | 1-5 yrs | >5 yrs | Total | Total | Tonnes | Gold |
| | (All in Notional Amounts) | | | | US$ | @Gold | Price |
| Deutsche Bank | in euros billion | | | bil. | Price | | |
| 1999 | 21.8 | 21.8 | 7.3 | 50.9 | 51.2 | 4934 | 290 |
| 1999 | average notional volume* | | | 35.3 | 37.7 | 3738 | 282 |
| | in DM billion | | | | | | |
| 1998 | 20.0 | 6.4 | .8 | 27.2 | 16.2 | 1579 | 288 |
| 1997 | 21.8 | 1.0 | .0 | 22.8 | 12.7 | 1226 | 290 |
| 1996 | 8.6 | . 1 | .0 | 8.7 | 4.8 | 367 | 369 |
| Dresdner Bank | in euros billion | | | | | | |
| 1999** | 8.3 | 6.9 | *** | 15.2 | 15.3 | 1472 | 290 |
| | in DM billion | | | | | | |
| 1998 | 4.9 | 3.6 | .6 | 9.2 | 5.5 | 534 | 288 |
| 1997 | 6.8 | 2.5 | 1.1 | 10.4 | 5.8 | 562 | 290 |

*  Conversions to US$ and tonnes at average 1999 rates and prices.
** Separately stated trading and investment portfolios summed.
***Includes over 1-5 years and later.

This table portrays a very disturbing picture. Deutsche Bank, the largest German bank, which had precious metals derivatives at the end of 1996 with a total notional value under US$5 billion, by the end of 1999 had grown this business to a total notional value in excess of $50 billion, or by more than 10 times in three years. What is more, a huge amount of this growth came in 1999, especially in the last half, as can be seen by comparing the average notional value for 1999 ($37.7 billion) with the year-end notional value ($51.2 billion). Note also that this growth was almost all in the longer maturities. shorter to longer maturities, mostly from under 3 months to over 1 year.

Nor can the 1999 growth in Deutsche Bank's precious metals derivatives be ascribed in any major way to its acquistion of Banker's Trust. Its OCC report for March 31, 1999, listed precious metals derivatives with a total notional value of around $6 billion, which by June 30 were just over $1 billion. shorter to longer maturities, mostly from under 3 months to over 1 year.

The 1999 figures for Dresdner Bank make it appear like the little brother aping his older sibling. There is the same surge in precious metals derivatives, with a similar move into the longer maturities. At a total notional value of $15.3 billion, only the absolute scale is smaller. Expressed in tonnes with a 10% reduction (probably too much) to exclude precious metals derivatives not related to gold, the total combined notional amount of the two German banks' gold derivatives at the end of 1999 exceeded 6400 tonnes, approaching twice the Bundesbank's stated gold reserves of 3470 tonnes.shorter to longer maturities, mostly from under 3 months to over 1 year.

The growth profile of Deutsche Bank's precious metals derivatives in 1999 closely matches that of Morgan Guaranty Trust, described in my prior commentary on Morgan. See also John Hathaway's article, JP Morgan To The Rescue, www.tocqueville.com/brainstorms/brainstorm0065.shtml. My Morgan commentary contains several paragraphs devoted to explaining the meaning of notional value in the context of gold derivatives and the risks implicit in large notional totals, particularly in a gold market that appears far out of equilibrium. Because this subject is a complicated one, I am planning to address it further in a future commentary.shorter to longer maturities, mostly from under 3 months to over 1 year.

However, the reports of the European banks contain data on replacement or market values that I have not yet found in the OCC data for U.S. commercial banks (although I believe it should be there somewhere). These values often but not always seem to move in a contrary direction from notional values. For example, the average PRV/NRV for Credit Suisse's total precious metals derivatives moved from SwF1.7 billion in 1998 to SwF2 billion in 1999 while total notional value declined. In contrast, the same number for UBS went from SwF7.8 billion in 1998 to SwF3.2 billion in 1999 while total notional value rose slightly. At the end of 1999, the total notional value of UBS's precious metals derivatives was four times that of Credit Suisse, but its replacement values were less than twice as great.shorter to longer maturities, mostly from under 3 months to over 1 year.

Deutsche Bank's replacement values are even more difficult to fathom, with average values over 1999 (PRV, E888 million; NRV, E818 million) more than four times year end values (PRV, E201 million; NRV, E153 million), notwithstanding that total notional value at year-end exceeded average notional value by more than 40%. Anyone familiar with the pricing of options knows how volatile the prices can be, and looking at gold prices in 1999, it is possible to hypothesize various scenarios to explain the apparently odd movements of replacement values versus notional values. But the real question is whether some of these seemingly low replacement values are suggesting that certain notional values may be misleadingly inflated.shorter to longer maturities, mostly from under 3 months to over 1 year.

Again, as with the hedge books of mining companies, it is almost impossible to reach sound conclusions without access to the underlying data. However, three considerations suggest that the high notional values for banks like Deutsche Bank and Morgan are more than insignificant fluff. First, other large bullion banks did not experience the same extraordinary growth in their gold derivatives in the last half of 1999. If market events by themselves had caused this explosion of notional values, one would expect to see some evidence of the phenomenon in the books of other bullion banks like Chase or Credit Suisse. shorter to longer maturities, mostly from under 3 months to over 1 year.

Second, replacement values appear principally intended as a measure of counterparty risk, not position risk. A footnote in Deutsche Bank's 1998 and earlier reports states: "Since exchange-traded products and short positions in options do not involve counterparty risk, no replacement costs are to be given here." Several prior commentaries have addressed the possibility that certain bullion banks, most likely with some form of official support, have been writing unhedged calls with specific intent to control the gold price. This note suggests the possibility that any such calls might not be included in replacement values even though included in notional values. shorter to longer maturities, mostly from under 3 months to over 1 year.

Finally, and perhaps most importantly, these figures are generated as a result of capital risk adequacy standards adopted under BIS sponsorship for all major banks and dealers in the G10 countries. Positions that do not require risk capital are typically netted out since no bank wants to burden its risk capital any more than is necessary. What is more, all these derivatives reports are consolidated semi-annually in reports available at the BIS website (www.bis.org, click on Regular Publications, then on Regular OTC Derivatives Market Statistics). shorter to longer maturities, mostly from under 3 months to over 1 year.
Under commodity contracts, gold is broken out separately, and notional amounts and gross market values are given. The figures for gold in the most recent report as of December 31, 1999, are shown in the following table, with conversions to tonnes at the corresponding end of period gold prices except as noted.shorter to longer maturities, mostly from under 3 months to over 1 year.

| Gold Contracts | Notional Amounts US$ bil. | Notional Amounts tonnes | Gross Market Values US$ bil. | Gold Price |
|---|---|---|---|---|
| Dec. 31, 1999 | 243 | 26,063 | 23 | 290 |
| June 30, 1999 | 189 | 22,524 | 23 | 261 |
| | | 20,846 | | 282* |
| Dec. 31, 1998 | 182 | 19,656 | 13 | 288 |
| June 30, 1998 | 193 | 20,281 | 10 | 296 |

*Conversion of $189 billion at average 1999 gold price of $282.
*Conversion of $189 billion at average 1999 gold price of $282.

Here again, a large increase in notional values in the last half of 1999 is accompanied by flat gross market values. Footnote 1 to the BIS press release accompanying the report states:shorter to longer maturities, mostly from under 3 months to over 1 year.

The notional amount, which is generally used as a reference to calculate cash flows under individual contracts, provides a comparison of market size between related cash and derivatives markets. Gross market value is defined as the sum (in absolute terms) of the positive market value of all reporters' contracts and the negative market value of their contracts with non-reporters (as a proxy for the positive market value of non-reporters' positions). It measures the replacement cost of all outstanding contracts had they been settled on 31 December 1999. The use of notional amounts and gross market values produces widely divergent estimates of the size of the overall market and of the various market segments.shorter to longer maturities, mostly from under 3 months to over 1 year.

The press release itself goes on to say: "Transactions involving gold, the largest single component of the commodity derivatives market, were particularly buoyant." It then notes the sharp rise in the gold price following the Washington Agreement, but makes no effort to relate the effect of this rally on notional values or gross market values. What is clear, however, from other footnotes is that the BIS attempts to adjust for double-counting, including halving notional values between reporting entities, and that it estimates some of these adjustments for the gold category.shorter to longer maturities, mostly from under 3 months to over 1 year.

Talking in tonnes in round figures, the BIS report shows a notional increase in gold derivatives of 4000 tonnes in the last half of 1999. According to the OCC figures, Morgan's gold derivatives increased by almost 1900 tonnes in the same period. There are no mid-1999 figures for Deutsche Bank, but with a year-over-year increase of more than 3200 tonnes, close to 2000 tonnes in the last half is not an unreasonable estimate. Add in Citibank (485 tonnes) and Dresdner Bank (over 900 tonnes on the year), allow for excluding some double-counting between the four, and it is not unreasonable to attribute virtually the entire increase in the last half of the year to these four banks, principally Morgan and Deutsche Bank.shorter to longer maturities, mostly from under 3 months to over 1 year.

The only major gold fund manager that I know who never owned a single share of Bre-X told me that he never bought the stock because: (1) even if you believed the company's story, the stock almost always looked too expensive; and (2) however great the ore deposit, large gold reserves are not built as quickly or as easily as Bre-X claimed to do. So too, the amazing emergence of Deutsche Bank from almost no gold derivatives business in 1996 to a book with a notional value approaching 5000 tonnes, larger by far than the book of any of the three principal U.S. commercial banks in this business, does not pass the smell test. Indeed, it is very hard to see any reason for the rapid creation of this huge position in gold derivatives other than to try to manipulate and control gold prices.shorter to longer maturities, mostly from under 3 months to over 1 year.

With gold closing strongly at $289.10 on May 6, 1999, up $2.10 on the day, and threatening $300 as the IMF's proposed gold sales sailed into trouble, Bill Murphy of GATA reported on Deutsche Bank the same evening in his Midas column at Le Metropole Cafe: "[T]heir bullion desk is calling their clients saying that the gold market is stopping at $290." [Emphasis in original, copy at www.gata.org/graham.html.] The British gold sales were announced the next day, May 7, 1999.shorter to longer maturities, mostly from under 3 months to over 1 year.

Why would Deutsche Bank participate in a cabal to cap the gold price, and far worse, continue to do so after the Washington Agreement? The Bundesbank is not only a signatory to this agreement, but also is rumored to have played a leading role in its adoption. For the Bundesbank to permit Deutsche Bank to act in this manner, with Dresdner Bank doing the same thing but on a smaller scale, suggests that long term monetary policy in the EA, particularly as it relates to gold, is in utter disarray, and that monetary cooperation between France and Germany is far more mirage than real.shorter to longer maturities, mostly from under 3 months to over 1 year.

Indeed, the implications of the gold derivatives activities of these two big German banks in 1999 are so mind-boggling that further analysis must await another commentary. Their actions threaten not merely to sabotage the Washington Agreement, but also, and much more seriously, to jeopardize the euro itself. Those who believe in sound money look to the Bundesbank as a light in the darkness. For it to conspire against gold is as unthinkable as the act of the great baseball player that brought forth this plea from one of his young fans: "Say it ain't so, Joe. Say it ain't so."

Reginald H. Howe
www.GoldenSextant.com
May 26, 2000

Gold: Can't Bank With It, And Can't Bank Without It!

The huge jump in the gold derivatives of Deutsche Bank and Dresdner Bank in the last half of 1999 invites all sorts of speculation, particularly when coupled with similar increases at Morgan Guaranty Trust Co. and Citibank. But as intriguing as such speculation is, it should not be allowed to obscure the more important as well as more factual story that resides in the larger Bank for International Settlements numbers, of which the figures for these four banks are only a part.

Much has been written recently about the short position in gold. In its narrowest sense, this short position is the accumulated physical gold transferred by deposit (loan) from central banks and others to bullion banks. This gold creates deposit liabilities on the balance sheets of the bullion banks. It must be repaid in gold. Virtually all of it has been sold by the bullion banks into the market, creating various paper assets on their books. Besides central bank deposits, gold deposit liabilities of bullion banks include unallocated gold, often in certificate form, of private parties. But the key point is that this physical gold has left the vaults of the banks and the control of the bankers. It can be replaced only by new production or market purchases, and thus constitutes a net short physical position of the bullion banks.

The total net short physical position of the bullion banks is reliably estimated at between 7,000 and 10,000 tonnes, though it could be higher. Ultimately its size is limited by the willingness of gold owners to lend and of gold users (e.g., producers, fabricators, bullion banks, speculators) to borrow. Prudence dictates that the net short physical position be quite reliably hedged -- e.g., delta hedging in physical bullion, contracts for forward delivery from gold mining companies, call options on central banks with large gold reserves, or other instruments where the risk of counterparty default on the obligation to deliver physical gold appears minimal.

In a perfectly prudent world, the net short physical position would roughly correspond with the net short gold derivatives position. But in the absence of such a world, the net short gold derivatives position tends to be larger than the net short physical position. This phenomenon results because while part of the gold derivatives position may be hedged in the physical market or reliable substitutes, other parts may be hedged in less reliable forms of paper gold or even unhedged, such as naked calls.

As discussed in an earlier commentary, writing naked call options can be a very effective means of adding gold to the derivatives market, thereby putting downward pressure on the gold price. Of course writing naked calls is also a very risky activity. But it demonstrates a key point: The net short gold derivatives position is ultimately limited only by the prudence of the least cautious players and, if applicable, the willingness of governments or other official agencies to back them.

As summarized in tabular form in my prior commentary, the recent figures from the BIS on the size of the gold derivatives market are important because they suggest: 1) that the central banks may have loaned much more gold into the market than previously thought; and/or 2) that the net short gold derivative position is far larger than suspected or than anyone would deem prudent.

Before addressing these two alternatives, three points about the BIS figures should be emphasized.

First, under the Basle Capital Accord, all off-balance- sheet exposures, specifically including gold derivatives, are subject to the capital adequacy standards.
Second, the Basle Committee on Banking Supervision has adopted a number of recommendations "to encourage banks and securities firms to provide market participants with sufficient information to understand the risks inherent in their trading and derivatives activities."

And third, the statistics released semi-annually by the BIS on the global OTC derivatives market are an integral part of this risk assessment and disclosure process.
A wealth of further information on all these subjects is available at the BIS website (www.bis.org).

Turning specifically to the derivatives market statistics, the consolidation of notional value at the BIS level is intended to eliminate double-counting between reporting banks and dealers so that the total notional figure is in effect a measure of market size at a point in time. It is not turnover such as reported by the LBMA. For commodities and gold, the closest analogue would appear to be open interest on a commodities exchange. But OTC contracts being non- standard, counting the number of contracts obviously does not work. Accordingly, the best way to measure them is by underlying contract amounts or face values, halving those between reporting parties and taking other steps, as the BIS does, to avoid double-counting.

At the end of 1999, the BIS put the total notional amount of gold derivatives at US$243 billion, up from $189 billion at the end of June. Converting the year- end notional amount to tonnes at the year-end gold price ($290/oz.) gives just over 26,000 tonnes. Using a $300 gold price gives around 25,200 tonnes. But these 1999 figures are only for major banks and dealers with their head offices in the G-10 countries.

On a more irregular basis, the BIS collects similar information for as close to the whole world as it can. Its last larger survey as of the end of June 1998 showed a total global figure for gold derivatives of $228 billion compared to a G-10 figure on the same date of $193 billion, indicating that at that time there was an additional $35 billion (or 3,629 tonnes @ $300/oz.) in gold derivatives outside banks and dealers headquartered in G-10 countries. Accordingly, assuming a continuing difference of around the same magnitude, the total global gold derivatives market is on the order of 26,000 to 28,000 tonnes, more than twice the higher estimates of the net short physical position, and almost as large as the stated gold reserves of all the world's central banks put together.

What does this number mean? How should it be interpreted? Is it really as large as it looks?

Analysts are unlikely to agree.

I look at it this way. If the net short physical position is 10,000 tonnes, and if that position has been fully hedged (far from certain), the total notional value of all that business should be around 20,000 tonnes. In that event, using 26,000 tonnes as the total notional amount for all gold derivatives, the net short gold derivatives position -- over and above the net short physical position -- is about 6,000 tonnes, and the bullion banks have undertaken to deliver this amount in addition to what they must deliver to cover the net short physical position of 10,000 tonnes.

In other words, as I define it, the net short gold derivatives position is the amount by which the total notional value of all gold derivatives exceeds twice the net short physical position, and it must be added to the net short physical position to get a total net short position -- that is, the amount of gold that the bullion banks are committed to deliver on their outstanding paper. This formula effectively assumes that the net short physical position is fully hedged with zero risk of default but that any derivatives position in excess of twice the net short physical position is as a practical matter wholly unhedged in terms of reliable physical gold.

To return to the two alternatives posed earlier, is it possible that the physical gold borrowings underpinning total notional gold derivatives are larger than thought, thereby reducing, assuming they are credibly hedged, the net short gold derivatives position? Of course it is. Here are the obvious possibilities.

One, the central banks have on a net basis leased more gold than thought, thereby increasing the liquidity base of the gold derivatives market.

Two, the central banks have on a net basis sold more gold than thought, and this gold has remained within the gold banking system -- that is, sold to investors or others who have deposited it in unallocated accounts.

Three, the central banks have written covered calls in far greater volume than thought, thereby providing an additional sound base for gold lending.

All these possibilities require that the central banks on a net basis reduce their combined official gold reserves by much more than they have suggested they are willing to do or have done.

Indeed, looking at what central banks say and allowing for significant private lending as well, it is very hard to come up with even 7,000 tonnes as a net short physical position. In that case, the net short gold derivatives position would be 12,000 tonnes (26,000 - 2 x 7000), and the bullion banks are in even more parlous condition under my rough formula.

But whatever the exact numbers, and whatever the motives of some of the bullion banks or the officials who have supported them, there is a far more fundamental but apparently unrecognized problem here. By historic standards, the bullion banks are operating with wholly inadequate gold capital and gold reserves for the very extensive gold banking business that they have built.

Everyone, bankers and regulators alike, appears to have assumed that gold derivatives are a more or less ordinary variety of commodity derivative. However valid this assumption may be for markets like the COMEX or the TOCOM having open interest of only a few hundred tonnes, or for a single bullion bank with gold derivatives of similar size, it is dangerously false as applied to a total gold derivatives market where deposits or their equivalent exceed 10,000 tonnes. Exposures that amount to but fractions of annual new production are one thing; a total exposure equal to several years of new production is quite something else.

The Basle Capital Accord provides two methods for determining capital adequacy for off-balance-sheet gold derivatives: the current exposure method and the original exposure method. Without going into the details of these formulas, which are basically the same as for exchange rate derivatives, suffice it to say that the capital adequacy requirements range from 1 percent of total notional value for maturities under one year to 7.5 percent (or higher under the original exposure method) for contracts over five years. These percentages are less than those for equity, other precious metals, or other commodities derivatives. Further, there is no requirement that any of the necessary capital be held in gold bullion.

Under this regime, largely on the basis of deposit liabilities by the central banks and others amounting to something like 10,000 tonnes, the bullion banks have built a gold lending business of equal size, to which they have added a net short derivatives position of another 6,000 tonnes. All this has been done at gold prices in the $300/oz. neighborhood. And so far as can be told, almost all the gold deposited with the bullion banks has been sold into the market and disappeared from the gold banking system to India and other parts of the Middle East and Asia.

Accordingly, where by traditional standards the bullion banks should be holding in their own vaults on the order of 5,000 to 6,000 tonnes of gold reserves, under the new gold banking paradigm they are apparently almost completely naked to about this same amount of gold liabilities.

On an individual basis, perhaps, the gold derivatives business of some bullion banks may look like commodities trading. But taken as a whole, the gold derivatives business of all these banks has evolved into nothing less than full-scale gold banking, which done prudently has always required immediately available gold reserves equal to 35 to 40 percent of deposits.

This situation is ironic testimony to the true nature of gold as permanent, natural money. Bankers and governments could not abide the discipline of the gold standard, even in watered down forms such as the gold exchange standard or Bretton Woods. But even after expunging from the banking system any formal role for gold, neither the central banks nor the private banks capable of acting as bullion banks could resist the temptation to engage in gold banking. As money just lying around, the allure of gold proved too strong for the bankers, who, now calling it a commodity, proceeded to reestablish an enormous gold banking business while disregarding all the prudential rules that several hundred years of gold banking experience had taught.

In the process they fostered the illusion that low gold prices demonstrated confidence in their paper money system whereas in fact these low gold prices reflected only the reckless abandon with which they were creating paper gold liabilities in lieu of physical gold.

These low gold prices had two further deleterious effects. First, they encouraged the flow of physical gold to parts of the world where gold's true value is still appreciated, and from which only much higher prices will cause it to return. Second, they decimated the gold mining industry worldwide, all as brilliantly set forth in John Hathaway's newest essay, "The Folly of Hedging":
(www.tocqueville.com/brainstorms/brainstorm0067.shtml).

An old saying, long forgotten, is about to take on new life: "There's no rush like a gold rush, and no run like a bank run." In these circumstances, the safest gold is not in bank storage of any variety. It rests in more imaginative places: the snake pit, the closet with the black widow spiders, or buried in the backyard near the Doberman's bone and well within range of his leash.

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* Reginald H. Howe, proprietor of The Golden Sextant, is an author and private investor. A graduate of Harvard College, Harvard Law School and the Bologna (Italy) Center of the Johns Hopkins School for Advanced International Studies, he began his business career in 1964 as a financial analyst with the international division of The Kendall Company. From 1976 to 1984, Mr. Howe was a partner in the Boston law firm of Palmer & Dodge, where he specialized in civil litigation and was a member of the firm's investment committee. He was an associate at the same firm from 1970 to 1976. In 1983, Mr. Howe organized Golden Sextant Associates, a general partnership for investing in developing North American gold mining companies, and he served as its managing general partner until its profitable dissolution in 1987. For a few years thereafter, he continued as a sole legal practitioner and served as a registered investment adviser to private clients.

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# Chronological Commentary on the Manipulation of the Gold Market

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Prepared For

***The Gold Anti Trust Action Committee Presentation to***

***The Congress of the United States***
***May 10, 2000***

By

Bill Murphy
Chairman, Gold Anti Trust Action Committee

**Sept. 9, 1998** -- As stated in the last Midas, there is "Guns of Navarone" type of resistance at **$290** basis Dec.

**Sept. 23, 1998** -- Disaster hedge fund stories continue to proliferate. This one in particular may be a "biggie" for gold players. Last year we were informed a Mr. John Meriwether was short some 350 to 375 tonnes of gold. We have informed you that his firm, Long Term Capital Management (a misnomer if there ever was one) has gone belly up. Today their management met with 17 commercial lenders to bail them out and come up with a plan to keep them from having to liquidate more of its positions to meet margin calls. For the very serious, potential significance of this story, see below.

**Sept. 25, 1998** -- And that brings me to the most intriguing possibility of all. If the Fed, and banks not even involved in the Long Term Capital Management (LTCM) fiasco, had to do the unprecedented by stepping up to the plate to try and arrange a solution for the huge derivative problem that LTCM faced, what else could the Fed be up to? For a very long time now we have been harping about the incredibly large short gold positions by the hedge funds and what that liability could mean exposure wise. We made special note of this in the last Midas. Well, if we are correct and the hedge funds are short all this gold (true or not, it was last year that we heard Meriwether was short 350 to 375 tonnes) the LAST thing the Fed can allow in the very short term, is for the price of gold to take off too quickly.

The gold loans are cheap. Since the price of gold has not done much compared to the movement of other derivative positions, it would make sense the gold short would be one of the trades Long Term Capital Management (and other troubled hedge funds) still has on. That trade has not collapsed on them yet, so they have not been blown out as they have elsewhere. One thing the orchestrators (Fed and other banking institutions) of the bailout might do is borrow some gold from bullion banks and stop an out of control gold rally. An exploding gold market would undo their fixit plans for LTCM.

They need to buy time and figure a way out of this entire derivative problem. Besides, this potential problem (the gold borrowings) could be worse than the others. Where are all the hedge funds, that are short gold, going to find such massive quantities in a very short time period. That was the point of the Goldilocks and the Three Bears story. Does that sound far fetched? What would you have told me just months ago if Midas said that the Fed would puts its face in the business of a hedge fund and stop further repercussions from its irresponsible investment activities? The effects of this intervention and the ramifications of this bail out will be felt for years to come.

**Oct. 7, 1998** -- One of our more keyed in sources tells us that Long Term Capital Management has been let out of their short 300 tonne gold borrowing position by a

Central Bank in an "off market transaction". In our last Midas report, we stressed the fact that their short position was actually an impediment to the price of gold rising. There is no way they could just go out and buy 300 to 375 tonnes of gold at the market. That would have undone the "bail out boys" entire "save the system" program. Just look at the tremendously, violent bond run up and Yen run up. LTCM was supposedly short both of those and look what happened. Exiting the Yen short and short Treasury Bond positions was painful, but they could get out. Buying that amount of gold could have set off a world panic as other hedge funds and borrowers joined in to cover at the same time. A buying panic (instead of a catastrophic one) when the other big gold shorts try and cover down the road. We think this is important news for several reasons. It shows how desperate our government is to try and keep order.

**Oct. 15, 1998** -- Out of London, we hear that Ashanti may have recently just put out a seven million oz. forward hedge. Sam Jonah of Ashanti is a good man, but if we are right, I would not be a happy camper Ashanti shareholder. This selling is another example of how the producers continue to shoot themselves in the foot and helps to explain why gold set back recently.

**(Ashanti blew up in October 1999 as a result of their hedging policies. Goldman Sachs was lead hedging advisor.)**

**Nov. 24, 1998** -- We have insinuated in the past that "Something is Rotten in the State of Denmark" regarding the precious metals action. We are not the only ones that smell something is afoul. Nick Moore, is a very highly regarded base metals analyst for Flemings (Ord Minnett) in London. We heard that he was in N.Y. last week and also was not disinclined to say that the gold market was being controlled. This is not one of the gold family people like the Midas squad, so we were curious and gave him a buzz in London. According to Nick, what we had heard about his comments were indeed true. Some of the "buzz" that he had heard was that the U.S. was now leasing gold, but he made it clear that he had no confirmation of that.

**Nov. 30, 1998** -- In our last Midas, (Nov. 24) we spoke of the quiet buzz going around, that the gold price is being controlled. For some anecdotal evidence, we offered up Alan Greenspan's own comment: House Banking Committee, July 24, Alan Greenspan, "Central Banks stand ready to lease (i.e. lend) gold in increasing quantities should the price rise."

After the last interest rate cut by our Fed, we had a visceral reaction to Alan Greenspan's strong public mention of low commodity prices as one of his main reasons for the cut. This comment really hit home after his previous July 24 comment about gold. It appeared he was subtly making it clear that a rising gold price would not allow him to do what he wanted to do for the reasons he wanted to do them; certainly, a rising gold price would make his rate cut decisions more controversial. Therefore, we feared he might do what he could to keep the gold price from going up. His comments left an indelible effect.

**Dec. 9, 1998** -- Hit man sought to silence goon squad. Gold is trading very differently at times these days. Whoop up- then whack. Whoop up - then whack. It is trading much lighter as it pops up quickly on light volume and then the goons come in and sit all over it. This is a recent development and indicates less trade, scale up selling. It also tells us that our Fed and its CB cronies are still there; supplying whatever gold is necessary to keep gold from moving above $300. It would appear that some economic event might be needed to cause them to "give up the ghost".

**Dec. 11, 1998** -- Goldman Sachs (goon squad leader) was at it again today. They were the big sellers right after Comex opened. It cannot be more clear that they have become the designated agent to make sure that the gold market does not get through $300 for the time being. Cheap gold loans are being used in a massive way by hedge funds, banks and other financial entities to accommodate financial stress in their operations.

**Dec. 15, 1998** -- Goldman Sachs (goon squad leader of the gold cap sellers) reported its worst profit picture in four years today. Public reason given: poor bond trading. First we have J. P. Morgan come out and say they could not trade (stocks) their way out of a paper bag, last quarter, and now Goldman Sachs (with its hot line to Secretary Treasury Rubin) says it could not trade bonds worth a darn. Phooey on both of you. You are really caught up in the derivative mess and it is causing you big problems. You are the leaders of the gold capper selling cabal and are using cheap gold loans to help maneuver your way out of this mess.

It is clear that our Fed is orchestrating the formation of a Maginot Line around $300 gold. The Fed, by its own admission, had to bail out Long Term Capital Management. Has a Maginot Line been created so they will not have to bail out the Morgans, Goldmans and other Wall Streeters that are caught in derivative plays that have gone the wrong way and not resolved themselves yet? Goldman only reported a big drop in profits. What about the losing derivative trades that are still on the books that have not been reported yet? Could this have a great deal to do with the fact they have postponed going public?

I must say that anecdotal event after anecdotal event says that our theory about what is going on in the gold market is on target. In recent times, the derivative markets have grown exponentially. The trading was fostered to a great extent by borrowing cheap Yen and gold. Certain types of derivative trading had never been tested in a recession. Trades started to go awry (Long Term Capital Management went bust). When the Yen surged from 146 to 113, it caught the derivative community even more off guard. Many derivative trades went further south. Our own Fed was surprised by the extent of the moves (probably why Goldman did so poorly). The Fed had to bail out Long Term Capital Management for fear of "systemic risks" if it did not do so.

Derivative trading in the financial community was then scrutinized by the Fed and top management of financial institutions. A horror show was probably revealed. It certainly is the case that the LTCM crew, who managed to suck in Central Bankers as investors, was not the only financial entity in trouble. Gold lending by UBS and Merrill Lynch helped foster derivative schemes over the years. They know what they helped wrought. They also know how big the gold loans have become (probably 7,000 to 14,000 tonnes). It is important to remember that the gold loan area is a shadowy, secretive one. Very few really know what is what in this area. UBS and Merrill would have as good an idea as anyone would. Sensing serious potential danger that the gold loans have become too big to cover in a crisis, they have recently said "Sayonara" to the gold lending and derivative game.

Since some of the big lending players have pulled out and gold supply to the market has been reduced, Goldman Sachs was called on by our Fed to lead a goon squad of sellers to bash the gold market on rallies up to $300. The reason they are capping the gold market is to try and buy time so that losing derivative trades can right themselves. It is clear that the Fed knows the extent of these trades and what could happen to the financial system if they blowup, (they acknowledged this fact publicly when they bailed out Long Term Capital Management).

**Dec. 17, 1998** -- Like clockwork. The price of gold rallied from the lower end of its base and then was mauled today by the same group of sellers. They are relentless and it is clear that the cabal is part of one Fed orchestrated agenda that has been put in place. The best that we can do is to continue to monitor signs that they are losing control of the game that they have decided to play. Moreover, we will do so with great vigilance.

The same group went after silver causing it, at one point, to give up all of its 19-cent gains that it made yesterday. Silver has never traded like this ever before (see below). The gold selling today kicked into high gear when the lower house of Switzerland's parliament approved a constitutional amendment that would sever the Swiss Franc's peg to gold and allow the sale of 1300 tonnes of gold reserves over a period of time. It is only the first step in a process that must culminate with a popular referendum in the year 2000. This was totally expected. The real news is that they have asked the government "to present a legal framework detailing the request". According to Bloomberg, this will postpone Swiss Bank gold sales an extra year to 2001, if they happen at all. Outrage!

I am so mad I feel like screaming out the window like Peter Finch did in the movie, "Network". The difference between the two of us is that, while mad and screaming, I am only warming up and I can take a lot more. I hope you are outraged too. What our government is doing to manipulate the gold and silver markets is scandalous. Goon squad leader, Goldman Sachs, was the big seller again today. What is nauseating is that this is becoming so transparent and we hear so few outcries. Case in point is silver. TWICE now, silver has recently breached $5 to the upside and the very next day it has been broken back down by the goon squad by as much as it went up the day before. Never before, has there been anything like this. After a breakout out of a base like we just had, silver (or any other commodity) might run up to, at least, say $5.25. The specs would come in, and if the fundamentals did not justify it, the price might collapse. That could happen over a two week to a month period. That goon squad is so afraid of something, they will not let silver stay over $5 even for a day. Moreover, they have acted precipitously twice now to bash it down. How badly is the financial stress behind the scenes that they fell they have to be so concerned about the price of silver staying over $5? This smells to high heaven. It is only a matter of time before the situation gets out of hand and they have to pay for their arrogant, price manipulating ways.

**Dec. 21, 1998** -- Midas followers know that we think that the price of gold is being artificially suppressed in an orchestrated fashion led by US financial officialdom. The anecdotal evidence of that being the case is overwhelming. You know that we believe that Goldman Sachs is the visible ringleader of this effort. They are pros and are good at what they do. They come in and pound at just the right strategic times to attract other sellers. They sell a negative producer price index, they sell late Fridays when Europe and Asia are mostly closed, and they sell news events to attract commentary that is bearish, no matter how many times that same news event has been sold.

**Jan.7, 1999 --** 12 major banks chaired by Goldman Sachs and JP Morgan today formed a "Counterparty Risk Management Group" with the intent of enhancing best practices in credit and market risk management. The policy group will develop standards for strengthened risk management practices.

**Jan. 12, 1999** -- The Goon Squad acted right on cue. Last Friday, one of our sources made a very specific comment to us that he saw bullion houses cap the gold market rally. The comment was made that it was clear to him that borrowed gold hit the market to make sure the gold rally did not carry too far.

Knowing what was going on, one of the Leaders of the Pack, JP Morgan, came out singing at exactly the right time. Their precious metals analyst, Kevin Crisp, released a report today in London predicting gold prices would fall in early 1999 as the "market focused on supply and demand issues, **deflation in Southeast Asia and the drop in inflation in Europe and the United States".**

Reuters -- London -- Jan 12. 1999 -- " Even though significant event risk remain in global markets -- economic, political and financial -- we see no reason to believe that gold will respond any differently than it has in the recent past," Crisp said. "We forecast the gold price will average $280 in 1999, but will trade as low as $265 per troy ounce before the end of March."

The Goon Squad acted right on cue. Last Friday, one of our sources made a very specific comment to us that he saw bullion houses cap the gold market rally. The comment was made that it was clear to him that borrowed gold hit the market to make sure the gold rally did not carry too far. Yesterday, gold moved up a bit anyway as the Yen soared. When the Japanese government intervened today, the market was heavier than it looked with available gold and the market "sold off".

The Midas camp continues to believe that there has been, and is, an orchestrated effort to cap the gold price. This effort has been promulgated by our Fed, other official sectors, and a group of New York financial institutions. JP Morgan and Goldman Sachs just formed a crisis risk management group with 10 other financial institutions to handle emergency situations. It is our opinion that management of all their huge gold short positions is one of them.

**We reiterate this point, because if we are correct about all of this, something has to happen to trigger an upward move in the gold price.** This Goon Squad has been beating the gold market to death -- forcing it into financial oblivion and off the radar screen of many investors. The "squad", and this gold price capping camp, sell at strategic times. They make a point of making public statements that the price of gold cannot rally because of outside events. The press eats it up and prints it. The gold and silver markets have not rallied as a result of external events in years, (although that should change very soon-see below), so there is no reason yet for that to be the case now. They put out that sort of thing to the press anyway to spread the bear story. They want to make sure to tell you not to buy gold in a future crisis because that effort will be futile. However, the real bear story is that they make sure gold does not rally very much at any given point. One of the big sellers again today was their crisis associate, Goldman Sachs, of course!

Our camp believes, ironically enough this cabal is actually desperate in a way. They know -- I repeat, they know they have a tiger by the tail. They are all heavily short. They must find a way out of this, or they could be in serious trouble. They could not cover their short positions if they had, or wanted, to. There is just not enough physical gold available in the short term to accommodate their needs.

**Jan. 20, 1999** -- We are pleased to say that we have raised to the level of awareness about the "Goon Squad" and their activities. Queries have come back to us from everywhere: "Could Goldman Sachs (Secretary of the Treasury, Rubin's, former firm) really be a part of a cabal that has been holding down the gold price?"

The gold mine supply for 1998 was 2,529 tonnes according to GFMS, a leading trade organization. Demand for gold for 1998 is expected to be around 4,159 tonnes. That means that there is a 1,600 tonne natural deficit (demand over mine supply) that has to be filled by gold from scrap supply, the Central Bank coffers, forward hedge sales from producers, or leased gold. Gold can be leased and sold into the market place (adding supply) due to its cheap borrowing costs (say 0.75% to 1.8%) The resulting cash from the sale of the gold is then used for a variety of investment purposes. This is similar to what was done with loans borrowed in Yen.

The Yen carry trade was a big winner for years. It was fostered by incredibly low interest rates in Japan. Money was borrowed in Yen and then invested in, say, US Treasury instruments. Our Treasury loved it as it supported our debt instruments, keeping interest rates lower than they would have otherwise been. It also has fostered the credit bubble that is fueling the stock market bubble. As long as the Yen remained flat against the U.S. Dollar, or did not gain against the Dollar, this trade was a windfall winner for banking proprietary trading operations and the hedge funds. When the Yen rose from 146 to 111 in the late summer, the Yen carry trade soured for many of the "Johnny Come Lately" borrowers. Now, they had to face principal losses that skyrocketed their realized borrowing costs to 20% and more. AND, some of their "risk free arbitrage trades" also went amuck, compounding the situation. Voila -- Long Term Capital Management.

The big boys scored early and big with the Yen carry trade. If it could be done with Yen, why not gold? The gold loans were similar to the Yen loans in borrowing costs. As long as the price of gold did not take off (so that the principal did not have to be paid back as a result of a much higher gold price and thus making the loan an expensive one), it was a winner.

In the old days, gold was only lent out to fabricators and producers by bullion dealers. That was before the golden age of "gogo" Central Bankers. Before the days when they (The Central Bank of Italy, for example ) began to invest in the likes of Long Term Capital Management. But, when the word leaked out (the Wall Street "in crowd" always gets the "leaks") in the winter of 1996 that the Central Banks were going to be dumping some of their gold holdings, the bullion dealers and hedge fund jumped into bed together.

The bullion dealers made money by encouraging the producers to hedge and by lending out their bullion to willing borrowers. One fed on the other, the gold supply hitting the market ballooned, the gold price collapsed. Not only did the borrowers have money at a very low borrowing cost, they had a bonanza windfall profit because they could pay back their loans with much cheaper gold.

All has been well for those playing this game. Until NOW! The price of gold has been trading around the low $290 area for about a year and one half now. Deflationary forces have taken hold and the bears have fostered the notion that there is no reason to own gold. "Look how lousy it acts and look at its lowly price" has been the commentary dished out to the press. Behind the scenes, however, there is entirely different "wordspeak" going on.

Remember that deficit. It is some 1,600 tonnes. That means to keep the price of gold down here, the scrap people, Central Banks, gold borrowers and producers have to feed 1,600 hundred tonnes of gold into the market place. But, times are a changing. Many producers are not so comfortable selling gold forward at these low prices (therefore gold supply is reduced).

The pre-EMU Central Bank selling is over for the most part. Dow Jones - Frankfurt - Jan. 7, 1999 -ECB Vice President Christian Noyer - " the national Central Banks (ESCB) will keep their gold holdings for the foreseeable future". The ECB has also made well reported statements that is has no plans to sell any of its 15% foreign exchange gold reserves in the formative stages of the creation of the Euro.

That leaves the gold borrowing crowd and gold scrap people to feed the "junkie" bear habit and supply heavy tonnage of gold to the market place. The gold market has little transparency. No one really knows what is what. It is very, very hard to find out what the facts are in the gold market, especially about the gold loans. The best work on this subject was done by Frank Veneroso of Veneroso Associates. As a result of yoemen, Sherlock Holmes like detective work, he has come to the conclusion that the gold loans have risen to 8,000 tonnes, or so. This is a big deal as gold mine supply in 1998 was only 2,529 tonnes. If the shorts had, or wanted to cover, in a short time period (like they tried to do in the Yen carry trade) there is not a chance in China that they could do so. What is worse, many of the borrowers may have, or had, no idea, until recently, how large the gold loans have grown.

The "jig is up" time, is here! Enter Long Term Capital Management (LTCM). When this Nobel Prize winning led hedge fund blew up last fall, it was discovered that they had a big short gold position of say 300 tonnes that had been sold into the market place. Again, the proceeds were used to finance their "so called" riskless arbitrage trading positions.

When the Fed and fellow financial institution big shots came in to bail them out to prevent a "systemic" financial crisis", they found out about their short gold position. What to do? A buyback of 300 tonnes, or so, in a short period of time would cause a sharp up spike in the gold price that already was moving up as a result of the serious collapse of this hedge fund. Thus, they arranged an "off market" transaction with someone, or someones, to let them out of the "squeeze".

Back to the ranch. What is to be done about the gold loans? The Fed and the big shot financial boys in New York had to learn about the size and potential problem of the gold loans when they discussed it with each other during their scheme to bail out LTCM. I am absolutely convinced they found out how large the gold loans were, JUST in that group alone. "Good grief!", they must have collectively thought. They had to come to a consensus to try and develop and exit game plan.

Maybe the plan (not conspiracy) went something like this:

1. Foster the notion that gold is a "dead duck" for the time being. Make sure that your highly respected analyst reports project dismal future gold prices. This will encourage producers to sell rallies and help to continue to attract gold borrowers for leased gold.

Whether planned or not, the gold price projections for 1999 by this "in crowd" are very uninspiring. We know for a fact that one of these heavyweight institutions TOLD their respected analyst to come up with a bearish projection.

2. Make sure that gold is available for forward hedging purposes to the producer community.

Whether planned or not, Goldman Sachs was running around last fall offering credit terms to producers (South African in particular) at previously unheard of credit terms. Practically, no credit restrictions at times, at all. Just do it.

3. Defend the $300 price area at all costs for the time being. Every time, gold breaks through $300, kill it. Defend your positions and discourage gold buying as it approached $300 in the future and encourage producer hedging right below $300. We will make sure the gold is available for any of you that need it to do so.

Nice to have a little help from your friends. House Banking Committee, July 24, 1998 -- Alan Greenspan -- "Central Banks stand ready to lease gold in increasing quantities should the price rise".

Now, why did Alan Greenspan utter this in the first place? Gold traded at $385 for years and that did not bother anybody. What is he trying to protect? Why mention mobilizing gold reserves when gold is trading below $300?

Whether it was planned or not, the price of gold has been bombed every time it has reached, or tried to reach, the $300 area the past six months.

While Midas du Metropole is shouting this from the mountain tops: "If it looks like a duck, acts like a duck, trades like a duck, it is probably a duck." We are not the only ones who are aware about the time bomb, explosive nature of the gold loan situation.

Bloomberg -- Nov 26, 1999 -- Sydney -- " Normandy Mining Ltd. said it will realize 85 percent of the value of its forward gold sales booked over the next 10 years, giving it a profit of A$650 million. The Australian miner, one of the world's 10 largest gold miners, said it bought back 4.1 million ounces of its previously contracted gold sales, and says it replaced the sales with options.

Reuters -- Nov. 25, 1999 (US time) -- Sydney -- **"The transaction will simultaneously eliminate potential bank counter party risk," Normandy said in a statement.**
Why did Normandy even bring up "counter party risk"? What do they know?

The two most vociferous, and right on, pontificates of the bear case the past few years were Merrill Lynch and Union Bank of Switzerland. They encouraged their clients to go short and encouraged gold borrowing. They, more than anyone else, would have a very good idea of how large the gold loans have become. Whether planned or not, both have withdrawn from the gold derivative business. They were so right on the gold market. Why did they exit the gold derivative business? They were the bears' heroes!

Whether planned or not, 12 major banks chaired by Goldman Sachs and JP Morgan in early January formed a "Counterparty Risk Management Group" "with the intent of enhancing best practices in credit and market risk management. The policy group will develop standards for strengthened risk management practices". We realize this group was not just formed because of the gold issue, but why the need for it to be formed now? Is this not a "cabal planner" of sorts.

Looks like a duck to me!

Why did Terry Smeeton, who recently retired, as top official at Bank of England, completely clam up about the size of the gold loans when confronted? Why did a top executive of one of these 14 banks turn red when confronted about the same issue last weekend?

CFTC Chairwoman Brooksley Born sent a letter of resignation yesterday to President Clinton, because her efforts were thwarted.

**From one of her speeches,** -- "While the CFTC and the U.S. futures exchanges had full and accurate information about LTCM's exchange-traded futures positions through the CFTC's required large position reports, no Federal regulator received reports from LTCM on its OTC derivatives positions. Notably, no reporting requirements are imposed on most OTC derivatives market participants. This lack of basic information about the positions held by OTC derivatives users and about the nature and extent of their exposures potentially allows OTC derivatives market participants to take positions that may threaten our regulated markets or, indeed, our economy without the knowledge of any Federal regulatory authority."

**THE FEDERAL RESERVE AND THE TREASURY DEPARTMENT HAVE BEEN THE MOST PROMINENT CRITICS OF HER REVIEW OF DERIVATIVES.**

**Feb. 19, 1999** -- The Comex open interest, at 186,925 contracts is near recent high levels, as the "specs" remain very short. Resistance is "Rock of Gibraltar" solid at $290. That area has become as intense as the $300 area was earlier. There is probably a good reason for that. It is the gold borrowers who are holding down the price of gold. To keep the price down, they have to keep borrowing. A move up to $300 now is a 3% loss.

**Feb. 25, 1999** -- NEW YORK, Feb 24 (Reuters) -- Following are excerpts from the question-and-answer session after the second leg of Federal Reserve Chairman Alan Greenspan's semiannual Humphrey-Hawkins testimony before the House Banking Committee on Wednesday:

REP PAUL: "Is the price of gold still valuable as an indicator and a monetary tool as in the 1960s and does the government still buy and sell gold?"

GREENSPAN: "The price of gold has over the decades been a generally usable indicator of what the level of inflation has been. Obviously, during the period of the active gold standard, which was really prior to World War I, the price level locked itself into the gold price and by definition it did."

**MOTIVE ABOVE**

**Mar. 17, 1999** -- Treasury Secretary and former Goldman Sachs honcho, Robert Rubin: Reuters -- March 17, 1999 -- "The International Monetary Fund will probably sell 5-10 million ounces of gold to fund a program of debt relief but will not disrupt the markets with its sales."

**Mar. 26, 1999** -- Goldman Sachs and crew were very heavy buyers on the spike down in the gold price early this morning and they came in again as heavy buyers around mid day. The big sellers today were notorious funds such as John Henry and Moore Capital.

**Mar. 31, 1999** -- For years the collusion crowd has taken in the gold and silver black box fund traders such as John Henry. So much so that mega trader John Henry announced on April 26, 2000 that they were giving trading silver and cut back gold trading 40%.

**Apr. 9, 1999** -- Down and dirty. This is how we see it. On March 12, the large specs were short 70,000 contracts. We know that Goldman Sachs and cronies were big buyers around $285. The market runs up and stops in the mid $290's. We reported to you that Goldman Sachs was running around the countryside telling all the producers to sell.

"Liquidity" suddenly was everywhere. On March 26, the next report shows that the entire short position was taken out and reversed a bit on a move of only $9. Extraordinary! Gasps were heard through the Internet. Midas put out commentary that "Down" was ahead of us. Down we went and $285 was taken out easily. So was $280. New lows for the move.

All of a sudden the "squad" led by Goldman Sachs are big buyers again. We have reported that to you. They have been buying around the $280 area. So have their "compadres". That is why the commercials are so long (bullion dealers are listed as commercials).

**Apr. 13, 1999** -- But, today we received reports that at the Morgan Stanley Gold Conference, gold producers reported being harassed by Goldman Sachs to sell forward. And then the Treasury, run by former Goldman Sachs CEO, Robert Rubin, comes out again with another press release today after the gold close, urging the International Monetary Fund (IMF) to sell gold. Washington DC -- April 13 -- Reuters --U.S. urges Congress to help fund debt relief. The U.S. Treasury on Tuesday urged Congress to help fund an ambitious program of debt relief, authorizing gold sales from IMF reserves and stepping up bilateral help.

The bottom line is are the gold manipulators with their market trading followers setting up the market for another hit after the "specs" are run out of town once again? That would be easiest for the manipulators to do by selling into a "spec" buying panic and reversing their recent buying and then returning to the sell side. The moving averages start to turn above $285. The "biggies", the 100 and 200 day moving averages, sit today at $288.60 and $290 respectively. If gold does rally to that level and does not soar if those levels are taken out, you can bet your bottom dollar, the manipulators are playing their games again. The price of gold must shoot up sharply at times in the days and weeks to come or "It's the Same Old Song" and will have gold market players spinning like "The Four Tops".

Remember, the "specs" covered 70,000 contracts last time and the market hardly budged. That produced gasps of surprise and despair. The price of gold then plunged. In normal, free trading markets, that does not happen. Once maybe it could happen, but twice in a row? Now, the "specs" are short a staggering 100,000 contracts. Soon we should either be watching some serious bullish fireworks or another obvious revelation about market manipulation.

From John Hathaway, a Senior Portfolio Manager at Tocqueville Asset Management L.P. and portfolio manager of The Tocqueville Gold Fund: On Friday, March 12, 1999, hedging managers of gold producers received phone calls from a leading bullion dealer asserting that the gold price rally was over. At the time, the gold price had just barely broken above its 200 day moving average, a key chart point. Further upside could have damaged the equity and bond markets, as the Federal Reserve has stated that it watches gold to predict future inflation. A strong showing by gold would force the Fed to raise interest rates..

**Apr. 19, 1999 --** Let the good times roll! Would you believe nine out of 10 days. That is how many days gold has closed higher. Today, was a surprisingly quiet one as we stick to our bullish guns. Stops were moved up a bit to the $287.50 area basis June. A move into that price point should give us a $6 up day and some serious excitement. We will have decisively breached the 100 day moving average by then and should just zoom right up to the 200 day moving average around the $290 area. If the gold market has delinked from its manipulated near term history, we are set up for a dramatic move to the upside, for which few are looking.

**May 6, 1999** -- We know "the squad" are all lining up to try, one more time, to stifle a decent gold move to the upside. Deutsche Bank, Chase, Swiss Bank and Goldman Sachs were all there selling gold during today's session and, when they had to, even throwing the kitchen sink at the bulls attack. Deutsche Bank has been especially aggressive and noticeable in their selling the past few days. **We got word late this afternoon that their bullion desk is calling their clients saying that the gold market is stopping at $290.** I don't think Midas followers will be surprised when we tell you that big sellers late in the day today and taking on all bids were "Squad" honchos Goldman Sachs and Deutsche Bank.

**Bank of England Coming Gold Sale Announcement made on May 7 "England announces sale of up to 300 tonnes of gold -- gold drops as much as $10 per ounce."**

**May 10, 1999** -- Based on the tremendous feedback we have been receiving from around the world, it is clear that most market participants now believe that there is an orchestrated effort by certain "officialdoms" to hold down the price of gold. We have been saying as such for the past five months and we just take it one step further by suggesting that this orchestration includes "collusive market activity" by various bullion dealers. We do not know why GATA's allegations should rankle so many people. The U.S. Justice Department has subpoenaed many of these same institutions and is investigating them on suspicion of the same price fixing, anti-trust violations that we are looking into. The trading patterns alone in the gold market these past six or seven months suggest that something is very amiss. Markets don't just happen to trade like this by accident. We only ask for market observers to have an open mind.

Did you ever wonder how smart Bob Rubin really is? Do you suppose when he left Goldman Sachs in 1992 that he had this great plan? Move to Washington DC and take over the economic apparatus. Use his market knowledge to get the stock market up

500%. Manipulate the gold price to keep inflation down to zero. Allow Goldman to sell itself to the public at huge multiples. Then get out of Washington DC and back to the Street before anyone caught on!

After this morning's surprise, at least there is no longer any doubt among the gold cognoscenti about one thing. There is indeed an orchestrated effort to take the gold price capped.

One could imagine this: since the Swiss referendum to sell gold and the IMF deliberations to auction gold have not been sufficient to hold the price down - in fact the price is UP - that Rubin had to revert to Plan C. The US Congress would be unlikely to buy into this, so U.S. puppet Britain was the quickest route to an immediate dumping.

The inflation scare of the past three weeks has seen capital rotating into resource and cyclical issues. Bond prices tanked. Precious metals then start to rear their 'ugly' head. Greenspan runs to the media with his canned warnings. And Rubin, still hiding in the shadows, hits the red alert button.

If the scuttlebutt is even partly true, Rubin wants to get out of DC before the end of Clinton's term. One eye on the exit door and one eye on his legacy, he needs to keep the stock market up, bonds steady, gold down.

Posting 2: **May 12, 1999** -- Goldman Sachs and Deutsche were all over gold today, selling it in "boatloads". They were all over it yesterday too…

Thus, the conspirators, especially our administration, made the call to the English Poodle to devastate the gold bulls with this dramatic announcement Before doing so, the "squad" (Goldman Sachs, J.P. Morgan, Deutsche Bank) were obviously given the word and they told their big name clients that, "the price of gold will not go above $290".

The Bank of England and the British Treasury made this gold announcement under severe duress and in near panic. In time, this will become more apparent and someone is going to have to answer many, many questions. In the meantime, GATA will continue to alert The Banking and Financial Services Committee to this time bomb and hopefully they will learn what we know and take action. The longer this goes on, the bigger the problem will be down the road.

Ms. Haruko Fukuda, Chief Executive of the World Gold Council, seems to agree somewhat with GATA on the raison d'etre for the decision by the British Treasury. She made these comments yesterday to a London conference:

"Gold is at once a commodity and a universal currency. Is the British Chancellor of the Exchequer challenging that long-held assumption by bringing the gold ratio down to a mere 7% of the UK's total official reserves? Or, was there another hidden political agenda? We at the World Gold Council have been told by HM Treasury that it was emphatically a political decision."

**May 18, 1999** There is a method to this madness and sound reasoning from their perspective. The powers to be and the "bullion boys" knew the gold was about ready to rocket as the price approached the $290 area. Reports were surfacing that expectations for much higher gold prices in the near future were rampant. Stockbrokers were experiencing the highest order volumes for the senior gold companies that they had seen in many years. We highlighted the fact to you that the Australian gold shares experienced their biggest surge one-day in six years.

The bears knew $290 had to be protected as that was where many of the present gold borrowings were initiated and a move much above that point could create a bandwagon effect of encouraging new spec buying and causing some of the gold borrowing shorts to run for the hills by buying back bullion to close out their leased gold positions. That sort of combo buying was threatening the control of the gold price that the "gold cartel" had in place.

The bears had (and still have) a problem. The natural supply demand deficit was eating into all their "borrowed gold selling". The collusion was about to unravel. They had run of out bullets as all the talk about IMF and Swiss gold sales was so overdone and so over hyped that it had become stale and had lost its effect.

Desperately, they pulled a trump card out of their hat and in doing so may have sealed their own doom down the road as the story is played out. It is no secret that the Bank of England (BoE) is distancing itself from the Treasury on the sale of the English gold. The recently retired Terry Smeeton, a "lifer" at the Bank and former number two man at the Exchequer, would never have made those negative comments about the BoE sale without some sort of higher up approval.

The word is out that it what a "political" decision to sell the English gold. Now what does that mean? Why was a political decision made to sell gold right as it was about to break out of a very strategic point? Why not wait? Why was this political decision made at a time when several bullion dealers were telling their clients the day before the BoE sale that the price of gold would NOT go north of $290?

**May 25, 1999** -- The big sellers early today in the cash market were Goldman Sachs (once again) and Morgan Stanley. Our take on the gold market is very clear. Unless something is done to break up the cartel of bullion dealers that are terrorizing the gold market in a collusive manner, or some outside market factors come into play that force them to cover their outrageously large short gold positions (which fortunately could happen very easily), the price of gold will go nowhere. The gold producers, other gold companies, gold stock shareholders and believers in free markets must fight back. If not, here is what we have to look forward to, and speaking for GATA, we will not stand for this.

**June 11, 1999** -- Do we really want to pick on Goldman Sachs? No! It is just that everywhere we turn, there they are. Needless to say, they have been noticeably on the sell side almost everyday since the BoE announcement. Yesterday (with Fed emergency meeting rumors all over the street), they were finally buyers.

Meanwhile back at the ranch, Britain's Finance Minister, Gordon Brown, was all over the tape yesterday talking about the righteousness of his gold decision and also that he was confident of an agreement about IMF gold sales by autumn. What timing! Just as bond yields are surging and there was to be news about potential hedge fund problems. This is more than redundant and sad, it shows desperation. Gold has dropped $30 and he has to come out with this headline, U.K.'s Brown Sees Wide Support for IMF Gold Sales.

**June 19, 1999 ASSOCIATED PRESS**
RENO, Nev. -- Sen. Richard Bryan is assuring gold producers in Nevada and around the world that Congress will block the Clinton administration's attempt to sell off international gold reserves to help some debt-laden poor countries. "It requires congressional approval. It ain't going to happen," Bryan, D-Nev., said today from Washington.

Bryan, a senior member of the Senate Finance Committee, outlined the dim prospects for the International Monetary Fund gold sale during a confirmation hearing Thursday for Lawrence Summers, the current deputy Treasury Secretary.

Bryan intends to support President Clinton nomination of Summers for the top Treasury job, but vowed to block any effort to sell off 10 million ounces of IMF gold reserves. The selloff would devastate world gold markets already hovering around 20-year lows, and probably hurt the heavily indebted countries the IMF is trying to help, he predicted. Not to mention harm miners in Nevada, which is the world's No. 3 gold producer behind South Africa and Australia. The state had a record output of 8.86 million ounces last year, worth $2.6 billion. But low prices have led to layoffs.

"The recent drop in the price of gold has caused the layoff of over 1,000 mining employees in the State of Nevada alone," Bryan said.

Other high-powered Senate opponents of the IMF gold sale include Minority Leader Tom Daschle, D-S.D., and Frank Murkowski, R-Alaska, Chairman of the Energy and Natural Resources Committee.

A White House spokeswoman said today there was no immediate response to Bryan's assurances that Congress would reject the sale.

**June 29, 1999** -- What this story fails to say is that Senate Minority leader Tom Daschle and a good number of Democratic senators have already come out publicly against the IMF gold sale.

Hot off the press and just in: Reuters June 29, 1999 -- Washington DC - House Republican Leader, Dick Armey on Tuesday **denounced** the proposed sale of

International Monetary Fund gold to help reduce poor countries' debt and said he would back legislation to block the proposal.

**July 6, 1999 Reuters -- July 6, 1999 -- London: Major gold miners seek Blair statement on UK sales**

"Executives from some of the world's leading gold miners demanded on Tuesday that British Prime Minister Tony Blair answer rumours that UK gold sales were timed to help out speculative short sellers in the market.

"The letter arrived as Britain sold 25 tonnes of gold, the start of a programme intended to cut reserves from 715 tonnes to 300 tonnes during the next few years.

"Chairman and chief executives at Canada's Placer Dome Inc., U.S. miners Newmont Gold and Homestake Mining, South African's Anglogold and Gold Fields Ltd. and Ghana's Ashanti Goldfields, sought Blair's response to rumours that reserve sales were to bale out firms running short positions in gold.

The letter, a copy of which was faxed to Reuters, quoted parliamentary remarks made by British opposition MPs on June 16 suggesting Britain's announcement of reserve sales had been to "save the bacon of those firms running short positions".

"We believe it would be helpful for you to make a public denial of these rumours or investigate them publicly", said the letter, signed on behalf of all the companies by Place Dome Inc. President and CEO John Willson." End

Now where have you heard that sort of commentary before? If that letter by many of the leading gold companies in the world does not have GATA's stamp all over it, nothing ever would!

**July 7, 1999** -- GATA harbors no personal ill will towards Goldman Sachs, but the firm's name has surfaced not only in London but also everywhere GATA turns in our own investigation about the manipulation of the gold market. So consider this about Goldman Sachs:

- **Former Treasury Secretary Robert Rubin, is a former Goldman Sachs CEO.**
- **Former N.Y. Fed Governor, Ed Corrigan is a senior partner at Goldman Sachs.**
- **London based senior partner, Gavyn Davies, is Goldman Sach's international economist and has close ties to Tony Blair. Davies wife, Susan Nye, is chancellor of the exchequer's office manager.**
- **Dr Sushil Wadhwani, former Director of Equity Strategy at Goldman Sachs International (1991-95), sits on the Bank of England's Monetary Policy Committee. The committee's duties include determining the Bank's objectives**

**and strategy, ensuring the effective discharge of the Bank's functions and ensuring the most efficient use of the Bank's resources.**

- **Jon Corzine former Goldman Sachs, CEO, has close ties to John Meriwether, chairman of Long Term Capital Management.**

- **Former Fed vice chairman, David Mullins , was a partner in Long Term Capital Management, which, of course, was bailed out in part by Goldman Sachs.**

**July 13, 1999** -- The "GATA poodle sale theory" is actually gaining steam. Just today we heard from extremely credible sources that U.S. officials were instrumental in the Belgian gold sale a few years ago. We will give you specifics in the weeks to come, but need to keep the details under raps for the moment for GATA investigative purposes. Our sources of this information are very highly regarded and not involved with the gold market in any way.

**July 21, 1999** -- The two dollar rule with a little dessert. Had to laugh today when reading this Dow Jones comment, "It's only a bear market rally (in gold). Since the Bank of England announced it would sell its gold, every **$2 rally** has been sold into, but we'll see what happens this time." Midas has suggested for some that the "colluding crowd" would only allow $2 rallies so that the price action of gold would never create any excitement. Seems someone else has noticed the same thing.

**July 30, 1999** -- The manipulator's mantra -- no gold excitement -- no gold excitement -- was in full chant today. After the biggest one day move up in some time ($2.90 yesterday), they beat gold down in this trading session. Midas still thinks we have a pretty good rally coming, but it is coming very begrudgingly. The "gold cartel" is only going to let the price of gold go up because of the political heat that is being drawn to what they have been up to. Their machinations are becoming too obvious.

We have heard recently that the certain members of the bullion dealer cartel that have been manipulating the price of gold, recruited one, or more, very large hedge fund clients to borrow gold and sell it in the gold market possibly right before, but surely right after, The Bank of England gold sale announcement; we hear of very, very big numbers! That (AND the reduction in CB gold supply availability) can partly account for the big gold price drop as well as an increase in the gold loan lease rates.

Now this all fits in with GATA's understanding that the gold market has been manipulated, BUT in the not too distant future, this "collusion activity" is going to backfire on the some of the bullion dealers, some of their clients, and certain officialdoms. More on that below.

**When the Washington Agreement was announced in surprise fashion on September 26, 1999, the price of gold rallied $84 in a matter of days.**

**Aug. 3, 1999** -- Meanwhile, the word on "The Street" is that there is panic producer selling occurring which is holding down the gold price. The reason offered for the selling is pressure by the banks on certain producers to hedge. The "banks" in this case are the "Hannibals" as it is the bullion banks that lend to producers. Pretty neat. The "Hannibals", in like Flynn, on the BoE sale announcement went short along with a few of their big clients before the announcement. The market panics upon the BoE news, the death of gold is pronounced, "Hannibal" sells for weeks and the gold price drops $38 per oz.

Now, some gold producers feel "compelled" to hedge or are panicking and selling forward as a result of "Hannibal Pabulum." Hannibal, knowing a big rally is coming, is quietly covering his shorts that the cowered producers are handing him. Gold producers who are selling forward now are being snookered -- plain and simple -- by their own bankers!

Now, to the good stuff. We believe that there is a short squeeze of sorts coming in the gold market. You will not hear this from too many others because of this "Hannibal Pabulum" phenomena that has influenced mainstream analysts and those in the press that report on the gold market.

Why do we think this? First, the One-Month lease rate refuses to ease. 3.3% is four times what the 1 month lease rate was running until recently. After a spike up to 4% and an ease off to around 2.5%, the nearby gold loan rate moved back up sharply today - with no apparent reason given. That occurred with a narrowing of the spreads between the contract months on the Comex, so Midas will offer his version of what is going on. You will like it.

Regardless, of what you hear from the zillions of analysts tell you that the high rates are solely due to urges by producers to sell, the truth is that the Central Banks are very concerned about the liquidity of their gold loans going on into the end of the year. Many weeks ago we told you that access to gold loans would be cut back to the middle tier of borrowers -- on down. That is happening at this very moment! Yes, certain borrowers can roll over gold loans, but they must pay these much higher rates and they must also take a much greater price risk at the same time.

A move to $280 gold from here in a month would mean a 10% principal loss on any gold loan that was rolled over today. Add 3.3% for the lease rate to that. Annualize that out and the cost of borrowing becomes about 160%. Not such a great deal - especially if one invested in Treasury bonds that are sinking in price. Losses on all sides abound.

It appears that Central Bankers are finally waking up and acknowledging the danger that is lurking out there in the gold loan arena. The loans (10,000 to 14,000) tonnes are out of control relative to mine supply (2,529 tonnes in 1998).

It also may just be that Y2K fears, that are starting to circulate more widely now, may be the catalyst that finally woke the Central Bankers up. Maybe it is rising interest rates around the world that is causing them to reflect that on their gold loans, maybe it the widening of the credit spreads (expressing liquidity concerns) that has them taking action regarding the gold loans. No matter, the "jig is up" for the shorts. Midas has been telling you we have them right where we want them; that the conditions for a bull market in gold are in place, and the only hold out until now is the gold price. And that could blow sky high any day -- or week.

Because the gold loans are much, much too large relative to supply, we could have a squeeze that might develop.

**This analysis was right on the money. Newmont Mining later announced it bought puts and wrote calls about this time. European Central Banks announced they would curtail lending in the Washington Agreement.**

**Aug. 8, 1999** -- Goldman Sachs has been taking in gold ever since their sudden, auspicious, suspicious conference call two weeks ago. In that conference call they strongly suggested to their clients that the price of gold was going up. All I can do is shake my head at the naivete of the gold industry. If bullion dealer, "Hannibal Lechter", (Goldman Sachs) says the price of gold is going up, it is going up.

However, the "gold cartel" is doing whatever they can to keep the gold price from rising too fast. With the financial scene as precarious as it is ( more signs of financial stress showed up late Tuesday; U.S. Insurance firm, General America Life, advised it was having problems meeting substantial requests to redeem variable rate products without jeopardizing the interests of other policy holders), they do not want any of the press to alert the public that gold is rising due to concerns in the credit markets. An $8 rise in the gold price might do that. Thus, with gold trading $2.70 higher with 10 minutes left in the trading session, they whack it down a dollar. The $2 rule was invoked again by the "Collusion Crowd" The $1.70 rise that we had today will not excite many. Interestingly, gold is trading 90 cents higher right now in the after market.

**Aug 10. 1999** -- Let me ask you this, if I may. Go back 8 months in time. If someone had told you that the following August: 1) the price of oil would be $21.25 (the price was about half that then); 2) the CRB and Journal of Commerce index's had based out and were headed higher; 3) the bond yields would rise from just above 5% to 6.25%; and 4) the credit market spreads would widen to decade high levels signifying severe liquidity problems in the credit markets and many of the bank stocks would be trading 40% off their highs; what would you have said the price of gold would be today?

$300? - $350? - $400? - $450? - $500?

The fact that the gold price is only $257.30 is ludicrous and makes no sense, unless you understand that the market has been manipulated to serve the interests of various bullion dealers, U.S. officialdom, certain hedge funds and, to some curious degree, the British Government.

The technicals and fundamentals of the gold market have taken a back seat to the status of the "manipulation" -- for until this "collusion crowd" loses their iron hand grip on the market, the price of gold will not do what it should be doing.

**Aug. 24, 1999** -- For example, the gold analyst at Goldman Sachs issued the following comment in a report yesterday:

"Why hedge now? With the dire state of the gold market, companies that have tried to stay fully levered to gold price movements can no longer ignore hedging alternatives. The survival motive takes precedence over all others. Especially for those companies with significant debt obligations, boardroom logic would seem to demand plans to survive if current depressed gold prices continue or get worse. Even if the chances of the gold price falling significantly further are assessed at being less than 50%, a responsible manager or director will, in our view, find it very difficult to bet the company on taking that chance."

"Hannibal" is creating sheer terror at the Board of Directors level. Faced with the choice of ignoring the almighty "Cannibal" and facing possible suit for ignoring such an all knowing creature, "Boards" are blinking. The orchestration of the lower gold price is feeding on itself and it would appear certain producers are panicking or taking action because their own bankers have "put this gun to their heads."

This is what the "gold cartel" set out to accomplish with the Bank of England sale. They got the word (Midas had it) that the U.S. Congress would block the proposed IMF gold sale and that gold supply would not be coming on stream as expected. It became apparent they needed a new strategy to hold down the price of gold. What better way to terrorize the gold industry than by having the British come out and say they no longer wanted their gold.

The plan has worked perfectly to date, but there is a "quid pro quo" for this successful manipulation of the gold market so far. They have created a "sling shot" of sorts. The lower they pressure down the price of gold, the bigger the monthly gold deficit gets and the larger the gold loans become. At some point the manipulators will lose control of what they are doing and when they do, they will not be able to stop an explosion in the price of gold -- it will have "sling shot" velocity.

**The price of gold on Aug 24, 1999 was $252.60**

**Sept. 8, 1999 (Spot gold only at $256.50)** -- I am scratching my normal format again in protest of today's obvious collusion in the gold market. Writing about the technicals and the fundamentals seems like such a wasted exercise.

The CRB surged today and closed at 202.52 up 0.80. Included in that surge was a 54 cents move up in the WTI crude oil market. The October futures contract closed at $23.25 per barrel. Meanwhile the bonds are approaching contract lows in the Dec. option while bond yields rose to 6.10%. If that was not enough, a surprisingly stronger than

expected 2nd quarter GDP out of Japan propelled the Yen sharply higher as it finished the day at 107.91 -- a three year high.
All in all, a very bullish scenario for the price of gold. However, the "Hannibal Cannibals" were out in force today. This is what I was told: "Chase Bank and Goldman Sachs will sell whatever amount of gold anyone wants to buy. They are not pressing the market, they just won't let it go up."

That was early in the day, so I called up a good press contact of mine to point out the obvious nature of the "collusion." This contact checked around and found out from the mainstream brokerage crowd: "Yes, some banks are selling, but since it was the top of a recent range, that made sense." Sense? We are talking about $257 gold here not $457. The only thing that makes sense is to understand that certain bullion dealers have been manipulating the gold market and have been doing so for some time now.

The only reason to monitor and be involved in this outrage is that the "Hannibals" are too, too short and too, too exposed. They have borrowed too much gold to try and hold down the gold price for any length of time now. Some day this whole "manipulation trade" will blow up on them and the price of gold will double. I have said this before and I say it again. And I will not stop saying it and will not quit pointing out the sham of it all until they are exposed and the price of gold soars to its proper equilibrium price.

**Sept. 23, 1999** -- For the past few days, the volume on the upside has been 2 to 3 times normal. That also is very constructive. There are very few gold bulls out there as very few gold market analysts and industry participants really understand the dynamics that are now in place to propel the gold price sharply higher in the months and years ahead. That also is very constructive. **(gold at $266)**

**Sept. 27, 1999** -- Spot Gold $282.50 up $14.20 The gold price surged higher today, culminating in the biggest one day price increase in 15 years.

**THE EUROPEAN CENTRAL BANKS TO STOP NET NEW GOLD LENDING ; MARKET REACTION SUGGESTS THE "BIG PLAYERS" KNOW THAT THE CURRENT LOW IS DEPENDENT ON LARGE AND UNSUSTAINABLE FLOWS OF BORROWED GOLD**

The price of gold has risen $13 in only a few hours on a joint communique of 15 European Central Banks, including those of the EU, Switzerland and the United Kingdom? Why?

These central banks have announced: 1) They will limit their official sales to 2000 tonnes over the next 5 years; and 2) They will cease net new gold lending over this period.

**Sept. 28, 1999** -- Today, the prices of gold and silver moved in a fashion that few thought possible anymore. The reason most everyone thought that way is because of the $2 rule that the manipulators put in place to control the gold market and minimize any excitement for its price prospects. That I have documented to you ad nauseum. The negative publicity launched about gold by the "big money crowd" was unprecedented. They tried to delude the world that "gold was dead." That adjective may be applied to the gold shorts soon.

**Oct. 9, 1999** -- **Gold reaches $337 up $84 in weeks.**

**Oct. 26, 1999** -- What kind of market trades like this? Weeks ago (with gold trading around $322) the gold market was in a state of total crisis as overly hedged gold producers were blowing up and bullion dealer departments were in total disarray. Enter mega super bear gold analyst, Prudential's Ted Arnold, who announced the following to the gold world:

Dow Jones - London - Oct. 11, 1999 -- "Central Banks are selling gold in order to prevent a further sharp rise in prices from causing a major financial crisis….

Central Banks, according to our sources, have acted swiftly to prevent a repeat of an LTCM-type of crisis by making sure that gold prices remain in a tight range. Enough selling is done by agents of the monetary authorities involved to cap gold.

"Central Bank ‘regulation’ of the bullion market always seems very far fetched to most observers, but it is a ‘cheap’ option compared with the potential cost of bailing out banks and generally injecting liquidity into an economy if there were a full-blown crisis, he said." End.

That is exactly what our bullion dealer sources have been telling us has been going on these past two weeks. If that were not enough, the Government of Kuwait announced last week it is sending its 79 tonnes of gold to The Bank of England to add liquidity into the physical gold arena. A few days later, Café member EP sent me the following note:
Did you see the news about the U.S. spending 173 million dollars to upgrade three bases located in Kuwait?

This is the second time in six months that the bullion dealers, led by "Hannibal Lecter" himself (Goldman Sachs) have cried "Uncle!" Last May, the gold price was about to blow through a key $290 borrowing level. Goldman Sachs utilized its political connections to influence the peculiar "Bank of England" gold sale announcement on May 7. The day before that announcement, Deutsche Bank conveniently told its clients: the price of gold will not go above $290 (see Midas May 6, 1999)

**Nov. 2, 1999** -- As predicted, many producers want to buy back some of their forward sales. Among others, Cambior bought back 1.3 million ounces, Aurora, in Australia, restructured its hedge book to better accommodate higher gold prices and Echo Bay bought back and cut its forward sale gold position by a third. Café sources have told me that they know of two large producers that also want to cover some forward coverage, but are waiting for volatility's to drop.

**Nov. 8, 1999** -- As an adjunct to my comments, Steve D. sent the following by Bill Jamieson, the Business Editor of London's most widely read mainstream newspaper, The Telegraph:

**November 7, 1999 -- Gold fix**

"Is the world gold market, of which London is the centre, free or fixed? Searching questions are being asked of the U.S. Federal Reserve Board and the operational support it may have given to relieve pressure on those with massive short positions such as Goldman Sachs. Comparisons are being drawn with the LTCM affair, and a full inquiry is surely due."

"Over here, Gordon Brown faces more questioning this week from Sir Peter Tapsell, MP on the UK gold sales. As the Bank of England was a signatory to the Washington statement of European Central Banks freezing gold sales and lending, when exactly did the Bank act as a depositary for the Central Bank of Kuwait to lend part or all of its official gold reserves to the market?" End.

**Nov 19, 1999** -- They are very effective. After last month's $85 gold price streak, many bullion desks were in complete disarray and many of the same dealers were sorting out what to do with Ashanti and Cambior -- among other potential gold producer blow ups. The bullion dealers clamored for peace and calm to return and obviously called on the official sector to inject liquidity (Kuwait, etc.) into the physical gold arena to save their own butts. It is no secret that Alan Greenspan was called on to make good on his July 24, 1998 pledge, "Central Banks stand ready to lease gold in increasing quantities should the price rise."

Mission accomplished. The gold market has gone comatose once again, even as the oil price zoomed to $27 a barrel today in the expiring December contract. In one year, the price of oil goes from $10 to $27, bond yields travel from 5% to 6.18% and the price of gold does nothing. Makes a lot of sense -- right? You could have counted the economists on one hand who would have predicted oil and bond moves this past year of these magnitudes. And yet, I can almost guarantee you that ALL the economists, given those oil and bond numbers in advance, would have predicted a much higher gold price.

**Dec. 21, 1999 --** There was a piece in the Wall Street Journal today by former Fed Governor, Wayne Angell, entitled, "The Fed Should Tighten - but for the Right Reasons." Angell is now the chief economist at Bear Stearns.

In that piece he says: "Why, then, do I favor an increase in the Federal funds rate to 5.75% during the first quarter of next year? First, the current inflation rate of 1.5% to 2% is not zero. Just as the FOMC enhanced growth by cutting interest rates from its 3% to 4% range of 1993, the economy would derive further benefits by gradually cutting the inflation rate in half again."

I believe that FOMC actions count even when the FOMC fails to announce its intention. An increase in the funds rate to 5.75% would likely lower inflation expectations, and the price of gold would likely respond by moving back to a $250 to $280 range.

**Two well known institutional money managers have told Café sources that Wayne Angell told them that the U.S. was responsible for jawboning the Belgians into selling gold.**

**Jan. 21, 2000 --** Brick wall hit again! The "gang" does not want spot gold much above $290. Anytime it approaches that price level, they put up a "Do Not Pass Go" sign and gold retreats. Ironically, the floor remains more bullish than usual.

The gold spreads continue to widen (back months gaining on nearby months) and our floor sources think that is a bullish signal. As covered in this commentary for weeks now, the open interest continues to shrink (down another 2,973 contracts yesterday to 145,564 contracts outstanding) and continues to tell us the specs have little interest in the gold market while the trade does not want to be so short anymore. Every week there is talk of a producer buy back of some sort.

The fact that gold is still below $300 with commodities surging and bond yields sharply higher is mind boggling. At least, it would be if we did not understand that the U.S. officialdom is sitting on the gold price.

**Jan. 25, 2000 --** There they go again! Right on cue, "Hannibal Lecter" (Goldman Sachs) and his cohort Hannibals (Deutsche Bank and Chase Bank) came in to clobber the gold market today as it was about to take out key resistance in the low $290's. Right before the Bank of England auction results were announced, the price of gold spiked up $3.70 before drifting off slightly. The auction results were, if anything, bullish as the sale was 4.3 times oversubscribed and the gold was sold at a price of $289.50 which was above market expectations.

**Feb. 15, 2000 --** Late this afternoon, I received word that Bloomberg has taped a presentation given by Fed Governor, Ed Gramlich, at the Business School of the University of Virginia. After his presentation, he entertained some questions.

This is just a recap of what I was told and I hope to get the exact wording between Gramlich and his questioner as soon as possible. It goes something like this:
Gramlich was asked if the Government was leasing gold (wonder where that question came from?) and reportedly said no. Of course, that still leaves the entire derivative market.

Then, the questioner asked him about a 1998 Investors Business Daily interview in which he said that he was concerned about inflation and that gold was an indicator that he watched regarding inflation. In an extraordinary comment, he said, "At the moment, there are funny things going on in the gold market." From what I was told, he went on to say, "that banks (not sure whether he meant Central or bullion) are going to be 'adjusting their positions' so the gold price could be 'erratic'." The inference (as I understand) was that if the gold shot up it might have nothing to do with inflation or be an indicator of future inflation as it would have been in 1998.

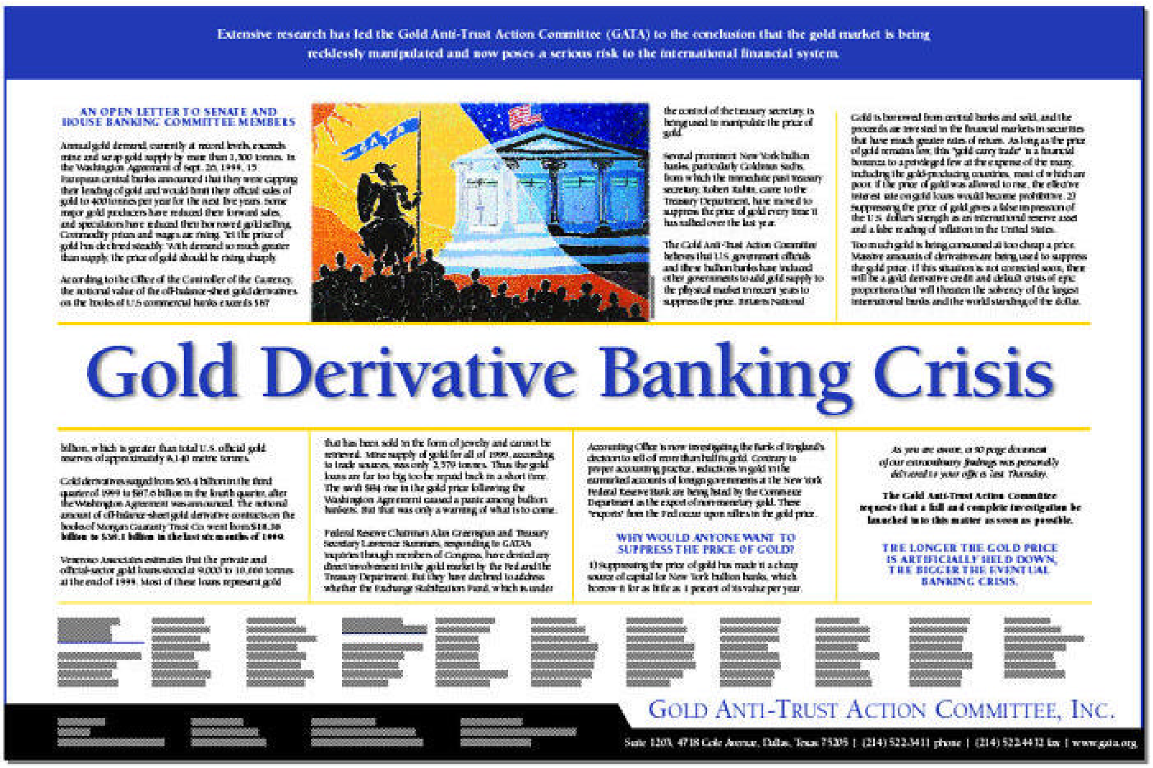
I will get more on this, but that is what GATA has been talking about for a year now and have said so, a zillion times. The gold price can shoot up like crazy, not because of inflation, but because those banks that have been manipulating the gold market and "not allowing" the gold price to rise decide to stop their manipulation, or because of outside market forces, lose control of their manipulation and collusive activity.

**Much of the important key points from this point on through May 6, 2000 are covered by Mr. Frank Veneroso and Mr. Reg Howe in the "Banking Gold Derivative Crisis" document.**

# - BONUS -

# Full Page Open Letter Placed by GATA in Roll Call

**In GATA's continuing search for the truth about what is really going on in the gold market, they presented the following centerfold, <u>Gold Derivative Banking Crisis</u>. This was published in Roll Call, a Washington, D.C. publication which is delivered to the House, the Senate, the White House, and many other venues in our country's capital.**




## An Open Letter to Senate and House Banking Committee Members
## Gold Derivative Banking Crisis

Extensive research has led the Gold Anti-Trust Action Committee (GATA) to the conclusion that the gold market is being recklessly manipulated and now poses a serious risk to the international financial system.

Annual gold demand, currently at record levels, exceeds mine and scrap gold supply by more than 1,500 tonnes. In the Washington Agreement of Sept. 26, 1999, 15 European central banks announced that they were capping their lending of gold and would limit their official sales of gold to 400 tonnes per year for the next five years. Some major gold producers have reduced their forward sales, and speculators have reduced their borrowed gold selling.

Commodity prices and wages are rising. Yet the price of gold has declined steadily. With demand so much greater than supply, the price of gold should be rising sharply.

According to the Office of the Controller of the Currency, the notional value of the off-balance-sheet gold derivatives on the books of U.S commercial banks exceeds $87 billion, which is greater than total U.S. official gold reserves of approximately 8,140 metric tonnes.

Gold derivatives surged from $63.4 billion in the third quarter of 1999 to $87.6 billion in the fourth quarter, after the Washington Agreement was announced. The notional amount of off-balance-sheet gold derivative contracts on the books of Morgan Guaranty Trust Co. went from $18.36 billion to $38.1 billion in the last six months of 1999.

Veneroso Associates estimates that the private and official-sector gold loans stood at 9,000 to 10,000 tonnes at the end of 1999. Most of these loans represent gold that has been sold in the form of jewelry and cannot be retrieved. Mine supply of gold for all of 1999, according to trade sources, was only 2,579 tonnes. Thus the gold loans are far too big too be repaid back in a short time.

The swift $84 rise in the gold price following the Washington Agreement caused a panic among bullion bankers. But that was only a warning of what is to come.

Federal Reserve Chairman Alan Greenspan and Treasury Secretary Lawrence Summers, responding to GATA's inquiries through members of Congress, have denied any direct involvement in the gold market by the Fed and the Treasury Department. But they have declined to address whether the Exchange Stabilization Fund, which is under the control of the treasury secretary, is being used to manipulate the price of gold.

Several prominent New York bullion banks, particularly Goldman Sachs, from which the immediate past treasury secretary, Robert Rubin, came to the Treasury Department, have moved to suppress the price of gold every time it has rallied over the last year.

The Gold Anti-Trust Action Committee believes that U.S. government officials and these bullion banks have induced other governments to add gold supply to the physical market in recent years to suppress the price. Britain's National Accounting Office is now investigating the Bank of England's decision to sell off more than half its gold. Contrary to proper accounting practice, reductions in gold in the earmarked accounts of foreign governments at the New York Federal Reserve Bank are being listed by the Commerce Department as the export of non-monetary gold. These "exports" from the Fed occur upon rallies in the gold price.

**Why would anyone want to suppress the price of gold?**

1) Suppressing the price of gold has made it a cheap source of capital for New York bullion banks, which borrow it for as little as 1 percent of its value per year. Gold is borrowed from central banks and sold, and the proceeds are invested in the financial markets in securities that have much greater rates of return. As long as the price of gold remains low, this "gold carry trade" is a financial bonanza to a privileged few at the expense of the many, including the gold-producing countries, most of which are poor. If the price of gold was allowed to rise, the effective interest rate on gold loans would become prohibitive. 2) Suppressing the price of gold gives a false impression of the U.S. dollar's strength as an international reserve asset and a false reading of inflation in the United States.

2) Too much gold is being consumed at too cheap a price. Massive amounts of derivatives are being used to suppress the gold price. If this situation is not corrected soon, there will be a gold derivative credit and default crisis of epic proportions that will threaten the solvency of the largest international banks and the world standing of the dollar.

As you are aware, a 90 page document of our extraordinary findings was personally delivered to your offices last Thursday.

The Gold Anti-Trust Action Committee requests that a full and complete investigation be launched into this matter as soon as possible.

**The longer the gold price is artificially held down, the bigger the eventual banking crisis.**

**Gold Anti-Trust Action Committee, Inc.**

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