

Panic Is Near if 'The Gold Is Gone'

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Gold. It's been called a barbarous relic, and those who focus on its historic role as a standard of value frequently are labeled "lunatic fringe." Given the recent highs in the gold market, it looks like the crazies have been having a hell of a year. With the stock market taking its third yearly loss, gold returned nearly 30 percent to investors, moving from \$255 an ounce to six-year highs of \$380.

Just about every analyst and "expert" on Wall Street willing to mention any of this has been quick to explain that the increase in the price of gold is due to impending war with Iraq. But hard-money analysts are arguing that should the United States go to war it will be of very little consequence to the price of gold -- a momentary blip -- because gold is a commodity and its price a matter of supply and demand.



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The "lunatic fringe" long has argued that the price of gold was being manipulated by a "gold cartel" involving J.P. Morgan Chase, Citigroup, Deutsche Bank, Goldman Sachs, the Bank for International Settlements (BIS), the U.S. Treasury and the Federal Reserve, but that the manipulation had been sufficiently exposed to

require that it be abandoned, producing the steady upward increase in the price of the shiny, yellow metal.

In fact the "gold bugs," as they're known, are so sure of their research that not only do they believe the price of gold will continue to climb, but many are expecting to see prices of \$800 to \$1,000 an ounce. Until recently, most in the gold and financial worlds scoffed at such a prediction, but last month the Bank of Portugal made an announcement that shocked those who credit official gold-reserve data and added fuel to the contention of the gold bugs that the "gold-cartel" manipulation is in meltdown.

What the Bank of Portugal revealed in its 2001 annual report is that 433 tonnes [metric tons] of gold -- some 70 percent of its gold reserve -- either have been lent or swapped into the market. According to Bill Murphy, chairman of the Gold Anti-Trust Action Committee (GATA), a nonprofit organization that researches and studies the gold market and reports its findings at www.LeMetropoleCafe.com: "This gold is gone -- and it lends support to our years of research that the central banks do not have the 32,000 tonnes of gold in reserve that they claim. The big question is: How many other central banks are in the same predicament as the Portuguese?"

Murphy explains: "The essence of the rigging of the gold market is that the bullion banks borrowed central-bank gold from various vaults and flooded the market with supply, keeping the price down. The GATA camp has uncovered information that shows that around 15,000 to 16,000 tonnes of gold have left the central banks, leaving the central-bank reserves with about half of what is officially reported."

This is why those who follow such arcana are predicting an explosion in the price of gold. According to Murphy, "The gold establishment says that the gold loans from the central banks are only 4,600 to 5,000 tonnes," but his information is that these loans are more than three times that number, which means "they're running out of physical gold to continue the scheme."

According to Murphy, "The cartel has been able to get away with lying about the amount of gold in reserve because the International Monetary Fund [IMF] is the Arthur Andersen of the gold world." He has provided to Insight documents from central banks confirming that the IMF instructed them to count both lent and swapped gold as a reserve. "In other words, the IMF told the central banks to deceive the investment and gold world[s]. Once this gold is lent [or] swapped, it's gone until such time as it can be repurchased. And with the skyrocketing price of gold we're now seeing, it would be incredibly expensive, let alone nearly physically impossible, to get it back."

What is important to understand, says Murphy, "is that there is a mine and scrap supply deficit of 1,500 tonnes, which is an enormous deficit when yearly mine supply is only 2,500 tonnes and

going down. On top of that, there are these under-reported gold loans and other derivatives that are on the short side. There is no way to pay this gold back to the central banks without the price of gold going up hundreds of dollars per ounce. So the peasants and women of the world will have to sell their jewelry at say \$800 an ounce to bail out these short positions or someone is going to have to tell the world that they don't have the gold that they have reported," shaking the world's financial system to its core.

The gold bugs appear to be basing their identification of a world gold shortage on industry data, much of which has been summarized in two papers prepared by four different gold analysts at different times using separate methods. The first paper was written by governmental investment adviser Frank Veneroso and his associate, mining analyst Declan Costelloe. Titled *Gold Derivatives, Gold Lending: Official Management of the Gold Price and the Current State of the Gold Market*, it was presented at the 2002 International Gold Symposium in Lima, Peru, and estimates the gold deficit of the central banks at between 10,000 and 15,000 tonnes. The second paper, *Gold Derivatives: Moving Towards Checkmate*, by Mike Bolser, a retired businessman, and Reginald H. Howe, a private investor and proprietor of the Website www.goldensexant.com, estimates the alleged shortage of central-bank gold at between 15,000 and 16,000 tonnes -- nearly a decade's worth of mine production.

George Milling-Stanley, manager of gold-market analysis for the World Gold Council (WGC), a private organization made up of leading gold-mining companies that promotes the acquisition and retention of gold, is aware of these papers and shortage numbers but tells Insight that "there are no official [gold-reserve] reports." That is, "The central banks are under no obligation to report what they lend into the market, what they place on deposit and what they do with their swaps, so there's a conventional-wisdom view, and a couple of different bodies have done some fairly serious research in[to] this and have come up with a figure [of] around 4,500 to 5,000 tonnes."

Stanley's estimate is based on data provided by so-called "serious" researchers, including London-based Gold Fields Mineral Services (GFMS), one of the world's foremost precious-metals consultants, and a report titled *Gold Derivatives: The Market View*, commissioned by the WGC to London-based Virtual Metals Consultancy. While these two groups appear to be the research choice of the official gold world, there are in fact no "official" figures, and both studies, like the Veneroso/Costelloe and Bolser/Howe reports, are based on interviews, data analysis and other research generally available to the industry.

Those who believe the central banks to have misrepresented their actual gold holdings place much of the blame for the lack of transparency on the shoulders of the IMF, which presents itself as being responsible for ensuring the stability of the international financial system. Although the IMF would not respond to questions about its gold-loan/swap requirements, what information has been made public appears to support GATA's understanding of how central-bank reserves are

reported.

For example, in October 2001 the IMF responded to questions posed by GATA by saying it is not correct that the IMF insists members record swapped gold as an asset when a legal change in ownership has occurred. According to this response, "The IMF in fact recommends that swapped gold be excluded from reserve assets." Nonetheless, says GATA, there is abundant evidence that this is not the case, citing as an example the Central Bank of the Philippines (BSP).

A footnote on the Website of the Central Bank of the Philippines (www.bsp.gov.ph) in fact directly contradicts the IMF's claim: "Beginning January 2000, in compliance with the requirements of the IMF's reserves and foreign-currency-liquidity template under the Special Data Dissemination Standard (SDDS), gold swaps undertaken by the BSP with noncentral banks shall be treated as collateralized loans. Thus gold under the swap arrangement remains to be part of reserves, and a liability is deemed incurred corresponding to the proceeds of the swap."

The European Central Bank (ECB) also made it clear that the IMF policy is to include swaps and loans as reserves. The ECB responded to GATA: "Following the recommendations set out in the IMF operational guidelines of the 'Data Template on International Reserve and Foreign Currency Liquidity,' which were developed in 1999, all reversible gold transactions, including gold swaps, are recorded as collateralized loans in balance of payments and international investment-position statistics. This treatment implies that the gold account would remain unchanged on the balance sheet." The Bank of Finland and the Bank of Portugal also confirmed in writing that the swapped gold remains a reserve asset under IMF regulations.

Although the WGC's Stanley stands by the data provided by the industry's "serious" researchers, he insists he cannot say for certain that the numbers are accurate. "There is no requirement on any country to tell the IMF how much gold it owns," says Stanley. "The requirement is to tell the IMF how much gold it has decided to place in its official reserves. Nobody knows whether that is the total of what they own or not. Obviously they can't report more than what they own, but they can certainly report less if they chose to. That gold may have been lent out, but is nevertheless still owed to them. It's a bit like any company reporting a cash position. It will report cash on hand and cash due -- money owed by other people. I'm not saying this is ideal, but this is how it works."

John Embry, the manager of last year's best-performing North American gold fund and manager of the Royal Precious Metals Fund for the Royal Bank of Canada, says he is putting his and his clients' money on the "lunatic fringe" in this dispute: "I've examined all the evidence gathered by GATA and everyone else, and I think these guys are anything but lunatics. They've done their homework and have unearthed a lot of interesting stuff. The problem, though, is that the market is sufficiently opaque that there is really no way to know who is right and who is wrong."

"The fact is," continues Embry, "a lot of this stuff is based on estimations. I do however believe that, based on the evidence dug up by Veneroso and Howe, they are presenting equally if not more credible numbers than the other side. I find the campaign to undermine their credence simply bizarre. I think these guys [GATA] are right and that the number put out by Gold Fields Mineral Services as the amount of gold loaned out by the central banks is definitely wrong. Now, whether it's as much as 15,000 is up for interpretation. The recent release by the Bank of Portugal is important. When a central bank has 70 percent of its gold loaned or swapped, I don't think it is operating independently, and I suspect there are an awful lot of them that have loaned out much more than has been reported."

Embry says, "I've made a fortune for my clients investing in gold and gold stocks because I have operated on the premise that the Veneroso/Howe reports are right -- that gold was significantly undervalued in the daily quote and that it was going a lot higher. The circumstantial evidence, and I bet my clients' money on it, was very much in favor of the guys who said a great deal more central-bank gold had entered the market and driven the price down far too low. GATA has had this story from day one. I think that they're right and that officialdom doesn't want this exposed. GATA is willing to have a public debate but the gold world won't debate. I think there is a tacit admission of anyone who has an IQ above that of a grapefruit that Veneroso and Howe have a pretty good point. I'm an analyst who has looked at both sides of the issue and I bet my money on GATA. So far they've been right."

Whether the gold bugs are right about the reasons for the meteoric rise in the price of gold is uncertain, but, according to GATA's Murphy: "It's all the more reason to have the central banks come clean about the actual amount of gold that physically exists in their reserves. Either way, the price of gold will continue to rise because, as we already know and others are discovering, the gold is gone."

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