Obama team may not be friendly to gold

By John Embry


John Embry

Gold entered 2009 with good momentum only to run into strong headwinds in the last days of the disastrous Bush administration. As economic and financial conditions continued to deteriorate daily, gold was driven down by US$70 an ounce to a London closing low of US$810 an ounce on Jan. 15, representing Henry Paulson's final insult to the gold market during his reign as U.S. Treasury Secretary.

I well remember thinking that gold was going to face a rocky path when the ex-Goldman Sachs chief was installed at the Treasury, and he didn't disappoint. His actions, in conjunction with those of the western central banks, ensured that the gold price remained several hundreds of dollars below its true equilibrium level during his tenure.

Immediately upon his very welcome departure, gold began a spirited rally that saw the price rise by US$100 an ounce from its earlier low in a mere seven trading sessions. With the new president, Barack Obama, a man for whom I have immense regard, now installed in the White House, could it be that things are about to change dramatically for the better in the gold market? Quite frankly, it depends on which side of the equation you favor. If you take President Obama's words at face value, there is reason for considerable optimism. The new president recently said the following:

The way to make government responsible is to hold it accountable. And the way to make government accountable is to make it transparent so that the American people can know exactly what decisions are being made, how they're being made, and whether their interests are being well served. The directions I am giving my administration today on how to interpret the Freedom of Information Act will do just that. For a long time there has been too much secrecy in this city.

If this approach were applied to the gold and silver markets, the revelations should be something to behold. The new administration could start with a public audit of the U.S. gold reserve along with the release of any pertinent papers relating to gold swaps, gold leasing, etc. I suspect that little more would be required if this information were to be made public.

However, lest one get too giddy over these prospects, consider the team that President Obama has assembled to advise him on economic matters. To call them the same tired old bunch that got us into the current economic and financial mess would be described as charitable at best.

As Chief Economic Adviser, President Obama has recycled Lawrence Summers, one of the Treasury Secretaries in the Clinton administration and a former president of the World Bank. Among Summers's many dubious claims to fame is his co-authorship of a paper in 1988, entitled "Gibson's Paradox and the Gold Standard" in which he proved empirically that real interest rates and the gold price tend to move in concert.

This became the essential playbook for the whole gold suppression scheme because keeping gold prices low virtually ensured that real interest rates would also remain low. This phenomenon played a major role in facilitating the bubbles that have led to today's debacle.

The new secretary of the Treasury is Timothy Geithner, who is known to be a protege of Robert Rubin, another Clinton-era Treasury secretary whose major achievement was the "strong dollar policy," which consisted primarily of the gold-suppression scheme and a lot of rhetoric. Geithner, who is also a confidant of Summers, was most recently the head of the New York Federal Reserve, so he can hardly be described as an agent of change.

So the battle lines are drawn. Is it going to be a bright new dawn as President Obama lives up to his promised mandate of change or is it going to be business as usual from the Clinton and Bush eras? Time will tell, but from gold's perspective, even if it is business as usual, it is just going to represent a slight delay in what in my opinion is going to be an absolute explosion in the price. Just as Canute couldn't hold the tides back forever, the U.S. government and its various accomplices will not be able to restrain the gold price much longer.

It is just going to represent a slight delay in what in my opinion is going to be an absolute explosion in the price

Very simply, the fundamentals are going to overwhelm them, and in my opinion, it would be in Mr. Obama's best interests to let the truth out about the long-term gold-price suppression so his administration will be absolved of any blame. Interestingly, the whole cover-up is somewhat akin to L'affaire Madoff, the world's largest Ponzi scheme. For nearly 10 years, a gentleman named Harry Markopolous provided copious information to the U.S. Securities and Exchange Commission regarding his concerns about the Madoff operations and, other than a couple of cursory looks, the SEC did essentially nothing. Now they are enduring a storm of criticism and backtracking quickly while offering a litany of weak excuses.

I strongly suspect that the U.S. Commodity Futures Trading Commission is going to suffer the same fate when the true facts concerning the gold and silver manipulation surface. For years, Ted Butler on the silver front and supporters of GATA (The Gold Anti-Trust Action Committee) have been bombarding the CFTC with persuasive evidence suggesting that all is far from right in the gold and silver markets. They have been ignored, stonewalled or insulted with form letters, often from minor functionaries in the organization.

Fortunately, there appears to have been some movement on this front recently as a CFTC commissioner named Bart Chilton has been most forthcoming and actually receptive to the many complaints that have been coming from numerous quarters. Perhaps finally this is a belated recognition of the reality that has been ignored for so long by the CFTC. However, the damage that has been done to investors through the years has been considerable.

Turning to the fundamentals for gold, one inherently knows that the world of pure fiat currency is in deep trouble when the U.S. dollar is among the world's strongest currencies. The well advertised financial and economic problems of the U.S. virtually ensure an accelerating debasement of that currency, the current strength notwithstanding.

The combination of a collapsing economy, absolute crippling levels of debt internally and massive foreign liabilities, which can never be repaid and will become more and more difficult to service, will inevitably lead to accelerating money creation to avoid financial Armageddon.

Insolvent

However, the potentially catastrophic condition of the financial sector may be the real clincher. The extremely prescient economist Nouriel Roubini recently checked in with his latest prognostication and it qualifies as a true shocker. He suggested that credit losses in U.S. institutions could now peak at a level of $3.6 trillion, half of them absorbed by banks and broker-dealers, and to him, this means the U.S. banking system is insolvent.

However, those wishing to flee the U.S. dollar aren't going to be all that thrilled with their alternatives in other currencies, all of which appear to be terminally flawed.

The euro is being dragged down by the countries formerly know as Club Med but now derisively being referred to by the acronym PIGS. (Portugal, Italy, Greece and Spain). These countries are suffering from economic and financial infirmities that are approaching or, in some cases, exceed those of the U.S. The question is not what the relative value of the euro might be but whether it can even survive if things continue to worsen.

The English pound does not even deserve mention in view of the horrific state of the British economy, while the Japanese yen, despite its current strength, will ultimately be dragged down by the endemic deflationary problem plaguing the country which has one of the highest government debt-to-GDP ratios in the world. The Russian ruble is headed down the toilet hand in hand with the discredited oligarchs whose proclivity for debt has brought many of them to the edge of ruin.

This brings me to the world's largest creditor, China, a country currently being accused by incoming U.S. Treasury Secretary Geithner of manipulating its currency. I honestly think most observers may be missing what is really going on in China. The country for years has had one of the most unbalanced economies on the planet with exports and capital spending constituting an inordinately large amount of the economic activity in the country.

The bad news is exports are now falling precipitously, and the worse news is there is massive overcapacity throughout the country, obviating the necessity of much capital spending anytime soon. If they are going to transform themselves into a consumer-driven economy to sustain growth, they are going to have to keep an awful lot of the money they have been recycling back to the U.S. at home. In addition, to keep the Yuan from rising in this circumstance, China is going to have to print a lot of money domestically.

This will all be part and parcel of the world's major nations staging a race to the bottom in a declining currency derby.

The big money in the world is just in the process of discovering that the true refuge in this remarkable mess is gold, as it has been through all past financial and currency upheavals.

As the wealthy position themselves, the investment demand for gold is literally going to explode. This should easily overwhelm any meaningful attempts to further suppress the price and lead to gold prices that will seem unfathomable to many people.

John Embry is chief investment strategist at Sprott Asset Management.