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Here come the gold knockers – again

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PREPARE yourself for the precious metals knockers to crow. But it won't last long. *The Outcrop* by Robin Bromby.

All it took was a 3% fall in gold's price on Tuesday night, followed by a smaller decline last night. Immediately, the golden sky was seen by some to be falling.

It happens every time there's a correction. And then the knockers go quiet again until the next correction.

Actually, there are one or two reasons to be worried in relation to gold and silver, but we'll get to that later. And also to an interesting new take on the gold scene.

In the meantime, last night was gold's worst performance since early December. Gold fell to $US1372 an ounce, silver to $US27.80/oz. Oh dear, does that mean we'll never see $US1400 and $US30 (respectively) ever again? Well, the naysayers are hoping it is so.

But they're in for a big disappointment.

Nevertheless, these predictions that the best is over are welcome in that all the commentary over the past few months has been bullish, some of it super-bullish. So it does us good to go back and re-evaluate the situation.

However, such an evaluation of precious metals is made harder by the fact that, even among the mega-wealthy, there's a clear divergence of opinion.

It's a year now since George Soros stood up at the World Economic Forum's January 2010 meeting and called gold the "ultimate asset bubble". The yellow metal was then worth $US1087.10/oz.

Yet this week the internet, including *The Financial Times'* Alphaville website, is running hot with rumours that the world's richest man, Mexican telco tycoon Carlos Slim, is about to make a big lunge at the silver market.

The story is that he will be making a takeover move on Mexico's Fresnillo Plc, the world's largest primary silver producer. He wants in on the gold and silver bull markets apparently.

Everyone these days trots out what they think are the reasons for gold's spectacular performance. The usual – and plausible – suspects are the decline of the US dollar and the growing disenchantment with and suspicion of paper money. It stands to reason that the more money they print, the less valuable each dollar of paper money is worth.

It's not quite Weimer Germany yet; in 1923, you could order a cup of coffee in a cafe for 5000 marks (which is an extraordinary sum in itself) but by the time you came to pay the bill it could be 8000 marks.*

But my local bread shop has just raised the price of my favourite loaf by 30%; a frequent breakfast spot jacked up its prices by 20%, and is "frequent" no longer. You'll have your own examples of how inflation is rampant but unnoticed by official statistics.

By contrast to the 24/7 money printing, the argument goes, you can't turn on the tap and produce more gold.

Ah ha, might be the response to that from Pawel Rajszel. The analyst at Toronto-based Veritas Investment Research this week sent out a report arguing that the gold drought is over.

As he notes, gold production has been dipping since 2001, but the 2009 performance by the global mining sector – its best year since 2003 – is showing a trend to rising output.

Twenty of the world's top gold producers, which account for half the world's gold production, have aggressive growth plans, Rajszel said. They plan to increase production by 25% through to 2013. In other words, he implied, there'll be plenty to go around.

The other side of the coin comes from the team at Standard Chartered in Hong Kong.

And it's a copper coin. A recent survey they did showed that 79 of 81 copper projects they identified were running an average 18 months late due to the GFC.

"Why, you may ask, is that important for gold?" they continued. "Simply because 40 percent of the mined gold supply each year comes from copper mines as a by-product." Needless to say, the boys at Standard Chartered are now braced for another gold breakout.

Also bullish are Swiss traders MKS Finance which is predicting "another glorious year for gold". It is calling an average $US1502/oz in 2011 for gold, $US36.25/oz for silver. If that happens, it will also represent a significant closing of the ratio between the two metals, a fascinating trend in itself.

Now the real dangers for gold.

One is any major financial collapse or implosion (think China) and/or the impact of debt deflation in Europe and God knows what next fiscal disaster in the US.

If people need cash and they hold gold, might they not be tempted to liquidate those holdings to save their properties or other assets? One can presume that most asset classes will drop in value in such a scenario.

We simply don't know what the attitude to gold will be in those circumstances.

Of wider concern is the whole question of deflation itself. Here we can't look to the 1930s for a guide due to the way the gold price was set then.

We can see what happens to gold when you get inflation and money printing – after all, who doesn't look to hard assets in these times.

But deflation and reduced money supply?

Remember, it probably won't be an analyst who sounds the warning bell. You'll know about when it comes out of left field.

* For those interested in the 20th century's second worst economic screw-up, a 1975 title, *When Money Dies* by Adam Fergusson, has just been re-issued. Gold bugs will be interested in what happened to gold marks as opposed to paper ones.

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