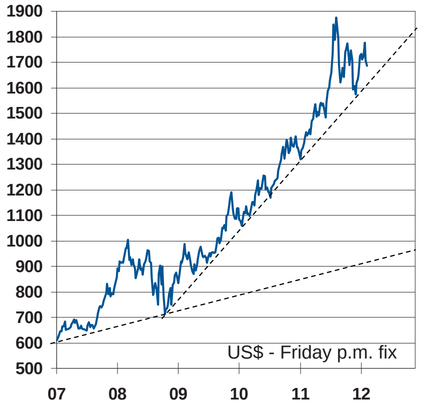
Gold Monitor

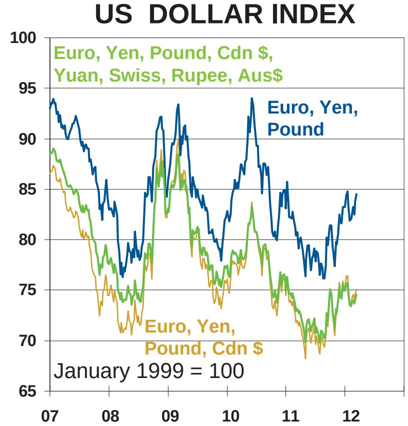
by Martin Murenbeeld

March 9, 2012

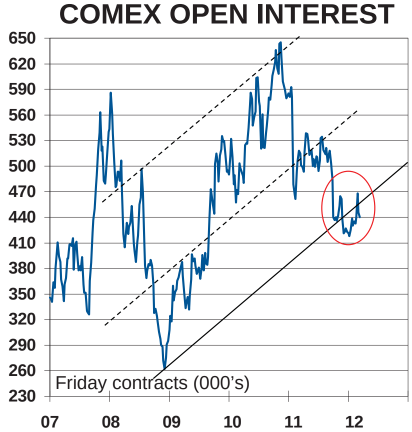
GOLD PRICE



US DOLLAR INDEX



COMEX OPEN INTEREST



	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09
Gold - 2nd Fix	1705.00	1669.00	1677.50	1690.00	1687.50
Gold - COMEX	1703.90	1672.10	1683.90	1698.70	1694.30
Silver - HH	3407.00	3270.00	3338.00	3338.00	3387.00
Platinum - NYME	1662.60	1611.90	1627.30	1656.70	1667.60
Crude Oil - NYME	106.72	104.70	106.16	106.58	107.69
CRB Bridge - NYBOT	319.45	314.45	314.24	316.04	316.36
US $ (Excluding Cdn.)	80.18	80.20	80.20	80.06	81.13
Fed Funds (Overnight)	0.12	0.12	0.12	0.12	0.12
US Bonds - CBOT	140.91	142.00	142.00	140.69	140.09
TSX Global Gold Index	363.56	357.93	359.07	361.12	362.04
S&P 500	1364.33	1343.36	1352.63	1365.91	1374.29
Gold Price Average (2nd fix, daily) - 2012 to date					**1698.44**

Herewith some notes from the road.

Attached is our presentation at the Prospectors and Developers Association Conference in Toronto (PDAC), which must now certainly be the world's largest mining conference. The BNN interview at the PDAC was sent to readers earlier this week.

A short summary of our key points from the many presentations and client meetings this last week: The **(a)** world economy is severely weakened, regardless of recent employment trends in the US. The US economy may not be in recession (and we are not forecasting a recession) but many of the key economies are slowing, and the IMF has cut its growth rate to below 4% this year and next (a line in the sand which when crossed invariably leads to year-over-year declines in many commodity prices). With governments of developed economies massively in debt and under pressure to reduce those debts **(b)** the central banks will continue to be under severe pressure to maintain aggressively easier monetary policies for years to come. In short, without a fiscal policy option, only monetary and exchange rate policy options are left to boost employment and growth – and we expect

Executive Summary

1. *The big picture remains quite bullish*
2. *And central bank interest in gold appears to be rising*
3. *Meanwhile the case for a lower dollar grows*
4. *As US trade data worsen*

them to be used. This means, among other things, that **(c)** it will take many years to bring the Fed (and ECB) balance sheet back to normal, unless **(d)** the dollar can be devalued and US tax-spend policies can be redirected towards production and investment, away from consumption. But because the world economy is weak **(e)** 2012 is unlikely to be a stellar year for gold (better for gold equities, we think) unless there is a financial calamity in Europe (which the ECB has done its best to date to apprehend) and/or some geopolitical crisis such as the bombing of Iranian nuclear energy installations (which, if the 1980 experience is to be repeated could see … well, maybe not a doubling of gold prices … but a serious spurt higher). Somewhere out there **(f)** will come a time when the gold price will experience its first "long-bull-cycle" correction, but it does not look to be 2012. Meanwhile, it looks to us that **(g)** central banks are increasingly interested in gold as an asset to hold.

To underscore these general points I note in no specific order the following:

(1) Despite some mildly upbeat statements by several central banks this week (i.e., "*Recent developments suggest that the outlook for the Canadian economy is marginally improved from the January MPR (Monetary Policy Report)"* – that sort of thing) we note that Australian unemployment is rising; Brazil recently cut rates by a more-than-expected 75 basis points; India cut its cash reserve ratio (CRR) requirement for banks today "*sooner and more sharply than expected*", (Reuters, 03/09); and that "*China's inflation eased to the slowest pace in 20 months while new loans, industrial output and retail sales were below analysts' forecasts, boosting the case for easing monetary policy in the world's second-biggest economy", (Bloomberg*, 03/09). My point is that the world economy – and the BRIC – is either flat or weakening perceptibly.

(2) "***Stimulus Measures*** *- Parliament last month passed Prime Minister Yoshihiko Noda's fourth extra budget, a package of 2.5 trillion yen ($30.7 billion), and the Bank of Japan expanded monetary stimulus to 65 trillion yen from 55 trillion yen to support growth and drive down the value of the yen*", (*Bloomberg*, 03/08). In this one statement the reader can find all the classic economic prescriptions for dealing with economic contraction: fiscal stimulus, monetary stimulus and currency devaluation. And what might one expect will happen to the price of gold in yen as a result of such policies? And incidentally, against which currency is the Bank of Japan expecting to drive down the yen? Are we the only ones who think the system is seriously biased against the US dollar?

(3) To underscore point **(2)** the reader may be aware that Japan has published current account and trade balance deficits of late. That, according to many, is a good reason for the yen to decline. But against which currency should the yen decline? The US dollar? That is the implication of course. But the US trade deficit with Japan is increasing again (see page 4). So why should the yen go down against the dollar?

Our answer is that the yen should go down against currencies of countries with which it has serious deficits and up against currencies of countries with which it has serious surpluses. The same can be said for the renminbi/yuan, ringgit, TW-dollar, baht, etc.

The real problem is that the world currency complex is seriously out of whack, and the US dollar suffers accordingly. The latest report from the Peterson Institute of International Economics (PIIE) indicates that from a multi-currency perspective (i.e., when third party effects are taken into account) the yen is 9% overvalued in total, but 2.7% undervalued against the dollar – see the table on page 3 (which we were not able to include in the PDAC presentation last weekend on account of time limitations).

The reader will also note the currencies that are most undervalued against the dollar include the renminbi and Asian tiger currencies!

(4) The World Bank has just released a study that points to the fact the renminbi undervaluation seriously hurts other emerging economies, by displacing their exports to developed markets such as the US. Accordingly, one of the authors suggests the US recruit "*allies among developing countries*" in its "*campaign to get China to lift the value of the yuan*", (*WSJ*, 03/08).

We firmly believe the US economy requires a prolonged period of export-led growth, and a more appropriately valued dollar would help. Romney appears to agree! (Bullish gold factor: the dollar is overvalued!)

(5) For skeptics of this view, the US trade balance charts make for interesting viewing. US balances with the major economies are all in deficit to a greater or lesser degree – and worsening. If the US economy continues to post sub-par growth one should assume Romney (if elected) will honor his election promise to do something about chronic dollar overvaluation.

(For students of international economics the fundamental question is how the US can ever begin to pay back its debt to foreign holders of US Treasuries if the rest of the world refuses to allow the US to run trade surpluses. As it stands, with other countries insisting on running surpluses with the US, the costs of these imbalances are borne by US domestic producers. At a time of chronic unemployment the US government – Romney - should address this issue more forcefully. The US could also press hard to have foreign markets open up to US exports of services, where US producers are very competitive. But unfortunately the leverage the

Bullish: (2) Global Imbalances

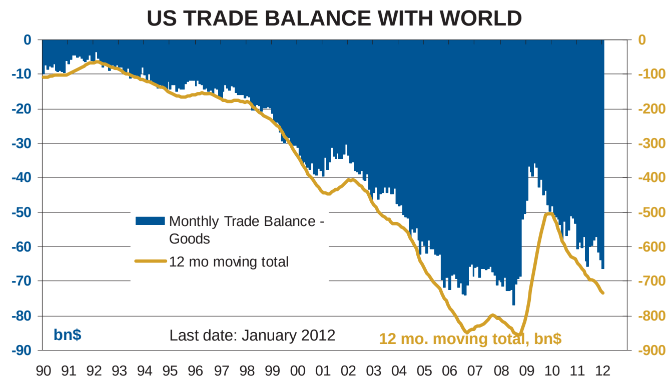
Currencies are generally misaligned

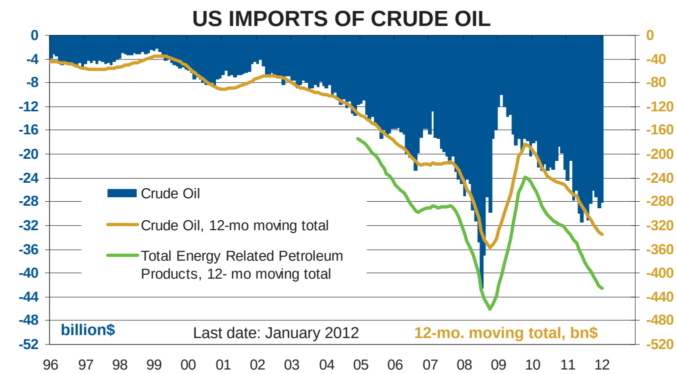
Estimated overvaluations as of late October 2

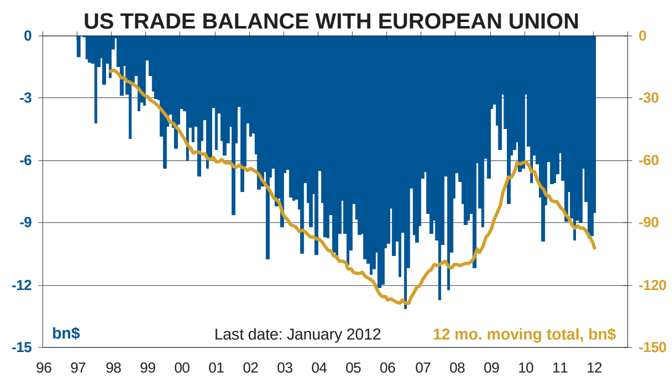
Country	Effective overvaluation	Overvaluation against the dollar[(b)]	Country	Effective overvaluation	Overvaluation against the dollar[(b)]
Argentina	5.4	-1.7	Korea	0.0	-12.5
Australia	15.5	4.8	Malaysia	-14.7	-31.0
Brazil	5.2	-1.5	Mexico	-12.9	-13.5
Canada	-3.5	-5.5	New Zealand	21.0	14.9
Chile	-0.2	-8.0	Philippines	2.5	-10.9
China	-10.6	-23.5	Poland	-4.1	-11.1
Columbia	0.3	-4.4	Singapore	-21.5	-37.4
Czech Republic	-0.4	-8.6	South Africa	5.5	-3.8
Euro area	1.6	-6.9	Sweden	-8.0	-15.0
Hong Kong	-15.4	-29.7	Switzerland	-6.1	-11.8
Hungay	-8.0	-15.6	Taiwan	-17.7	-32.2
India	-2.4	-15.3	Thailand	-0.6	-13.1
Indonesia	1.0	-15.5	Turkey	21.7	12.7
Israel	-2.7	-9.3	United Kingdom	2.8	-5.1
Japan	9.0	-2.7	United States	9.3	0.0

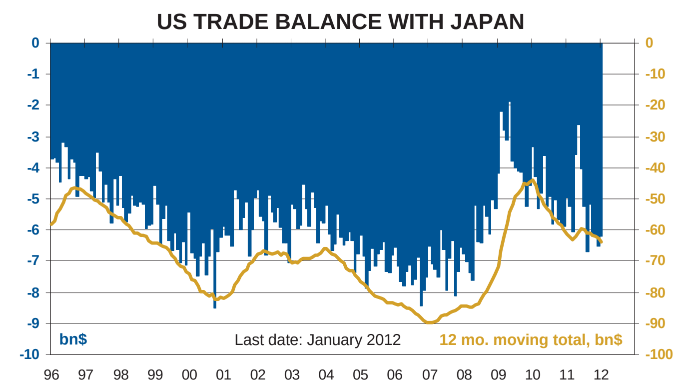
Source: Peterson Institute for International Economics, Nov 2011

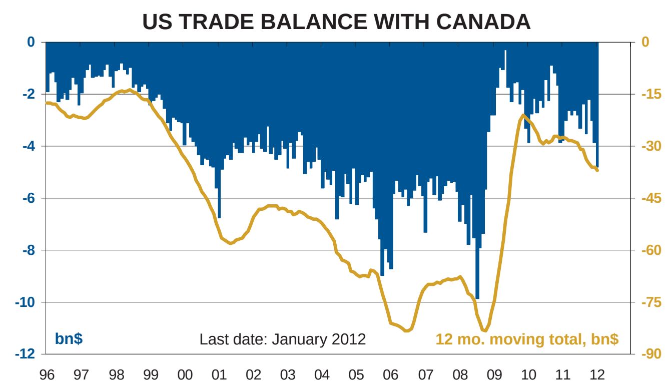
[(a)] Average: October 27, 28, 31.
[(b)] If all currencies move to their fundamental equilibrium rates

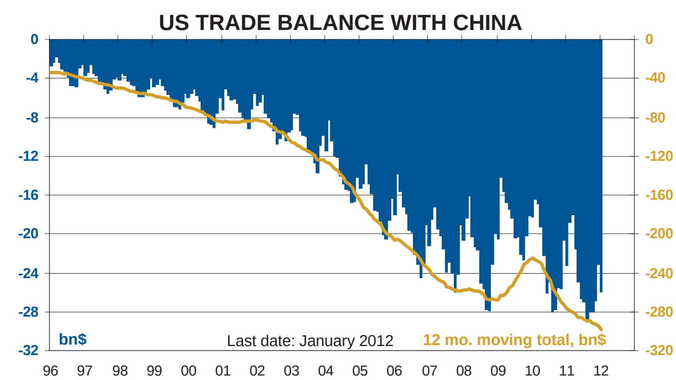






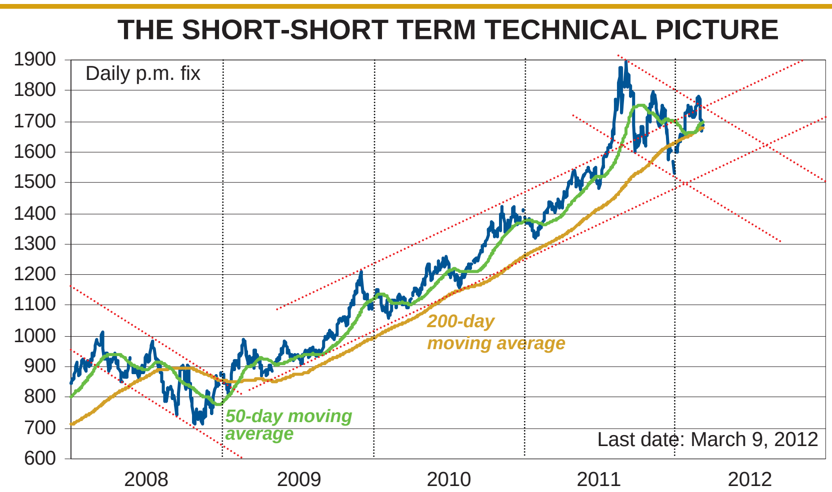


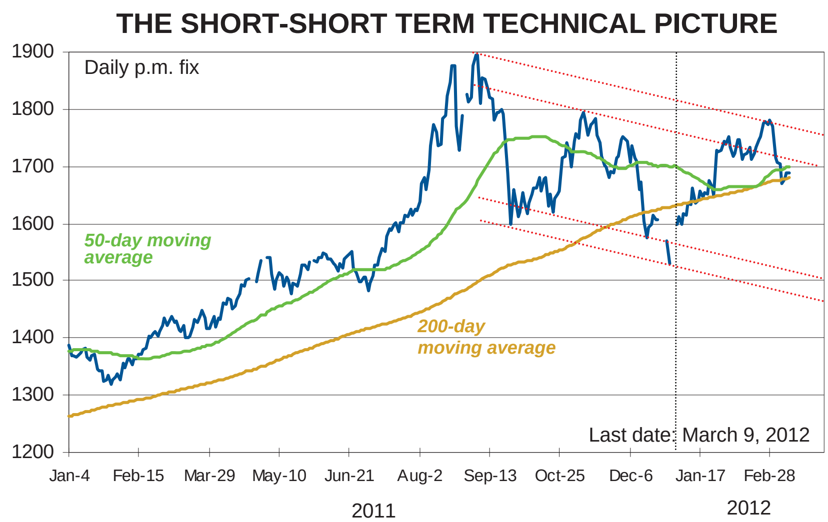




US trade deficits continue to rise, and yet Japan (and China) wants its yen (renminbi/yuan) to decline against the US dollar.

Japan has the second largest foreign exchange reserves holdings in the world (after China), which is indicative of Japan's currency intervention, something really does not add up!





Gold is struggling to break free of the "recession-induced" downward sloping trend lines - and its 50-day and 200-day MA.

US has on the export side isn't nearly as great as the leverage it has in threatening to limit imports – which is the route I would expect Romney to take. One way or another chronically undervalued currencies must be revalued.)

For gold, of course, a weaker dollar helps the dollar price of gold. But the resultant improvement in the US competitive position will also make US equities very attractive indeed – which could provide some headwinds for the investment demand for gold. Yet, all this is at least a year away.

(6) "*The era of risk-free government bonds nears its end*" (*Washington Post*, 03/08). The *Post* is referring to the Greek debt write-down, but there is a larger point here: government debt really is not risk-free. It never was! This may be more obvious when government debt is denominated in a currency the government cannot print – which is the unfortunate case for Greece (and was the case for Argentina and other sovereign defaulters of past years). It is less obvious when government debt is denominated in a currency the government can print, because then the investor is at least assured the investment will be returned – if not necessarily 100% of the investment's original purchasing power.

We are not raising this point to make a case for the "safe haven" properties of gold; when gold sucks down some $80 in a couple of days – as it did last week - it isn't "safe" in the sense the average investor may appreciate. Indeed, a Canadian or US T-bill is about as safe a short-term asset as there is, but of course only for Canadian or US investors (because these respective investors will not then carry a currency risk). Yet precisely because the Greek default raises the general question about a government's ability to return the full value (purchasing power) of what has been lent, we offer the opinion that gold is an excellent ("safe/hard") asset for the medium term (and most certainly an excellent asset within a diversified portfolio).

I might also point out that government bond prices are generally negatively correlated with bond prices (though not when central bank liquidity flows freely).

(7) There are press reports that German lawmakers want an audit of Germany's 3396 tonnes of gold, and that several Swiss lawmakers want Swiss gold reserves to be "repatriated" from the New York Fed (where the majority of the world's gold reserves are stored). Our interpretation: even lawmakers are experiencing monetary and currency angst!

Lawmakers may not necessarily appreciate what central banks must do to keep the economic system functioning (i.e., the Fed, the ECB, and even the SNB by limiting the SF to €1.20 with a flood of SF liquidity in the FX market), and stave of the depression that would otherwise almost certainly have descended upon the world economy (partly the result of the idiotic policies of lawmakers/ politicians around the world). But there is little doubt in our minds that lawmakers around the world have become increasingly interested in their country's gold reserves, that they want to be certain these reserves are "safe", and by corollary that lawmakers are increasingly disinterested in selling gold reserves and more interested in acquiring gold reserves. (As noted often, the changing government attitudes towards gold is one of our bullish gold factors.)

(8) "*Greece has implemented all agreed prior actions in a satisfactory manner … Against this background, the disbursement of the euro area's contribution to the PSI operation in the form of EFSF bonds for the settlement of the Greek-law bonds as well as the accrued interest on the exchanged bonds can proceed as planned*", noted today's statement by Euro-group President Jean-Claude Juncker. We are not surprised, although in these matters nothing is absolutely certain. Assuming nothing gets in the way (CDS problems?) Greece will be able to make its March 20th roll-over deadline for €14.5 billion.

Is this the end of the problems? Certainly not! I still think Greece will leave the Eurozone before yearend. But all these efforts at providing Greece liquidity (through the EFSF, ESM, and IMF – one has to be an acronym specialist when it comes to what governments have done these last three or so years – remember TARP, etc.) have bought some time for "domestic restructuring" and fiscal retrenchment, and for the depression in southern Europe to work its way into political action and demonstrations!

We are not optimistic; but liquidity is good for gold – and southern Europe will require lots of it if it is to stay in the Eurozone.

Gold Watch

(1) Gold is back over $1700 as we write – "*bargain hunting*" reports suggest. ETF gold holdings are now at an all-time high, meaning investors have taken this opportunity to establish larger positions. If now only COMEX traders were to increase their gold exposure there could be a nice rally in the works. We'll see. The technical charts are not outright bullish in our opinion, as gold is flirting with its 50-day and 200-day MA.

(2) Risk Ranges: Narrow $1625-1825, Wide $1575-$1875. The risk ranges have not been changed this week.

Outlook for Gold

Presented at PDAC 2012

Dr. Martin Murenbeeld
March 4, 2012

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Overview: Gold Price Corrections

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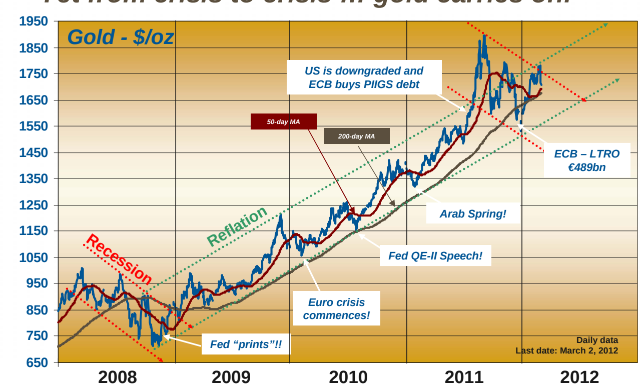
Overview

Yet from crisis to crisis … gold carries on!



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Ten Bullish Factors for Gold

1. **Monetary reflation:** recession, unemployment, debt
2. **Global imbalances:** dollar “fundamentally” weak
3. **Global FX reserves “excessive”:** diversification
4. **CB’s buying/not selling gold:** huge attitude change
5. **Gold not in a bubble:** room to rise
6. **Mine supply up only modestly:** gold costly to find
7. **Investment demand:** Asian market deregulation, ETF
8. **Commodity price cycle:** many years to run (BRIC)
9. **Geopolitical environment:** Iran??
10. **Inflation in the EM’s:** boosts local demand

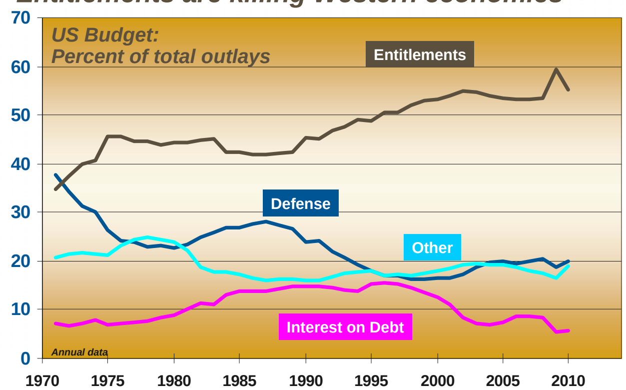
Bullish: (1) Reflation

Antecedents of the Sovereign Debt Crisis

1. **Baby-Boomer Retirements:** Creates huge fiscal pressures going forward on account of over-promises by governments
2. **The Great Recession:** Pushed budgets into record deficit – just when the early boomers were starting to retire
3. **The Euro Common Currency:** Membership in the Euro System allowed interest rates to “converge” - and “undisciplined” governments to borrow excessively
4. **Massive FX Reserves:** high oil prices and undervalued currencies led to massive increases in FX reserves which then had to be recycled

Bullish: (1) Reflation - Retirement

Entitlements are killing Western economies



Bullish: (1) Reflation

How will governments deal with their debts?

Government Choices:

- Renege on promises
- Cut other services
- Raise taxes
- Print more money

Bullish: (1) Reflation

Print more money? Really?

> ***"Throughout history, feckless governments have dodged their fiscal responsibility by turning to their monetary authority to devalue the currency, monetize debt and inflate their way out of structural deficits"***

Richard Fisher:
President and CEO of the FRB of Dallas
March 10, 2011

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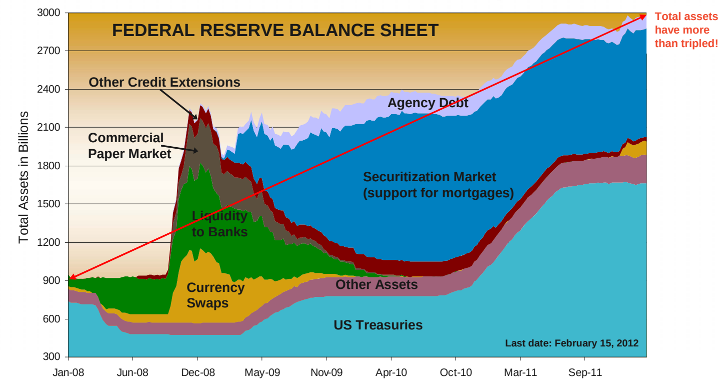
Bullish: (1) Reflation

The Fed balance sheet has blown up …



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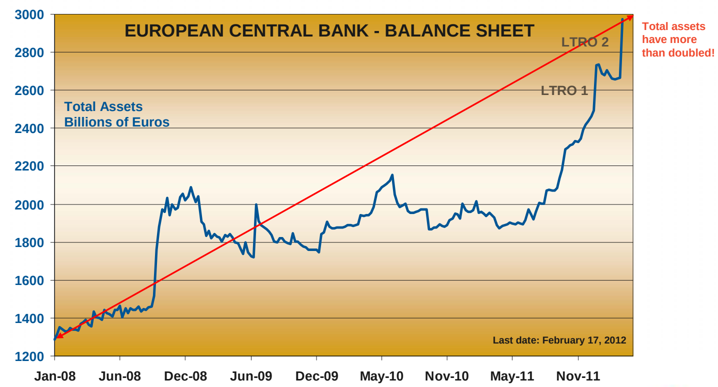
Bullish: (1) Reflation

ECB is buying paper from banks and governments



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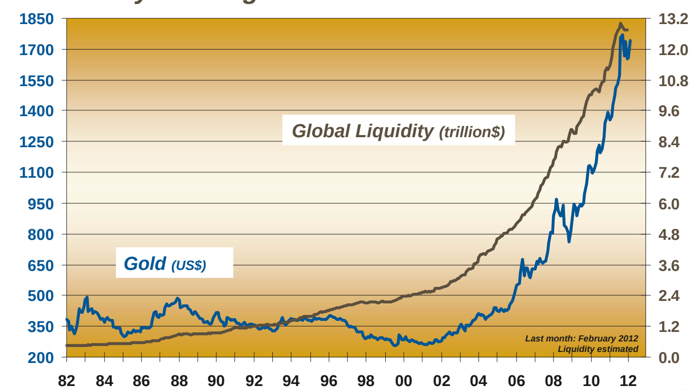
Bullish: (1) Reflation

Money drives gold …



Global Liquidity: FX Reserves + US MBase
Source: IMF, Federal Reserve

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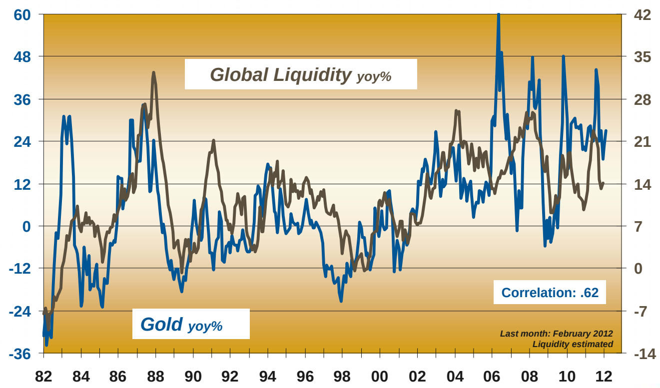
Bullish: (1) Reflation

Gold rises and falls with liquidity



Global Liquidity: FX Reserves + US MBase
Source: IMF, Federal Reserve

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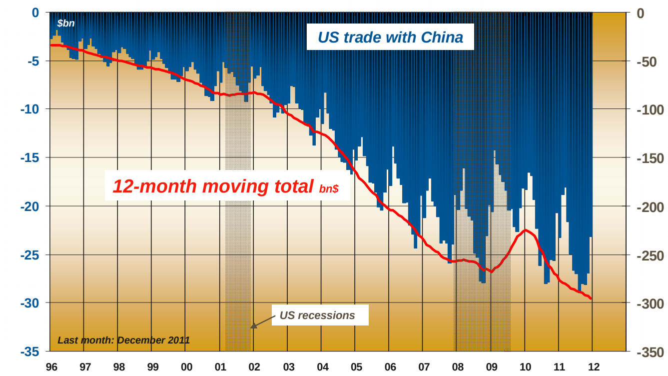
Bullish: (2) Global Imbalances

Trade deficit with China is unsustainable



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Bullish: (3) Global Reserves

Diversification out of reserve-dollars is likely

The choices for a central bank are limited:

1. ***Other currencies***
   - *These currencies must have deep international capital markets - some do not: renminbi, ruble; some do: yen, pound, euro* ***(but is euro now suspect?)***
2. ***SDRs issued by the IMF***
   - *The SDR is a basket currency that includes only the dollar, yen, pound, and euro - it has limited use outside of central bank markets*
3. ***Gold, other "hard" assets, mining investments***
   - *But gold market is "narrow" and China likes commodity-producing assets*

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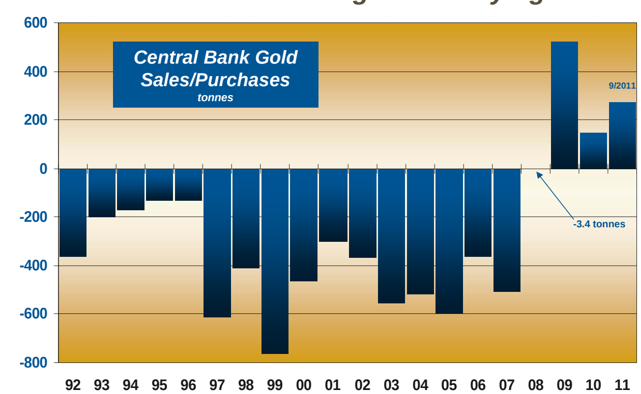
Bullish: (4) CB's Buying/Not Selling

Central banks were selling – now buying



Source: IMF
Data as reported in IMF statistics, which do not necessarily agree with date of actual gold sales or acquisitions because Saudi Arabia and China reported purchases long after the fact

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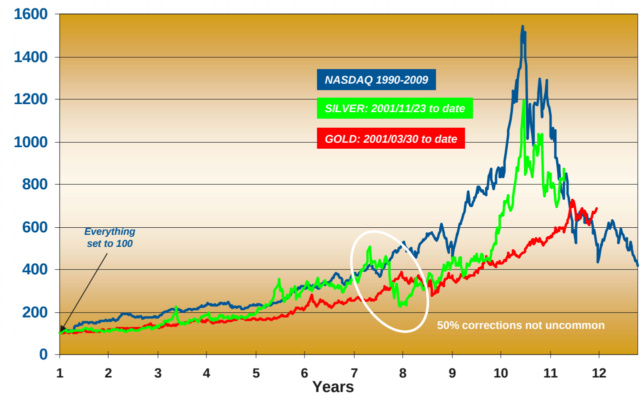
Bullish: (5) Gold Not in a Bubble

Silver might have been … but it is volatile!



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Bullish: (6) Gold Supply

The general commodity supply outlook is impaired

1. ***Difficult governments:*** *i.e., Venezuela*
2. ***Governments are in debt:*** *i.e., Australia has introduced a "resource super-profits tax" , Colombia raising mining taxes, etc. …*
3. ***Environmental hurdles:*** *i.e., the Gulf of Mexico disaster changes the future for off-shore drilling*
4. ***"Peak" gold, "peak" oil, peak … :*** *The low-hanging fruit has been picked …*

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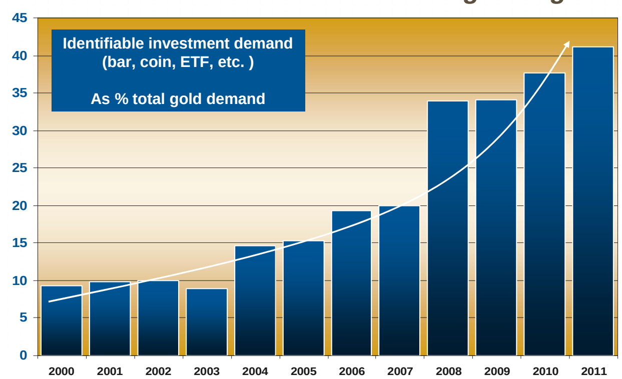
Bullish: (7) Investment Demand

Identifiable investment demand is growing



Source: World Gold Council "Gold Demand Trends 2011-Q4" data tabulated by Thompson Reuters GFMS

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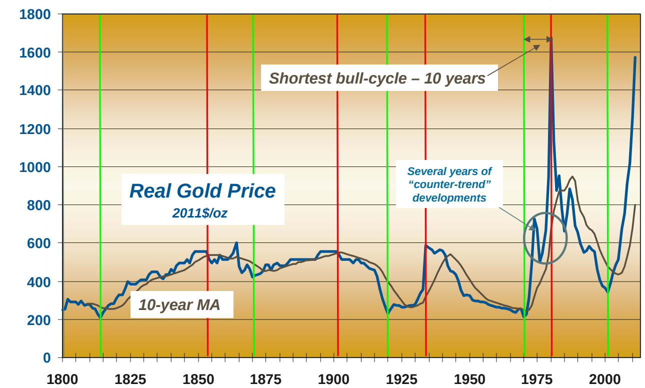
Bullish: (8) Commodity Cycle

The shortest gold cycle lasted 10 years



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Bullish: (9) Geopolitical

The biggest geopolitical crisis to date …

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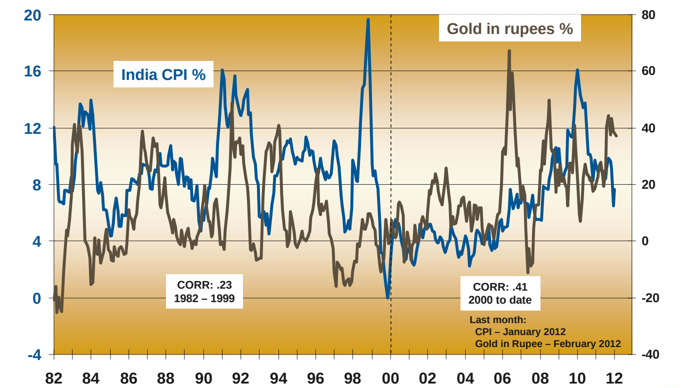
Bullish: (10) Inflation in EM's

Inflation is having an impact on Indian demand



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Eight Bearish Factors for Gold

1. **EU Recession:** fiscal retrenchment, deflation
2. **Chinese recession:** commodity demand plunges
3. **Physical demand weakens:** high prices/weak economic growth
4. **Strong dollar:** flight out of euro
5. **Liquidity of last resort:** for Greece, Italy … investors
6. **Equity market confidence improves:** investment interest in gold wanes
7. **Dehedging finished:** hedging recommences
8. **Policy "exit strategies":** rising real interest rates

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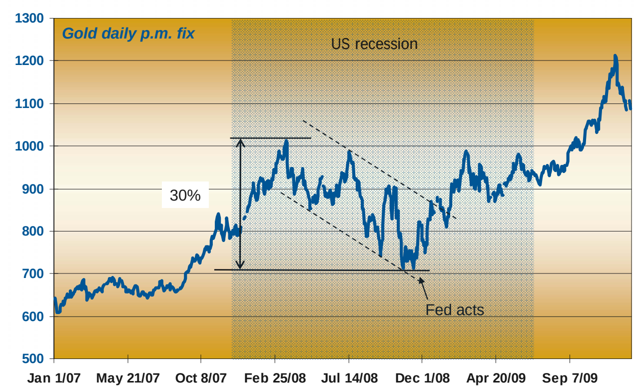
Bearish: (1) OECD Recession

Gold declines before stimulus kicks in



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Bearish: (5) Liquidity of Last Resort

The PIIGS need cash!

- ***The PIIGS hold over 3000 tonnes of gold, and the Eurozone over 10,000***
- ***We have been concerned about Italy for years***
- ***But Greece, Portugal, and Spain might be the first to swap/sell – were it to come to that***

Gold Reserves	tonnes
Portugal	382
Ireland	6
Italy	2452
Greece	111
Spain	282
Total	3233
US	8133

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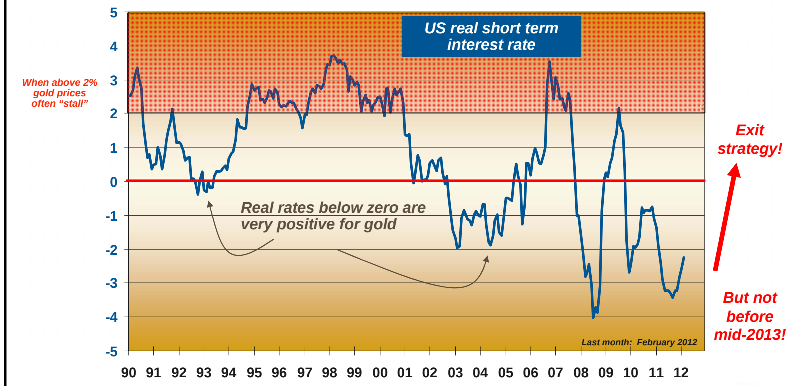
Bearish: (8) Exit Strategies

US real rates will rise eventually … after 2014?



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The Latest Forecast

The scenarios make no allowance for geopolitics!!

Gold Price Scenarios

	2012-avg	2012-end	2013-avg
Scenario A: p = 10%	$1366	$1310	$1325
Scenario B: p = 50%	$1761	$1825	$2010
Scenario C: p = 40%	$2018	$2245	$2520
Weighted:	$1825	$1942	$2145

•Based on January 13, 2012 projections
•Next update March-end

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Thank you for your attention!

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