Gold revaluation - Clutching at golden straws

Some gold analysts are coming up with theoretical moves which could have a huge impact on the gold price, but will the suggested scenarios ever happen?

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Gold analysis and theorising is a hazardous exercise with the metal price seldom seeming to follow what would appear to many to be the logical path to new heights - and on the occasions it does surge dramatically, it then tends to come crashing down again, burning the fingers of many. This is not to say that gold is not a good investment as has been shown by its overall performance against markets in general over the past year, and is not to say it will not regain its upward trajectory before too long, but some of the admittedly well thought out, and perhaps economically logical, theories put out by gold proponents, which would lead to a huge gold price increase, are still, in our view, unlikely to come about

Notable amongst these theories are two, very logical moves either of which would increase the gold price dramatically, but will they in fact ever happen?

The first of these 'solutions' is that China starts buying substantial amounts of gold in place of U.S. dollars for its huge currency reserve surplus, the logic being that long term dollar parities are likely to fall against most other currencies and this would be a way for China to protect its reserve position.

The second is that the U.S. Treasury and world Central Banks will impose a huge revaluation of gold vis a vis the dollar as a contributory element in easing the world's economic ills - a neat solution according to some well respected economic theorists.

The China point would seem logical to the investment community as this sector is so geared to material growth that it cannot see that other institutions do not necessarily think the same way. From the Chinese point of view what is a trillion dollars here or there when one is sitting on so much? One doubts that they are actually too bothered about maximising values here. Politically, buying large sums of gold to replace the dollar would further destabilise the dollar and the U.S. economy, but this would undoubtedly also impact adversely on Chinese industry.

To some extent this option has already been overtaken by events as the U.S. economy has contracted, and is still contracting, dramatically and China is catching a severe cold as a result. If anything may convince the Chinese not to further destabilise the U.S. economy by buying huge sums of gold and thus add another major element to dollar devaluation too, then this would be a strong sign that it might be very foolish to follow this route.

The second theory which has surfaced is that, after years, so the theory goes, of conspiring to hold the gold price down, the U.S. Treasury and Central Banks may now be looking to very substantially revalue gold and control its sale. This may not be as far fetched as it may sound to those used to operating in a supposed fee market economy as it mirrors steps taken by President F.D. Roosevelt to end the Great Depression. Roosevelt ordered U.S. citizens to sell all their gold to the U.S. Treasury in 1933 - and then in 1934 ordered a 70 percent increase in the gold price from $20 to $35, with the U.S dollar fully backed by the U.S. gold holdings.

With President elect Obama a keen student of Roosevelt's policies, so the theory goes, he may well consider the same kind of dramatic move which would put huge amounts of cash into the U.S. economy, at the expense of printing more money, and huge amounts of gold into the U.S. treasury in return which should help prevent further dollar destabilisation despite the potentially inflationary impact of the enormous money supply increase. The subsequent gold revaluation would, at a stroke, substantially improve the U.S reserve postion. This argument is set out in detail by Stewart Thomson, a retired Merrill Lynch broker who now runs the Graceland Newsletter - see http://www.321gold.com/editorials/thomson_s/thomson_s_011409.html

For this to have an effect globally would require other Governments and their Central Banks to do something similar - the revaluation part of which would no doubt be approved of by those who have long berated as a conspiracy the supposed Central Banks' consensus in gold price manipulation to keep the price down. But a 'conspiracy' to manipulate the price upwards is, of course, another matter altogether! However restrictions on the individual's right to hold any gold at all is perhaps a move too far for most to accede to in today's political environment.

It is doubtful whether a number other countries, though, could quite follow suit in terms of gold 'confiscation', although there might be some kind of consensus in terms of gold price revaluation.

To an extent one would consider these ideas as 'clutching at straws' by the gold bull theorists, however economically neat the latter solution may be as a help in curing the world's financial ills. Given the recent unprecedented, and seemingly unsuccessful, moves by governments worldwide to try and kick start economies again, one cannot rule out such a dramatic move by an Obama administration looking for another financial experiment to try and stimulate the economy. Politically, getting something like this through Congress has, to say the least to be problematic, but in these days where 'free world' government controls over what citizens can and cannot do are continually increasing - who knows?

For the medium term, the global financial meltdow, and its continuation, will likely see a rise in gold price over the next half year, and possibly beyond, although a decline in jewellery fabrication and sales has to be a worry from a fundamentals pont of view. Global gold output, though, is still falling - a trend which is likely to continue - and with the gold majors all expressing confidence in the metal price, some dehedging will likely continue, although here the requirements of financial institutions to protect themselves on new project risk may see some forced hedging too which will mitigate the overall dehedging position.

Most of these factors are positive for gold, but as always its price progress remains unpredictable and may well be as dependent on the strength of the dollar as ever. And the dollar has defied logic by rising despite the U.S. economy's travails. Whether this will continue or reverse may be the ultimate bellwether for the gold price.