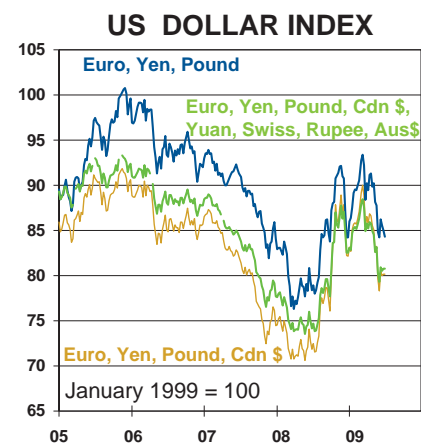
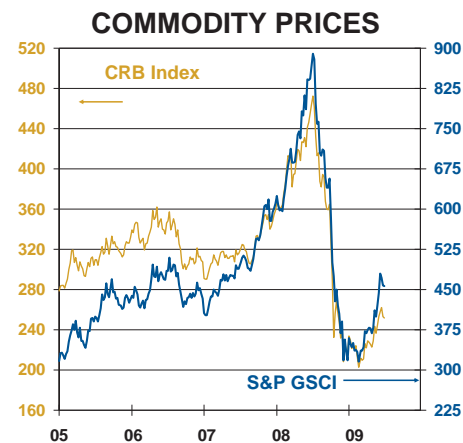
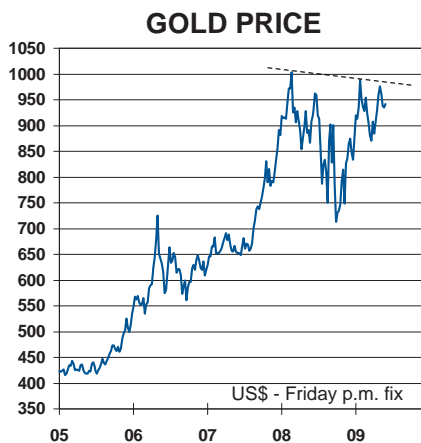


# Gold Monitor

by Martin Murenbeeld

June 26, 2009



	Jun-22	Jun-23	Jun-24	Jun-25	Jun-26
Gold - 2nd Fix	919.25	920.75	933.50	937.25	942.00
Gold - COMEX	921.00	924.30	934.40	939.50	939.40
Silver - HH	1383.00	1377.00	1403.00	1400.50	1411.00
Platinum - NYME	1169.10	1173.60	1175.20	1197.00	1207.60
Crude Oil - NYME	67.50	69.24	68.67	70.23	69.17
CRB Bridge - NYBOT	246.07	249.80	249.84	253.38	251.95
US \$ (Excluding Cdn.)	86.06	85.10	85.59	85.72	85.11
Fed Funds (Overnight)	0.25	0.25	0.21	0.19	0.21
US Bonds - CBOT	116.36	117.20	116.56	118.02	118.28
TSX Global Gold Index	295.15	307.70	315.31	330.36	327.03
S&P 500	893.04	895.10	900.94	920.26	914.57

Gold Price Average (2nd fix, daily) - 2009 to date

914.85

We have written periodically on the evolution of the international monetary system and the importance of this evolution for gold. Recently, in an article entitled “*Is the US Dollar Heading for History’s Dustbin*”, I argued that the dollar will be an “international currency” for at least the remainder of our lifetimes. Gold will outlast the dollar, I stated, but it is difficult to see any other currency now in circulation replacing the dollar. That won’t stop certain governments from trying however!

China and Russia are two that seem to be bent upon removing the dollar from its perch as the world’s key “international currency” (defined as a currency which is acceptable around the world in both private and official transactions). This week’s Monitor addresses the latest effort in this regard, as outlined in a 170-page report from the Peoples’ Bank

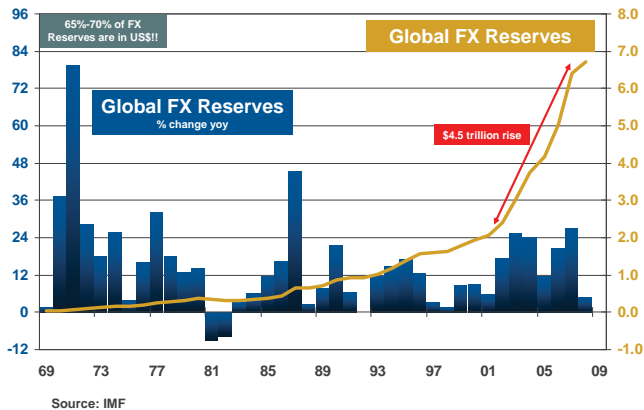
of China (PboC). It states, among other things, that “to avoid intrinsic shortcomings in using a sovereign currency as a reserve currency, we need to create an international reserve currency that is divorced from sovereign states and can maintain a stable value over the long term”. (This is quoted from a Reuters report of June 26 because the full report does not appear to have been posted on the PboC’s website.)

If any reader concludes right here that there is only one currency which has durably served in the role of reserve currency throughout history, and this currency is not the liability of any central bank or political jurisdiction, the reader need read no further – and get on with the weekend.

Gold is that “currency”, of course. Indeed, because of gold’s unique attributes it was an integral

## Executive Summary

1. China is pushing for a new international currency (SDR?)
2. A new SDR could well include gold
3. Meaning gold might one day reemerge as an international monetary asset



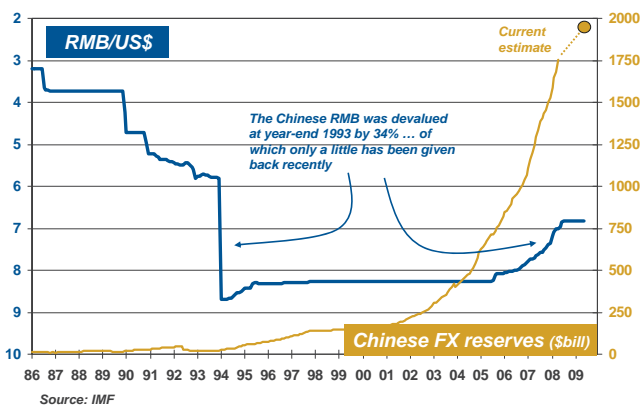
### Foreign Exchange Reserves (countries over \$50 bn)

	bn\$		bn\$
China	1950.0	Algeria	140.0
Japan	983.6	Thailand	114.1
Taiwan	458.8	Libya	89.6
Russia	367.3	Malaysia	85.0
India	241.7	Mexico	82.8
Korea	205.6	Turkey	64.2
Brazil	189.6	Poland	57.8
Hong Kong	186.2	Indonesia	52.4
Singapore	177.5		
			5446.3

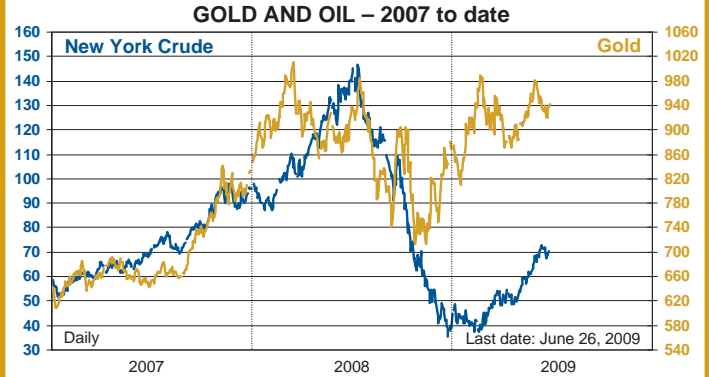
Source: IMF, June 2009

Not in total:

Fuel Exporters 861.52



Global currency reserves are approaching \$7 trillion. The large holders want to diversify into a currency not under US control. So, is it time for gold to re-enter the international monetary system, or should the large reserve holders finally upvalue their currencies against the dollar? Either way, of course, gold benefits.



In a round of presentations this last week there were a number of questions on oil versus gold. The chart makes it clear that they often go their separate ways.

component of literally all monetary systems right until 1971, when the US brought down the Bretton Woods system and ushered in a system that might best be described as one of "managed floating" currencies. The IMF even went so far as to legislate gold out of this new system. And, indeed, a number of countries began selling off their gold reserves in the 1980's and 1990's.

It is clear that the China isn't happy with the new system, whatever its views might have been prior to its new economic status. Nor are some other emerging countries, including Russia. The predominantly-Muslim countries have also been discussing for some years now how to construct a regional monetary system that would reduce their dependence on the dollar. There have been discussions about a Gold Dinar, for example, which would serve as the centerpiece of a regional currency system. Accordingly, those of us who follow gold must sit up and take notice because, depending upon how all this unfolds, we could be witnessing the re-introduction of gold in the international monetary system.

I won't go into the details of my disagreement with the theory China seems to have employed to come to its conclusions about the current monetary system. It must however be noted that China could have avoided many of the problems of the current system, and could have helped the world avert the latest financial and economic crisis, had it simply allowed its currency to rise against the dollar on the back of its trade surplus and capital inflows – much as many central banks, including the Bank of Canada, had persistently suggested it should do.

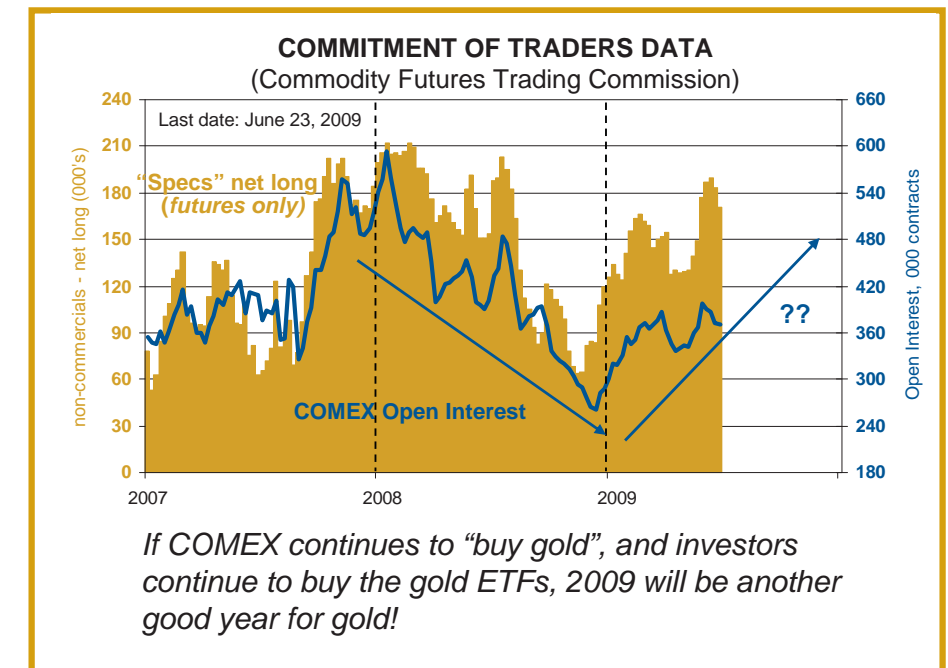
The three charts on the left hand side of this page provide some background to China's complaint. (The charts come from several presentations the reader may already have seen.) World foreign exchange reserves



have risen nearly \$5 trillion since 2001. There are 17 countries that now hold more than \$50 billion, and 11 that hold more than \$100 billion. Since most of these reserves are held in dollars it is clear that these countries have a significant interest in the value of the US dollar specifically, and US policy that might affect the dollar more generally.

But here is the rub! All these countries could only have built up their reserves through foreign exchange market intervention to keep their currencies down against the dollar. Indeed, as the third chart makes clear, China devalued its currency quite sharply during the 1990s in order to lower it further against the dollar. In short, most of these countries like to keep their currencies “undervalued” against the dollar. But should they then complain when the inevitable day arrives that the dollar must go down?

The PBoC’s report went on to note that “*the economic development model of debt-based consumption is most difficult to sustain*”, which is technically true, of course. But then China’s economic development model of investment-based production is also “most difficult to sustain”. For some reason that escapes me certain

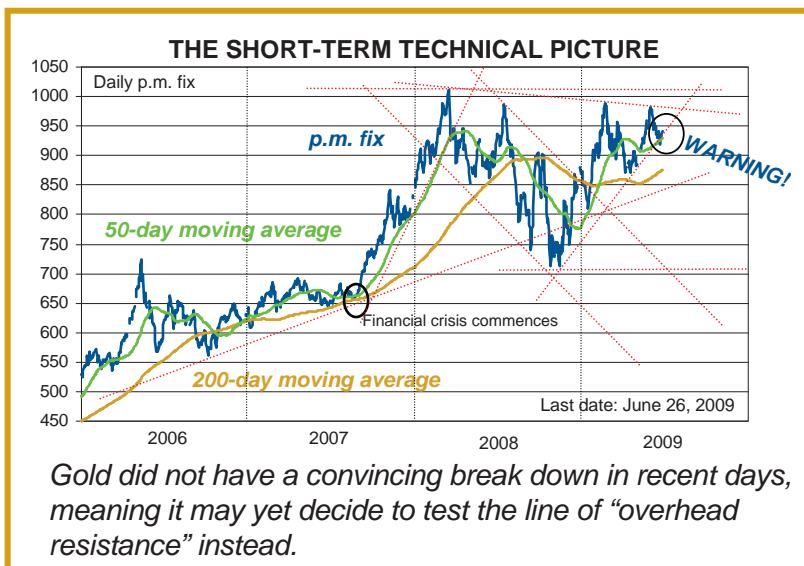


economic observers seem to have difficulty connecting production with consumption. They seem to think that China can produce goods *ad infinitum* but that the US may not consume *ad infinitum*! So who will buy China’s output if not the US?

I may have mentioned here before that Keynes suggested in the aftermath of WWII the world adopt the Bancor as an “international” currency; the Bancor was to be fixed to some 30 commodities, including gold. Who knows but that the Bancor could have worked for

the next 30 or so years! But Keynes understood that in a fixed exchange rate world (currencies were to be pegged to the Bancor, and thereby pegged to each other) some countries would run deficits and some surpluses. And the surplus countries would amass reserves – Bancors – while the deficit countries would lose Bancors. Ergo, he also suggested that if surplus countries didn’t enact policies that would see them spend these reserves they would be taxed. In short, his proposed tax would force surplus countries to use their reserves to import from the deficit countries and/or upvalue their currencies. Pretty simple, really! (His tax would have forced at least 11 of the countries in the aforementioned chart to alter their behaviour.)

How things have evolved however is that China and Russia now want to resuscitate the SDR, which is a basket currency composed of the dollar, yen, pound and euro. And they want to expand the basket to include the renminbi, ruble, rupee and gold. Given that gold is the most durable currency



of the lot, my guess is that in the fullness of time demand for gold will vastly outstrip the demand for this new SDR. But even so, when countries convert, say, \$2 trillion of reserves into this new SDR, what will happen to the dollar's exchange rate against the SDR? Indeed, what will happen to the dollar's exchange rate versus the yen, pound, euro, rupee, ruble, renminbi and gold – the other currencies in the SDR? Well, the dollar will go down of course! The dollar will go down against whatever these countries diversify into – be it gold, SDRs, euros, renminbis, etc. The IMF, through some complicated recycling

process – issuing SDRs to China in exchange for the dollars China doesn't want, will try to camouflage the dollar's devaluation but the laws of supply and demand are pretty clear on this: what you don't want goes down and what you do want goes up!

In fact, for the first time in a long while, I am beginning to think that the world is moving closer again to reintroducing gold in the international monetary system – countries like Russia want gold in the system. Indeed, Russia seems to have stumbled upon an historical fact: in history countries have tended to gravitate back to gold

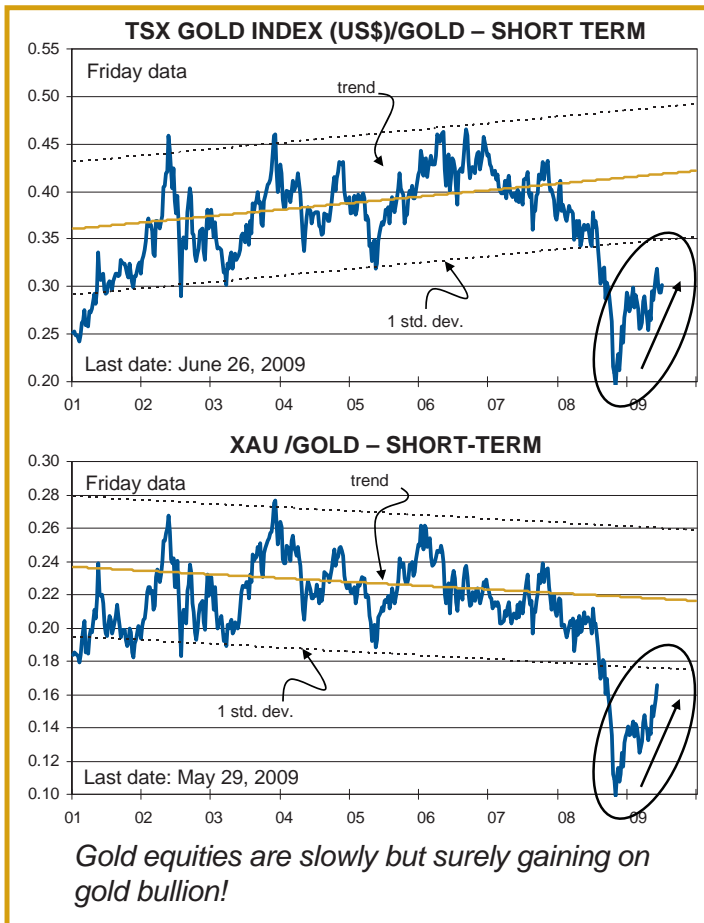
as a reserve item precisely because it is the one item no central bank can print. To put it differently, if China doesn't like the look of US monetary and fiscal policy, it can buy gold – or it can let its currency appreciate. Either way, it will curb its hoard of dollars.

(By the way, just in case the reader forgot, the IMF can "print" the SDR on the collective nod of 85% of the IMF voting weights. Since the US can block

this "printing" with its 17% voting weight, China and others will soon make sure the US vote is reduced to less than 15%! The fact is, there is always demand for an ability to "print" money; it's just that China and Russia don't want the Fed to do the printing this time around. But were they ever to get the chance – watch out!)

To conclude, I wrote an editorial piece on "dominant" central banks and "satellite" central banks in 1999. I plan to update that piece soon. The essence of it was that dominant central banks – the Fed, ECB, Bank of Japan, Russian Central Bank, the PboC, and the Central Bank of India to name the obvious – would find it very useful to hold gold in their reserves. Satellite central banks – say the Bank of Canada – would not need to hold gold; they would hold their reserves in the currency of their "dominant" bank – in Canada's case the Fed. With China and Russia stating they do not want to hold all their reserve in US dollar form, I believe my "dominant" central bank theory is beginning to turn into reality. And this means gold has a very positive future. (There are other reasons for a positive future for gold, of course, but with all the news on the international monetary front these days we are likely to be highlighting this reason for the next while.)

**Gold Watch (1) Risk Ranges: Narrow \$900-\$975, Wide \$875-\$1000.** The risk ranges have been raised a little at the bottom end this week. The gold charts are less weak and the dollar is suffering from overseas criticism – as discussed above.



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