Gold Monitor

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Murenbeeld & Co.
Subscription research for the gold business.

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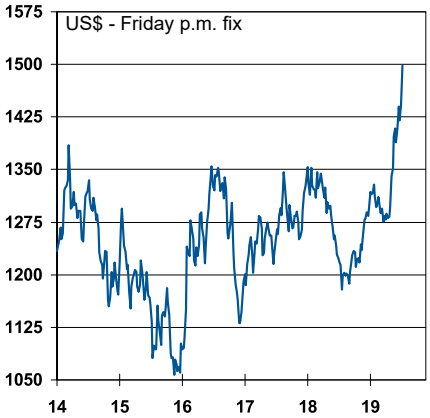
GOLD PRICE



Source: Bloomberg, Murenbeeld & Co.

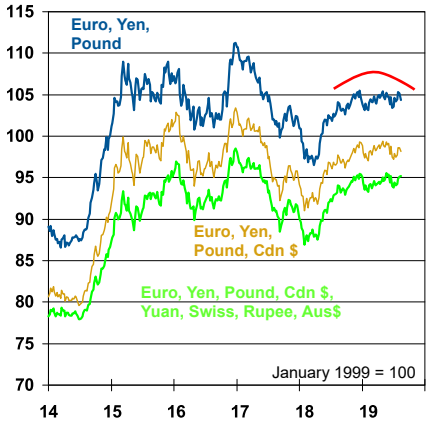
	Aug-05	Aug-06	Aug-07	Aug-08	Aug-09
Gold - 2nd Fix	1465.25	1465.25	1506.05	1495.75	1497.70
Gold - COMEX	1464.60	1472.40	1507.30	1497.70	1496.60
Silver - HH	1636.60	1643.70	1709.50	1696.60	1701.50
Platinum - NYME	857.90	853.20	871.00	867.50	864.40
Crude Oil - NYME	54.69	53.63	51.09	52.54	54.25
CRB Bridge - NYBOT	171.49	170.54	167.89	170.32	172.09
US $ Index (NEFXR0)	95.15	95.27	95.43	95.25	95.17
Fed Funds (Overnight)	2.13	2.13	2.12	2.12	2.12
US 10-Year TIPS Yield	0.11	0.08	0.10	0.06	0.09
TSX Global Gold Index	-	246.78	253.95	254.92	252.20
S&P 500	2844.74	2881.77	2883.98	2938.09	2918.65

Source: Bloomberg, Murenbeeld & Co.

TSX GOLD/TSX COMPOSITE

Source: Bloomberg, Murenbeeld & Co.

US DOLLAR INDEX



Source: Bloomberg, Murenbeeld & Co.

Review

by Martin Murenbeeld

It was all one way in the gold market this week!

After the US Treasury declared China a "currency manipulator" Monday, gold exploded upwards to set a new cycle high of $1506.05 at the London pm fix on Wednesday. The pm fix this morning came in at $1497.70, which was $55.95 ahead of last Friday's pm fix. This $55.95 is the largest weekly gain in 183 weeks; gold rose $89.40 in the week ending February 12, 2016 when the current bull market was in very early days.

We discuss currency manipulation and the trade/ currency war below, but first we'd like to review our latest forecasts in light of this new development. It certainly appears that the economic and geopolitical environment has flipped into Scenario C, our bullish gold price environment. Scenario C projected gold to average $1470 in Q3 ($1460+$10) and $1505 in Q4 ($1495+$10). Scenario C

Gold Price

Source: Bloomberg, Murenbeeld & Co.

Gold Price Outlook – Update

		18-2	18-3	18-4	19-1	19-2	19-3	19-4	20-1	20-2	20-3	20-4
Actual		**1306**	**1213**	**1226**	**1304**	**1309**						
Scenario	**A**						1364	1320	1271	1263	1258	1251
	B						**1410**	**1446**	**1455**	**1477**	**1513**	**1546**
	C						1460	1495	1521	1565	1622	1681
Probability	**A**						0.00	0.00	0.00	0.00	0.00	0.00
	B						0.25	0.25	0.25	0.25	0.25	0.25
	C						0.75	0.75	0.75	0.75	0.75	0.75
Probability-Weighted							**1448**	**1483**	**1505**	**1543**	**1595**	**1647**
Factor for Geopolitical Crises							**15**	**15**	**15**	**15**	**15**	**15**
FORECAST							**1463**	**1498**	**1520**	**1558**	**1610**	**1662**

also projected gold to average $1696 in 2020-Q4 ($1681+$15) – see the July 19 *Gold Monitor*.

But these are model-based forecasts, dependent upon assumptions and historical relationships that have generally guided us in the right direction. However, if the emerging currency war leads to a larger rise in central bank gold demand than assumed in Scenario C, and/or a sharper change in investor sentiment, and/or wholesale flight from a dollar that the US Administration clearly wants to devalue, and/or US interest rates turning negative, then even the bullish assumptions of Scenario C may fall short of the mark.

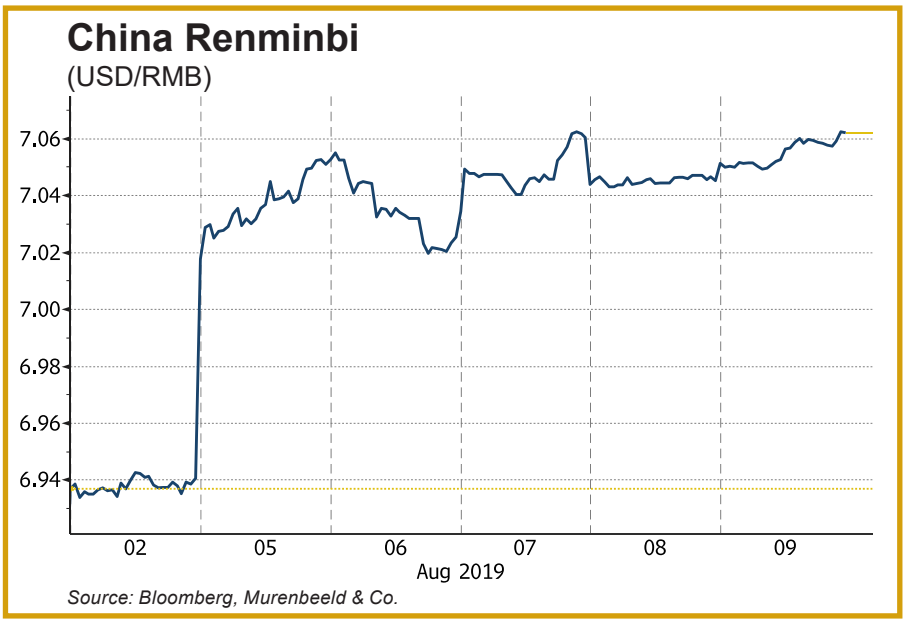
We had put a 35% probability on Scenario C; this might well be upped to 75% in the wake of developments this week. Scenario B, (our baseline Scenario which projected $1420 in Q3 ($1410+$10) and $1561 in 2020-Q4 ($1546+$15)) had a 55% probability, which might well now be cut back to 25%. And if we then also raise the geopolitical factor from $10 to $15 across the board, we get the revised forecasts in the table above.

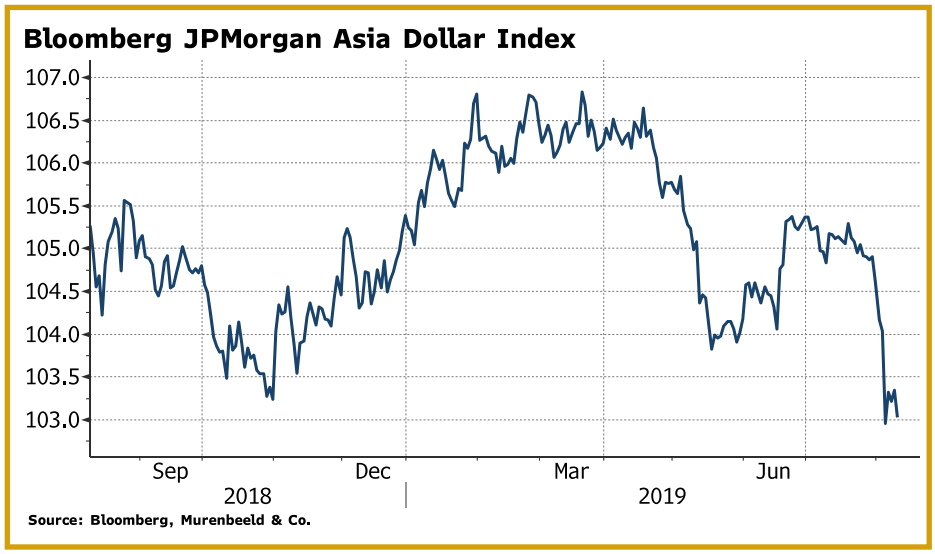
The gold price average for Q3 to date is $1426; were gold to average $1500 for the rest of the quarter (doubtful, but …??) the Q3 average would come in at $1466, about where the revised forecast puts gold. If gold continues to rise sharply (possible … but??), then even this revised forecast will be too low.

Regardless of how gold prices play out however, our strong advice is to stay long gold in one's portfolio. We haven't waivered on this at all because, regardless of the near term, the medium and long-term outlook is very bullish. Eventually, as we have noted repeatedly, gold will take out its inflation-adjusted high, which currently stands at $2787 (see chart on page 9).

US-China Trade/Currency War

The trade war has finally morphed into a currency war – why are we not surprised? The chart below shows that the yuan (renminbi) broke 7.00 early Monday (5th). Within hours the US Treasury officially declared China to be a currency manipulator.





(Note: when the yuan declines, most Asian currencies decline right along with it, see chart above; Taiwan, South Korea, Thailand, etc. do not want to jeopardize their own competitive position by letting their currencies rise against the yuan along with the dollar. It is precisely for this reason that we believe the whole complex of Asian currencies is seriously undervalued – along with the yuan!)

Herewith some excerpts from the Treasury's press release on currency manipulation:

"Secretary Mnuchin, under the auspices of President Trump, has today determined that China is a Currency Manipulator … China has a long history of facilitating an undervalued currency through protracted, large-scale intervention in the foreign exchange market. In recent days, China has taken concrete steps to devalue its currency, while maintaining substantial foreign exchange reserves despite active use of such tools in the past. The context of these actions and the implausibility of China's market stability rationale confirm that the purpose of China's currency devaluation is to gain an unfair competitive advantage in international trade … The Chinese authorities have acknowledged that they have ample control over the RMB exchange rate. In a statement today, the People's Bank of China (PBOC) noted that it "has accumulated rich experience and policy tools, and will continue to innovate and enrich the control toolbox, and take necessary and targeted measures against the positive feedback behavior that may occur in the foreign exchange market." This is an open acknowledgement by the PBOC that it has extensive experience manipulating its currency and remains prepared to do so on an ongoing basis."

The WSJ noted earlier on Monday that: *"China's central bank suggested the depreciation was in response to Mr. Trump's decision last week to extend punitive tariffs to almost all Chinese goods … The currency's slump was "due to the effects of unilateralist and trade-protectionist measures and the expectations for tariffs against China," the People's Bank of China said in a statement … Given that China's central bank isn't independent, it would likely need approval from the political leadership to allow the yuan to depreciate below the 7 level."*

Long-time readers of this report will know that China's currency manipulation has been a global fixture for over 20 years. China was finally allowed to join the WTO in December 2001 (after years of repeated applications,which were refused for non-market policies). China's FX reserves were $212 billion at the time it joined the WTO (already quite large: less than Japan's reserves but more than the Euro Area's reserves). But that proved to be only the beginning; by June 2014 China's reserves had grown to just shy of $4 trillion! (Never in the history of international finance has one country gamed the system to such a degree!)

The *Peterson Institute for International Economics*, among others – i.e. editors of the *Gold Monitor* – claimed China was manipulating its currency (keeping its currency systematically undervalued for mercantilist reasons, which then encouraged massive inflows of foreign investment for the production of exports back to the countries that were the source of these investments).

Yet the US Treasury, under previous Administrations, refused to name China a currency manipulator (each Administration being fearful of rocking the boat and hoping for a change in Chinese policy).

And why has China built such a large hoard of FX reserves (built on the back of Chinese workers, of course, underpaid and under-consuming)? Well, if you are a China hawk in Washington, the answer is simple. China may hold just over $1 trillion of US government debt, but it can use its remaining $2+ trillion of foreign exchange reserves to help fund, for example, its Belt and Road Initiative - BRI (aka *Silk Road Economic Belt and the 21st-century Maritime Silk Road or One Belt One Road*). ("*The 70 BRI projects in 'corridor economies', excluding China, in all sectors that are already executed, in implementation, or planned are estimated to amount to US$575 billion"*, World Bank).

The BRI will not be funded entirely with yuan debt, of course, because yuan can only be used to buy goods from China. China's reserves are therefore important to the BRI, and they also help fund investments in Africa, Latin America, and Europe.

In short, China's massive reserves make it a financial hegemon on the Asian continent, and its overseas investments promote the formation of client states – which in due course will become geopolitical and the cultural satellites – as indeed is apparent already.

To be sure, the fact that the PBOC set the yuan rate above 7.00/$ is not strong evidence of "*currency manipulation*". Fred Bergsten of the PIIE notes "*China did manipulate from 2003 to 2013, intervening massively in the foreign exchange markets to strengthen its competitive position by buying dollars to hold the renminbi down. Since then, however, it has on balance intervened heavily on the other side of the market: selling dollars to keep the renminbi from weakening … This [latest] depreciation is due to market forces: Trump's tariffs push the dollar up against all currencies, the Chinese currency weakens as a result of the trade hit, and China will undoubtedly lower its interest rates to counter that slowdown. There is no evidence that China has sold renminbi for dollars to overtly push its exchange rate down*".

This last point is echoed by Chinese officials: "*'The renminbi's depreciation through seven to the dollar was a market move, not a government target', says Guan Tao, a former official at the country's foreign exchange regulator now teaching at Wuhan University in central China. 'It is a result of what the US government has done [during the trade war] not what the Chinese government has done'*", (FT 08/05).

But that is how it goes! The US Administration should have acted on China's currency manipulation many years ago but didn't. Now it is finally acting, as Trump promised he would. Furthermore, US Democrats have little sympathy for the Chinese position, nor does the EU business community and economists like myself who have watched China flaunt global trade and investment rules for years on end.

So now that China has officially, finally been declared a "*currency manipulator*" what happens next? *The [US] Trade Facilitation and Trade Enforcement Act of 2015*, which modifies *The [US]*

Omnibus Foreign Trade and Competitiveness Act of 1988, requires that:

The President take one or more of the following actions:

1. Deny China access to OPIC financing *(OPIC provides financial products such as loans and guaranties, political risk insurance, and support for investment funds, all of which help American businesses expand into emerging markets)*;

2. Exclude China from U.S. government procurement;

3. Call for heightened **IMF surveillance** of Chinese currency practices;

4. Instruct the United States Trade Representative to adopt appropriate policies in assessing whether to enter into a trade agreement or initiate or participate in trade agreement negotiations with China.

("IMF surveillance" is bolded because it is likely to be the first Presidential action, according to Washington observers!)

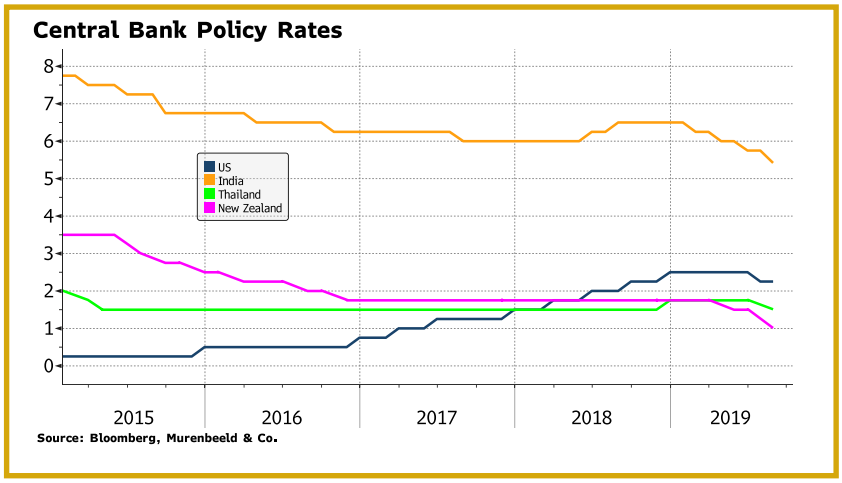
The reader will note immediately that this is rather mild punishment for currency manipulation. The 1988 Act however allowed for retaliatory countervailing duties if all else failed, and this is why I believe Trump called China a currency manipulator at this time – it "legitimizes" his use of tariffs against China.

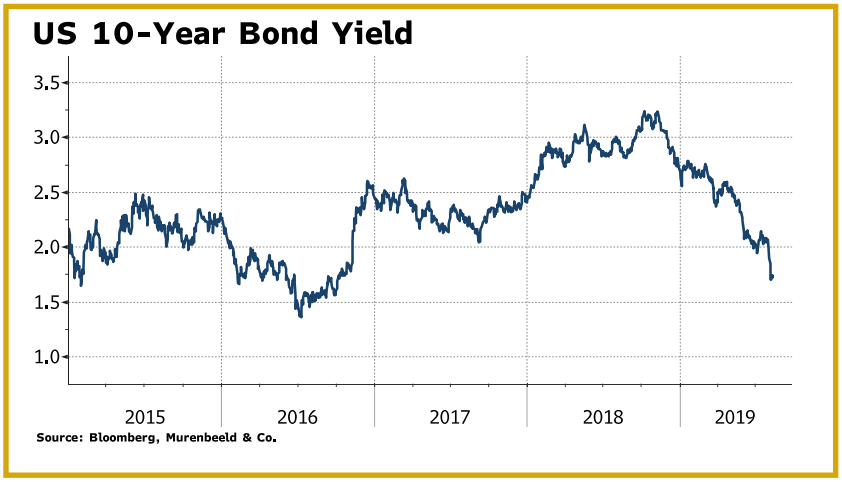
Stay tuned; this issue is far from resolved. ***Bottom Line***: gold will benefit hugely from time to time as more US/China crises unfold!

Other Fallout – Lower Interest Rates

"*Federal Reserve officials would need to consider more stimulus aimed at boosting the economy if growing trade tensions lead to a sharper pullback, a senior Fed bank president said Wednesday. Chicago Fed President Charles Evans already has said he thought the Fed would need to cut rates this year by at least one more quarter-percentage point, following last week's quarter-point cut, to lift inflation back to the Fed's 2% target. But on Wednesday [08/07], he suggested trade and other global developments 'have perhaps created more headwinds against that, and it would be reasonable to do more than just that. I don't know,' he said*" … WSJ (08/07).

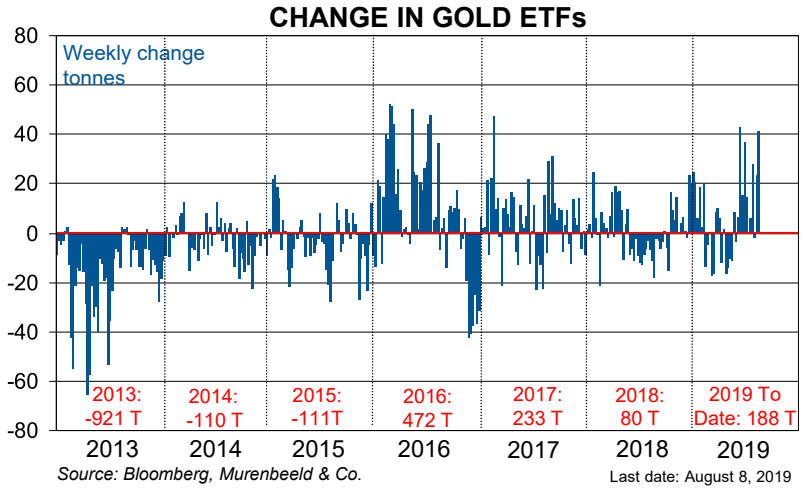
The Journal goes on to note (bolding added): "*Three central banks in the Asia-Pacific region* ***lowered interest rates in an unexpectedly***



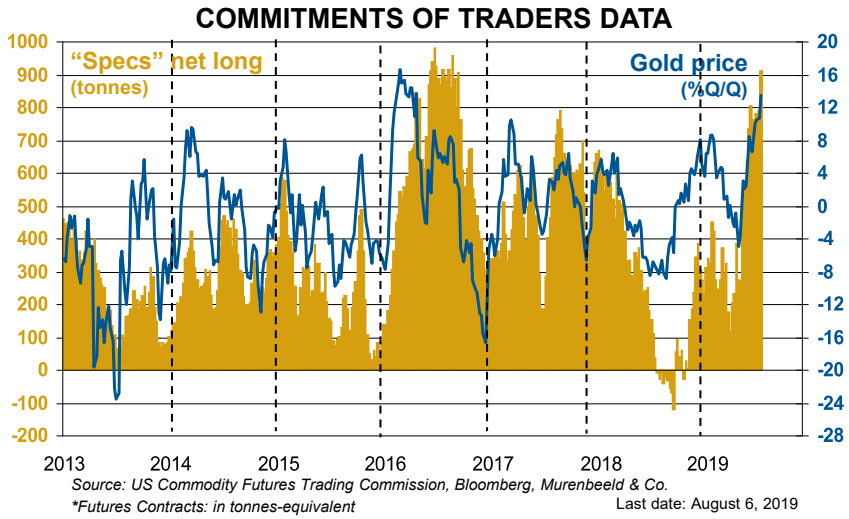


aggressive fashion *earlier Wednesday amid worries of growing fallout from the trade dispute between the world's two largest economies … The trade war has hit hard markets in Southeast Asia, a fast-growing region deeply intertwined with global supply chains supported by demand for Chinese goods … Central bankers in India and New Zealand already had started lowering their rates when they* ***cut their policy rates again*** *on Wednesday, while officials in Thailand reduced rates for the first time this year, reversing a late 2018 increase. The Philippines central bank is expected to follow its Asian peers with another rate reduction on Thursday."*

Have we mentioned before that lower interest rates – indeed, negative interest rates – are hugely positive for gold?

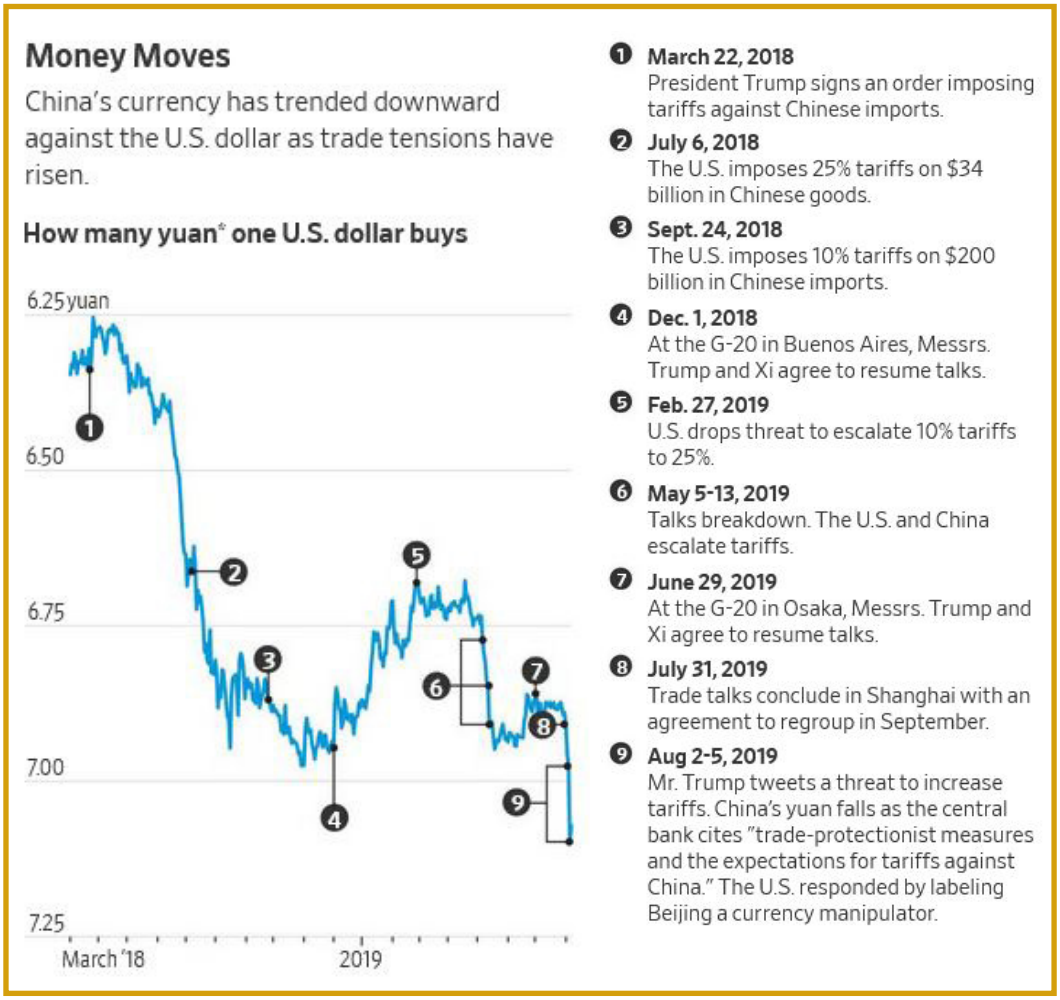


Gold ETFs rose by just over 41 tonnes over the five days through Thursday. (It is not often that we see such large weekly demand from the ETF sector.)



The net-long position of the "specs" on COMEX now exceeds the equivalent of 900 tonnes for the first time since 2016! (A contrarian will look upon this as a sign of a pending "correction".)

Background to Trade/Currency War



Source: WSJ, "In Allowing Yuan to Devalue, China Policy Makers Concede Economy Needs a Boost", August 7.

The yuan has systematically declined as the trade war has escalated.

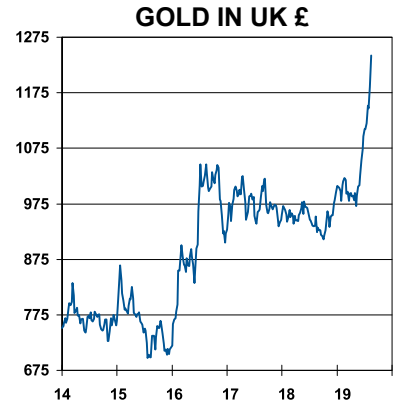
But the history of the yuan suggests that China systemically depresses the yuan against the dollar for mercantilist purposes.

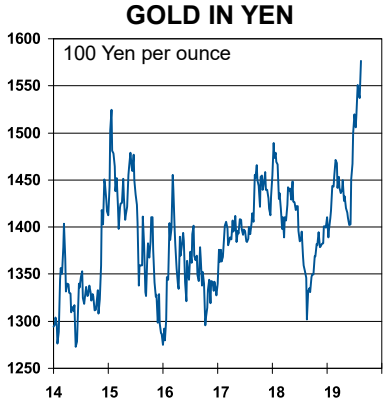
US Treasury - Three Criteria for "Currency Manipulation"

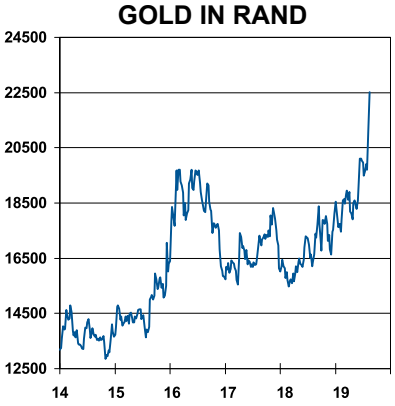
1. ***A significant bilateral trade surplus*** with the United States – one that is at least $20 billion. This threshold captures a group of trading partners that represented three-fourths of the value of all trade surpluses with the United States in 2018. It also captures all trading partners with a trade surplus with the United States that is larger than about 0.1 percent of U.S. GDP.
2. ***A material current account surplus*** – one that is at least 2 percent of gross domestic product (GDP). This threshold captures a group of economies that accounted for more than 90 percent of the value of current account surpluses globally in 2018.
3. ***Persistent, one-sided currency intervention*** – when net purchases of foreign currency are conducted repeatedly, in at least 6 out of 12 months, and these net purchases total at least 2 percent of an economy's GDP over a 12-month period.

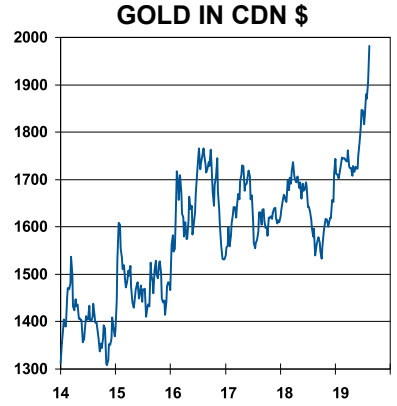
US Treasury, "Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States", May 2019

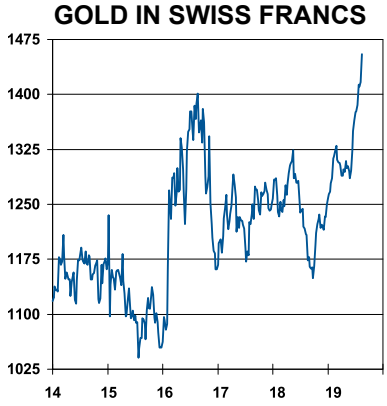
GOLD IN VARIOUS CURRENCIES

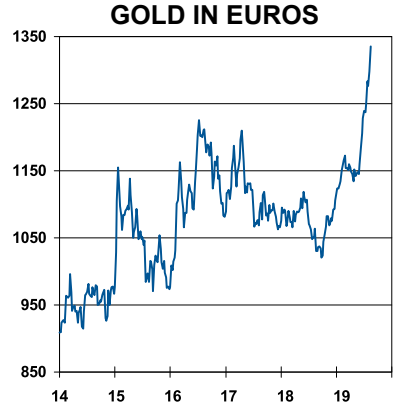


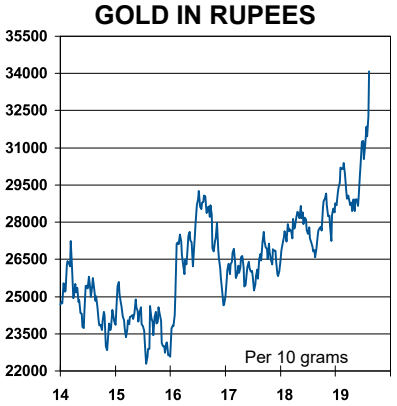


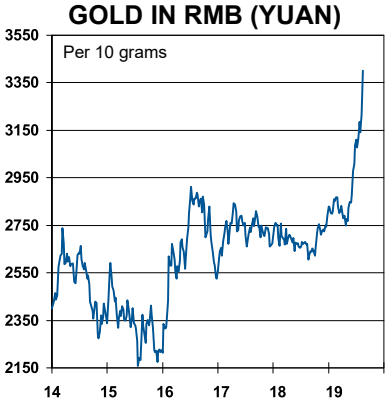


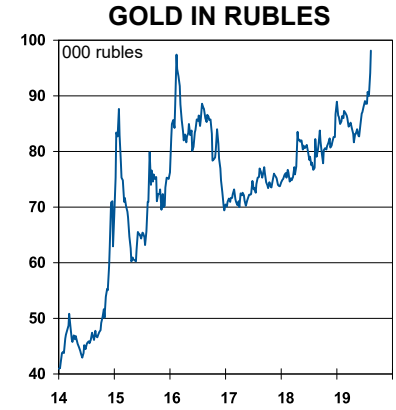


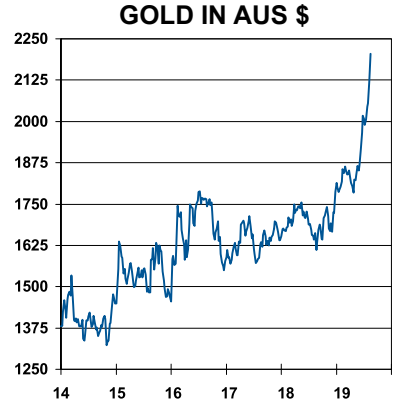






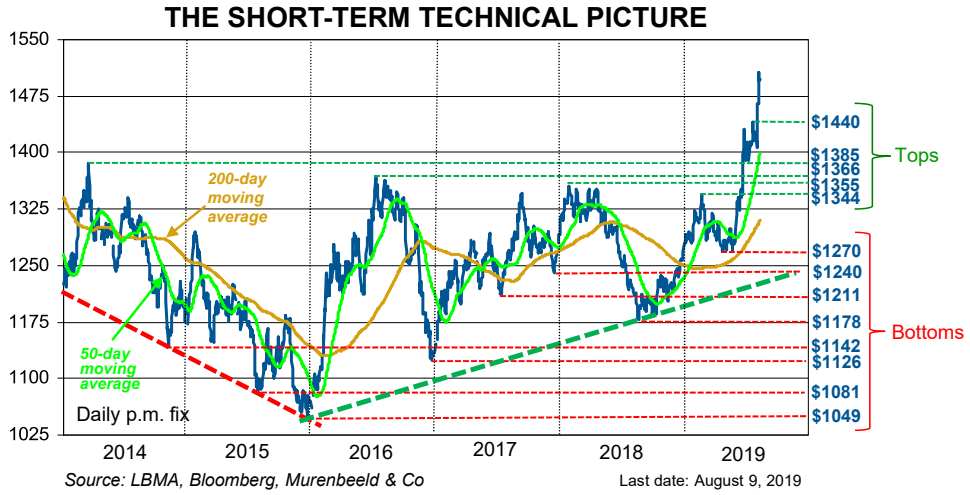




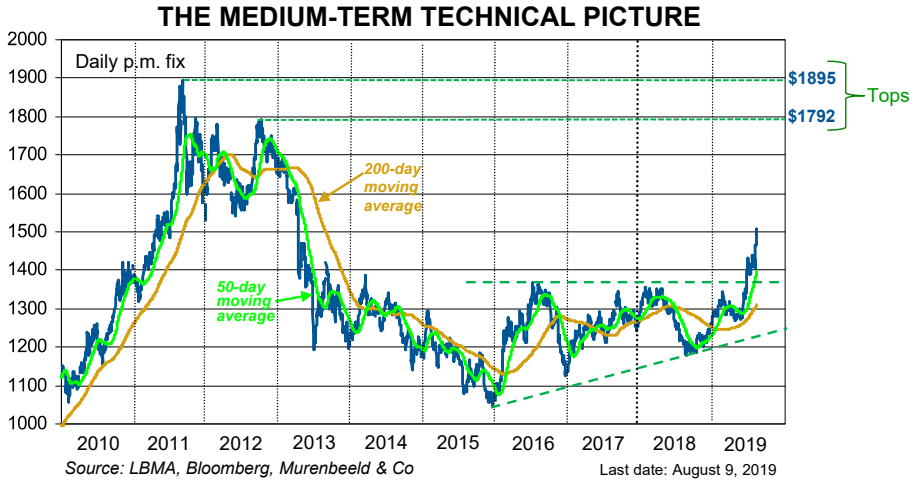


Source: Bloomberg, Murenbeeld & Co

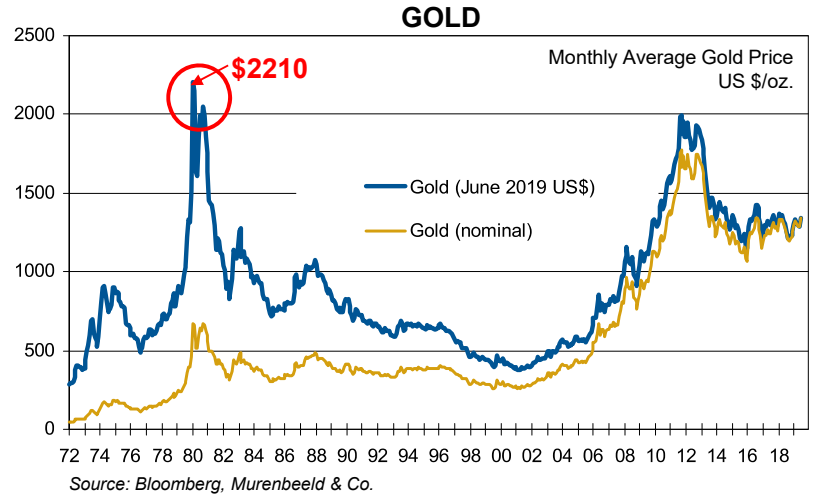
The charts speak for themselves; gold is in a bull market against all currencies!



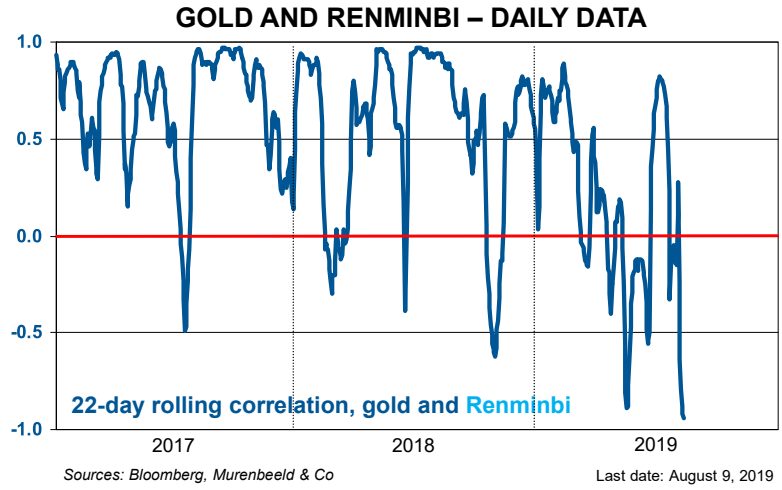
The short-term technical chart is devoid of technical references now that gold has surged through $1440 ...



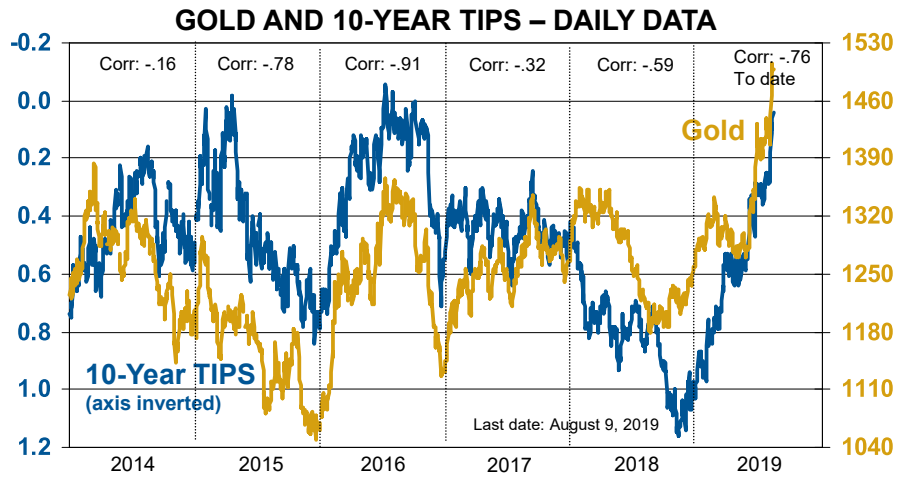
... we have accordingly lengthened the time frame in order to indicate that there is little in the way of technical clues until gold reaches $1792.

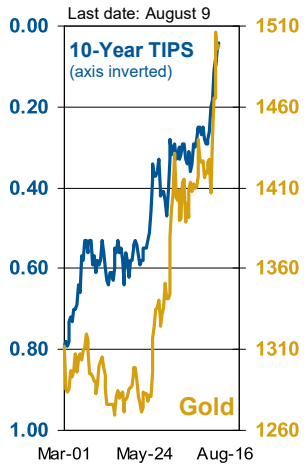


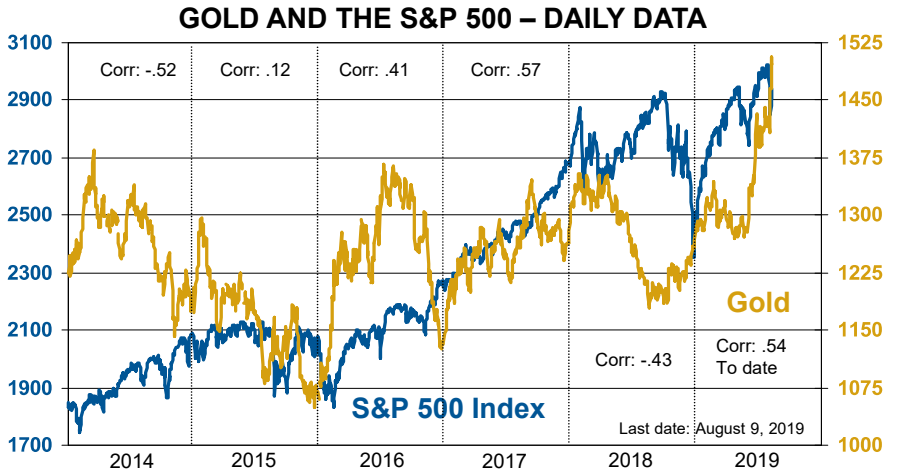
The inflation adjusted gold price (in today's dollars) shows that the January 1980 monthly average gold price of $675 is $2210 in today's dollars. However, the peak in January 1980 was $850, which translates into $2787 in today's dollars. Our view is that gold will take out these highs during this cycle!

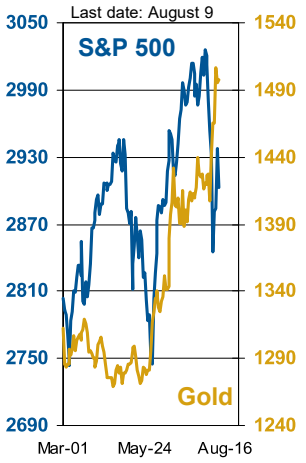


In recent years gold and the renminbi have had a positive correlation, meaning that when the renminbi rises gold rises as well. Recently however, on account of the trade war, the correlation has turned massively negative. A sharply lower Renminbi now goes hand in hand with a sharply rising gold price.









The 10-year TIPS yield has dropped to nearly zero – very bullish for gold!