

The diminishing glitter of gold

BY BERT ELY

ALEXANDRIA, Va.—The price of gold is going down, and that is having an enormous wealth effect around the globe.

The market value of the world's existing above-ground gold supply has dropped almost \$500 billion since early last year. The U.S. government alone has suffered a \$30 billion loss as the market value of its "investment" in 8,140 metric tons of gold has plunged. That's \$112 for every American.

Despite occasional upticks driven by fears of events like a renewed Iraq war, the dollar price of gold will continue to decline. Why? Because gold's relative inefficiency as a store of value is becoming increasingly evident.

That's the reason the spot price for gold dipped briefly below \$300 a troy ounce last Friday before closing in New York at \$303.70 on the Commodity Exchange. Since gold is losing its monetary value, its pricing — like that of any other commodity — increasingly reflects nonmonetary, supply-and-demand considerations.

Gold is losing its allure as a store of value due to the increasing ability of the credit markets to set interest rates that not only protect creditors against inflation, but also generate at least a modest real rate of return.

In the past, gold's stature as a store of value reflected the absence of credit markets that reliably protected creditors against inflation. Increasingly, though, creditors can earn positive real returns because electronic technology has created a truly international capital market whose pricing the central bankers have difficulty distorting.

As less-industrialized countries develop better banking systems and become more integrated into the global capital market, the number of people for whom gold is the best available store of value will steadily decline, further reducing mon-

etary demand for gold.

Gold's loss of monetary value must, of necessity, focus the gold market's attention on fundamental supply vs. demand considerations, and here gold's picture looks particularly bleak.

When viewed as just another commodity, gold suffers from a horrendous inventory overhang that will take literally decades to work off.

Half, perhaps as much as two-thirds, of the world's supply of 130,000 tons to 135,000 tons of gold is owned by central banks and individuals who view their gold holdings as an "investment" or inflation hedge.

The privately owned gold is in the form of gold bars, coins and clunky jewelry of little artistic value.

Central bankers well understand what is happening, which is why many central banks have sold or are planning to sell some or most of their gold holdings and invest the proceeds in interest-bearing credit instruments, such as U.S. Treasury debt.

Last month, the Swiss government endorsed its central bank's plan to sell almost one-third of its gold. If the Swiss no longer believe in gold as a sound store of value, why should anyone else?

The revelation last week that the German central bank, the Bundesbank, has been leasing its gold further unnerved the gold market. Hence we can expect to see more gold coming on the market just as demand for gold drops in Asia due to its economic problems.

The price of gold will continue to decline, falling well below the production cost at many mines, until excess inventories are worked off years from now.

Gold could easily go below \$250 an ounce, which will further stimulate the sell-off of gold now held as an "investment."

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