Paul van Eeden

Commentary

The Gold Price

Attempts at predicting the future invariably lead to embarrassment; so why would I even bother trying to figure out what the gold price is likely to do?

Because, contrary to popular belief, the market is not efficient. What's more, the market acts like a manic-depressive, and the greatest opportunities occur when the market is either manic, as with Internet stocks a few years back when Doug Casey was shorting them, or depressive, as the gold market is right now.

I believe a historic rise in the gold price has already commenced, but it's not too late to get positioned, as the best is yet to come. Here's why.

Using only first principles (as opposed to witchcraft, conspiracy theories and evil cartels) it is possible to explain why the gold price averaged $378.04 an ounce for thirteen years from 1984 to 1996; why the gold price declined from 1996 to 2001; and why the gold price spiked from 1979 to 1980 - but crashed again from 1980 to 1982.

Based on the same principles, you will see why the gold price is going to at least double in the next few years, and possibly triple within five.

It might surprise you to see how simple the methodology really is. But then, most complex problems can be broken up into simple, easy to understand components. It is most often those who don't understand what they are talking about that resort to

complex theories that don't make sense or unquantifiable forces such as conspiracies.

My intention is not to bore you into a comatose state with mundane history but it is really important that we synchronize our thoughts. Let's start at the Gold Standard, since we know what an ounce of gold was worth then, and continue to why it is trading for $325 an ounce today, and why I think it will be over $700 an ounce in the near future.

Floating currencies

During the Gold Standard, gold's value was determined by its purchasing power and the value of paper currencies, when they existed, was measured against gold. As a result of paper currency inflation to finance both World Wars, all countries abandoned the Gold Standard and gold lost its role as currency.

The Bretton-Woods Accord of 1944 briefly assured stability for a world without hard money by making the US dollar convertible into gold at a fixed rate, and then using the dollar as the world's reserve currency, against which all other currencies were measured. The deficiency embedded in the Bretton-Woods Accord was that it allowed the United States to inflate the dollar without recourse, since the ratio between it and gold was fixed, and set by decree. Therefore, from 1934 to 1971 gold was "worth" $35 an ounce only because Franklin Roosevelt decreed that it be so, in 1934.

The fallacy that the United States could create reserve currency (dollars) at will, without impacting the dollar's value, while the rest of the world had to produce goods and services to earn dollars, came to an end in 1971 when Richard Nixon was forced to abandon the fixed exchange rate between the dollar and gold.

So what is an ounce of gold "worth" today? Because most currencies in the world are floating, meaning their exchange rates relative to each other are determined by market forces, as opposed to declared by governments, you have to specify in which currency you want to measure the gold price. For our purposes we will restrict ourselves to the US dollar. The question therefore becomes, what is an ounce of gold worth in dollars today?

Two factors always influence the relative value of gold in any currency. The first is the increase in the amount of currency (inflation of dollars) and the second is the increase in the amount of gold (inflation of gold).

When the amount of dollars increases (inflation), the dollar loses buying power and that typically shows up as an increase in the prices of goods and services. It stands to reason that as the dollar is inflated, it also increases the price of gold, in dollars, even though gold's inherent worth (buying power) is not affected.

Similarly, if the amount of gold increases, the value of gold will decrease. Due to its physical properties almost all of the gold ever mined is still around in one form or another, which is one of the reasons why gold is so suitable to be money in the first place. The amount of gold mined on an annual basis is nothing other than inflation of the total amount of gold ever mined. The inflation rate of gold is thus new mine production as a percentage of above ground gold stock, which in turn is equal to the total amount of gold mined since the beginning of time.

Consequently, the change in the gold price, in dollars, over time will be in proportion to the inflation of the dollar and inversely proportional to the inflation of gold. We can calculate the theoretical gold price (Au[n]) as follows:

Au[n] =Au[n-1](M3[n]/M3[n-1])(GP[n-1] /GP[n]) {Au = gold price; M3 = money supply; GP = gold production}.

But for this to work we need to establish a time at which gold was priced correctly. This means we have to go back to the Gold Standard and work forward from there.

Reserve currencies

World War I destroyed both physical property and, through inflation, the European currencies as well. After the War most countries were up to their eyeballs in debt with little or no hope of ever repaying it.

Prior to World War I the gold backed British pound was the world's primary reserve currency because London was the largest financial center and Britain the largest trading nation in the world. But monetary expansion to finance World War I forced most countries, including Britain, to abandon the Gold Standard temporarily.

In 1923 Britain announced that it would honor all war debts in an attempt to restore confidence in the British economy and the pound. To accomplish this Britain had to raise taxes and that only hurt its already crippled economy.

In a second attempt at trying to boost confidence, Britain reinstated the Gold Standard in 1925, at prewar parity. At the same time many other nations devalued their currencies in an effort to reduce the burden of war debts and to stimulate their

economies. Britain's return to the Gold Standard therefore pushed up the relative value of the pound, diminishing British exports while promoting imports, and led to further erosion of its economy. By 1931 Britain was forced to abandon the Gold Standard again.

As opposed to Britain, the United States returned to the Gold Standard in 1919. That, and its increasing importance in global trade, put the dollar in a position to replace the British pound as the world's reserve currency.

The end of the Gold Standard

The crash of 1929 precipitated a deflationary economic contraction. The combination of a series of bank and brokerage failures, losses on Wall Street, increased unemployment and decreased confidence in the economy led to an increase in the savings rate as people attempted to preserve their capital. Because they were saving, they were not spending, resulting in a reduction in demand for goods and services and leading to reduced economic activity: the Great Depression.

The government needed increased spending to stimulate the economy, but how do you get people to spend if they are saving? People tend to spend more during inflationary times because their paper money is losing value relative to goods. So they are better off spending it as soon as possible, before it devalues any further. Hence, the Government wanted to create inflation.

To create inflation and stimulate spending, the Government needed to devalue the dollar. But it couldn't just print more paper dollars because gold was also a component of the monetary system. If the Government devalued paper dollars by printing more of them, people would switch their savings to gold without a net increase in spending. Individuals were already hoarding gold and savings in the banking system tied up gold too, since banks had to maintain reserves, which were mostly in the form of gold.

As long as gold was money, devaluation of the dollar would not necessarily lead to an increase in spending. To resolve this dilemma, Roosevelt declared private gold ownership illegal in 1933, freeing him to print as many paper dollars as he saw fit.

"By virtue of the authority vested in me by Section 5 (b) of the Act of October 6, 1917, as amended by Section 2 of the Act of March 9, 1933 …, in which Congress declared that a serious emergency exists, I as President, do declare that the national emergency still exists; that the continued private hoarding of gold and silver by subjects of the United States poses a grave threat to the peace, equal

justice, and well-being of the United States; and that appropriate measures must be taken immediately to protect the interests of our people." Franklin Roosevelt – March 9, 1933

This did not affect the dollar's status as an international reserve currency, as foreigners could still convert their dollars into gold at a fixed rate.

In 1933 a $20 gold coin contained 0.9675 ounces of gold. So the gold price was $20.67 ($20/0.9675) an ounce by definition, as it had been since 1879 when the United States joined the Gold Standard. The Executive Order of March 9, 1933 forced citizens (in their own best interest, of course) to exchange their gold for paper dollars at the rate of $20.67 per ounce.

The very next year Roosevelt increased the gold price by 69% to $35 an ounce, thereby instantaneously devaluing these same paper dollars by 41% – in the best interest of the people, of course.

Dollars for gold

Back in 1933, when gold was money, an ounce of it was worth $20.67. Therefore we can safely say that gold was overpriced the following year when Roosevelt arbitrarily set it at $35 an ounce. But if gold was overpriced at $35 an ounce in 1934, at what time was it actually worth $35 an ounce? We can get an answer by looking at the movement of physical gold into, and out of, the United States Treasury, and the purchasing power of the dollar.

Because the gold price was arbitrarily raised to $35 an ounce in 1934, which meant it was significantly overpriced at the time, and due to the demand for dollars as reserve currency, the Unites States' gold reserves expanded from 8,998 tonnes in 1935 to 19,543 tonnes in 1940, as many foreigners cashed in on the overnight gain that the United States' Government handed them. Gold was happily sold to the Treasury in exchange for dollars, which could then be converted into local currency abroad for a 69% windfall, less transaction costs of course.

By 1952 gold reserves had reached 20,663 tonnes and the United States owned approximately 33% of all the gold in the world and more than 65% of the Official Gold Reserves, i.e. gold owned by governments.

But after 1952 the incessant inflation of US dollars made the rest of the world realize that thirty five of them just weren't worth an ounce of gold any more. Massive redemptions of dollars, in exchange for gold, depleted the Treasury's gold

reserves by 58%, to 8,584 tonnes by 1972. In 1972 the United States had less gold than in 1935 but it had approximately ten times more dollars outstanding as measured by the change in M1 (currency held by the public plus demand deposits, checkable deposits and travelers' checks).

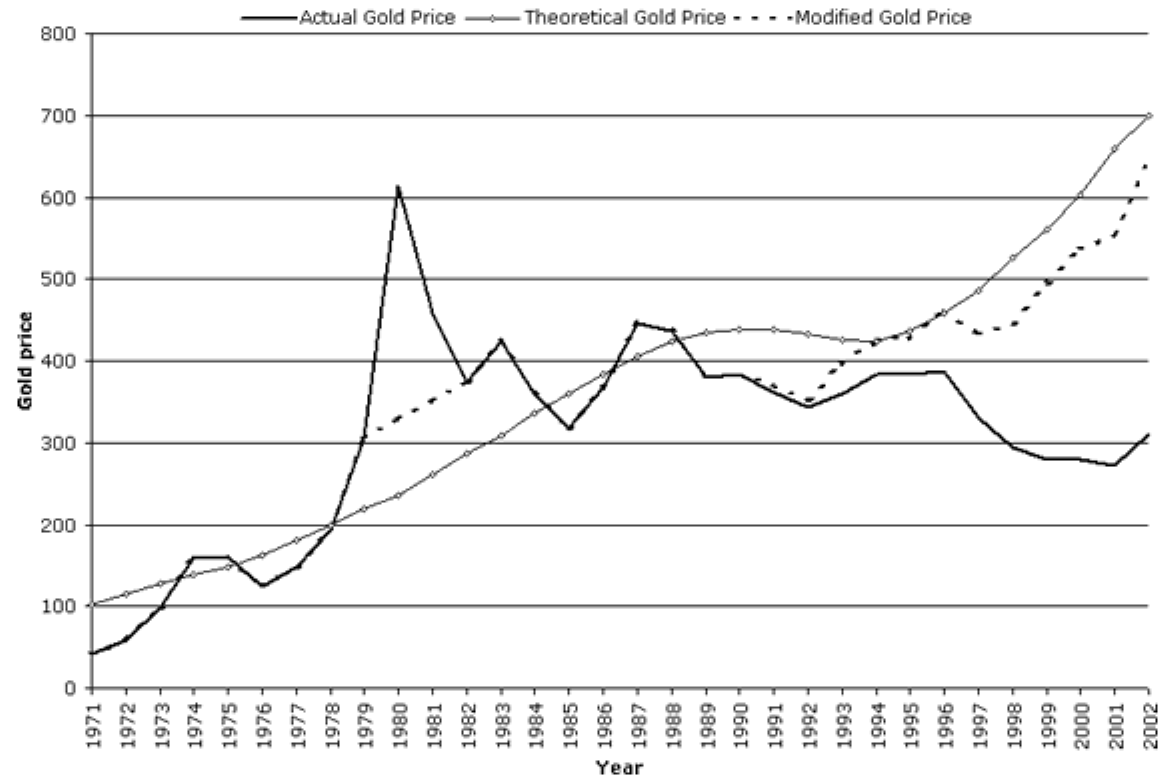
We know that gold was overvalued at least up to 1940 because the world was converting gold into dollars as fast as it could. We also know that gold was undervalued after 1952 because dollars were now being redeemed for gold at a rapid pace. US gold reserves stayed roughly at 20,000 tonnes from 1940, when gold was overvalued, to 1952, when it was undervalued. So somewhere between 1940 and 1952 one would expect gold to have been "worth" $35 an ounce.

Changes in the Consumer Price Index (CPI) give us a measure of how the dollar's inflation impacts its purchasing power. That means we can determine when gold was really worth $35 an ounce by looking at how the CPI (Reserve Bank of Minneapolis) changed since 1933, when we know gold was correctly priced at $20.67. From 1933 to 1947 there was a 69% increase in the CPI, so $20.67 in 1933 would have been worth $35 in 1947.

This coincides with the flow of gold into the Treasury up to 1950 (20,279 tonnes), peaking in 1952 (20,663 tonnes) and then declining rapidly as the realization that inflation had caught up with the gold price led to the redemption of dollars. That gold was worth $35 an ounce in 1947 is thus plausible, as judged by the flow of gold, and validated by the change in the dollar's purchasing power, as measured by the CPI. We can therefore conclude that gold was actually worth $35 an ounce in 1947.

We did not consider gold inflation between 1933 and 1947, as the implied assumption is that gold production was in line with general economic growth in the US, and thus the increase of goods and services implicitly accounted for by the CPI also accommodated the increase in gold. This is obviously not ideal. Unfortunately M3 data only goes back to 1959, although we did find a study that extrapolated M3 to 1948. The CPI we used goes back to 1913.

From 1947 onwards however, M3 (dollar inflation) and mine production (gold inflation) were used to calculate what the gold price should have been (theoretical gold price), according to the formula given on page 2. The results from 1971 onwards are shown in Figure 1.



Following is a comparison between the theoretical gold price and the actual gold price, to see how well the model stands up to reality.

Closing the Gold Window
The massive redemption of dollars forced Nixon to close the Gold Window in 1971, in a desperate attempt to retain some gold in the Treasury. When forced to choose between holding gold or his own dollars, Nixon chose gold. That, in and of itself, should tell us something about the value of gold.

Gold was now officially demonetized and since it could no longer be acquired at a price of $35 an ounce, the market was left to determine what the actual price should be. Since we know that gold was worth $35 an ounce in 1947, we can calculate what the price of gold should have been in 1971, and compare it to what actually happened in the market.

Dollar inflation from 1947 to 1971, offset by gold inflation, meant that the gold price should have been $103 an ounce when the Gold Window was closed, almost three times its official price of $35 an ounce. With the gold price at only a third of its value, it just had to go up.

Not only was this upward force at work, but inflation during the 1970s also lit a fire under the gold price. M3 more than doubled from 1971 to 1978. By 1978 the gold price should have been $199 an ounce and, in fact, its average price for that year was $193 an ounce.

It's very reassuring that the theoretical gold price coincides this well with the actual price for 1978: it confirms that the establishment of 1947 as the year during which gold was actually worth $35 an ounce, is most probably right on the mark, and that the model is working.

But if you look at Figure 1 you will notice that the gold price continued to rise far beyond what the model predicts, and remained above the theoretical price until 1984.Why?

1978 - 1984
The gold price's deviation from its fair value between 1978 and 1984 can be explained by looking at what else went on during that time.

In retaliation for the Western world's support of Israel, during the Arab-Israeli War of 1973, Arab members of OPEC took control of the organization, cut oil production and increased the oil price from $3.00 a barrel in October 1973 to $11.65 in January 1974, a 288% increase in just four months. In addition, the United States and the Netherlands were cut off from OPEC oil supply due to their close relationships with Israel.

This did not, however, push the price of gold up. In fact the gold price had reached fair value in 1974, remained essentially flat during 1975 and fell 22% in 1976. By 1978 the gold price had reached fair value again. This market action seems normal and does not indicate any gold price premium as a result of the oil embargo, or the increase in the oil price.

But on the backdrop of this tension between the United States and the Arab World, the Iranian Hostage Crisis in 1979 did cause a dramatic rise in the gold price. When fifty two Americans were taken hostage by Iranian students in November 1979, at the American Embassy in Tehran, the gold price shot up from an average price of

$305 to $615 in 1980, briefly trading over $800 an ounce in January of that year. The hostages were finally released on January 20, 1981, four hundred and forty four days after their capture, and the gold price was on its way down again, to find its theoretical level of $236 an ounce.

From 1980 to 1984 the gold price declined by 41% to $361 an ounce, which differs by only $25, or 7%, from its theoretical price of $336 an ounce.

1984 - 1988
With the oil crisis over, the hostages released, and the status quo of the Cold War casting an eerie calm over the world, not much happened between 1984 and 1988 to upset the gold price. The actual gold price differed, on average, by only 7% from its theoretical price during those four years. This is a remarkable correlation. Especially considering that we started with gold at $20.67 in 1933, and relied only on a logical adaptation of the gold price based on sound economic reasoning, without in any way modifying the results to better “fit” reality.

1988 - 1996
On the surface, the gold market between 1990 and 1996 was about as exciting as watching paint dry, but a lot was happening in the undercurrent.

Notice that the actual gold price started to deviate from its theoretical price in 1998. The reason, this time, may not be so obvious to those not intimately familiar with the gold market.

In 1983 a new financial risk management tool was developed to mitigate the impact of gold price volatility on mining companies: Hedging. Total gold hedging increased from four tonnes in 1983 to forty five tonnes in 1986. But from 1987 to 1990 a total of eight hundred and seventy six tonnes were hedged.

Whether it had anything to do with George Bush Senior’s term as President or not, M3 growth increased only 6% between 1989 and 1993. Gold inflation on the other hand was 8% during that period, and so the gold price should have declined by 2% over those four years.

This downward pressure on the gold price, coupled to the expansion of hedging, decreased the actual gold price by 19% between 1987 and 1993. The gold price was now more than 15% below its theoretical value and the upward pressure again began to show.

The vigorous resumption of dollar inflation in 1994, and the already undervalued gold price, exerted strong upward pressure on the Midas metal. Yet in 1996 the gold price began a 30% decline, to $273 an ounce, which it reached in 2001. This occurred despite the increase in M3, which drove up the theoretical gold price to $659 an ounce over the same period.

Before we examine what happened since 1996, it is important to note that even with the advent of hedging between 1984 and 1996, the actual gold price differed, on average, by only 12% from its theoretical price during those years. This is five decades after we began our theoretical calculations and once again validates the concepts on which the theoretical price is based.

The dollar exchange rate

Gold is quoted in US dollars as a remnant of the period between 1944 and 1971, when the US Treasury owned most of the official gold reserves, and an ounce of gold was convertible into 35 dollars.

Prior to 1971 most currencies were pegged against the dollar at fixed exchange rates, so the price of gold in other currencies did not change much between 1944 and 1971 either. After 1971 the exchange rates between most currencies started to fluctuate. Nothing was convertible into gold anymore, so there really wasn't any standard to measure a currency's "value" against.

The dollar was still regarded as one of the most stable currencies in the world as the United States had both the largest economy and the most foreign trade. It was therefore natural to continue to use the dollar as the de facto reserve currency. But as the dollar was now also floating against most other currencies, it was possible for the dollar's exchange rate to increase in response to the demand for dollars, and decrease in response to supply.

To determine the price of gold in any other currency one would still just multiply the dollar denominated gold price by the relevant exchange rate. The difference is that the gold price now fluctuates in dollar terms (due to dollar inflation and gold inflation), and the dollar itself fluctuates against other currencies. So the gold price in Japanese yen, for example, would behave quite differently than the gold price in dollars – as we will see later.

From 1988 to 1992 the dollar exchange rate was relatively stable. But it has not been so since 1992.

Currency crises

Recall that the upward pressure on the gold price predicted by the model since 1994, due to increased M3, was not reflected in the actual gold price, and that from 1996 to 2001 the gold price actually declined. The reason lies in the phenomenal increase in the demand for dollars following a series of currency crises, each one compounding the demand further, tightening the supply, and strengthening the dollar against almost all other currencies.

During a currency crisis capital, seeking a safe haven, typically flows out of the troubled country. Between 1992 and 1994 the Brazilian real lost essentially all its value. The capital flight from Brazil created demand for dollars and some of it found a home in the United States. In response, the dollar increased by about 10% against a Gross Domestic Product (GDP) -weighted index of thirty five currencies we monitor.

From 1994 to 1995 the Mexican peso declined by over 50% against the dollar, the worst financial crisis in Mexico since the Revolution. More capital moved into the United States and this further increased demand for dollars.

The Japanese yen lost 24% against the dollar from 1995 to 1996, and still more capital fled to the United States, but the “Big One”- the South East Asian Crisis - didn’t hit until 1996.

From 1996 to 1998 the Indonesian rupiah lost 76% of its value against the dollar, setting off a domino effect that dragged the South Korean won down 56%, the Malaysian ringgit down 40% and the Philippine peso down by 40%. A truly massive flight of capital ensued, most of it destined for the United States, and increased the dollar by almost 30% against our GDP-weighted index.

In 1998 Russia defaulted on its foreign debt, sending the ruble down over 70% in 1998 alone. The euro’s launch in 1999 was also the beginning of its 28% decline against the dollar. Back in 1998 the “new” Brazilian real collapsed again, the Turkish lira fell in 2000 and the Argentine peso followed in 2002… you get the picture.

In all these cases capital fled to the United States. As a result, the dollar increased by more than 120% from 1990 to 2002 against our GDP-weighted index currencies.

Regardless of what the gold price is doing in other currencies, the gold price in dollars is inversely related to the dollar exchange rate. Just like any other import, if

the dollar gets stronger the price goes lower. There is an almost perfect correlation between the decline in the gold price, between 1996 and 1998, and the increase in the dollar exchange rate as a result of capital influx from abroad.

This explains the deviation from gold's theoretical price up to 1998, but it does not explain why the actual gold price stabilized between 1998 and 2001, and then commenced a 30% increase in 2002, while the dollar exchange rate did not decline.

The consolidation in the actual gold price from 1998 to 2001, and the ensuing increase in 2002, is a result of the raging, worldwide, bull market in gold that is finally affecting its price in dollars.

Gold in other currencies
We can calculate the gold price in any currency by multiplying the dollar gold price by the currency's exchange rate. If we do this for all 35 currencies in our GDP weighted index, we can actually calculate the weighted average gold price in the world, excluding the US dollar. The currencies are weighted by GDP so as not to give too much influence to small, volatile currencies.

Doing exactly that, the astonishing fact that gold has been in a bull market for more than five years is blatantly apparent. On average the gold price worldwide has increased by more than 70%, and no one knows it, because most people are too fixated by the US dollar denominated gold price.

The theoretical gold price
Our model shows that, given the increase in M3 and gold inflation since 1947, gold is worth $700 an ounce as of 2002. The gold price is currently $325 an ounce. What is this telling us?

Just as the actual gold price did not deviate from its theoretical price for very long after the Iranian Hostage Crisis, the current gold price cannot remain below its theoretical price for much longer.

In fact, were it not for the dollar exchange rate's tremendous increase over the past decade, the actual gold price would differ by less than 10% from its theoretical price. This can be shown by going back to 1990 and backing out the dollar exchange rate from the actual gold price; in other words, essentially keeping the dollar constant.

You can see the result of this exercise represented in Figure 1 by the modified gold price line. Notice how well it tracks the theoretical gold price, and keep in mind that these two lines were derived independently of each other. The theoretical price is based on gold being $20.67 in 1933 and adjusting for inflation. The adjusted gold price is merely backing out the exchange rate from the actual gold price since 1990.

The undeniable correlation is no coincidence, and begs the question whether the dollar can sustain its current exchange rate.

Trade deficits

The influx of capital into the United States had a broader impact on America's economy than just increasing the dollar's exchange rate. This was discussed in the February 2003 issue, so suffice it to say here that the Trade Deficit is directly related to the strengthening of the dollar because it made imports cheaper and exports more expensive, during an economic boom that was itself propagated by the influx of capital from abroad.

Barry Eichengreen, from the University of California at Berkeley, has shown using historical data that First World countries can in fact eliminate large Trade Deficits. The good news is that the Trade Deficit can be eliminated quite rapidly. The bad news is that it almost always requires a major, and prolonged, recession. Given the size of the United State's Trade Deficit, it is unlikely that we will have a mere recession - a depression is more likely.

However deep, or prolonged, the economic downturn is going to be, it is impossible to imagine that the United States will continue to attract in excess of $400 billion dollars' worth of foreign capital every year. And when the foreigners stop sending their saving to America so that we can finance our consumption habits, the dollar will decline.

The euro

I do not particularly like the euro, as it is the ultimate fiat currency, but it does offer the world an alternative reserve currency to the dollar. If it weren't for the fact that dollars are being created at the rate of about 600 billion a year, I probably wouldn't have given the euro a second thought.

But the inflation of the dollar, the debunking of the American economic miracle, the arrogance of American Foreign Policy and, perhaps most importantly, the detrimental impact that the War on Terrorism is bound to have on American liberty - not to mention the misallocation of capital and increase in debt that go hand-in-

hand with war - are all virtual guarantees that the dollar is going to lose some of its super hero status.

There were two reasons why the dollar became the reserve currency of the world. One, it was convertible into gold – which is no longer true. Two, the dollar was in demand to settle international transactions, as the United States became the world's largest economy and trading nation.

The introduction of the euro has created a viable alternative to the dollar. Neither currency is backed by gold, so the one is just as bad as the other, and the aggregate economy of the European Union is similar in size to the United States'. But Europe has one big advantage over the United States: it has a Trade Surplus. We still have to work off our Trade Deficit, and we know that is going to hurt.

The euro is also likely to get a booster shot from US Foreign Policy. Backlash at American imperialism has already caused several countries to convert massive amounts of dollar reserves to euro reserves.

The real clincher will be the expansion of the European Union though. As more and more countries join the Union, the demand for euros will increase, and the need for dollars will decrease.

Gold, the savior of capital

Most people would expect a monetary crisis to cause the gold price to increase; especially one that rocks the globe like the South East Asian Crisis. Some believe that gold failed to protect capital during that crisis, but here are the facts.

The gold price did not increase in US dollars – but the US was not in crisis. The gold price in Japanese yen however, increased by 34% between 1995 and 1996. The next year the gold price jumped more than 40% in both Philippine pesos and Malaysian ringgit, and 67% in Korean won. Indonesia suffered the most during the South East Asian Crisis and the gold price, accordingly, increased more than 400% in rupiah.

The next currency crisis may well be the almighty dollar. Gold will once again fulfill its role as a store of wealth and protector of capital. The question is just whether or not you own any.

The dollar is likely to fall approximately 50% from its current level. That would free the dollar denominated gold price to find its way back towards its true value of $699

an ounce (as of 2002). Given the mounting pressure on the dollar, there is virtually no chance that it will not collapse.

Conclusion
Our model demonstrates beyond any doubt that the gold price is ultimately defined by the inflation of the dollar relative to the inflation of gold. Any deviation from this theoretical gold price can be adequately explained, and is temporary.

What is important for us in 2003, is that the gold price is either going to increase to $700 an ounce, or more; or the US money supply has to decrease by 50%. This is not the same as saying that the inflation rate has to decline by 50% - this is saying that we need a 50% decrease in the amount of dollars outstanding, which is a practical impossibility. Therefore, the only conclusion is that the gold price is going up.

Buying gold now is the lowest risk investment you can make. And the upside is a once-in-a-lifetime opportunity. If you do not already have gold or gold related investments in your portfolio, I suggest you call one of the following people and rectify the situation immediately.

Gold and War
War is unpredictable and destructive. It has the effect of unnerving financial markets, increasing volatility and strangling the economy by misallocating capital.

Whether the gold price increases or decreases as the war progresses, it should not deter you from owning gold. The weak US economy, exacerbated by new misallocations of capital, will weigh heavily on the US dollar. Volatility introduced by war can be endured if you have both patience and fortitude.

The increase in the gold price earlier this year was due to uncertainty surrounding the Middle-East. The subsequent decrease in the gold price was neither unexpected nor unwelcome. This is a very, very good time to increase your ownership in gold and related investments.

A few last thoughts
You may have noticed that we modified the gold price between 1979 and 1982 to ignore the effect of the Iranian Hostage Crisis. If we compare the modified gold price, as shown in Figure 1, to the theoretical gold price, the two differ by only 17.5%, on average, from 1971 to 2002. That means our model predicted the actual (modified) gold price with 82% accuracy, on average, from 1971 to the present.

Given the simplicity of the model, and the accuracy of the results, I have no doubt that we will see $700 an ounce before long.

Nixon decided to keep the Treasury's gold and decline the revered dollar in 1971. Similarly, Thailand asked its citizenry for physical gold to save the baht during the South East Asian Crisis. In the final analysis, the world seems to always turn to gold.

Alan Greenspan said the following on May 20, 1999: "Gold still represents the ultimate form of payment in the world… Gold is always accepted." The Federal Reserve Chairman offered this remark as one of the reasons why the United States should not sell its gold reserves. So has gold lost its value as monetary asset?

During a "true" Gold Standard, gold is money and as such most of the gold is in the hands of the public, not held by governments. We are again in a situation where the public owns most of the gold in the word.

Gold is money by evolution of choice, not decree. In this regard governments have always been forced, ultimately, to follow the will of the people, not the other way around.

This is not the first time that governments have experimented with fiat currencies. All previous experiments, bar none, ended in disaster. Our current experiment with a monetary system based entirely on fiat currencies is unlikely to end any different.

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