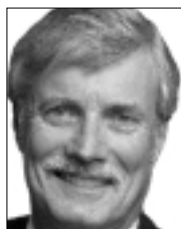


# Lending crisis sets U.S. dollar on fatal course

After firming through most of July, the gold price was hit hard in late July and early August as the sub-prime lending fiasco morphed into a full-scale credit panic, marked by Bear Stearns's CFO characterizing conditions in the bond market as the worst he had seen in his 22 years in the business.



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This caused the anti-gold cartel to throw caution to the wind in an overly blatant attempt to drive the gold price lower. Central-bank selling intensified, the bullion banks worked their standard magic in the futures market and the anti-gold rhetoric was raised several decibels.

This was not terribly surprising given the central banks' genuine fear of gold being seen as a go-to asset in times of financial crisis, and, make no mistake, this is an unfolding crisis in credit markets. It was the same old drill; attempt to discredit the yellow metal at the very time it should be doing well.

The cartel is aided and abetted by some of their sycophants in the gold world who invent reasons to rationalize the counter-intuitive price action. Perhaps the most egregious comment came from Leonard Kaplan of Prospector Asset Management who attributed gold and silver price weakness to the broader risk aversion plaguing the market and then stated, "It's just absolute complete fear. Gold has not been a flight to quality since God was a child."

When the gold cartel can elicit a comment that inane from an allegedly knowledgeable gold investor it must be music to their ears.

However, a more germane comment on the subject came from Dan Norcini, a veteran commodity trader, who, in the face of a particularly transparent capping of the gold price in early July, observed that, "anyone, and I do

not care how well respected or how well known they are, who denies that there is official sector intervention to keep the gold price down is willfully blind and has forfeited any right to be listened to when it comes to commenting on gold." I totally concur with his view.

The central banks have a massive problem on their hands. By failing to remove the punch bowl at the appropriate time in the past (credit former Fed chairman Alan Greenspan for that gaffe), they have let this credit cycle run amok.

The cracks in the facade are now appearing, triggered by the sub-prime-lending catastrophe in the U.S. that is causing the credit market as a whole to seize up. Doug Noland, who writes weekly at the *Prudent Bear* website, is, in my opinion, as knowledgeable on the intricacies of the current credit cycle as anyone that I have come across. For years he has commented intelligently on the expanding credit bubble and has warned investors that it could reach levels far greater than the rational mind could comprehend.

Therefore, I found it very noteworthy that at the outset of August, Noland observed, "the credit market has dislocated, liquidity has evaporated and our academically-inclined new Fed chairman is in store for a historically challenging real-world first test."

I suspect that Fed chairman Ben Bernanke will do exactly what his predecessor Alan Greenspan did for 18 years. He will talk soothingly about how the problems are under control while providing massive dollops of liquidity.

When that approach is inevitably unsuccessful, he will launch a series of rate cuts while maintaining that inflation is not an issue. All of this is ultimately very inflationary and fatal to the U.S.

dollar but it is absolutely essential to avoid a potential economic and financial collapse in the U.S.

There has been a lot of commentary recently stating that the U.S. has become considerably less relevant in the overall world economy and that the robust growth elsewhere will carry the day. Perhaps, but I think the fallacy in this thinking is that the entire world economy is so inter-linked and has also been fuelled by the runaway growth in credit. To think that it would be unscathed in the event of a serious dislocation in the U.S. strikes me as somewhat naive.

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I believe the physical gold market has long since figured out that liquidity has to be continuously pumped into the global economy to avoid a financial and economic Armageddon. Demand is exceptionally strong, and nothing illustrated this fact better than the stunning Turkish gold import

numbers in July.

They totalled 45 tonnes and were up 328 per cent year-over-year and exceeded the previous record month (May 2006) by 36 per cent. When one considers that monthly mine production is only 200 tonnes, it is not terribly surprising that the Spanish central bank dumped 25 tonnes and the Swiss 35 tonnes during the month in order to keep a lid on the price. Despite this selling onslaught, gold was up roughly one per cent for the month even though the aforementioned orchestrated attack knocked the price down over \$20 per ounce in the last week.

The central banks and their allies are becoming increasingly desperate as they are being rapidly overwhelmed by adverse financial developments that only promise to get worse. The gold price, as a result of their actions, has been very frustrating for all gold enthusiasts, but I expect this to change dramatically in the not too distant future.

The inadequacy of the gold price with respect to the economics of gold mining has been reflected in most recent earnings (or lack thereof) statements from gold companies. The few doing relatively well generally have a high base-metal byproduct credit and have benefited enormously from the spectacular prices in



that sector.

Pure gold companies are faring materially less well and it is starting to take a toll on management. Two individuals who were virtually synonymous with their companies, Bernard Swanepoel of Harmony, a major South African producer, and Peter Brad-

ford of Golden Star, an emerging producer in Ghana, have both departed recently, and the lacklustre results at both companies had to be a contributing factor.

The sad fact is gold mining was spectacularly uneconomic at \$300 per ounce and is barely more profitable today as a result

of the decline in the U.S. dollar and massive cost increases which have combined to erode virtually all of the price gains to date. The key today is surviving until the gold price explodes, which, given the fundamentals, is inevitable.

One company in this category is an old favorite of mine, **Wesdome Mines** (WDO-TSX, \$1.29) which has certainly had its travails with the huge increase in the value of the Canadian dollar plus a few mining snafus. However, it appears to be ironing out the restart problems at the old Kiena Complex in Val d'Or, Que., and the Eagle River mine in Wawa, Ont., is coming up with some rich new ore.

The recent merger with its parent, Western Quebec Mines, has added an interesting explo-

ration prospect abutting Agnico-Eagle's Goldex property. Thus we have a Canadian-based company with two producing mines possessing quality infrastructure and the promise of long-term reserves.

The added exploration sizzle is a bonus. Wesdome is a company that I believe will benefit tremendously when the gold price reflects its true fundamentals.

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