Gold price fall points to global deflation

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The rapid fall in the price of gold over the past few days—its biggest plunge in more than 30 years—is an indication that deflationary tendencies are strengthening throughout the world economy.

As one commentator on the Australian *Business Spectator* web site put it: “Are we witnessing a global slump unfolding before our eyes?”

On Monday the gold price dropped by $110 per ounce, eclipsing its previous biggest one-day loss recorded in January 1980. It was accompanied by what the *Financial Times* described as a “rout” in metal markets, with silver falling by 11 percent. Commodity prices have also fallen across the board.

While there could well be upward movements in the course of the next days, the sell-off appears to mark a significant turning point. The flood of money pumped into the financial system following the collapse of Lehman Brothers in 2008 saw the value of gold rapidly escalate. Viewed as a hedge against paper money and debased currencies, it tripled in value over three years, reaching a high of $1,930 per ounce in September 2011.

It then flatlined for the next 12 months before starting a downturn last October that has seen the price fall by 20 percent, much of the decline coming in the last few days. As recently as 10 days ago the price of gold was $1,600 per ounce. It is now down to under $1,400.

This downturn flies in the face of market expectations that, given the continued expansion of the money supply through the quantitative easing programs of the world’s major central banks, the price of gold would rise or at least hold firm.

The perplexity over the fall was expressed in the comments of one market trader cited in the *Australian Financial Review*. “I’m baffled,” he said. “The US is printing more money, the yen is collapsing as the Japanese rev up their printing presses, so we have the market shorting both the yen and gold, whereas gold they cannot print—it just doesn’t make any sense.”

The fall in the gold price, despite the flood of money into financial markets indicates that other, more powerful, forces are at work. An examination of the operation of quantitative easing indicates the underlying causes.

The official reason for the historically unprecedented measures being undertaken by the world’s central banks—the injection of trillions of dollars into the monetary system through the purchases of government bonds—is that such emergency action is needed to revive the economy. But the inflow of money is not going beyond the confines of the banks and finance houses.

Rather than financing new investment projects, thereby stimulating demand and production, the money supplied by the central banks has largely been used for speculation in equity and commodity markets.

The upswing in these markets has taken place against the background of deepening recessionary and deflationary tendencies in the world economy as a whole, as even a brief review makes clear.

In the United States, joblessness remains chronically high, with the average duration of unemployment reaching 37 weeks in March. In Europe, unemployment in Spain, Greece and other countries has reached more than 25 percent. Youth joblessness is more than 50 percent. The economy of the eurozone as a whole contracted last year and will stagnate or even contract further in 2013.

Since the global financial crisis erupted in 2008, millions of words have been expended to advance the claim that, notwithstanding the difficulties in the older advanced economies, the world capitalist economy can be sustained by China and other so-called emerging markets.

Those claims are being exposed on a daily basis. On Monday, as gold made its record plunge, Chinese authorities announced that growth in the first quarter of this year was 7.7 percent, down from 7.9 percent in the last quarter of 2012 and well below the expected rate of 8 percent and above.

But numbers alone do not convey the significance of the shift taking place in the Chinese economy. As Michael Pettis, finance professor at Peking University and a long-time observer of the Chinese economy, has noted, in the past China's growth easily exceeded the targets set by the government. Not so this year.

In his last formal statement, outgoing Chinese premier Wen Jibao last month announced that the target growth rate of 7.5 percent for this year would be difficult to attain. He said that there was a "growing conflict between downward pressure on economic growth and excess production capacity."

According to a report by the Xinhua news agency, the industries suffering most from overcapacity include steel, cement, aluminium, plate glass and coking coal that are operating at between 70 and 75 percent of their total capacity.

Moreover, the real Chinese growth figures may be well below the official numbers. In the past, energy consumption in China has risen faster than gross domestic product. Last year, however, as the economy supposedly expanded by 7.8 percent, energy usage grew by only 5.5 percent.

As Pettis commented, actual growth may have been 7.2 percent for 2011 and 5.5 percent for 2012 with "other economists … suggesting even lower numbers, closer to zero."

In another expression of global recessionary and deflationary trends, the South Korean government announced yesterday on Tuesday that it was bringing down a supplementary budget, equivalent to $15.4 billion, to kick-start the economy. The South Korean economy has been hit by sluggish domestic consumption even as export revenues are cut back because of the weaker Japanese yen and falling global demand.

South Korea's supplementary budget is much bigger than had been anticipated when the proposal for stimulus measures was first announced last month. A statement issued by the finance ministry said: "The economy is losing vitality and people's livelihoods are deteriorating as our economy posted low [sequential] growth of less than 1 percent for nearly two years."

Summing up the state of the world economy as a whole, the latest Brookings Institution- *Financial Times* tracking index of global recovery found it remained "stuck in a rut, unable to sustain a decent recovery and susceptible to a sudden stall."

The fall in the gold price may well be the first indication of a deepening slump. It could also set in motion a new round of financial crises if major investors get caught on the wrong side of its gyrations. And the sudden rush for the exits out of gold, producing the very sharp falls of the last few days, may well be pointing to a similar exit from equity and other markets.