

How Governments Manipulate the Gold Market – A Primer

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After gold trading closed in New York on Friday \$13.70 lower from the previous day, a Reuters article gave the following reason for gold's rout: "*Gold tumbled 3.5 percent in New York on Friday as the first rise in U.S. payrolls in eight months lifted anxiety about economic growth and undermined the safe-haven case for bullion days after it had hit seven-year highs.*"

Their point of view sounds plausible I suppose, though I think the recent "seven-year highs" in gold are far more telling about gold's prospects than any one month's economic data. But regardless of whether Reuters conclusion makes economic sense or not, the payrolls data was released at 8.30am, and gold's sell-off didn't start until 12.10pm, almost four hours later. Therefore, did we see a delayed knee-jerk reaction to the data? Or was some other factor at work?

In my view, it was clearly the latter. It is now becoming a well-known 'secret' that governments are trying to manage the gold price by actively intervening in the gold market, and Friday's trading was a good example of their fiddling with the free-market process. Here are some pointers for everyone interested in learning how governments intervene in the gold market.

(1) Work with a proxy. The US Exchange Stabilization Fund is the ringleader of the government's manipulation efforts, but it never enters the market directly itself, regardless whether it is intervening in the currency or the gold market. It works with proxies in order to cover its tracks. The secretive ESF places its orders to intervene with the Federal Reserve Bank of New York, which carries out all intervention for the US government as well as all orders from foreign central banks placed for execution during US market hours.

When asked about its activity, the FRBNY never discloses for whom it is acting, claiming that its account agreements bind it to respect the confidentiality of its customers. But this approach is still not enough to hide the tracks of the ESF and the various governments who intervene to distort normal market forces. They want more cover, so the FRBNY places these government instigated trading orders with the big New York banks. Because these banks have such huge trading volume, the logic is that government instigated trading will be hidden amidst the huge order flow handled by these banks.

This line of attack to hide the government's trades works, except when the government's orders are so huge and one-sided that they overwhelm normal market forces. So it stands to reason that the repetitive and continuing entry by banks like Morgan Chase and Morgan Stanley on the sell side of the gold market at particularly critical market junctures and at unusual times smacks of government intervention. This unholy alliance, also known to some as the Washington/Wall Street Axis, demonstrates that these two forces are in bed with each other to serve their mutual benefit. The banks that act as government agents aim to make money anyway they can, even if it means taking despicable steps that are unfair and harmful to those unaware when the government intervenes. For its part, the government aims to distort markets from operating normally. Why does the government do this?

Because market prices communicate information, sometimes that information runs counter to what governments would like us to hear and believe. So governments intervene in a market by preventing it from alerting us of the market-message that governments don't want us to hear. For example, we all know that the message of a rising gold price means that the dollar is headed for

rough times, which is useful and important knowledge. But the government is more concerned about protecting its own interests and those of the banks who help it manipulate markets, rather than letting us receive a useful market-message to help protect our wealth.

(2) Wait until after the London market closes, which because of the time change is 12.00 noon New York time. The London market is basically a market for physical gold, while New York trades paper, which just represents promises to pay gold. There's a big difference between these two markets. It is easy to manipulate paper because all a government has to do is to create these paper promises 'out of thin air', just like they do all the time when they intervene in the foreign exchange markets. But governments cannot create physical gold 'out of thin air'.

Therefore, they tend to stay away from the London market, and only put physical gold into their market interventions sparingly because once they are out of physical (or unwilling to use what they have left, which was the case with President Nixon in 1971), their intervention game is over.

On Friday gold closed in London at \$382.75, \$13.35 above the New York close only 1½ hours later. So clearly, the government through its compliant bank agents only bombed the paper market.

(3) Intervene on a Friday afternoon in order to have the maximum impact from your intervention. The reason is clear because after 12.00 noon New York time, not only is London closed, but the rest of the world is closed as well. This afternoon period in New York represents the moment when the least amount of liquidity is in the market. So if government interveners want 'more bang for their buck', they can get it when the rest of the world is asleep or already enjoying their weekend.

The limited liquidity that is the dominant characteristic of the New York market on Friday afternoon makes it easier for the interveners to get bigger price moves, which then gives them a corollary benefit. A big price move can scare people, particularly when they have the whole weekend to think and worry about what the next week will bring. That result gives governments even more 'bang for their buck'.

(4) Just keep selling & selling. When you intervene in the market on a Friday afternoon with the intention of forcing the market lower, you begin selling short. Because you are the government and you are only creating promises to pay gold 'out of thin air', you just keep selling and selling until you hit key sell-stops resting in the market. After all, who is going to give the government a margin call? Consequently, there is no practical limit as to how many paper promises the government can sell. So how much do they sell? Simple, they sell enough until they complete their task, which is to drive the market lower. But they also use the market itself to help them accomplish their objective of lowering the gold price. Here is how they do it.

It was no secret that \$378 had become an important support point, and that consequently, it was obvious that a large number of longs had placed sell-stops under that level, or intended to sell if that level was broken. So let's assume that the government starts selling and selling and that it takes them 20,000 contracts in thin Friday afternoon trading to force the market down to the point where the \$378 level is broken. The government's selling is now complete. Its mission is accomplished because of the new selling that is generated when support at \$378 is broken. The market is now being driven lower by the longs who begin selling to cut losses or protect profits.

As the market heads further below \$378 support, more and more sell-stops are generated because the snowball started by the government is now rolling downhill on its own momentum. Then the government interveners step back in and slowly begin buying back their 20,000 contract short 'paper gold' position as the gold price heads down. They buy what the longs are now

selling, enabling the government to cover its short position.

The net result is that the government ends the day with no position, and assuming they made \$8 per ounce on average (which is not an unreasonable assumption given Friday's \$13 drubbing), the government walks away with \$16.0 million picked from the pocket of the longs – loot that it splits with the banks who acted as their agent. More importantly to the government, it achieved its primary objective, which is to distort the free-market process by forcing a lower gold price, thus hindering yet again the market-message that the dollar is in trouble and that people should be stocking up with gold for the tough times ahead. And the government did it without using one ounce of physical metal.

So that's how they do it. Further proof will emerge later today when Comex reports Friday's drop in open interest. It may not be 20,000 contracts, but I would be surprised if it is less than 12,000. But if the drop turns out to be less than 8,000 contracts, given Friday's estimated volume of 165,000 contracts (of which 125,000 apparently occurred after 12.10 when the government started intervening), then the shorts are in real trouble.

A small drop in open interest would mean that too few longs were scared out of the market in Friday's price plunge, and that as a consequence, the longs are tenacious in looking for higher prices. In that case, the shorts with their huge position have become even more vulnerable. Further, if open interest drops by less than 8,000 contracts, look for gold to quickly rally, back into the \$375-\$385 range seen the past four weeks.

Do I have documents proving the government intervention I discuss above? No, but the body of evidence developed over the past few years by me (see www.fgmr.com), www.GATA.org, Reg Howe (see www.goldensexant.com), Frank Veneroso (see <http://goldmoney.com/en/commentary/2003-09-04.html>) as well as many others is not only huge and compelling, but this body of evidence continues to grow. What's more, I've just made a new discovery, but let me start with a little background information.

Back in December 2000 I wrote "The Smoking Gun" <http://www.fgmr.com/smokegun.htm> and noted the discrepancy between the size of the US gold stock published by the Federal Reserve in its monthly *Bulletin*, which included "gold held by the ESF" in its report, and the size of the gold stock published by the US Treasury in its monthly *Bulletin*. The two reports were different, establishing that the ESF held gold or owed gold (because in some months the discrepancy was a negative balance) at the month-end record dates in which there was a discrepancy, which was virtually every month from the end of 1996 to my December 2000 publication date.

Then less than two months after the publication of my discovery, the Federal Reserve in February 2001 inexplicably changed its reporting of the gold stock to delete any reference to the ESF, thus making its record of the size of the US gold stock equal to the Treasury's report. This hasty change by the Fed is reported in: <http://www.fgmr.com/whatgold.htm>

This after the fact 'adjustment' to US government reports was revealing, given that the government felt sufficiently compelled to hide further the tracks of the ESF to make this embarrassing change to its reports. But that appeared to be the end of this little window into the operation of the shadowy ESF because the Fed was no longer reporting the US gold reserve plus the ESF's gold balance. Or so I thought.

Recently I was analyzing the Fed's audited balance sheet released in its 2002 annual report, and I noticed that the discrepancy has reappeared. As of December 31, 2002, the Federal Reserve reports \$11,039 million in its Gold Certificate Account, but as of the same day, the US Treasury *Bulletin* reported the US Gold Reserve to be \$11,043 million. At the \$42.22 book value used to record these entries, there is a discrepancy of 94,741 ounces of gold on that one day. What is the

reason for this divergence in these two reports?

It seems obvious that this difference is the weight of gold held by the ESF, which used to be reported by the Federal Reserve in its monthly *Bulletin*. The divergence between the two reports has again reappeared because the Fed can report in its monthly *Bulletin* whatever it wants to include, or in this case, exclude. But it cannot exclude the impact of the ESF on its year-end financial statement because if it did, its auditors, KPMG, would not give an unqualified opinion in the audit. So even though the Fed, presumably under the direction of the ESF, tried to re-write history by changing their monthly unaudited reports, in the end they failed because their manipulation of the gold market has now been exposed in the Fed's audited financial statements, which raises an interesting question.

Does this blatant management of the gold market by the US government mean that we should not buy gold? Definitely not, unless you would rather rely upon the hollow promises of politicians instead of the proven and reliable trustworthiness of gold. And regardless of any short-term considerations such as Friday's trading action in the paper market for gold, consider instead the important long-term case for gold. Recently, it was summed up wonderfully by fund manager John Embry. His article – "*15 Fundamental Reasons to Own Gold*" – has been posted to the GoldMoney website, so there is no need to get into it here, except to say that the long-term potential for gold is truly outstanding. See: <http://goldmoney.com/en/commentary.php>. Each of John's fifteen reasons offers sufficient incentive in itself to continue buying and accumulating gold each month as your cash-flow allows.

In summary, government manipulators and their bank agents won another battle on Friday to keep the gold price under control. However, it is clear that they are losing the war.

Since touching \$252 over four years ago, gold has been in a primary bull market. There is a steady and resilient worldwide movement out of national currencies into gold, and given all the fundamental reasons to own gold in preference to any national currency, I expect that gold's primary bull market will continue.

Consequently, Friday's setback will soon be forgotten, and while it hurts to see any market trashed in this way by the government, there is a bright side to it. Friday's late-day sell-off has no doubt converted many more, who had been skeptical, about government manipulation in the gold market. Yes, even though the government intervenes in seemingly every market, there still are some who believe that the government doesn't intervene in the gold market. But that group is rapidly declining in number, and not only because of blatant manipulations like the one that occurred on Friday. Another factor is at work.

All one has to do is look at the dollar and its bleak prospects. Given that sorry future, it is no wonder that people are increasingly moving into gold, which explains the recent "seven-year highs" in gold noted in the Reuters article. When one sees what is happening to the dollar, they opt for gold regardless of the government manipulation. The ongoing destruction of the purchasing power of the dollar and the relative undervaluation of gold increasingly makes gold the prudent choice.