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*With both China and India now gobbling up the precious metal, we may soon have to contend with the reality of scarce bullion*

# Gold increasingly likely to be in short supply

Following its record high of roughly US$1,900 late last August, gold has had a lengthy consolidation.

John Embry

This has occurred despite developments that can only be described as extremely gold friendly.

And that, in turn, attests to both the desperation of the powers that be, as well as their ability to dominate price action in the paper gold market for a long time.

Following an historic downgrade of U.S. government debt by Standard & Poor's in early August of 2011, gold suffered a sharp takedown after Labour Day.

Then, on Feb. 29 of this year, gold, having started to rally strongly, was once again taken to the woodshed, counterintuitively collapsing as Europe's woes worsened.

This had the desired effect in the West where sentiment towards gold is now about as sour as it's been any time in our 12-year bull market.

Yet, this hasn't deterred China which continues to load up on the precious yellow metal.

Indeed, based on its import rates, China is on track this year to pass India as the world's biggest consumer of gold.

Considering how small the market actually is for physical bullion, the voracious demand from both India and China is leaving less and less gold for the rest of us.

With the world's central banks now major gold buyers, the reality of significant bullion shortages now lies heavily upon us.

Add to this the staggering amount of paper gold in exchange-traded funds, futures, pooled accounts and the like and the magnitude of the emerging shortage can be easily appreciated.

This is exacerbated by the recent discovery that in many allocated gold accounts, the metal isn't even readily available, having been hypothecated and, in many cases, re-hypothecated.

That's an extremely explosive, situation, given that gold is now primed for a powerful spike — one that may even surprise the metal's most ardent supporters.

Not only do I believe that gold has bottomed out, I also contend that it could easily top its all-time highs of last August.

The backdrop to this will be the growing necessity for a massive increase in quantitative easing throughout the West as economies continue to slow down and grossly excessive debt levels become an ever greater burden.

Despite officialdom's continual denials that any significant quantitative easing is on the horizon, the truth is about to emerge.

There are times in history when events simply overwhelm those who think they can control the system. I believe we're in the early stages of just such a period.

Take Europe. A leading German parliamentarian recently stated unequivocally that it was mathematically impossible for the Euro zone to save Greece.

Yet, at roughly the same time, Greece's prime minister acknowledged that his country is now in a great depression, similar to the one in the U.S. in the 1930s.

But the Troika — the European Commission, the European Central Bank and the International Monetary Fund — think differently.

They continue to insist that Greece must adhere to the prescribed austerity program in order to qualify for future funding.

Without it, Greece will likely default for the second time in six months. But because Greece is a small country, I suspect the Euro zone could survive its departure, although the banking system would undoubtedly take a hit.

Spain, on the other hand, is the big enchilada and, to put it mildly, is in dreadful shape.

In the days leading up to the recent bailout of its banks, Spain's prime minister repeatedly insisted that his country could cope without much outside assistance.

What rubbish! Spain is on the verge of economic collapse — something that became readily apparent when it admitted that it needed at least 300 billion euros to stave off bankruptcy.

Irrespective of the outcome of the crisis, confidence in fiat paper currency is going to be further eroded, dramatically strengthening the case for gold.

The Continent's fireworks have taken the focus off the U.S. whose myriad financial and economic problems continue to worsen.

The U.S. Federal Reserve's plan to continue an interest rate policy of zero per cent through to 2014 effectively neuters any conventional monetary tools.

Meanwhile, an annual fiscal deficit well over US$1 trillion has created a serious debt trap.

## Belief is naive

Moreover, it's naive to think that any big increase in taxes or decrease in spending could rectify America's problems without triggering an economic collapse.

As in Europe, there's only one course of action left to shield the U.S. from a deflationary collapse and that's quantitative easing to infinity.

There are many observers who continue to believe, like Fed chairman Ben Bernanke, that the risk of mounting inflation is minimal.

This, in the short run, has proven to be true, despite massive monetary creation by the Fed.

Yet that's only because many

individuals and corporations are so frightened that they're just hoarding their cash, leading to a massive drop in the velocity of money.

But as the powers that be persist in pumping money into the system to avert deflation, people will attempt to get rid of their cash by either spending it or investing it in real assets.

This will lead to a rapid increase in velocity and, after that, to mounting inflation — a process that can unfold very quickly.

Now, I'd like to turn to **Barrick Gold Corp.** (ABX-TSX, $33.01), the world's biggest gold miner.

Because of a massive cost increase at its Pascua Lama project on the Chilean-Argentine border, Barrick says production there will be delayed for at least a year.

More ominously, because of cash constraints, Barrick has now indefinitely postponed development of its Donlin Creek project in Alaska, as well as its massive Cerro Casale operation in Chile.

In addition, the company has cut its forecast of future gold production to nine million from eight million ounces a year.

Barrick's revision is worth noting, since a one million ounce shortfall equates to more than one per cent of worldwide output.

Admittedly, many gold bugs have taken great delight in Barrick's woes, viewing them as retribution for the billions of dollars in losses the company logged in the 1990s as a result of its hedging policies.

But I view the bad news as proof of just how difficult it now is to do large-scale gold mining. Indeed, Barrick isn't likely to be the only miner that will suffer cost overruns, delays and cancellations.

As a result, I still doubt there will be any significant increase in gold mining production in the foreseeable future — another plus in the metal's ever-tightening equation of supply and demand.

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