

The Disconnect Between Physical Gold Demand And The Paper Gold Price

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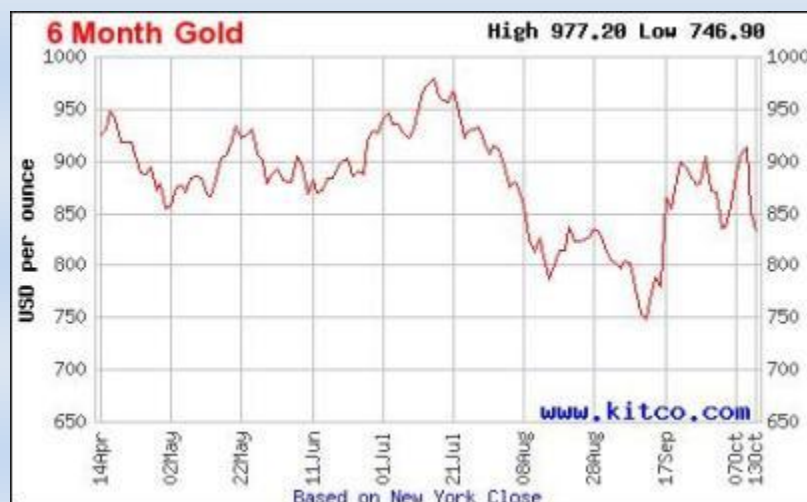
Anyone who's been following the gold story lately probably has noticed something doesn't seem right. Specifically, I'm talking about the disconnect between physical gold demand versus the paper gold price. I've been hearing a lot of stories of how recent demand for the physical metal has been absolutely on fire in the United States and elsewhere, especially with the chaos taking place throughout the financial system. From NumisMaster's Patrick A. Heller on October 7:

Gold and silver coins and ingots are almost non-existent anywhere in North America, Europe, the Far East and Australia. Premiums on what merchandise can be had are far higher than commodity market prices.

Banks in Europe, if they can find any, are willing to pay 10 percent to 15 percent over gold spot to buy Krugerrands or sovereigns. In the United States on Monday, some dealers were bidding well over 30 percent over intrinsic value to purchase immediate delivery silver coins or ingots. There are many reports of retail buyers paying more than double silver value to acquire U.S. silver American Eagles in recent days.

Partly in response to the lack of availability of gold bullion-priced coins and ingots, several buyers are purchasing common-date U.S. \$20 and \$10 gold coins in all grades. Prices are up sharply in the past few weeks, as much as 25 percent to 30 percent in some instances, with supplies dwindling rapidly.

With all this going on, **I find it strange the paper gold price hasn't reflected these circumstances.** In fact, after falling off a cliff near the end of July, the Comex gold price has resembled a sickening roller-coaster ride ever since.



So what gives? Why isn't the paper price of gold going up in an environment of strong physical demand and financial uncertainty? Here are two insights into this phenomenon. Alex Wallenwein, editor and publisher of the [EURO vs. DOLLAR & GOLD MONITOR](#), wrote on The Market Oracle (UK) website yesterday:

Why is gold dropping right now when anyone in their sane mind would expect it to rise? **The simple answer to this question is, “because Comex-gold isn’t gold” – and because it deceptively pretends to be ‘the’ price-setter for real gold.**

Gold is gold, paper is paper, and “Comex gold” is nothing but paper masquerading as gold while simultaneously pretending to be the price-setting medium for actual gold in the world. Now, finally, Comex-gold is in the process of being unmasked.

The real supply and demand determinants for Comex gold are not actual gold investors but fund managers. Fund managers are inextricably intertwined with the world of contract-based credit instruments. They use bet on Comex gold contracts to hedge their other (currently horrendously losing) bets with something they all, in their in-bred belief in paper markets, believe will ‘go up’ in value while everything else is going down.

However, these very same fund managers and their paper-bound investment psychology are the exclusive reason why Comex gold is dropping in these times when everyone (including fund managers) expects gold to rise. As already stated, though, and as they now finally realize to their own dismay, Comex-gold just isn’t gold – and that causes even further selling.

Fund managers’ other bets are losing money fast, now, so they need to raise cash to keep up the overall value of their respective funds, so they can earn their management bonuses and avoid getting booted for lack of relative performance. Guess what they cash in on? The very same Comex paper-gold they mistakenly bought as a ‘hedge’, of course.

Meanwhile, real investors in real gold are enjoying their shopping spree – except that the spree turned into a treasure hunt as the shelves and display cases of gold dealers look more and more like the supermarket shelves in the old Soviet Union - bare.

This is the only ‘bare-market’ in real gold the world will see for a long, long time to come.

With this split, this disconnect, between Comex illusion and gold reality, one thing or the other will have to give, and it won’t be physical gold that gives.



Also discussing the paper gold price physical gold demand disconnect yesterday was Tony Allison, a registered representative for the PFS Group. He wrote on the Financial Sense website:

Gold has been known throughout history as a safe haven during troubled times. Sure enough, there is now unprecedented demand world-wide for physical gold and silver. There are shortages and high premiums from the US to Europe, from the Middle East to Asia. In some areas, delivery times are running into the two month range or longer. Other dealers are simply not selling, as they are unsure of obtaining any supply.

At the same time the paper gold price, set on the Globex world-wide trading system (dominated by the NY Comex) has gyrated wildly. It moved sharply lower during last Friday's chaos on Wall Street, causing analysts to dismiss gold's value in a crisis atmosphere. It is logical that the world's central banks would want a lower gold price to calm the jittery markets. Paper gold traded on the Comex appears to be dancing like a puppet to a tune emanating from Washington. That tune may continue until the crisis has calmed. But sooner or later the global rush to physical gold and silver will reconnect precious metals prices to the reality of supply and demand.

William Fleckenstein of Fleckenstein Capital had some interesting thoughts on this "disconnect" recently.

"What I haven't talked about is gold lease rates have gone through the roof. That appears to be because central banks are becoming credit-adverse and not lending out their gold as they once did. I've also heard rumblings about some large holders of gold futures deciding to take delivery, since they're having trouble buying physical gold in sufficient size. If that's the case, **it could cause a mad scramble at the Comex, because there's not enough gold to meet the open interest. It looks like physical gold, as compared to paper gold, is rapidly becoming the flavor of the day; meaning that a huge price move may lie just in front of us.**"