Connecting the Dots of Chinese Gold and Currency Reserves

By The Mogambo Guru

10/04/10 Tampa, Florida – Bill Bonner here at *The Daily Reckoning* is one of those guys who, for some reason, figures that we (represented, apparently, by me) are smart enough to "connect the dots," when some of us (again, me as "everyman") are obviously not smart enough to engage in such mental gymnastics.

For example, as the gold-bug, Austrian school of economics, gun nut, paranoid, lunatic, greedy lowlife that I am, I am instantly alerted to buy more gold when he writes, "Gold makes up only 1.7% of China's foreign exchange reserves. Many analysts believe China is targeting a 10% figure. If so, it would have to buy every ounce the world produces for two and a half years. Or, if it relies on only its own production – China is the world's largest producer – it would take nearly 20 years of steady accumulation to reach the 10% level."

'"Wow!" I said to myself!

The problem for me is that China's annual production of gold is, obviously, relatively fixed in the short run and, due to depletion of a finite resource, bound to hit something like Peak Chinese Gold, especially since gold and gold mining are not new to China!

So this "20 years of buying all internally produced gold" figure also supposes that China's foreign exchange reserves will not grow at all – zero growth! – for 20 years.

Watch carefully here, as I note this inevitability of China accumulating more foreign reserves, which is, I figure, a dot to be connected! A dot!

I was so happy to have discovered a "dot" that I quit work early and went out to have a few congratulatory drinks to celebrate, and thus only needed one more dot to have something to connect! Wow! This is the kind of thing of which careers are made!

Sadly, I never did discover another dot, no matter how much I drank and/or thought about it, and I ended up getting really smashed, which is, admittedly, how I would have ended up if I had celebrated actually discovering another dot, and actually connected something.

So, either way, I ended up the same! It's a win-win situation! Hahaha!

But it was still a rewarding experience, as towards the end of the night I noticed, as I "relaxed" on the floor of the bar, that the old wooden floor was tilted. Because of this slope in the floor, and my unique perspective of lying face-down on the ground in a puddle of what I hope was only beer, I could see by the light of some neon beer signs and a jukebox that two puddles of some unidentified liquid were slowly draining downhill, and the trails of them both curved down and around in big arcs. Arcs! Of course!

“Eureka!” I shouted, which caused the rest of the patrons to shout out, almost as one, “Alaska!” and then, apparently, argue about whether or not Eureka was the capital of Alaska, and if it wasn’t the capital of Alaska, then what is the capital, you loudmouth, which evolved into a discussion of who is calling who a loudmouth and who is going to do something about it, with or without the help of some alluded-to army.

“No, you morons!” I shouted from where I lay on the filthy floor, prostrate and stinking of beer, “I emulate the excited exclamation of Archimedes upon discovering the principle of specific gravity to indicate that I see, glinting in the glaring neon of the beer signs of this dreary little bar, the curving, upward-sloping line of China’s foreign reserves rising exponentially faster than the upward-sloping line of their internal production of gold, meaning that China cannot ever have enough internally-produced gold to equal 10% of their reserves if foreign reserves keep rising unless gold goes up a lot – a lot! – in price when priced in the currencies of those reserves, one of them being the dollar!

In that case, gold will go up wonderfully up in price!

Otherwise the Chinese are going to need to buy a lot – a lot! – of gold from the rest of the world, which will also drive up the price a lot – a lot! – to the point where today’s gold-bug people are going to be rich, rich, rich, and who will be a happy band of people who abruptly disappear from one town and mysteriously appear in another, fabulously wealthy, sporting nice clothes and snazzy new convertibles, and about whom lurid, wickedly delicious stories are told in whispers.

Fortunately, the Austrian school of economics and the Mogambo Lazy Bum Portfolio Plan (MLBPP) both figured that this was going to happen, and while I can’t speak for an entire school of economics, the MLBPP dictated that one should buy gold, silver and oil when the Federal Reserve is creating so outrageously, so unbelievably, so insanely much new money.

And because merely buying gold, silver and oil is so easy, one can only say, “Whee! This investing stuff is easy!”