A gold backed currency for Zimbabwe

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1.0 Introduction

There's a growing opinion tide advocating for the return of the gold standard from all over the world. Zimbabwe's Reserve Bank Governor, Gideon Gono was quoted as saying "There is a need for us to begin thinking seriously and urgently about introducing a gold-backed Zimbabwe currency which will not only be stable but be internationally acceptable. We need to re-think our gold-liberalisation and marketing strategies as a country. The world needs to and will most certainly move to a gold standard and Zimbabweans must lead the way."[1]

Elsewhere, notable individuals have also voiced their support. Ron Paul, a Republican Presidential aspirant has been a leading voice in the Western world. Manuel Hinds, twice Finance Minister of El Salvador is on record in *The Wall Street Journal* advocating the classical gold standard. India's leading advocate of monetary integrity, S.S. Tarapore, former deputy governor of the Reserve Bank of India has advocated for a return to the gold standard.

However it is recent events in China that should highlight just how popular a return to the gold standard is becoming. China is increasing its monetary gold reserves at an alarming rate. It is now the world's leading gold producer and currently has the world's fifth largest bullion reserve. It is, however, projected to own more gold than the US Federal government (the current number one) in five years. To achieve this China:

- recently removed restrictions on personal ownership of gold
- legalized domestic gold exchange traded funds
- is purchasing all gold mines in China
- has become the largest importer of gold (750 tonnes, or 27% of global output in 2011).
- publicly stated its intention to add 1000 tonnes per year to its central bank reserves.
- is buying major stakes in foreign gold mining companies.

1 – The Herald, 14 May 2011

1.1 *Why is gold so popular as an investment?*

Investors generally buy gold as a hedge against economic, political, or social fiat currency crises.

But why is its price so erratic and what or who determines it?

There is a lot of speculation in the gold market through the use of *futures contracts* and *derivatives*. Because of its popularity as an investment gold tends to behave more as a currency than as a commodity.

Futures contracts are a contract between two parties to buy or sell a specified asset of standardized quantity and quality for a price agreed today (futures/strike price) with delivery and payment occurring at a specified future date (delivery date).

Derivative is a contract between two parties that specifies conditions under which payments are to be made between the parties.

2.0 Gold Price

2.1 How it is determined…the Gold Fix

Every morning, at exactly 10:30 am GMT in the centuries-old city of London, five men (people, so as to be politically correct) meet in a small room at Rothschild's headquarters on St Swithin's Lane and over a cup of tea (as is customary in the Queen's island) they decide the price of gold for the day. Amazing isn't it? What happened to the laws of supply demand that we learnt in Economics 101?
Five people deciding the livelihood of thousands of workers in gold mines around the world, inflation rates and the price of that wedding band you plan to buy for your wife.

These five work for Scotia-Mocatta, Barclays Capital, Deutsche Bank, HSBC and Societẽ Generalẽ. The five men come to the table with their companies' gold orders which can either be their own (proprietary orders) or their clients' (brokerage). Clients usually set a limit order i.e an order to buy gold at no more than a specific price. By doing this, clients try to control the price rather than the certainity of execution.

One of the five, the lead participant, begins by proposing a price near the current gold spot price. All five then determine how much gold they will be able to trade as per limits and quantities set by their employers and clients. Each one then states how much gold they intend to buy or sell. After each one of them has stated this amount they determine if the overall net amount is zero. If so all transactions succeed and the fix is complete. The lead participant , in custom British eccentricity, then says "There are no flags, and we are fixed"

However if not, then the lead participant must change the proposed price. If the amount proposed for sale is higher, he must lower the price. This will result in more proposed purchases and less proposed sales. And vice versa if the proposed amount for purchase is higher. This process is repeated until a price (fix) is found.

To fund the fix process, buyers are charged a premium of 20 cents per ounce. At 3pm daily, the five meet again in the small room and fix the price again.

So ultimately the price of gold is a factor of supply and demand as you learnt in basic Economics. That sort of soothes your rising anti-western sentiments now, doesn't it?

2.2 But what exactly influences the demand for gold?

As we have just established, the price of gold is actually driven by supply and demand. However another major driver is speculation. Gold is not really 'consumed' like most other commodities such as crude oil. Most of the gold ever mined is still available in accessible form such as bullion and mass-produced jewelry. The gold in jewelry is valued at slightly more than bullion gold and can thus be readily brought back into the trading market.

To put this into perspective, at the end of 2006 all the gold that had ever been mined could be stored in a room twenty metres long, twenty metres wide and twenty metres high !! This amounts to about 158 000 tonnes.

There is always more gold stored in vaults around the world than that being produced by mines therefore price is affected more by demand than by production (supply). In recent years gold production per annum has reached around 2 500 tonnes. Of this 2000 tonnes is used is in dentistry and to make jewelry. The other 500 is traded.

3.0 <u>Zimbabwe as a Gold Producer</u>

3.1 History

Since pre-colonial times Zimbabweans mined gold and traded it with the Portuguese and Arabs. Many mines established during the colonial era were simply extracting from old workings. It is estimated a third of the gold Zimbabwe has ever produced (about 700 tonnes) was produced during this time.

3.2 Gold deposits and reserves

Zimbabwe is a gold-rich nation. The Archaean terrain of Zimbabwe is in terms of gold yield per square kilometer, the most productive of its kind in the world. It is more productive in fact than South Africa's archaean terrain which holds the world's largest proven reserves of gold. The graph below shows the countries with the top three proven reserves, in comparison to Zimbabwe's.

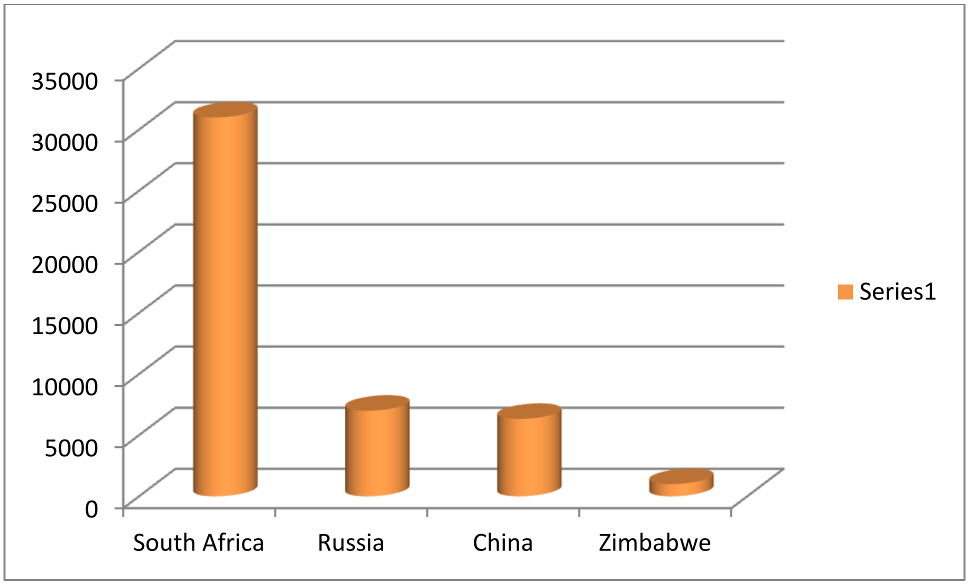

Fig 3.1: The world's top three gold proven reserves holders (in tonnes) in comparison to Zimbabwe

In terms of total proven reserves, Zimbabwe still falls far short of the global giants. However the graph doesn't truly show how well endowed Zimbabwe is as it doesn't take the sizes of the countries into consideration. The graph below shows this by comparing tonnes produced / square kilometer.

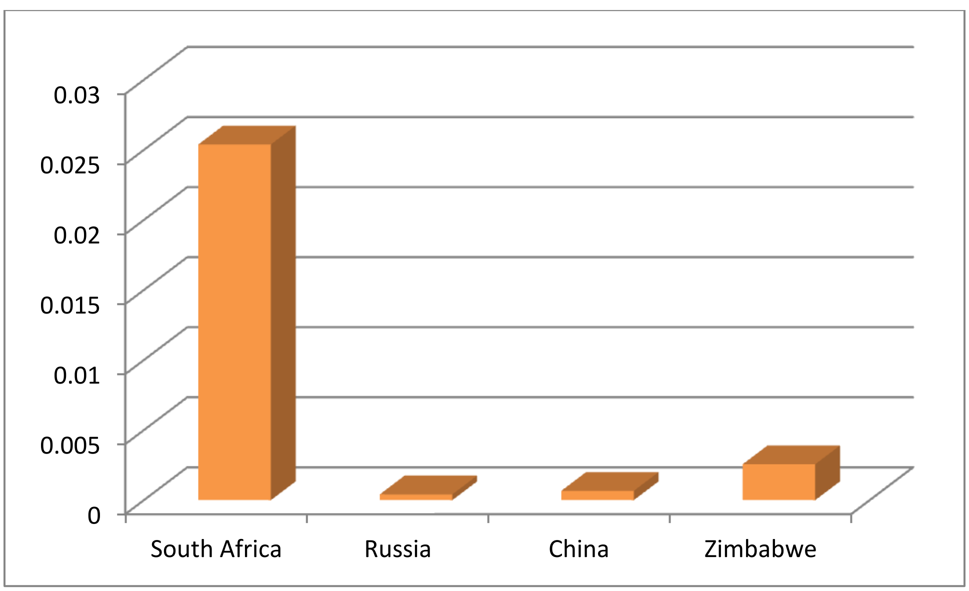

Fig 3.2: Gold reserves per square kilometre

While it can be seen that South Africa's gold reserves are unmatched, Zimbabwe has more gold per square kilometer than Russia and the world's current top producer, China.

With trillions of dollars worth of gold reserves Zimbabwe has the potential to become a top gold producer. At its recent peak in 1998, Zimbabwe's gold production was 27.1 tonnes. Zimbabwe is estimated to have a capacity to produce 30 tonnes annually. The graph below shows the trend of gold production between 1992 and 1999 (in blue) as compared to production between 2007 and 2012.

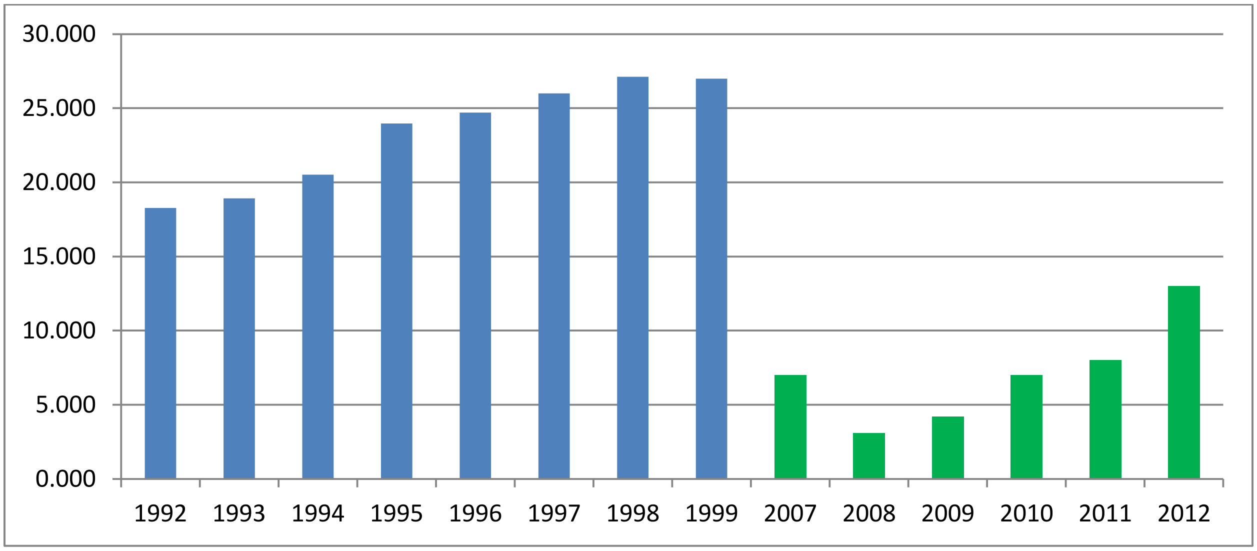

Fig 3.3: Zimbabwe's gold production

However this production is relatively low when compared to the production of the top ten producers in the world currently. This is shown in the graph below:

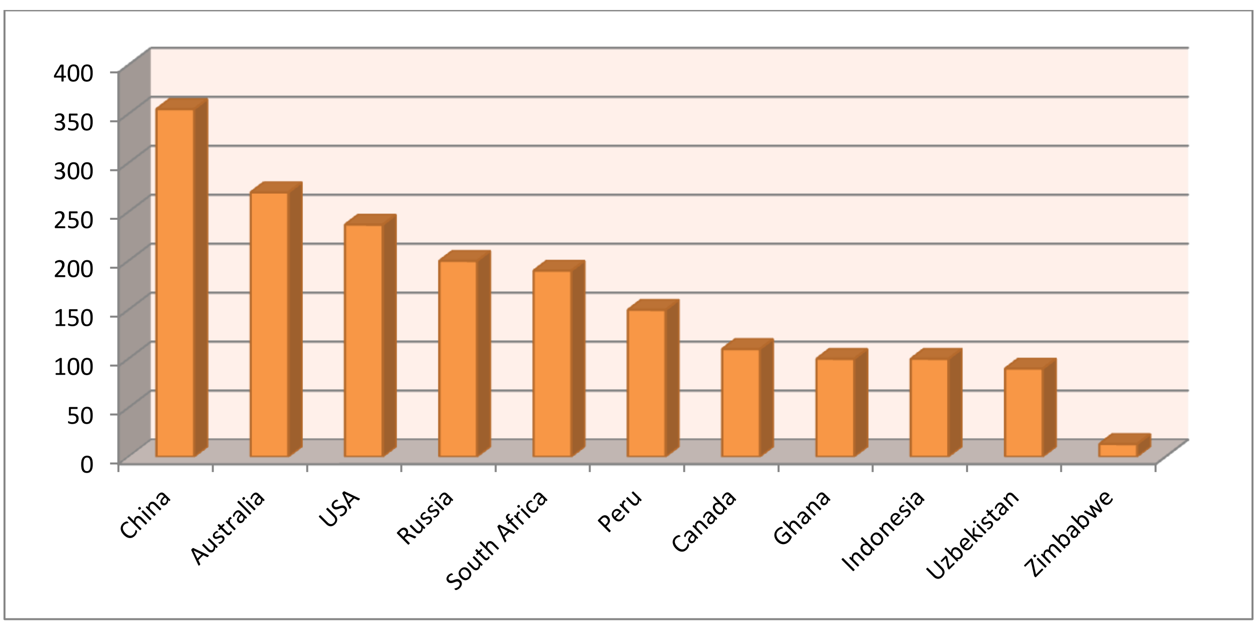

Fig 3.4: Top ten gold producers compared to Zimbabwe

But again when this production is taken as a factor of the country's population (per capita) as shown below:

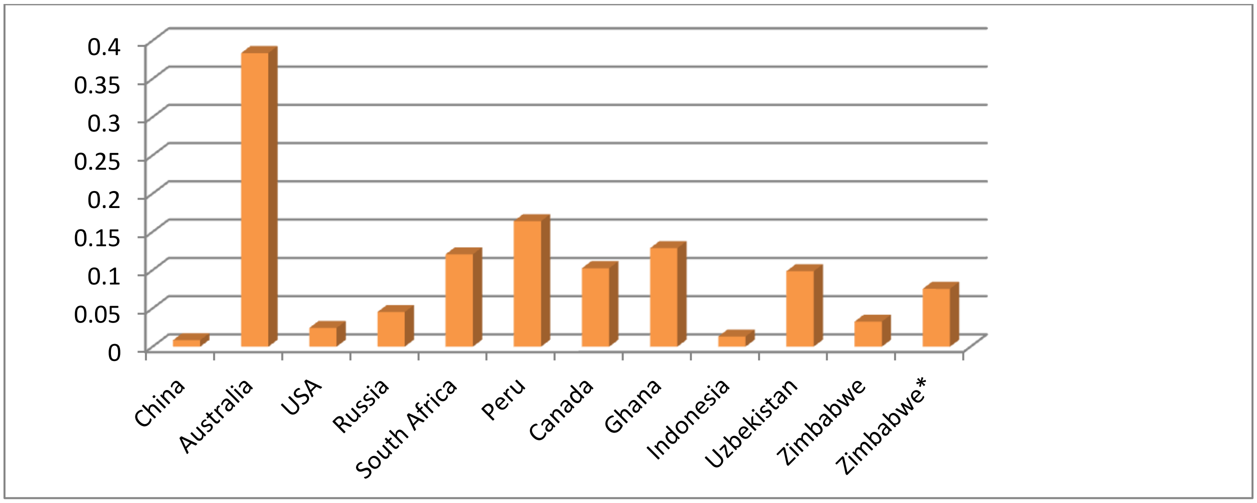

Fig 3.5: Gold production per capita

*Gold production at full capacity

It can be seen that Zimbabwe's gold production in ounces per capita surpasses that of Indonesia, USA and Indonesia. At full production, Zimbabwe would be producing more gold per capita than three of the world's top gold producers (China, USA and Russia).

It is also important to note that most parts of Zimbabwe have not fully explored and thus the known reserves fall far short of the actual amount of gold deposits. Reserves are the economically mineable parts of known deposits. Reserves usually only represent a small part of the actual amount of the gold in the ground.

4.0 <u>Value addition and alternative uses</u>

Gold is a non-renewable resource thus there is a need to utilize it for economic purposes other than trading it for foreign currency in order to enhance its intrinsic value and its economic benefit to the nation.

4.1 Jewellery Production

The Reserve Bank of Zimbabwe wholly owns Aurex Holdings, a jewellery manufacturing company located in Ruwa. It is currently operating far below capacity and is capable of producing 20 tonnes of jewellery a year.

4.2 A Case for a gold standard currency

Currencies can be either fiat or gold-backed (gold standard). A fiat currency is one that derives its value from government regulation or law and is not directly linked to any commodity or physical asset. It's value relative to other currencies is derived by the relative demand for that particular currency. A gold standard however is one that has its value tied to the spot price of gold. For example the US dollar was backed a gold standard until 1971, which in theory means one could exchange their dollars for gold in 1971.

Currently all currencies around the world are fiat. The use of fiat currencies however means that governments can spend much more than their nations are actually producing. This is what has been at the root of the current financial turmoil in Europe and the global recession of 2008. For Zimbabweans, the extent to which a fiat currency can go wrong is something we are personally and painfully acquainted with.

But is a return to the gold standard possible? Let's take the world's wealthiest country as an example. The United States has 8 133.5 tonnes of gold reserves (261 498 070 ounces) and an estimated currency circulation of US$ 2.38 trillion[1]. If the United States pegged their currency against their gold reserves the value of each ounce of gold in their vaults would be US$ 9 101.41 which would no doubt raise the price of gold globally to similar levels. Thus the US just doesn't have enough gold to return to the gold standard without risking the rest of the world dumping their US dollars and losing confidence in the currency.

By the end of 2009 all the gold mined totaled to 165 000 tonnes which at a price of $1 749.20[2] per troy ounce would be valued at $9.31 trillion.

Would it be possible for Zimbabwe to launch a gold standard currency?

Zimbabwe is estimated to have US$6.554 billion in circulation[3]. Theoretically, if today, Zimbabwe was to introduce a gold backed currency whose value is equal to the $US it would need 116.54 tonnes (3,746,855.71 ounces) of gold reserves.

This is a considerable amount of bullion. It would take 4 years worth of Zimbabwe's full-capacity production of gold to reach this value. But that's not the difficult part. Zimbabwean gold mines have no qualms with selling all their gold to the RBZ, it's what they always had to do until 2009. The difficult part is raising the $6.554 billion required to buy the gold.

The $6.554 billion dollar question: where from?

If ever there was a Zimbabwean version of 'Manifest Destiny', it was the discovery of the vast alluvial diamond fields in Chiadzwa. Unofficial estimates place the value of raw diamond sales by the top three producers: Mbada Diamonds, Marange Resources and Anjin at $4 billion dollars in 2011. If these fields were fully nationalized and the proceeds used for setting up a gold standard it would take only two years to achieve this.

1 – Federal Reserve Statistical Release, 11 October 2012

2 – Spot gold price on 14 October 2012, 17:58 GMT

3 – Estimate as at 31 December 2011, Source: CIA World Factbook

5.0 Legal Framework and Government Policy

Currently the trade of gold is regulated under the Gold Trade Act, Chapter 21:03. Under the act :

- People are prohibited from owning and the possession of gold unless if they are authorized to do so by the Ministry of Mines.
- Gives the Reserve Bank the monopoly to purchase gold produced in Zimbabwe.
- All locally mined gold should be sold to the Reserve Bank of Zimbabwe through its subsidiary, Fidelity Printers Refinery.

However in 2009 measures where taken to liberalize the trade in gold. These measures include:

- Allowing gold producers to sell their gold on their own
- Gold producers retain 100% of the sale proceeds in foreign currency
- Amounts owing by the RBZ to the gold producers for previously unpaid gold sales were convereted into Special Tradeable Gold-backed Foreign Exchange Bonds which carry interest at 8% per annum.
- Issuance of gold dealership licences to gold producers
- Relaxation on restrictions over foreign payments , which means that it is now relatively easy to make payments of less than $5 million to foreign suppliers, lenders and investors without the requirement for Central Bank approvals.

It is my opinion that restrictions on the private ownership and possession of gold should be completely removed and the Reserve Bank should put in place measures to build a bullion reserve that will enable it to peg a new currency against gold.