CHINA Takes Control Of GOLD From The COMEX

By David Brady – Sprott News

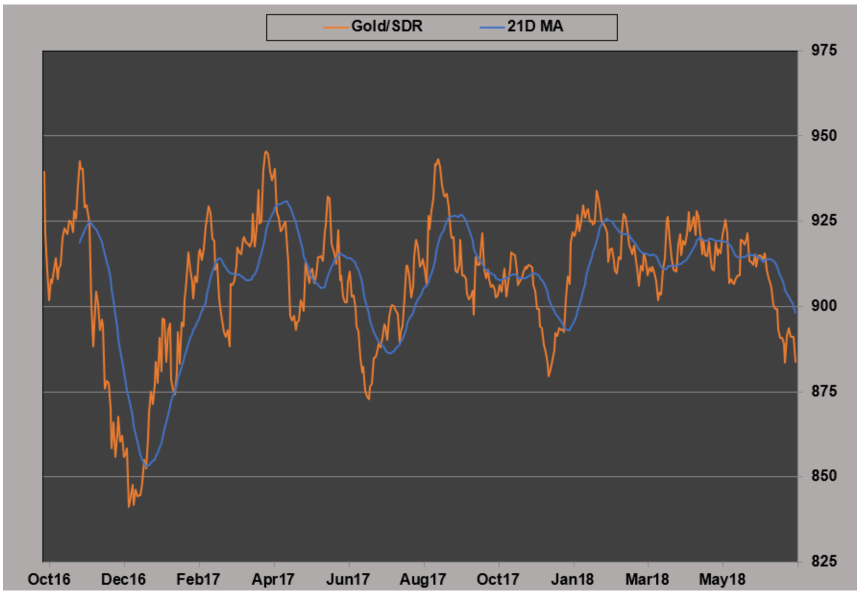
The correlation between Gold and the USD/CNY exchange rate has become clear recently. I first cited the idea of Gold being pegged in yuan terms in February, based on the increasingly narrow range in the Gold/yuan (or “XAU/CNY”) exchange rate. I emphasized this, given what it means for Gold in that USD/CNY becomes a primary driver of the price of Gold in dollars. Now it’s mainstream, thanks to the escalating trade war between the U.S. and China, and China’s response in devaluing the yuan by ~8% in 3 months.

In addition, Jim Rickards pointed out his belief last week that Gold is pegged against the IMF’s currency, the Special Drawing Rights (or “SDR”), and that China and the IMF are coordinating to keep the SDR within a range of 850-950 against Gold. This article goes into detail on what each of these pegs means for the Gold, but there are obvious common denominators between the two: Gold and China. It’s clear that China is now directly involved in Gold pricing and, by derivation, the role of the COMEX is diminishing in the process.

Starting with Gold in SDR terms, or the GOLD/SDR exchange rate, Jim Rickards says it is pegged at ~900 with a range of 850-950—a soft peg, that is likely to tighten over time. The SDR is determined by a basket of currencies including the dollar, euro, yen, pound and, since Oct 2016, the Chinese yuan—with the dollar being the most heavily weighted currency. Each day the SDR changes in value based on how these currencies perform against the dollar and their weightings in the SDR’s calculation. It’s a supranational currency in the sense that its value is based on the currency of multiple countries—not just one, like the dollar—and is the favored currency of both China and Russia to replace the dollar as the new global reserve currency.

The chart below as of July 11 shows the range of values for the SDR since the inclusion of the CNY.

The next chart shows Gold in SDR terms, with the broader 11% range between 850-950 and a narrower 5.5% range between 875-925 around 900.



In order to determine the effect of this GOLD/SDR peg on the value of Gold in dollar terms, I put the following matrix together.

	GOLD/SDR				
	850	875	900	925	950
1.46	1241	1278	1314	1351	1387
1.45	1233	1269	1305	1341	1378
1.44	1224	1260	1296	1332	1368
1.43	1216	1251	1287	1323	1359
1.42	1207	1243	1278	1314	1349
1.41	1199	1234	1269	1304	1340
SDR 1.40	1190	1225	1260	1295	1330
1.39	1182	1216	1251	1286	1321
1.38	1173	1208	1242	1277	1311
1.37	1165	1199	1233	1267	1302
1.36	1156	1190	1224	1258	1292
1.35	1148	1181	1215	1249	1283
1.34	1139	1173	1206	1240	1273
1.33	1131	1164	1197	1230	1264

On July 11, the SDR was ~1.41, and Gold in SDR terms was back to its lowest level since July 2017 at 884. This equates to 1244 in Gold, the closing rate that day. The equation is as follows:

Gold/USD = SDR * Gold/SDR

The matrix shows the derived values for Gold based on the SDR range since Oct'16 and the wide and narrow peg values for GOLD/SDR around 900. Given that 884 falls between 875 and 890, Gold at 1244 falls between 1234 and 1269, highlighted in orange above. That's the situation currently.

More importantly, based on the goalposts for these ranges, Gold is limited on the upside at 1387 and on the downside at 1131. It's no coincidence that the peak and trough in Gold since mid-2016 and now were 1377 and 1124, and that supports Jim's thesis that Gold is pegged in SDR terms. This means China, in coordination the IMF, is controlling Gold prices. It also means that Gold is unlikely to go higher or lower than these values unless the SDR breaks out of its range.

In the short-term, as long as the SDR does not fall significantly below ~1.41, and with GOLD/SDR limited on the downside to 850, this means Gold should find significant support at ~$1200 or slightly below.

Switching to the XAU/CNY peg, you can clearly see below how the downside has been limited to 8200, with the lower and lower highs on the upside capping Gold at ~8360 recently.

At the same time, USD/CNY has been in a range of ~6.25 to ~6.97 since the CNY was added to the SDR in OCT 2016.

Putting these two together, the formula for driving the Gold price in dollar terms is as follows:

XAU/USD = XAU/CNY divided by USD/CNY

Assuming XAU/CNY is pegged between 8200-8360, this means a higher USD/CNY exchange rate equates to a lower Gold price in dollars (XAU/USD) and vice-versa for a lower USD/CNY.

The closing price of Gold on July 11 can be calculated as follows:

1244 = 8299 / 6.6720

The matrix below shows the derived values for XAU/USD based on the 8200-8360 range in XAU/CNY and the 6.25-6.97 range in USD/CNY, with the Fibonacci levels as signposts for each.

							USD/CNY				
				14.6%	23.6%	38.2%	50%	61.8%	76.4%	85.4%	
			6.25	6.36	6.42	6.53	6.61	6.69	6.80	6.86	**6.97**
		8360	1338	1315	1302	1281	1265	1249	1229	1218	1199
	85.4%	8337	1334	1312	1299	1278	1261	1245	1226	1214	1196
	76.4%	8322	1332	1310	1296	1275	1259	1243	1224	1212	1194
XAU/	61.8%	8299	1328	1306	1293	1272	1256	1240	1220	1209	1191
CNY	50%	8280	1325	1303	1290	1269	1253	1237	1218	1206	1188
	38.2%	8261	1322	1300	1287	1266	1250	1234	1215	1203	1185
	23.6%	8238	1318	1296	1283	1262	1246	1230	1211	1200	1182
	14.6%	8223	1316	1294	1281	1260	1244	1228	1209	1198	1180
		8200	1312	1290	1277	1257	1241	1225	1206	1194	1176

You can see where 1244 falls in orange. The major takeaway here is that based on the ranges in XAU/CNY and USD/CNY, the limits in Gold are 1338 on the upside and 1176 on the downside.

So you may be asking how Gold hit a high of 1365 on April 11? XAU/CNY spiked to 8563 and USD/CNY fell to 6.2730. Since then, XAU/CNY has fallen and the range is now 8200-8360. It could spike above there again, but until it does, we have to assume that the range for Gold in dollar terms is 1176-1338.

The next question would likely be, “How does Gold break out of this range in the future?”

On the downside, the obvious answer is that the dollar continues to rise against the yuan and breaks 7.00. The Chinese could allow the yuan to depreciate further in response to U.S. tariffs. This could cause Gold to fall below 1176, assuming the XAU/CNY range remains intact. I don’t expect the USD/CNY to go much higher, as this undermines the whole purpose of U.S. tariffs by making all Chinese exports cheaper in dollar terms and would likely draw the ire of the U.S.

Gold could also be devalued in yuan terms (lower XAU/CNY), but this is extremely unlikely as it would instantly cause deflation in China and globally, precisely what the PBOC (China's central bank) and global central banks want to avoid.

For Gold to break to the upside, the dollar could fall precipitously against the yuan, below 6, and Gold could jump to $1400 or higher. This is possible, but would significantly increase the cost of Chinese exports in dollar terms and negatively impact their trade balance and economy activity. Another possibility is that Gold is revalued against the yuan to some higher level.

If Gold were revalued to, say, 9,000 XAU/CNY, then Gold could rise to $1440 at 6.25. If revalued to 10,000 XAU/CNY, Gold could reach 1600 at 6.25. You get the picture.

More importantly, this would put Gold front and center on the world stage also, increasing Gold's status and thereby diminishing that of the dollar at the same time. USD/CNY would initially adjust higher for the devaluation of the yuan, but then could fall. If that were to occur following a Gold revaluation, then who knows how high Gold could go. For this reason, I consider this a nuclear option the Chinese would only use as a last resort in response to pressure from the U.S.

In the meantime, unless the ranges for USD/CNY or XAU/CNY are broken, the range for Gold is 1176-1338 based on the CNY, and more broadly 1131-1387 based on the SDR.

Suffice to say that China is in control of Gold now, and this diminishes the power of the COMEX to manipulate Gold prices. That said, the Bullion Banks likely have the inside track on what's next for Gold, so if you see them loading up on long side, that is a good sign that Gold is going higher.

Lastly, I don't expect these ranges to hold when the dollar falls and/or the next global monetary reset occurs and the dollar is replaced as the global reserve currency. At that point, Gold is likely re-valued multiples higher.