

Gold set to rise if Saudis ditch petrodollar

Have we reached the end of the petrodollar? The answer is  "not quite", but the end could be very close – and that has big implications for the price of gold.

For the most part, gold is priced internationally in dollars. Since 1974, just after the Nixon administration broke the dollar-gold link, oil has also been priced in dollars, and the end of this arrangement would suggest a very much weaker and less safe U.S. dollar. Countries would scramble to acquire, euros, yen, yuan, pounds, possibly even gold, if that is part of how the Saudis might want payment for their oil. All oil producing countries adopted the petrodollar system after Saudi Arabia did. This meant that a U.S. dollar received in exchange for oil automatically became a petrodollar as the proceeds had to be deposited into a Western bank.

So how have we come to be contemplating the end of the petrodollar? Last month the U.S. Senate voted to approve the Justice Against Sponsors of Terrorism Act by unanimous consent. More than enough for the Senate to override the threatened veto of the act by President Obama. The House is expected to approve the act later in the year.

This legislation allows survivors and victims families of the 9/11/2001 atrocities to sue Saudi Arabia for damages in U.S. courts based on the alleged part the Saudis played in financing the 9/11 terrorists. The Saudis warned very publicly back in April that, if such a bill went into U.S. law, that they would have to sell off some \$750 billion of U.S. Treasury holdings in advance, to prevent those from being frozen by U.S. courts. But it quickly gets much more serious than that.

The stage is set for a monumental clash of wills later in the

year. The act pits a lame duck U.S. president fighting for the Saudis against a bipartisan Congress fighting for Americans, and does so in a highly charged U.S. presidential election year.

While the Saudis would be very reluctant to sell out of U.S. Treasuries and/or stop pricing crude oil in dollars, which then get recycled back into U.S. Treasuries to help finance the U.S. government, this legislation leaves them with little choice. Continuing to price Saudi oil sales in dollars but not able to recycle them into U.S. assets makes no sense at all. But ending the petrodollar, is a financial earthquake far bigger than the Lehman Bros. crash of 2008.

Most other countries, led by China and Japan, hold many billions of U.S. treasuries too. While they just might be persuaded not to aggravate things by following the Saudis and selling out of the greenback, they would be very reluctant to add more purchases in the event of the end of the petrodollar merry-go-round. And it is by no means certain that some countries might not, out of necessity, have to front-run any Saudi selling. We know that some countries are already quietly adjusting their U.S. treasury mix, due to local needs. But that gentle canter can all too easily turn into a stampede if they think the Saudis will be forced into selling.

So what might all this mean for gold? Higher prices probably, and sharply higher prices at that.

This new distrust between the Saudis and America, places a big negative uncertainty over the future of the petrodollar, and that in itself makes for a far more volatile and weaker U.S. dollar, one that at some point ahead will lose its main underpinning (in place since since 1974 and introduction of the petrodollar). That all this is about to come to a head in a matter of weeks or months. In a G-20 world completely unprepared for such dramatic change, this event will have a major bullish monetary implication for gold, both short term

and long term.

A weaker, less safe, U.S. dollar will have to be partially hedged via the monetary metals, but mostly with gold. For now markets, but especially the monetary metals markets, aren't pricing any of this in. Somehow, this will all blow over, Mr. Market thinks. The president will probably use the summer recess to try for a safer "pocket" veto.

The new legislation, once passed by the House, could force President Obama into an official veto, one that will get overridden. When will gold pricing start to reflect this slow motion train wreck? To this old dinosaur commodities trader, the market ought to be reflecting it now, but I suspect the trigger will likely be when the House of Representatives votes. Or possibly when the redacted 28 pages of the 9/11 report become a political issue nearer the U.S. election; those 28 pages of the 9/11 report are the "smoking gun" and reportedly link the al-Qaeda attack with the top levels of the Saudi government.

This was confirmed last months when former U.S. senator Bob Graham, a Florida democrat who co-chaired the Senate Intelligence Committee investigation of 9/11, is now calling for the release of the 28 pages suppressed in 2005.

Former US Sen Bob Graham says redacted pages in a congressional report on 9/11 are the 'smoking gun' needed to link the terrorist attacks with top levels of the Saudi Government.

Graham, who co-chaired the congressional joint inquiry on intelligence before and after the attacks, has called for the release of the 28 censored pages for more than a decade. I think the linkages are so multiple and strong and reinforcing that it's hard to come away from reading all this material and not feel that there was a support network and that support network came from Saudi Arabia,' he said recently.