THE GLOBAL SPECULATOR

04 January 2008

AUSSIE DOLLAR FUNDAMENTALLY POOR

The following is an extract from the December 07 Issue of **The Global Speculator** sent to subscribers on the 4th of January 2008.

AUSTRALIAN THEORETICAL PRICE OF GOLD UPDATE

Date	10 Year BB Interest Rates	Official CPI	M3 Aggregate Money Supply	Rate of Australian M3 Change	Gold Production Av Annual Increase (1.73%)	Australian Theoretical Gold Price	Actual Australian Gold Price	Actual as a % of Theoretical
Jun-07	6.26	2.10	867.9	3.3460%	0.14%	2,760.86	766.64	27.77%
Jul-07	6.03		874.6	0.7720%	0.14%	2,778.20	774.60	27.88%
Aug-07	5.92		895.8	2.4240%	0.14%	2,841.53	826.01	29.07%
Sep-07	6.16	1.90	911.9	1.7973%	0.14%	2,888.51	839.60	29.07%
Oct-07	6.18		939.1	2.9828%	0.14%	2,970.50	851.90	28.68%
Nov-07	6.00		964.7	2.7260%	0.14%	3,047.19	885.91	29.07%

As far as rampant money supply growth goes, the month of November 07 hasn't disappointed with monetary aggregates continuing to grow at a blistering 2.73%, taking the Theoretical price of Gold to over AUD$3,000 an ounce for the first time. If we look at the first 5 months of this financial year as a guide, we get an annualized growth rate of 25.68%. If I look back over the past 45 years of Australian M3 data, there has only been two financial years where 25% plus growth has ever been achieved. Those years were 1973 (25.67%) and 1989 (27.92%). What followed on both occasions were two very deep recessions. As at the conclusion of November 07, the actual price of Gold remains below 30% of the theoretical value. At current prices (AUD$980 an ounce) the actual is presently over 32% of the theoretical.

Over the new years break I read a very interesting article in the Australian Financial Review with regards to Australia's Current Account Deficit (CAD) and the potential ramifications of the ongoing credit crises on the Australian dollar. The key points I picked up on were as follows:

- Bank borrowing offshore is the key to the unusual structure of Australia's Balance of Payments. Australia runs a large and growing CAD. In most quarters Imports largely exceed Exports. This is the Trade Deficit and makes up one component of the CAD. Australia also pays interest and dividends on AUD$659B in Net Foreign Liabilities which is the accumulated result of past CAD's.

Together these two deficits make up the CAD. In the Sept Qtr 07 the CAD came in at a record AUD$17.5B.

- To be able to run a CAD on an ongoing basis Australia needs to match this by an equivalent **Foreign Capital Inflow**. The inflow in fact needs to exceed this deficit due to increased globalization by Australian businesses (Net Foreign Investment). Over the past decade additional offshore borrowing by Australian banks has supplied most of this capital inflow. In the decade to June 07, total Net Foreign Liabilities increased by AUD$372B (Accumulation of CAD's). Over this same period, the net foreign debt of Australian financial institutions increased AUD$343B, providing more than 90% of the CAD financing.

- In the September Quarter 07 financial borrowing abroad came to a dramatic halt. Australian banks actually reduced foreign debt by AUD$4B. For their part, non-financial businesses increased their offshore borrowing by a net of AUD$5.9B. The total increase in private business borrowing was therefore just under AUD$2B against a required debt inflow of AUD$29.9B (17.5 for the CAD plus 12.4 for Net Foreign Investment). Which begs the question, where did the missing AUD$28B shortfall come from?

- Enter the Reserve Bank of Australia (RBA). The RBA supplied the required capital. The ABS numbers show the foreign exchange reserves fell sharply in August and September and have continued to fall since. At just AUD$32.7B in November, the RBA foreign Reserves were less than half the level of July 07.

- If Australian banks remain reluctant to borrow offshore in 2008, something has to eventually give. The RBA will be reluctant to use its modest remaining foreign exchange reserves to support the currency or finance the CAD. If the banks do not borrow to match it and there is not a big turnaround in equity flows, the Australian dollar will take a tumble. It would have to fall enough to persuade offshore buyers that Australian assets were cheap. Interest rates would rise because banks would more than likely borrow domestically, increasing the demand for domestic borrowing.

The long and the short of it is the Australian dollar contains much inherent risk right now. The gold price in Australian dollars as we can see with our theoretical gold price analysis will be the major beneficiary of any future fall out in the Aussie dollar. I have had many conversations with various people about the fantastic value Gold presently offers. The looks I get in response are ones of dismay and disbelief as Gold in **nominal** terms is at an all time high (Funnily enough these were the same looks I got when Gold was at bear market lows!). I want to reiterate that unless you understand **why** the gold price has much more upside, chances are you will never invest in Gold and precious metals related investments (And that is probably a wise thing). The problem is history indicates that many people will more than likely enter the precious metals market at a much later date when the downside risks are substantially higher. That's human nature for you. The point I am trying to make is that you need to understand **why** you are investing in Gold. **"Because it is going up in price"**, will not suffice unless you are a trader playing this game by a defined set of rules. For anyone interested I write a free newsletter on the precious metals market which you can sign up for at the website below. Past issues of the newsletter may also be accessed at the website below.

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