



Dumb, Dumber, and Dumbest: Trading Gold for Oil

A Monday Morning Musing from Mickey the Mercenary Geologist

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A recent headline blasted the “breaking news”:

“India to Pay Gold Instead of Dollars for Iranian Oil: Markets Stunned”

I too was stunned; well, more like dumbfounded. That is one of the dumbest ideas to cross my desk in a long while. The article underneath the headline immediately brought China into the mix. These two countries, India and China, were purported to have made a deal with Iran to pay for their oil imports, totaling one million barrels per day, with gold in order to skirt United States and European Union sanctions. As you are aware, the freezing of Iranian offshore assets and the embargo of its oil exports came about because of the rogue nation’s continuing efforts to produce highly-enriched uranium and concoct an atomic bomb.

While reading, I immediately envisioned a sequel to the movie “Dumb and Dumber” called “Dumber and Dumbest.” However, I suggest we shed actors Carrey and Daniels and get Tommy Chong (aka “Man”) to play Dumber with Kal Penn (aka “Kumar”) to play Dumbest.

Let’s analyze the numbers and the economic, monetary, and political ramifications of such actions:

One million barrels of oil is about US\$100 million per day or \$36.5 billion per year. At a price of \$1700, that is 59,000 oz or 1.9 tonnes of gold per day and 690 tonnes per year. India’s oil imports from Iran cost \$12 billion per year or 227 tonnes of gold. China’s portion would be \$24.5 billion per year or 463 tonnes of gold. In 2011, China produced 345 tonnes of gold while India produced a measly 2.8 tonnes. Furthermore, last year saw record demand for gold in both countries with Indian imports estimated at about 1000 tonnes and the Chinese likely over 550 tonnes.

To put this in perspective, 690 tonnes is over 25% of 2011 world gold production of 2700 tonnes. That’s a whole lot of gold. So where could India and China obtain additional yellow gold to trade for black gold?

India’s central bank holds 615 tonnes of gold; China holds 1162 tonnes. If either country were to use its central bank holdings to buy oil, each would exhaust its gold reserves in little more than 2.5 years. Folks, that would be just plain dumb.

Alternatively, China could use its own fiat currency to buy a portion of the country's substantial and growing private gold production and then trade it for oil. But that seems incongruous given the country's current policy encouraging citizens to hoard gold.

Therefore, if either country were to purchase Iranian oil with gold, it would have to buy the gold, the single monetary instrument that retains its purchasing power, with a fiat monetary instrument (US dollars, Indian rupees, or Chinese renminbi) that, by its very nature, devalues continuously. Then it presumably would trade this steady-state asset (gold) for a commodity (oil) that is burned once and gone forever. That, my friends, would be even dumber.

Politically, the policy would further ostracize India with other nuclear countries, particularly in the West, because it has not signed the nuclear non-proliferation treaty since its inception in 1970. Both China and India currently import significant uranium and nuclear reactor technology to fuel rapidly growing energy demand. A move such as this could jeopardize recent agreements with uranium and technology exporting countries such as Australia, the United States, and France. Scuttling access to clean and green nuclear energy for access to a depleting, greenhouse gas-emitting fossil fuel is short-sighted folly. That, boys and girls, qualifies as dumbest.

Buying oil with gold is not a viable economic, monetary, or political strategy for either country. I do not think India or China would seriously consider buying Iranian oil with gold. The so-called "breaking news" seems merely unsubstantiated and poorly reasoned rumor and innuendo.

In my opinion, this scene will most likely occur when monkeys fly and there really is a yellow brick road that goes to the Emerald City and gets you back to Kansas.

Ciao for now,

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Acknowledgement: Erin Ostrom is the editor of MercenaryGeologist.com.

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Mickey has worked for junior explorers, major mining companies, private companies, and investors as a consulting economic geologist for the past 24 years, specializing in geological mapping, property evaluation, and business development. In addition to Mickey's professional credentials and experience, he is high-altitude proficient, and is bilingual in English and Spanish. From 2003 to 2006, he made four outcrop ore discoveries in Peru, Nevada, Chile, and British Columbia.

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