August 12, 2008: Compliments of The Telegraph... Stage two of the gold bull market is just beginning by Ambrose Evans-Pritchard

A war breaks out in the Caucasus, pitting Russia against a close ally of the United States. Inflation reaches a new peak in the euro-zone. The CPI reaches the highest in Britain since Bank of England independence. Rampant inflation sweeps the developing world.

All that glitters is not reliable in these uncertain times

Yet gold crashes. It has failed to deliver on its core promises as a safe-haven and inflation hedge, at least for now. Why?

Four possible answers:

1) Nobody seriously believes that Russia will over-play its hand. The world could not care less about Georgia anyway. Ergo, this is a bogus geopolitical crisis.

2) The inflation story is vastly exaggerated in the OECD core of countries that still make up 60pc of the global economy. The price of gold is already looking beyond the oil and food spike of early to mid 2008 (a lagging indicator of loose money two to three years ago) to the much more serious matter of debt-deflation that lies ahead.

3) The seven-year slide of the dollar is over as investors at last wake up to the reality that the global economy is falling off a cliff. Indeed, the US is the only G7 country that is not yet in or on the cusp recession. (It soon will be, but by then others will be prostrate). As an anti-dollar play, gold is finished for this cycle.

4) The entire commodity boom has hit the buffers. Looming world recession (growth below 3pc on the IMF definition) trumps the supercycle for the time being.

Gold has fallen from $1030 an ounce in February to $807 today in London trading. It has collapsed through key layers of technical support, triggering automatic stop-loss sales. The Goldman Sachs short-position that I have been observing with some curiosity has paid off.

For gold bugs, the unthinkable has now happened. The metal has fallen through its 50-week moving average, the key support line that has held solid through the seven-year bull market. This week is not over yet, of course. If gold recovers enough in coming days, it could still close above the line.

Courtesy of my old colleague Peter Brimelow - whose columns on gold are a must-read - note that Australia's Privateer point and figure chart has also broken its upward line for the first time since 2002. This is serious technical damage.

So have we reached the moment when gold bugs must start questioning their deepest assumptions. Have they bought too deeply into the "dollar-collapse/M3 monetary bubble" tale, ignoring all the other moving parts in the complex global system? Nobody wants to be left holding the bag all the way down to the bottom of the slide, long after the hedge funds have sold out.

Well, my own view is that gold bugs should start looking very closely at something else: the implosion of Europe. (Japan is in recession too)

Germany's economy shrank by 1pc in Q2. Italy shrank by 0.3pc. Spain is sliding into a crisis that looks all too like the early stages of Argentina's debacle in 2001. The head of the Spanish banking federation today pleaded with the European Central Bank for rescue measures to end the credit crisis.

The slow-burn damage of the over-valued euro is becoming apparent in every corner of the eurozone. The ECB misjudged the severity of the downturn, as executive board member Lorenzo Bini-Smaghi admitted today in the Italian press. By raising interest rates into the teeth of the storm last month, Frankfurt has made it that much more likely that parts of Europe's credit system will seize up as defaults snowball next year.

As readers know, I do not believe the eurozone is a fully workable currency union over the long run. There was a momentary "convergence" when the currencies were fixed in perpetuity, mostly in 1995. They have diverged ever since. The rift between North and South was not enough to fracture the system in the first post-EMU downturn, the dotcom bust. We have moved a long way since then. The Club Med bloc is now massively dependent on capital inflows from North Europe to plug their current account gaps: Spain (10pc), Portugal (10pc), Greece (14pc). UBS warned that these flows are no longer forthcoming.

The central banks of Asia, the Mid-East, and Russia have been parking a chunk of their $6 trillion reserves in European bonds on the assumption that the euro can serve as a twin pillar of the global monetary system alongside the dollar. But the euro is nothing like the dollar. It has no European government, tax, or social security system to back it up. Each member country is sovereign, each fiercely proud, answering to its own ancient rythms.

It lacks the mechanism of "fiscal transfers" to switch money to depressed regions. The Babel of languages keeps workers pinned down in their own country. The escape valve of labour mobility is half-blocked. We are about to find out whether EMU really has the levels of political solidarity of a nation, the kind that holds America's currency union together through storms.

My guess is that political protest will mark the next phase of this drama. Almost half a million people have lost their jobs in Spain alone over the last year. At some point, the feeling of national impotence in the face of monetary rule from Frankfurt will erupt into popular fury. The ECB will swallow its pride and opt for a weak euro policy, or face its own destruction.

What we are about to see is a race to the bottom by the world's major currencies as each tries to devalue against others in a beggar-thy-neighbour policy to shore up exports, or indeed simply because they have to cut rates frantically to stave off the consequences of debt-deleveraging and the risk of an outright Slump.

When that happens - if it is not already happening - it will become clear that the both pillars of the global monetary system are unstable, infested with the dry rot of excess debt.

The Fed has already invoked Article 13 (3) - the "unusual and exigent circumstances" clause last used in the Great Depression - to rescue Bear Stearns. The US Treasury has since had to shore up Fannie and Freddie, the world's two biggest financial institutions.

Europe's turn will come next. We will discover that Europe cannot conduct such rescues. There is no lender of last resort in the system. The ECB is prohibited by the Maastricht Treaty from carrying out direct bail-outs. There is no EU treasury. So the answer will be drift and paralysis.

When EU Single Market Commissioner Charlie McCreevy was asked at a dinner what Brussels would have done if the eurozone faced a crisis like Bear Stearns, he rolled his eyes and thanked the Heavens that so such crisis had yet happened.

It will.

Gold bugs, you ain't seen nothing yet. Gold at $800 looks like a bargain in the new world currency disorder.