

Central banks go on a gold rush

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Central banks are once again major buyers of gold, a dramatic shift that will buoy prices at their elevated levels and sow doubt about the future of an international monetary system based on the U.S. dollar.

Official net purchases of gold exploded in the third quarter, totalling 148.8 tonnes, more than double the entire amount of government buying in 2010, the World Gold Council, a London-based industry association, said in new report Thursday

The surge is startling because until last year, central banks had been net sellers of gold for two decades. But this year they are adding to stockpiles at what the Gold Council reckons is a record pace, reflecting deep concern about the longer-term viability of the U.S. dollar and the euro as stores of value.

With the European debt crisis roiling financial markets, the continent's central banks, which typically are incremental sellers of gold, now are keeping their vaults shut to buyers. But Asian and Latin American nations, which for years have plowed their excess cash into U.S. Treasuries, are suddenly looking to diversify.

The result: net gold purchases by central banks of about 350 tonnes over the first nine months of the year, compared with 76 tonnes in 2010. In 1988, the last year governments bought more gold than they sold, net purchases were 180 tonnes.

“We are seeing what now looks like unprecedented levels of central bank buying,” said Marcus Grubb, managing director, investment, at the Gold Council. “We do believe this is a long-term trend. This is not just short-term, tactical buying.”

Canada is sitting out the binge. In 1980, the country decided to sell its bullion, a stockpile

of 652 tons, completing the job in 2002. Like many others, Canada decided that government paper was a better investment: cheaper to store and easier to sell. All that's left in Ottawa's vaults is 100,000 ounces of gold coins.

Mr. Grubb said there was a burst of official purchases in the final weeks of the third quarter, suggesting reserve managers jumped on a sudden drop in gold prices from a nominal record of more than \$1,900 an ounce in early September. The metal closed at \$1,722.79 (U.S.) Thursday, a 2.9 per cent tumble from Wednesday, as investors scrambled for the safety of cash amid ongoing worries about the European debt crisis.

The Gold Council didn't name the central banks that were doing the buying, although it's widely known that governments in countries such as China, India, Brazil and Russia are intent on diversifying their holdings away from Treasuries, which have become far less attractive. The value of the U.S. currency is on a downward trend, and Washington's inability to constrain the growth of its budget deficit is undermining faith in U.S. debt.

A couple of years ago, the euro was gaining in allure as a reserve asset. But with three European countries saved from bankruptcy by an international bailout, and Italy and Spain struggling to stay solvent, the euro has lost its shine. Japanese and Swiss authorities have intervened to control the ascent of their currencies, leaving gold as the most attractive option.

“It's a mistake to say that central banks see this as some sort of investment play,” Bart Melek, head of commodity strategy at TD Securities, said of the jump in official gold purchases. “Instead, they see this as basically having a secure asset mix.”

Any pivot in the reserve strategy of countries such as China and India inevitably leads to speculation about the end of the dollar's dominant role in the international economy.

On Wednesday, a congressional commission established to track developments in the U.S. relationship with China said in its annual report that the yuan could rival the dollar as an international currency within a decade.

James Rickards, an investment banker and author of the newly published *Currency Wars: The Making of the Next Global Crisis*, says there is a significant risk that investors will lose all confidence in national governments, forcing a rocky return to the gold standard. In

an interview last week, Mr. Rickards said countries such as China quietly are buying gold in case markets eventually demand that currencies be anchored to a tangible asset.

To be sure, this is the pessimistic view. The mainstream take is that emerging-market central banks are realigning their holdings to reflect the evolution of their economies. One of the reasons China buys so many Treasuries is to control the value of the yuan against dollar. As the country moves toward a more market-oriented system, it no longer has to accumulate so many dollar-denominated assets.