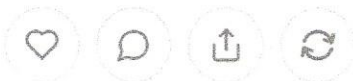


Are central banks selling gold?

Stories are circulating about central banks selling gold. These centre on Turkey, now Poland, and the Gulf nations. This report looks at the facts.

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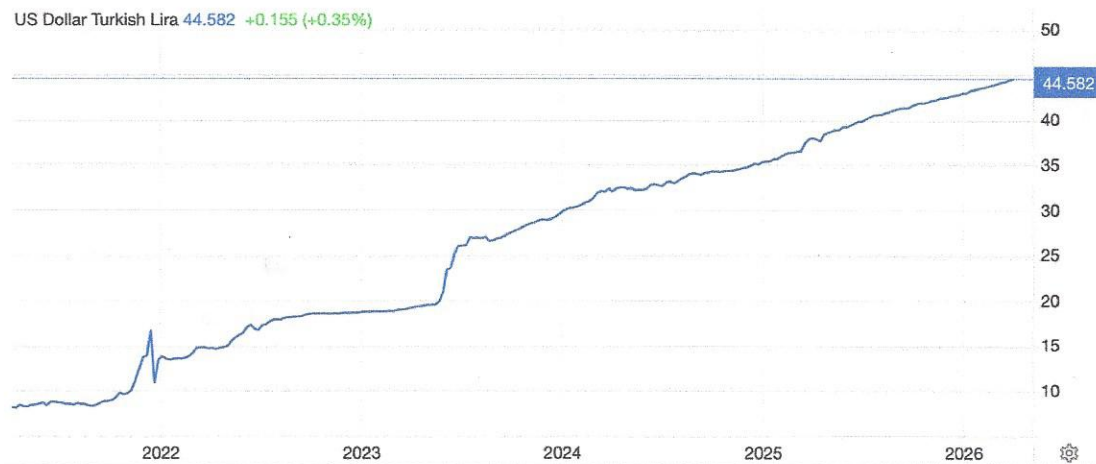
The easy one to dismiss is Poland. The head of its central bank reportedly said that Poland could take profits on some of its gold to finance anticipated defence expenditure. But those who read on would have noticed that he then said that the government has zero interest in doing so. So Poland is a non-event.

Turkey is a different matter but is a little more complex than headline numbers suggest. It should be noted that there is a healthy gold trade between the central bank and commercial banks with frequent leases and swaps between them.

The reason is that both commercial banks and their customers have had for a long time a significant interest in gold as a hedge from a chronically weak lira. Don't forget that in 2005 the process began of creating the new lira at an exchange rate of a million for the old one. And that in the last 10 years, the new lira has declined further from under 2 to the dollar to 44.6 currently.

The gold trade has become a regulator of money supply. By swapping with or selling

gold to Turkey's commercial banks, the central bank regulates credit. This brings us to the current situation Turkey faces. The knock-on effects of an oil price which has doubled is threatening the lira whose decline is bound to accelerate further under additional inflation pressures. The chart below shows how it has declined against the US dollar in the last 5 years:



Measured in gold, the decline is 140% greater. We don't know how much of the central bank's gold sales have been delivered to Turkey's commercial banks. All we can see from its weekly report to 27 March is that her gold reserves declined by 13.9% to \$100bn, and a 26.9% decline since February. That decline includes a dollar price which has fallen by 15%.

Clearly, the headlines about Turkey selling 69 tonnes last week bringing the decline in gold reserves to 118 tonnes for the last two weeks are misleading. According to Mining.com, three bankers (presumably Turkish) estimate that actual sales last week were 26 tonnes, and an additional 42 tonnes were used in swap transactions. We don't know if the 26 tonnes were bought by commercial banks in lira which seems likely in an attempt to tighten money supply. If not, Turkey could have sold them in whole or part to China or the

Bank for International Settlements. In any event, there are ready buyers for gold in this quantity.

Lastly, there were rumours that Arab nations caught up in the war against Iran were selling. This cannot be substantiated, but it should be noted that these nations have significant dollar reserves to hand earned through their exports. Therefore, there is little reason for them to sell gold first, whether it be government reserves or privately owned wealth. It is more likely that in these uncertain times that they would liquidate dollars and dollar-denominated financial assets.

Should investors take these reports seriously? Probably not. A far greater factor at the moment is the slow death of paper gold as physical bullion returns to centre-stage, fuelling demand. Shaking out flaky bulls is what the recent selloff was about, probably fuelling rumours of central bank selling. It is a process which might not have ended given the financial volatility in all credit markets, including currencies. But end it will, setting bullion up for a potentially spectacular run.