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Golden Plumbing

Its 'DOLLAR' DOWNSIDE

(a decade of gold pukes, large and small)

A (brief) History of Paper

The 1st Gold Swap

"In 1925, for example, the Federal Reserve Bank of New York made $200 million worth of gold available to the Bank of England with the understanding that the Bank of England would place proceeds from any gold sales in a sterling investment account for the Federal Reserve Bank of New York.

Michael D. Bordo, Owen F. Humpage, Anna J. Schwartz
NBER
U.S. Intervention during the Bretton Woods Era, 1962– 1973

The 1st Gold Swap

$200 million

Sold in market

to support £

kept as collateral on account for FRBNY

GOLD RECEIVABLE

Accounted for as if gold bullion was still in FRBNY's vault

Conventions of the Gold Swap

15. Central bank officials indicated that they considered information on gold loans and swaps to be highly market-sensitive, in view of the limited number of participants in such transactions. Thus, they considered that the SDDS reserves template **should not require the separate disclosure of such information but should instead treat all monetary gold assets, including gold on loan or subject to swap agreements, as a single data item**.

Executive Board Memo
March 10, 1999

Gold Lending/Leasing

“*The mechanics of gold lending are much the same as gold leasing. In a gold lease arrangement, a miner or gold producer sells forward future production to lock in whatever price, akin to hedging. In order to sell forward, the producer has to borrow existing bullion from somewhere – and the only holders of such large stores of physical gold have been central banks and bullion banks.*

Alhambra Research
May 28, 2013
The Basics of Leasing

Gold Lending/Leasing

Central Bank A

Wants to generate a return for its monetary holdings of gold

Gold Producer B

Wants to hedge against falling gold prices

Gold Lending/Leasing

Central Bank A

Forward sale

GOFO

Gold Producer B

Wants to generate a return for its monetary holdings of gold

Wants to hedge against falling gold prices

Gold Lending/Leasing

"

So, an increase in gold leasing dislodges formerly dormant stores of physical gold from central banks, acting as an added supply of gold onto the markets. That was one of the prime forces suppressing gold prices in the 1990's – the huge rise in producer leasing with central banks, and bullion banks acting as the intermediaries, that were more than happy to "monetize" their gold stores.

The accounting rules are such that the central bank continues to hold "gold" on its books despite the leasing arrangement that moved that actual physical metal into the marketplace. Thus the market has actual gold sold into it while central banks report no loss of supply (under the accounting line "gold and gold receivables"). Since these are opaque transactions, nobody really knows what has been leased out and what actually remains.

Alhambra Research
May 28, 2013
The Basics of Leasing

Gold Lending/Leasing

"*In a gold lending relationship, the bank uses the unallocated gold as collateral for cash (in whichever currency is needed, which is one of the appeals of using bullion for collateral). Now, the gold is in the hands of an intermediary that, apart from any haircut set with the borrowing bank, is at price risk. The cash lending bank will either sell the gold outright, since it only has to replace metal at the end of the agreement, or hedge its collateral position (based on the cost of selling futures).*

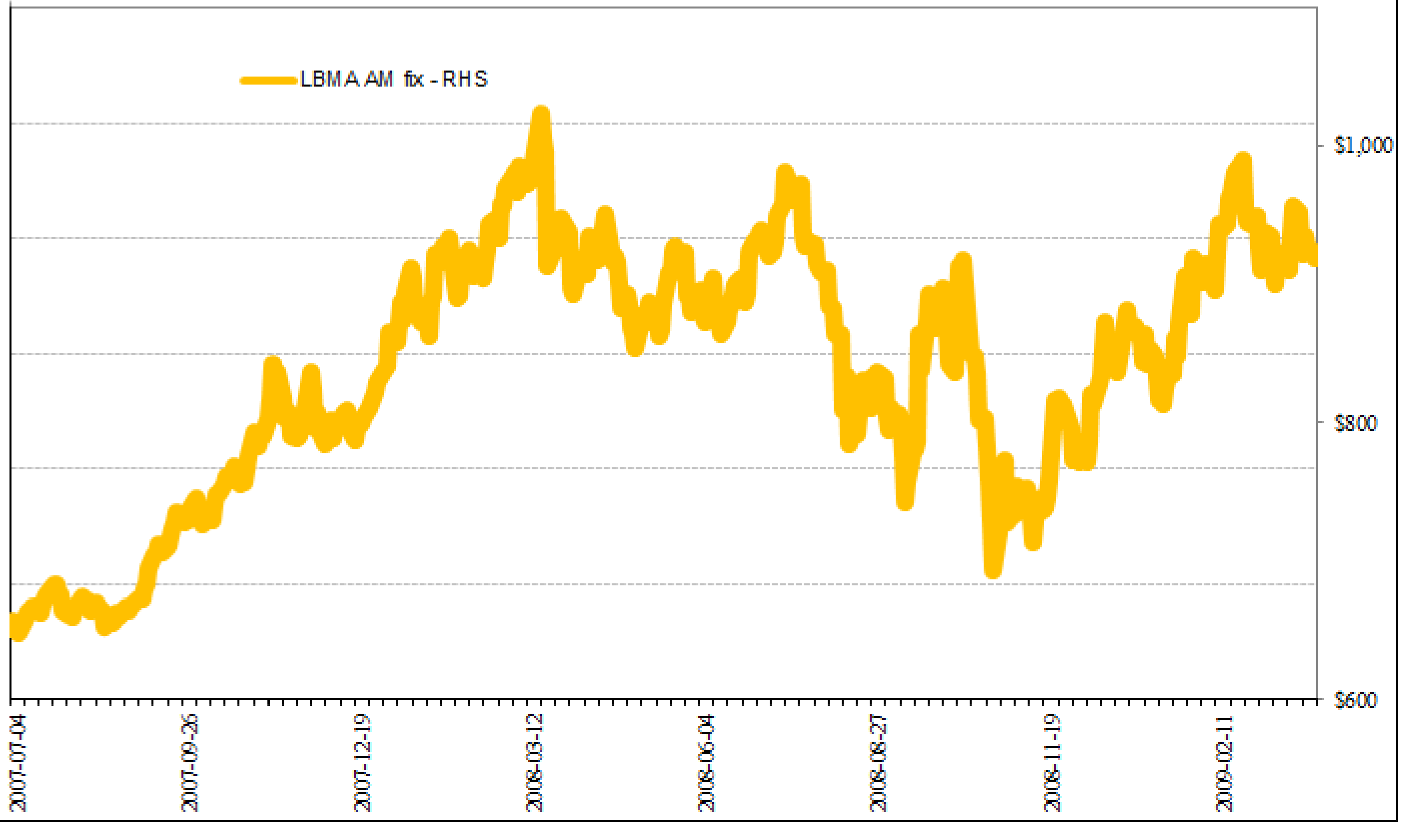
The end result is exactly the same whether lending or leasing gold. It acts as an agent to disgorge previously unmarketed supply into the physical or paper markets, or both. Gold that was until that time sitting idle in an unallocated account has now entered the market through physical (dumping by the cash lender/collateral holder) or paper (hedging the collateral holdings) markets, or some of both dependent on parameters like gold forward rates and futures curves.

Alhambra Research
May 28, 2013
The Basics of Leasing

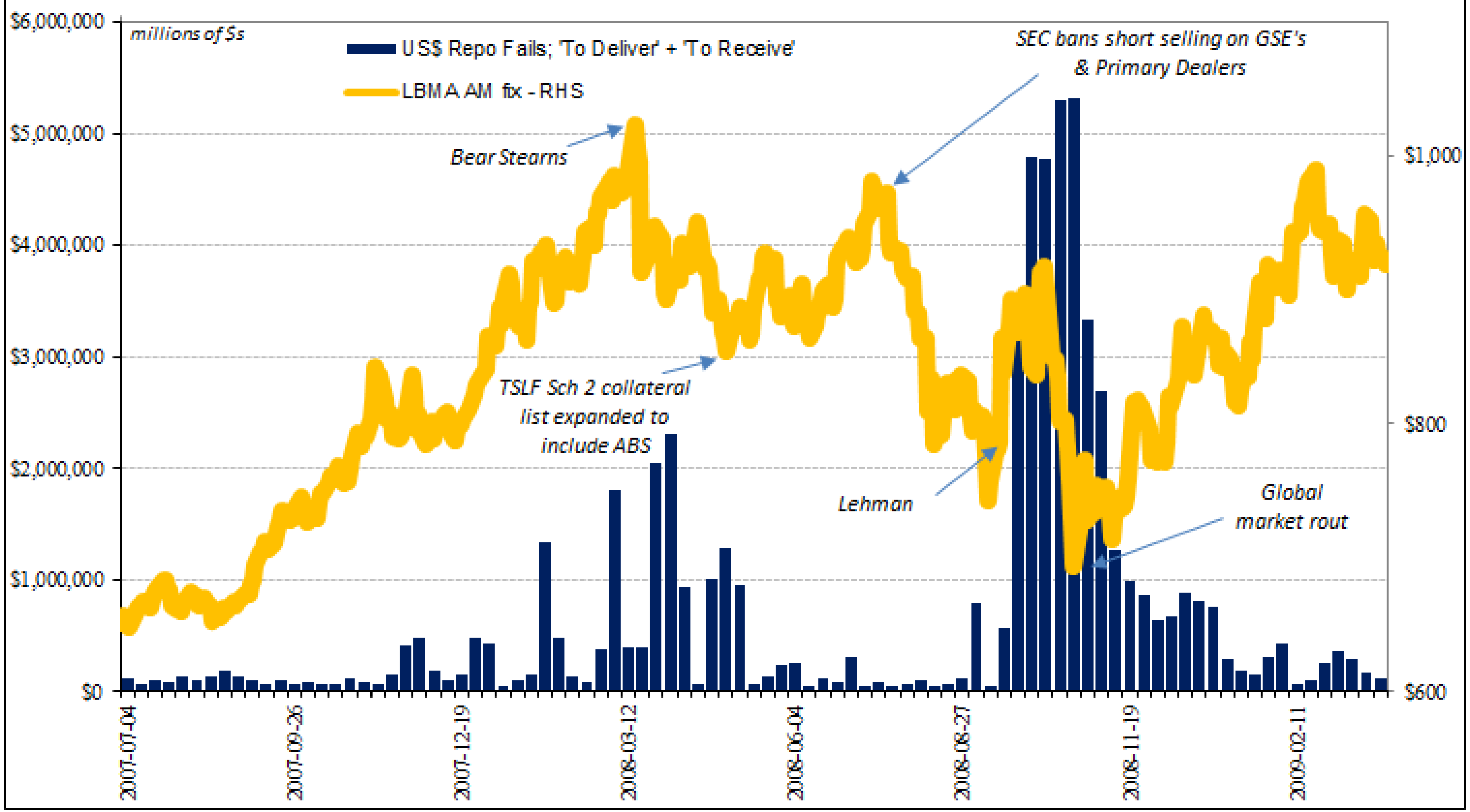
Gold in 2008


LIBERTY
2008
UNITED STATES OF AMERICA
E PLURIBUS
UNUM
IN GOD
WE TRUST
½ OZ. FINE GOLD~25 DOLLARS

Gold in 2008: Collateral Problems



Gold in 2008: Collateral Problems



Gold in 2008

"*In addition, the Federal Open Market Committee authorized an expansion of the collateral that can be pledged in the Federal Reserve's Schedule 2 Term Securities Lending Facility (TSLF) auctions. **Primary dealers may now pledge AAA/Aaa-rated asset-backed securities**, in addition to already eligible residential- and commercial-mortgage-backed securities and agency collateralized mortgage obligations, beginning with the Schedule 2 TSLF auction to be announced on May 7, 2008, and to settle on May 9, 2008. The wider pool of collateral should promote improved financing conditions in a broader range of financial markets. Treasury securities, agency securities, and agency mortgage-backed securities continue to be eligible as collateral in Schedule 1 TSLF auctions.*

Press Release, Board of Governors of the Federal Reserve System
May 2, 2008

Gold since 2008

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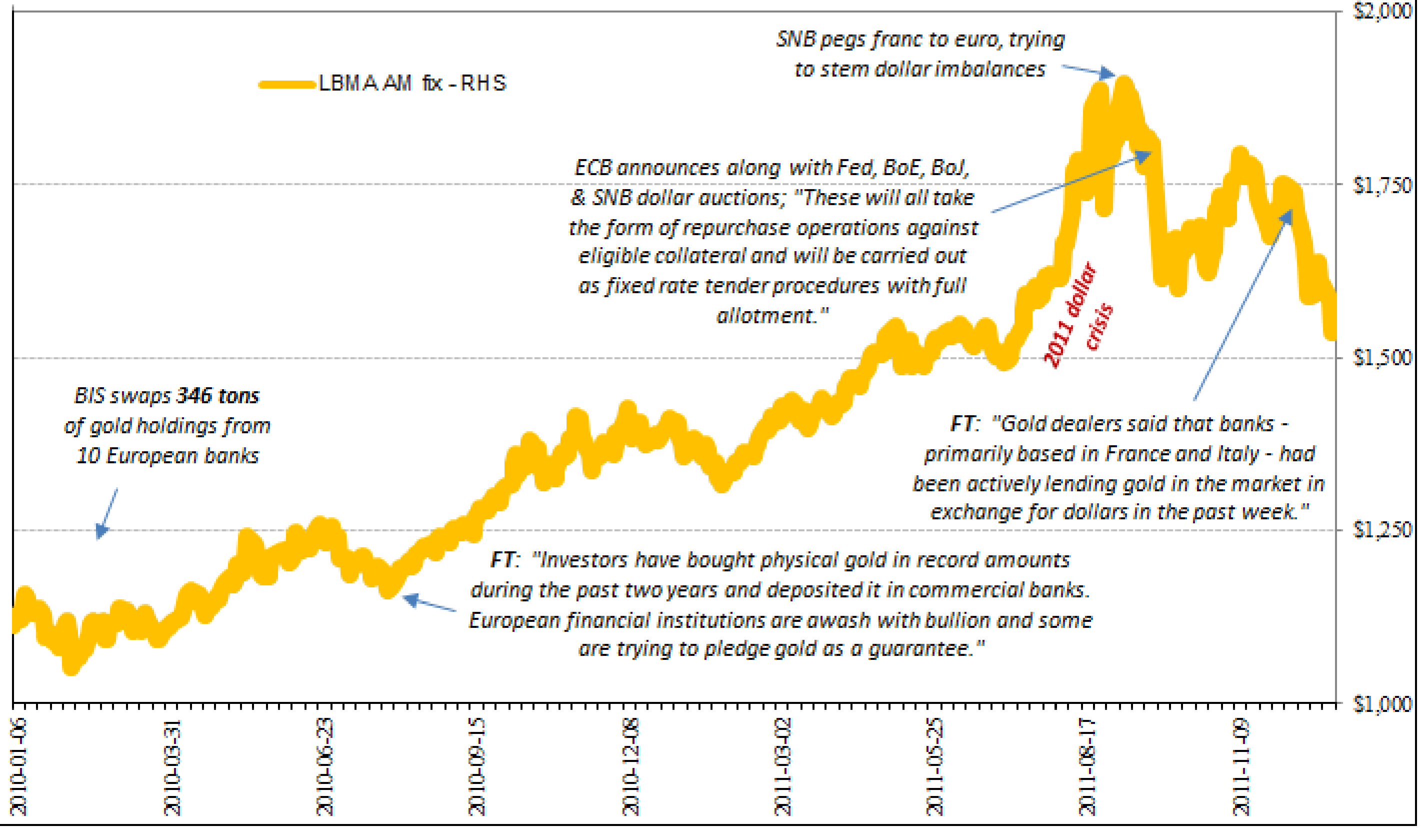
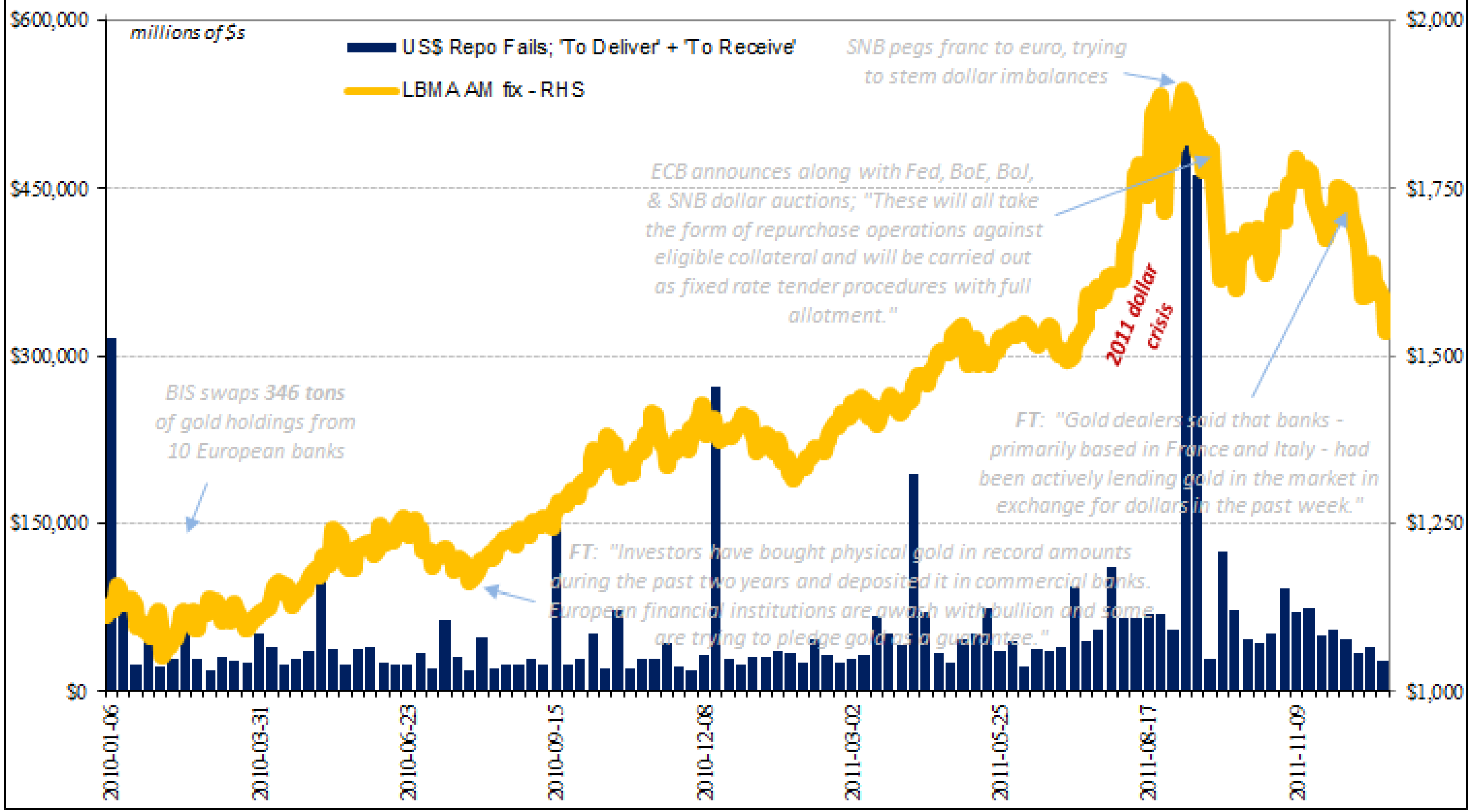
Gold in 2010-11: European Dollar Problems



Gold in 2010-11: European Dollar Problems



Gold in 2011

"

The implication here is that "markets" had no reasonable idea how desperate for dollars some banks had become. It is no surprise in that context that the very day after the *Financial Times* published that article the ECB announced its massive lending facilities through the LTRO's. In conjunction with the Fed's swap lines, the two central banks, coordinating with other central banks, aimed to end the liquidity crisis through massive money stock means.

Before those measures, central banks had been active in leasing out gold to commercial banks, similar to the BIS arrangement from 2010. **In January 2012, Thomson Reuters GFMS confirmed that central banks had increased the quantity of lent gold in 2011 for the first time since 2000**. GFMS further said that **commercial banks were swapping for gold with central banks in order to obtain dollars from the gold markets - thereby increasing selling pressure in the gold market itself**. This undoubtedly occurred in conjunction with leasing both unallocated gold holdings and rehypothecation through futures markets.

Jeffrey Snider; *The Gold Slam Is Evidence of Troubled Banks*
April 19, 2013

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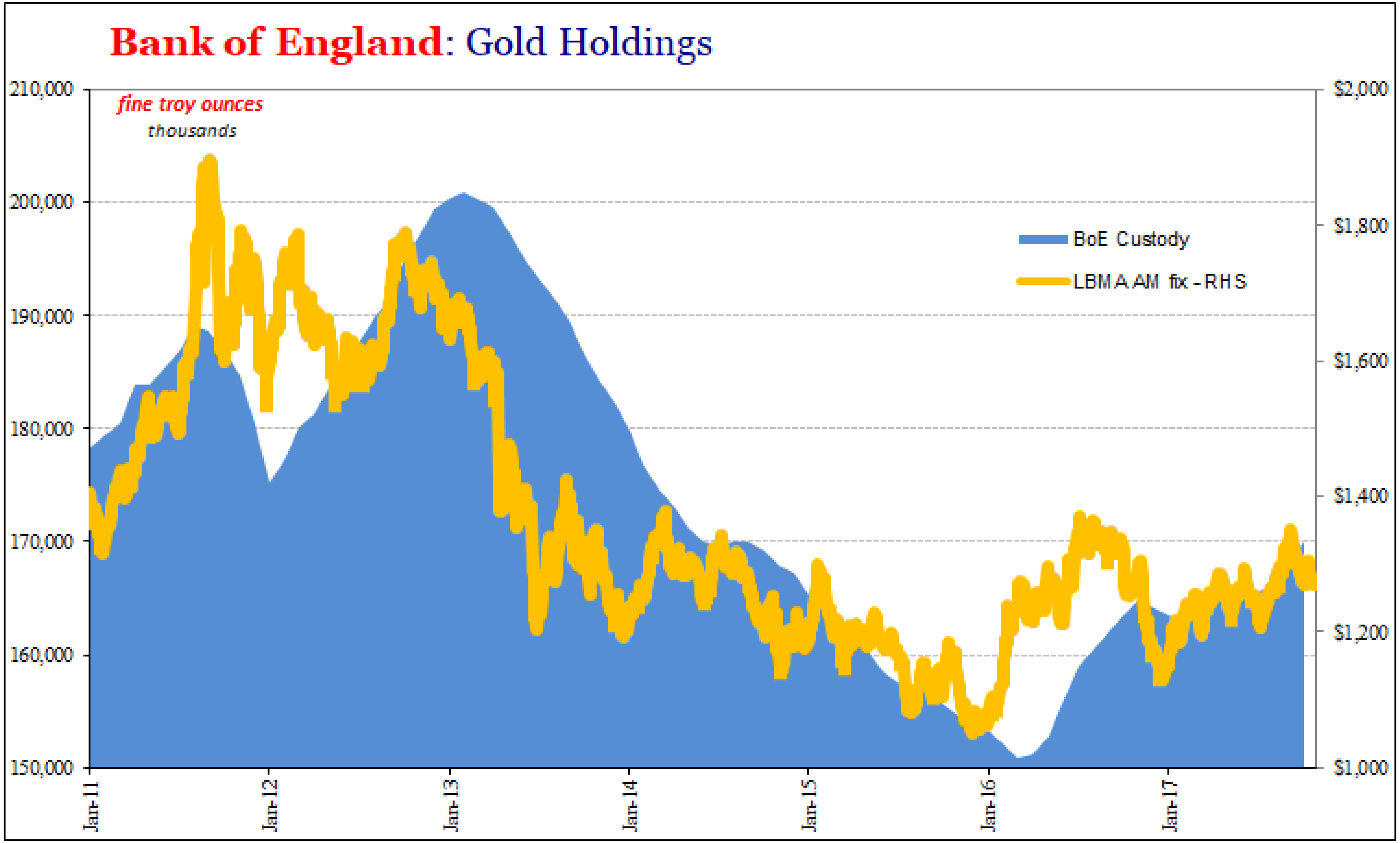

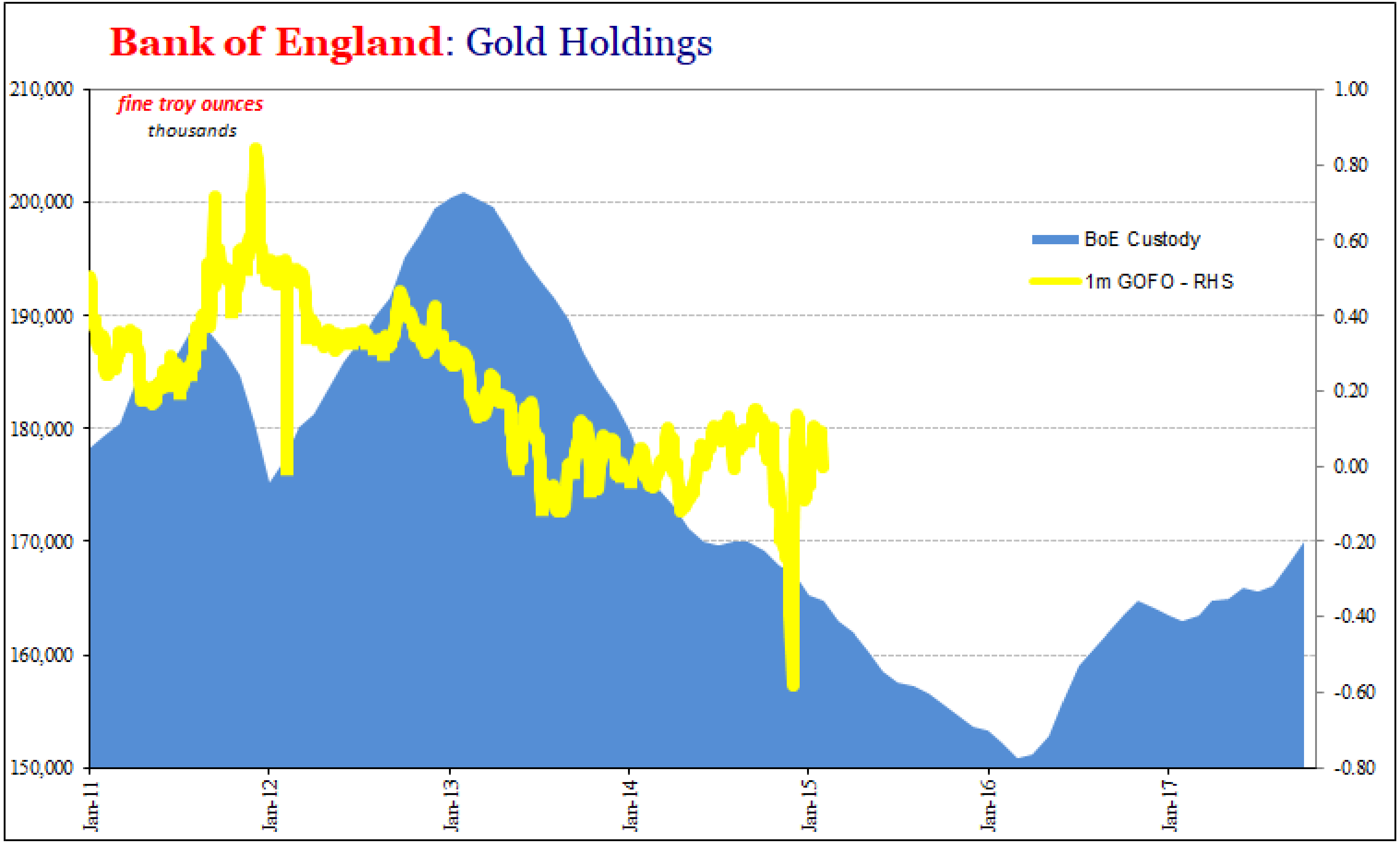
Bank of England: Gold Holdings
fine troy ounces
thousands
BoE Custody
1m GOFO - RHS
210,000
200,000
190,000
180,000
170,000
160,000
150,000
1.00
0.80
0.60
0.40
0.20
0.00
-0.20
-0.40
-0.60
-0.80
Jan-11
Jan-12
Jan-13
Jan-14
Jan-15
Jan-16
Jan-17

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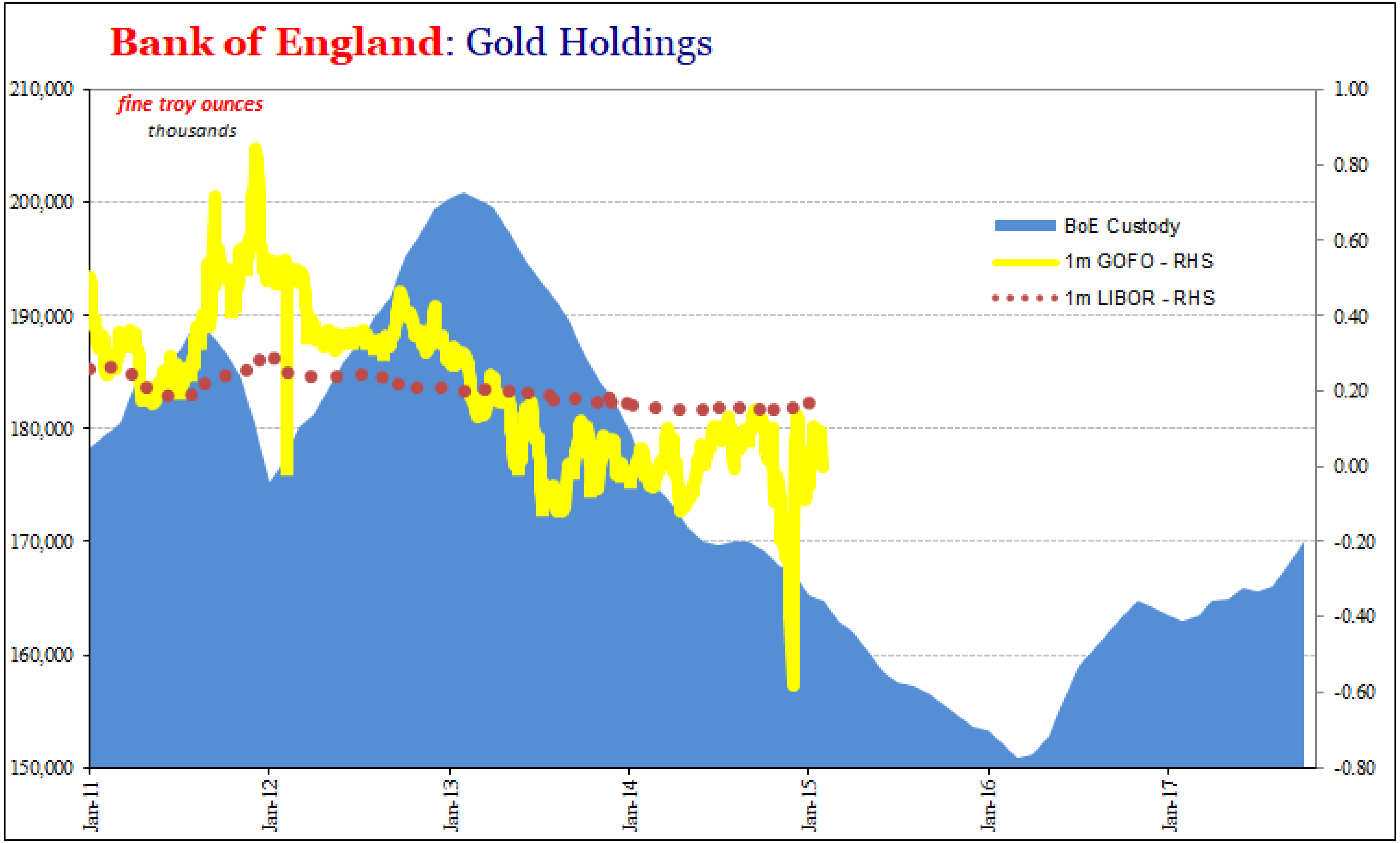

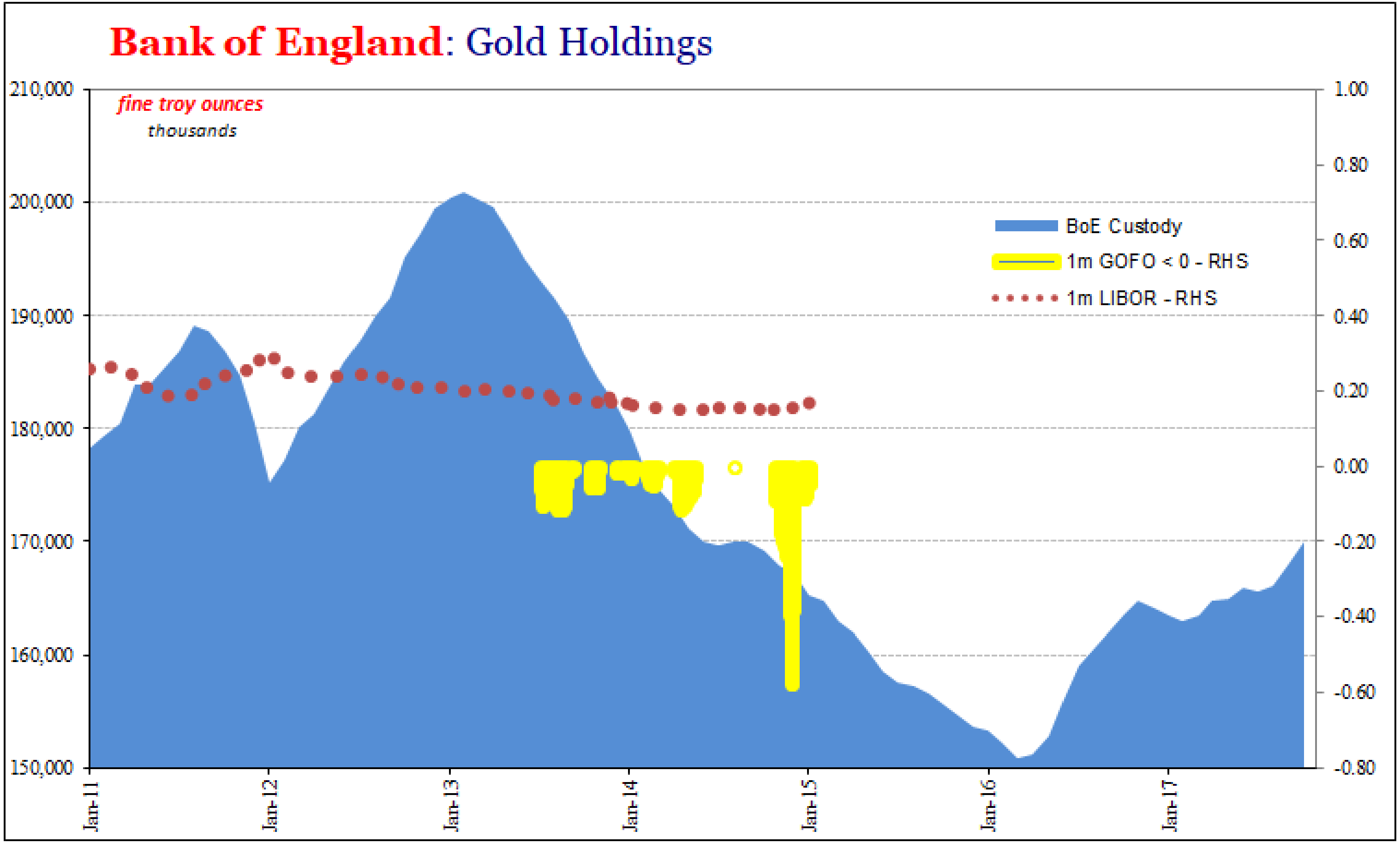
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-0.80
BoE Custody
1m GOFO < 0 - RHS
1m LIBOR - RHS
Jan-11
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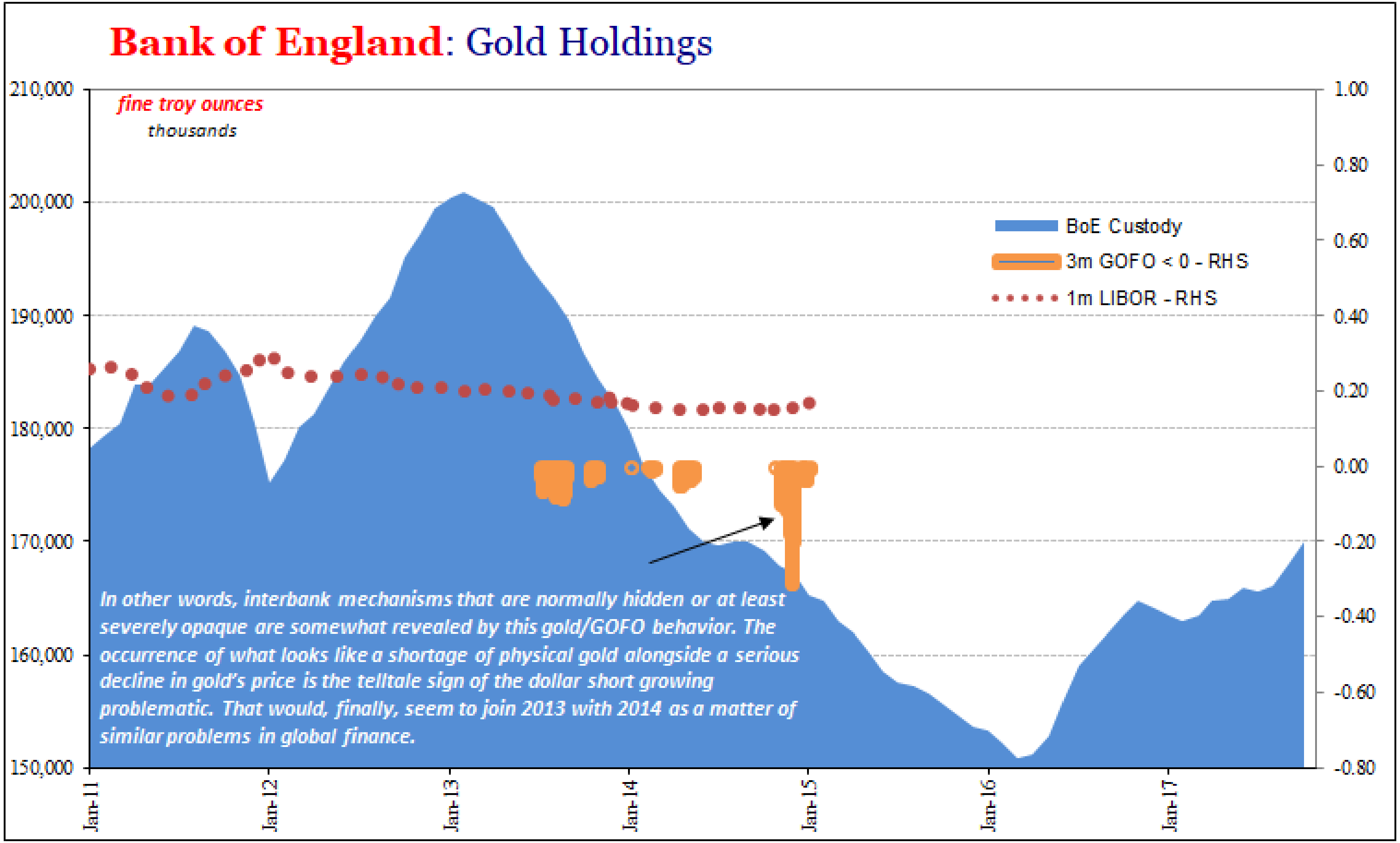
Jan-17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BoE Custody
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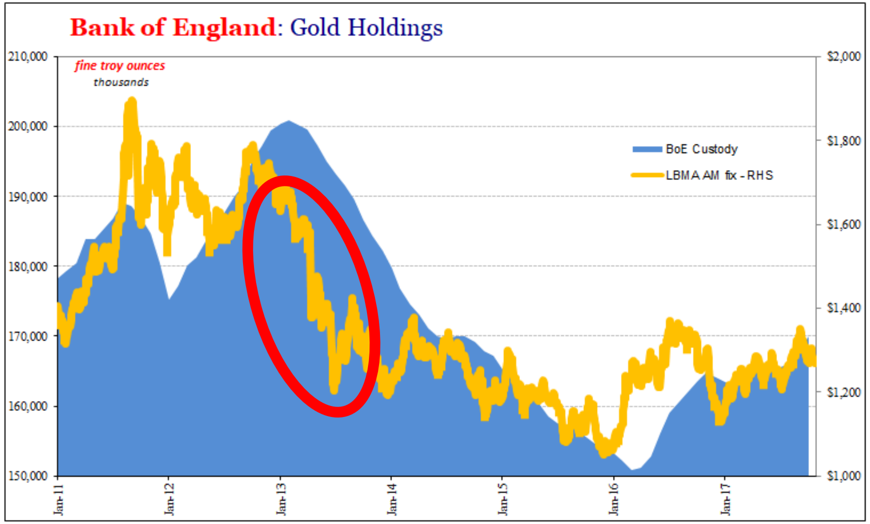
In other words, interbank mechanisms that are normally hidden or at least severely opaque are somewhat revealed by this gold/GOFO behavior. The occurrence of what looks like a shortage of physical gold alongside a serious decline in gold's price is the telltale sign of the dollar short growing problematic. That would, finally, seem to join 2013 with 2014 as a matter of similar problems in global finance.

Gold since 2008



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As a result, the falling price of gold is more important than simply being an opportunity for schadenfreude around the likes of Glenn Beck or John Paulson or Zero Hedge…

The biggest problem in the markets right now is that they're still far too risk-averse. Fear-based assets like gold, Treasury bonds, and cash are in high demand, while there isn't enough money flowing through greed-based assets like stocks and bank loans and into the economy as a whole…

My hope is that the price of gold will continue to fall, that goldbugs will look increasingly silly, and that as a result Americans with savings will conclude that the best thing to do with those savings is to put them to work in a productive manner, rather than self-defeatingly trying to protect what they have.

Felix Salmon
April 15, 2013
Reuters, The Fear Bubble Bursts

Gold since 2008

“

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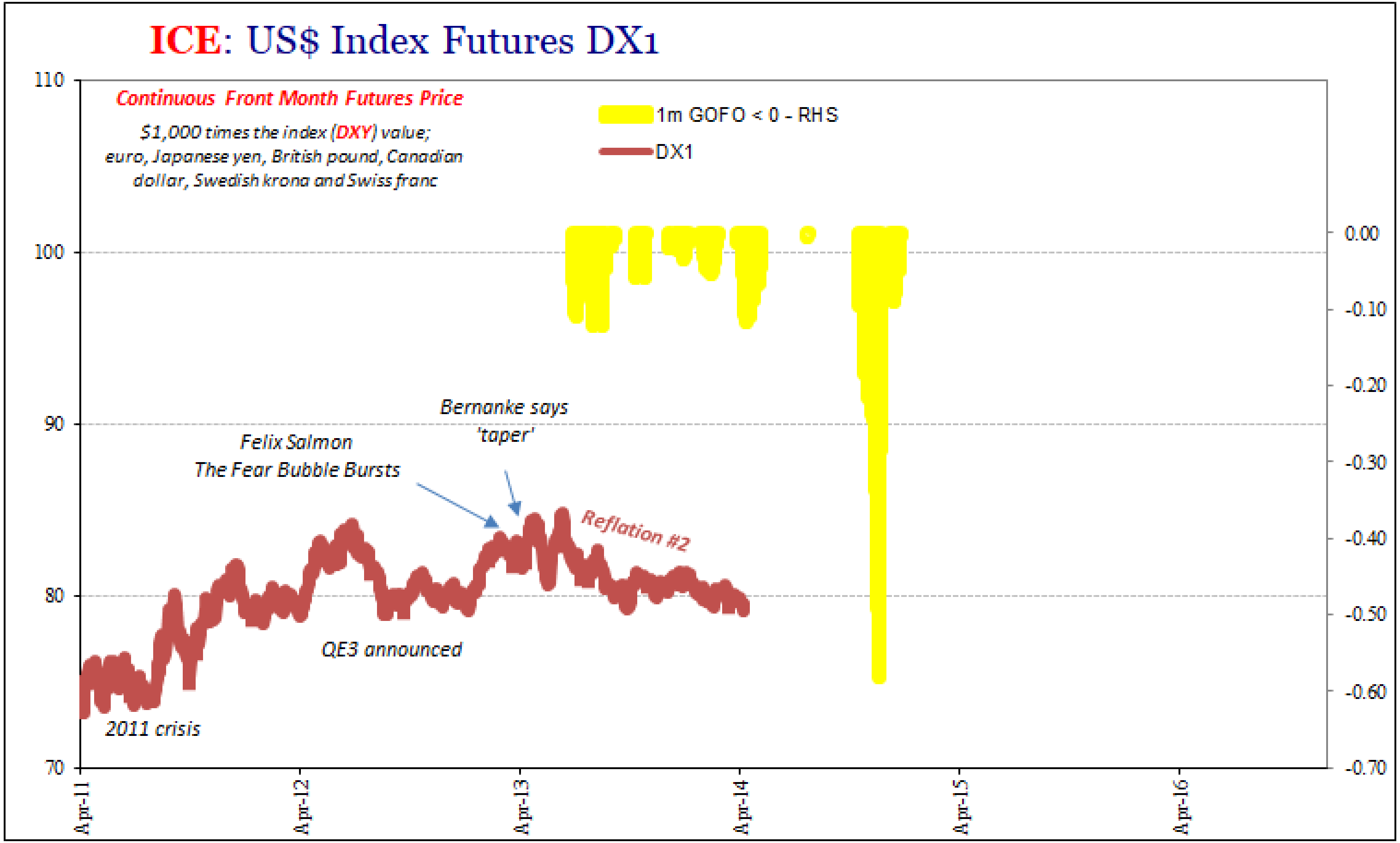
With central banks likely now reactivated in leasing gold (and the pathology certainly fits) there is the next step of trying to figure out who is having liquidity problems and why. Given the severity of GOFO, it may even be pressing to not just find out those details but to further look to how broad this may actually be. When even 3-month GOFO is -10.25 bps (and 2-month -14.5 bps) there is a serious imbalance "somewhere."

Alhambra Research
November 6, 2014
GOFO Back To Its 'Old' Tricks


ICE: US$ Index Futures DX1
Continuous Front Month Futures Price
$1,000 times the index (DXY) value;
euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc
1m GOFO < 0 - RHS
DX1
Felix Salmon
The Fear Bubble Bursts
Bernanke says 'taper'
Reflation #2
QE3 announced
2011 crisis
110
100
90
80
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0.00
-0.10
-0.20
-0.30
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-0.50
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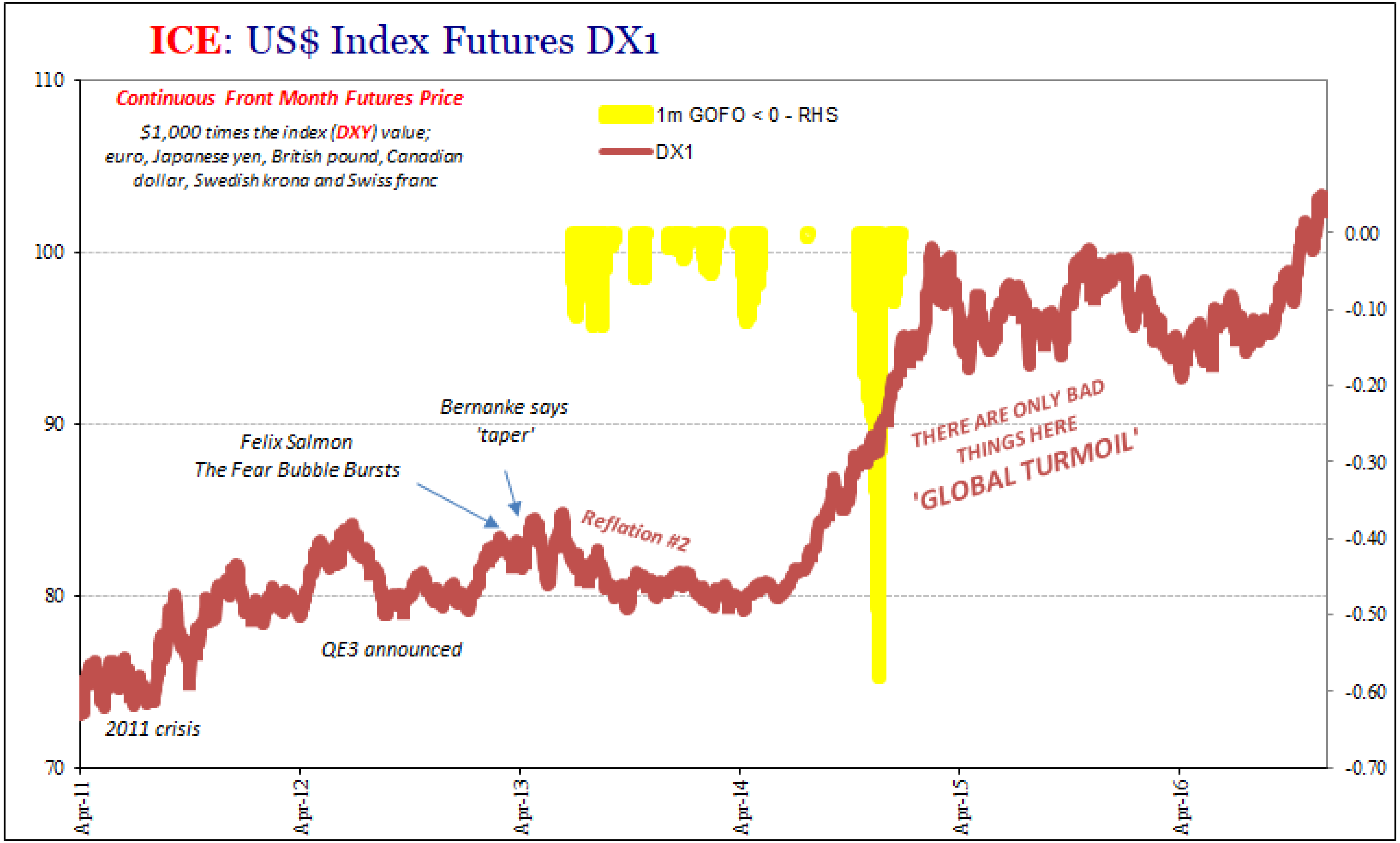
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THERE ARE ONLY BAD THINGS HERE
'GLOBAL TURMOIL'

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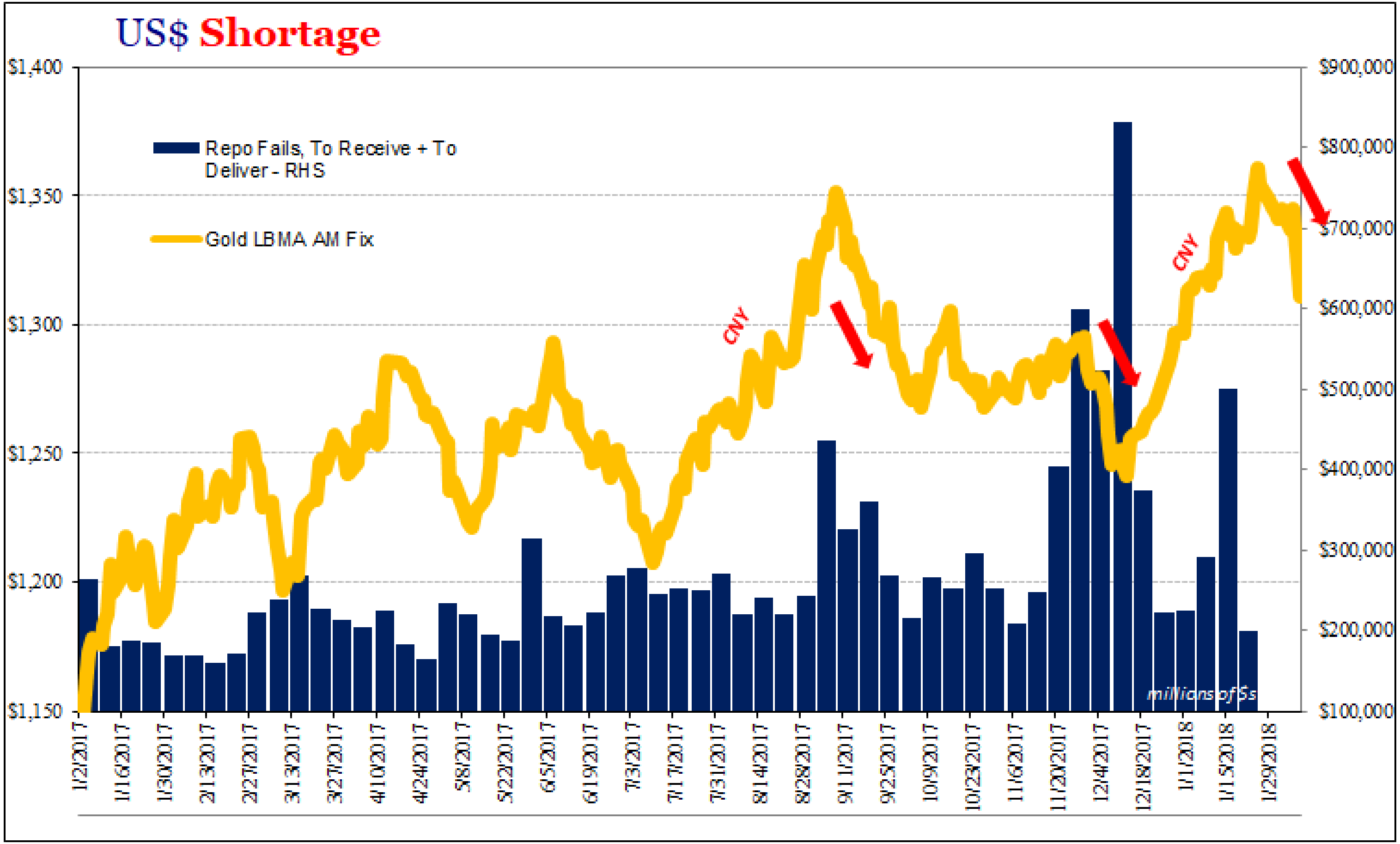

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Its 'DOLLAR' DOWNSIDE

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CONCLUDED