



18 January 2013

# Gold: Repatriation

## The importance of gold takes a step higher

The aphorism 'actions speak louder than words' refers to actions being thought to reflect more accurately the true intent of the observed. Furthermore while the motive of a speaker can be quite convoluted and contrary, the implication is that the motives of his/her actions are likely to be more direct or forthright.

We have noted previously the shift in central bank behavior over the past several years, from net sellers of gold to net buyers. This includes the significant deceleration of sales by Western Central Bankers. Implicit in this is that most of them are now buyers of gold (in so much as logic suggests that, if one holds an asset one is a buyer of that asset otherwise one would sell and hold something else). The relatively recent actions by central banks however to not only buy gold but also repatriate and upgrade owned bars, further demonstrates in our view an implicit acknowledgement of its monetary importance.

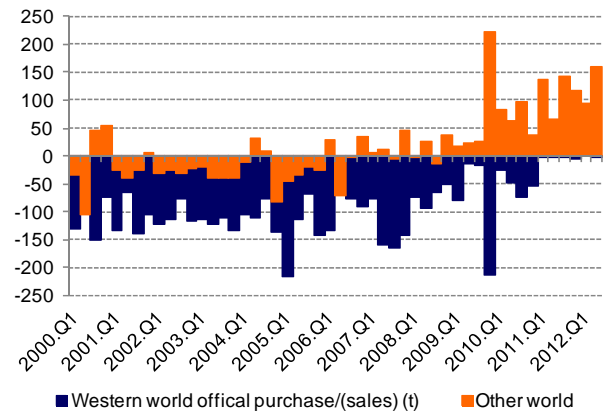
For various historical/liquidity reasons many central banks have in the past held their gold reserves in multiple jurisdictions. These reasons are, in many cases, no longer valid. This and the increased value of gold holdings combined with heightened budgetary pressures that many governments are now facing is, not surprisingly, resulting in a greater call to track assets more closely. On this basis, we believe the timing of the high profile German repatriation process is not altogether unexpected.

### Bundesbank Actions

Following on from a request by Germany's Federal Court of Auditors last year to review its overseas gold holdings, the Bundesbank has indicated that it will begin a process to rebalance the distribution of its gold reserves. The intent is to increase the amount of gold held domestically. In this process some of its gold will be repatriated (drawing down on stocks held in the US and in France). The Bundesbank wishes to increase its domestic gold holdings to 50% from 31% currently over the next six years or so.

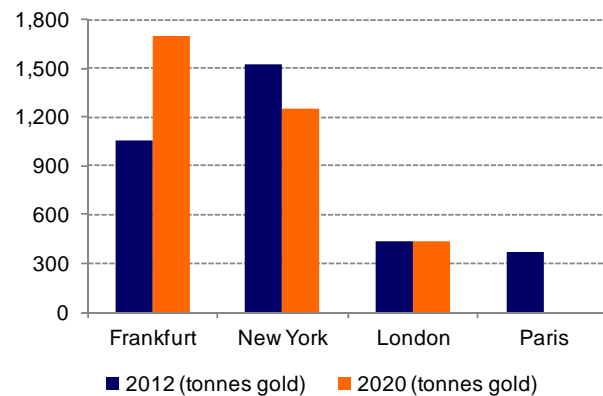
The Bundesbank has stated that its objectives in expediting this new storage plan are: 1) to build trust and confidence domestically, and 2) to ensure liquidity in an emergency.

Figure 1: Central bank gold purchases



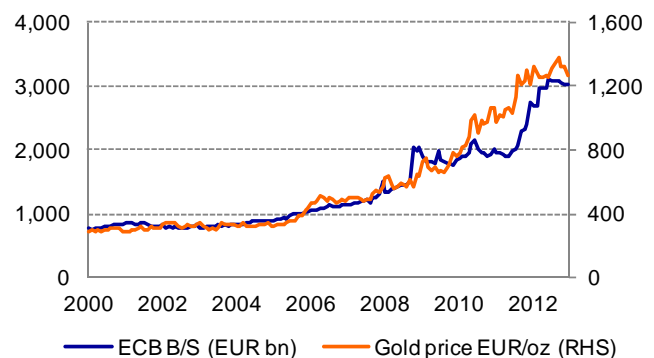
Source: Deutsche Bank, WGC

Figure 2: German gold re-allocation



Source: Bundesbank, Deutsche Bank

Figure 3: Gold price (EUR/oz) and ECB balance sheet



Source: Deutsche Bank

Not only will incoming bars be stored domestically however: these bars will, if necessary, also be upgraded to London Good Delivery (LGD) standards, thereby ensuring compliance with the request of the Court to 'spot check' their quality. We believe much of the gold held in NY is old, known as 'Fed Melts' or 'Deep Storage' bars and may not be acceptable as is for transaction without additional processing.

Furthermore we note that the Bundesbank has indicated that it will continue discussions to expand its rights to conduct audits in NY, London and Paris.

Given the highly 'charged' or politicised nature of the gold market as it pertains to central bank actions, particularly in the Western World, central bankers are generally highly sensitive to public perception and to perceptions of trust. In our view the Bundesbank is responding in large part to the Court of Auditors, who themselves have no doubt observed the increase in value of German gold reserves and may wish to raise the standard by which gold is treated on their books. Furthermore, we believe that the slow transfer of gold from the US Fed in NY back to Frankfurt, at 50t/year, is partly a reflection of its wish to avoid any perception of a change in confidence in the US Fed. A secondary factor could perhaps be the reluctance to put undue strain on the gold refining sector.

### **Impact**

Many central banks have already gone through the process of rebalancing gold holdings and upgrading where necessary; Germany happens to be a high profile example.

As we indicated previously, we view the repatriation and upgrade of old gold by the Western World's central banks as a further positive in gold's evolution as a legitimate form of money. While this is unlikely to have any impact on the near-term price performance of the metal, it could have important longer-term implications.

**Daniel Brebner, CFA, (44) 20 7547 3843**

[daniel.brebner@db.com](mailto:daniel.brebner@db.com)

**Xiao Fu, (44) 20 7547 1558**

[xiao.fu@db.com](mailto:xiao.fu@db.com)

# Appendix 1

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**David Folkerts-Landau**

Managing Director  
Global Head of Research

Marcel Cassard  
Global Head  
CB&S Research

Ralf Hoffmann & Bernhard Speyer  
Co-Heads  
DB Research

Guy Ashton  
Chief Operating Officer  
Research

Richard Smith  
Associate Director  
Equity Research

Asia-Pacific

Fergus Lynch  
Regional Head

Germany

Andreas Neubauer  
Regional Head

Americas

Steve Pollard  
Regional Head

Principal Locations

**Deutsche Bank AG  
London**

1 Great Winchester Street  
London EC2N 2EQ  
Tel: (44) 20 7545 8000

**Deutsche Bank AG  
New York**

60 Wall Street  
New York, NY 10005  
United States of America  
Tel: (1) 212 250-2500

**Deutsche Bank AG  
Hong Kong**

Filiale Hongkong  
Intl. Commerce Centre  
1 Austin Road West Kowloon,  
Hong Kong  
tel: (852) 2203 8888

**Deutsche Securities Inc.  
Japan**

2-11-1 Nagatacho  
Sanno Park Tower  
Chiyoda-ku, Tokyo 100-6171  
Tel: (81) 3 5156 6770

**Deutsche Bank AG  
Frankfurt**

Große Gallusstraße 10-14  
60272 Frankfurt am Main  
Germany  
Tel: (49) 69 910 00

**Deutsche Bank Ltd.**

Aurora business park  
82 bld.2 Sadovnicheskaya street  
Moscow, 115035  
Russia  
Tel: (7) 495 797-5000

**Deutsche Bank AG  
Singapore**

One Raffles Quay  
South Tower  
Singapore 048583  
Tel: (65) 6423 8001

**Deutsche Bank AG  
Australia**

Deutsche Bank Place, Level 16  
Corner of Hunter & Phillip Streets  
Sydney NSW 2000  
Tel: (61) 2 8258 1234

**Deutsche Bank Dubai**

Dubai International Financial Centre  
The Gate, West Wing, Level 3  
P.O. Box 504 902  
Dubai City  
Tel: (971) 4 3611 700

**Publication Address:**

Deutsche Bank AG  
London  
1 Great Winchester Street  
London EC2N 2EQ  
Tel: (44) 20 7545 8000

**Internet:**

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