Buy the Dip: Repatriation of Foreign Gold from the Fed could be Vote of No Confidence

Since 2012, there's been an unprecedented call from foreign nations to repatriate their gold from Federal Reserve vaults in the United States. This is an incredible development given many countries' more than 70-year reliance on the Fed as a custodian of their bullion.

Over the last few years, countries including, but not limited to, Germany, the Netherlands, France, Belgium, Austria, Poland, Ecuador, Finland, Switzerland, Venezuela, and Romania have either formally requested repatriation of their gold or are in discussions with the Fed about it.

Some of these nations have held more than 50% of their entire reserves of bullion in the U.S. since 1944, when the U.S. Dollar became the world's reserve currency.

A major shift in thinking must have occurred in the last few years to prompt such action; evidence suggests a break in foreign gold holders' trust in the Fed as a custodian of their precious metals.

The Evidence

There's evidence that, in recent years, the Fed has been leveraging some of its foreign gold holdings to tamp down rising gold prices as part of its grand plan to "engineer" an economic recovery from the 2008 Financial Crisis.

This is to be expected.

After all, the Fed has spent the past 7 years throwing everything but the kitchen sink at the chronically-ill American economy and its epidemic of long-term unemployment and underemployment.

Since 2008, the Fed has bailed out "Too Big to Fail" companies to the tune of $14 trillion and has expanded the money supply (i.e. has "printed") more than $4.2 trillion. What's more, it's crushed down interest rates to zero and has been keeping its boots firmly on top of rates for years.

It wouldn't be surprising, then, if the Fed were to include leveraging its foreign gold holdings in its campaign to prop up the economy. After all, high gold prices are a proxy for fear, and prices reached generational highs in late summer 2011– *3.5 years into the Fed's post-crisis "recovery."*

High gold prices are bad optics for the Fed.

Interestingly, gold prices began their long journey downward from their summer 2011 peak just after the Bureau of Economic Analysis and the Economic Cycle Research Institute (ECRI) called a double dip recession. While it's true that gold often falls with stocks prior to recessions, this is a completely new monetary paradigm in which the Fed has been expanding the money supply logarithmically and crushing down interest rates to historic lows and keeping them there for years.

As the Fed has made clear that it will print money to infinity and crush interest rates into oblivion to stimulate "The Recovery", one would figure that calls for a double dip recession would cause investors to anticipate a "doubling down" of money printing and interest rate crushing.

Thus, in this historically-dovish monetary environment, *one would think that calls for a double dip recession would cause a spike in gold prices, not a fall.*

"Engineering" an economic recovery from the Financial Crisis requires tools the size of tons of gold.

Destroying the global relationship between supply and demand is something only the Federal Reserve can pull off: It's the type of financial engineering that would require leveraging significant amounts of the central bank's most valuable assets.

The Fed doesn't own any gold, but it just so happens to be the custodian of trillions of dollars worth of foreign gold.

So, if the Fed has been leveraging its foreign gold holdings in order to "stimulate" the economy by–among other things–improving optics by lowering the price of bullion, it's quite possible that it simply doesn't have in its possession all of the foreign gold it should.

That doesn't mean that the Fed's vaults have less physical gold; it means that much of the gold may be hypothecated (used as collateral for loans).

This isn't a stretch. In fact, hypothecation is a common practice in the precious metals world… the Fed did it frequently when the U.S. was on the gold standard.

Hypothecation of foreign gold is prohibited by the Fed's current charter, however. While the Fed holds thousands of tons of gold, it owns none of it and therefore can't use it for anything, including collateral.

While the evidence is circumstantial in nature, it does seem that the Fed has ignored its own charter and has hypothecated some of its foreign gold holdings, at least recently.

Recently, as gold prices have been plunging in a monetary environment in which they should be rising, the Fed has been flat-out rejecting foreign nations' demands that they audit their gold.

What's more, they'll only return large holdings on installment plans.

Combined, these two facts suggest the Fed has been hypothecating its foreign gold holdings, despite its charter.

And, it's quite possible that the owners of the gold have caught wind of the hypothecation and are wanting their gold back now because of it.

Let's look at things from their point of view…

Why are foreign nations repatriating gold now? After all, there were no calls for gold repatriation during several global crises.

The timing of the calls for repatriation correlates well with the hypothecation thesis, particularly given the long history of foreign nations continuing to store their gold in Federal Reserve vaults during times in which repatriation may have been warranted.

The Fed became a popular custodian of foreign gold during World War II, when threats of appropriation of valuable assets by invading empires were an unfortunate reality in much of the world.

In 1944, through the Bretton Woods Agreement, much of the globe came to the consensus that:

1) The U.S. dollar would become the world's de facto reserve currency.

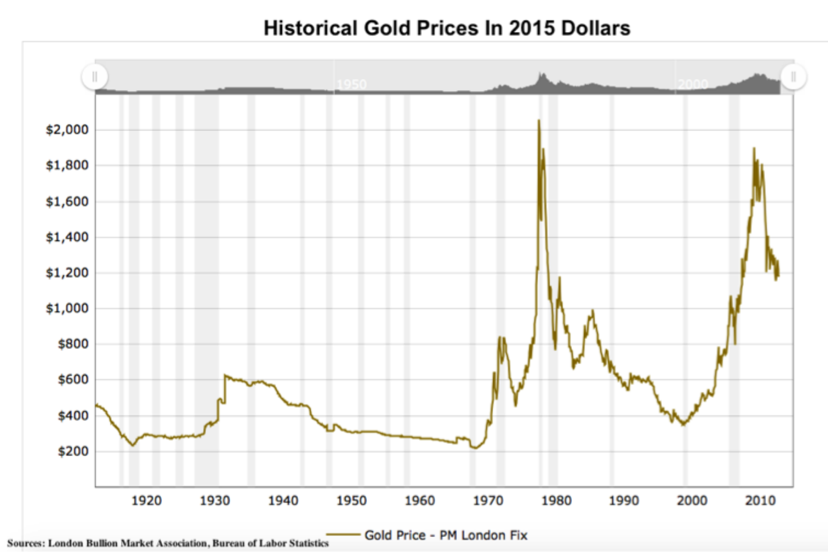
2) The dollar would be backed by foreign and domestic gold physically held by the Fed.

Then, in 1971, the U.S. repudiated its commitments under Bretton Woods: It untethered the Dollar from gold. You might think that foreign nations holding gold at the Fed would have recalled much of their bullion at that time.

But they didn't.

Not only was the gold not needed to back the world's reserve currency in the post-Bretton Woods 1970s, but the threat of appropriation by foreign empires had diminished significantly: Three decades had passed since WWII, the Khrushchev Era of the Cold War had ended years earlier, and the West had begun to develop diplomatic and trade relations with the Soviet Union and China.

But, despite these favorable conditions for repatriation in the 1970s, few nations called for it…it simply wasn't worth the cost or effort: The price of gold at the time was at an inflation-adjusted 20th Century low of $210. (See the adjacent chart, which shows historical gold prices in 2015 dollars.)



The financial incentives for repatriation improved significantly by the end of the 1970s, however…and then some.

By the end of the ‘70s, with the Fed’s home country mired in stagflation and shocked by an oil crisis, the price of gold skyrocketed to an all-time record inflation-adjusted high of $2,100 (a high that stands today). Decades removed from the threats of appropriation during WWII and from early Cold War-era empires, the late 1970s and early 1980s would have been an ideal time to repatriate bullion from the Fed.

But there were few calls to do so.

What’s more, there were few calls for repatriation in the 2000s (the “aughts”), a time when Alan Greenspan’s Fed was busy inflating the housing bubble (to “stimulate” the economy after the bursting of the tech bubble) and Al-Qaeda’s devastating attacks on the World Trade Center--located just blocks from where the Fed stores its lion’s share of foreign gold–sent gold prices spiking.

If there were an ideal time for mass calls of repatriation, it was the 2000s. But the calls just didn’t come.

Incredibly, they didn’t even come during the 2008 Financial Crisis, an event that created global financial panic and put the stability of the U.S. financial system into question.

No, foreign banks have only made the calls recently, during a period of time in which gold doesn’t seem to be following the rules of supply & demand and in which the Fed has been flat-out rejecting the efforts of foreign nations to audit their gold holdings.

Considering the above, the recent calls for gold repatriation suggest that foreign gold owners have lost trust in the Fed as a custodian of their bullion. The timing of the calls suggest that they want their gold back because the Fed has been hypothecating it, in violation of its own charter.

What does this mean for the price of gold?

It means a couple of things:

1) The Fed could be doing things to “stimulate” the economy that they haven’t disclosed.

Everyone knows about Quantitative Easing (the “printing” of trillions of dollars), but no one has discussed how the Fed might leverage the trillions of dollars of gold that it holds.

We’re already seeing asset inflation in the form of speculation in the stock market (you can read my *Seeking Alpha* article about it here). If the Fed is leveraging trillions in gold *in addition* to its tremendous money printing and interest rate crushing, inflation could spill out of the canyons of Wall Street onto the economy at large. In that case, the price of gold should rise. (Now would be a good time to “buy the dip”.)

2) Regardless of what the Fed is actually doing with the foreign gold it holds, nations are suddenly demanding it back. They’re “demanding” (as in *supply and demand.*), and the Fed continues to deny the nations’ calls, thereby limiting the “supply” of gold to meet that demand.

Given the natural law of supply and demand, the price of gold should rise due to the spike in demand for sovereign gold, irrespective of the Fed’s actions and irrespective of the recent counterintuitive dip, which I noted–and which many precious metals traders believe–may be the result of temporary price manipulation on the part of the Fed. (Now would be a good time to “buy the dip”.)

The bottom line: Nations are demanding their gold from Federal Reserve vaults, and the Fed has been acting suspicious in its replies to those demands. Now would be a good time to buy gold. Buy the dip.