Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
David Gitlitz, Chief Economist
Thomas Demas, Managing Director

TRENDMACRO LIVE!

On IMF Gold Sales

Thursday, April 2, 2009

Donald Luskin

The IMF doesn't determine the gold price. The Fed's response function does.

The "tradable rally" in stocks we called for in early March (see "Quantum of No Solace" March 10, 2009) continues as the US economic policy environment stabilizes somewhat, and the G-20 meeting in London emanates positive vibes about international cooperation to combat the global recession (see, at left, Barack Obama, Silvio Berlusconi and Dimitry Medvedev jocularly group hugging while Rome burns). The most dramatic response to the G-20 in any single market has been the drop in the price of gold to below $900, following reports citing the possibility of a substantial new sales of International Monetary Fund gold holdings, to help fund a vast new pool of Special Drawing Rights to enable more aid to distressed emerging economies.

Update to strategic view
GOLD: The uptrend in gold from its October 2008 bottom has been broken, as we expected it would be, on the catalyst of potential large sales from the IMF's reserves. Like other deflationary moves we have seen during the present crisis -- that is, distressed exchanges of tangible assets for money -- we expect this one will be met by accommodation by the Fed and other central banks. As long as such inflationary response functions continue to come into play, we expect that after some retrenchment gold will ultimately move to new all-time highs.
[see Investment Strategy Dashboard]

For some time we have expected gold to break its unsustainably sharp uptrend from its October 2008 lows (see, for example, "Stocks Test the Lows, Gold Tests the Highs" February 23, 2009). It has happened today, and *if* large-scale IMF gold sales do materialize as actual policy (the G-20 communiqué is unclear as to whether gold sales beyond those previously committed would take place, and in any event such sales would require legislative action in the US and in other member countries), that could be the catalyst for a serious retrenchment. But IMF gold sales in and of themselves, even though the IMF holds the world's third largest gold reserve and could be a very substantial seller, do not fundamentally alter our long-term outlook. We still expect the

http://www.trendmacro.com
don@trendmacro.com
dgitlitz@trendmacro.com
tdemas@trendmacro.com

Offices:
Menlo Park CA
Parsippany NJ
Charlotte NC

Phone:
650 429 2112
973 335 5079
704 552 3625

persistent inflationary response function of the Fed and other central banks to ultimately drive the gold price to new all-time highs. Recall what happened two weeks ago, when gold broke its uptrend intra-day, and then dramatically reinstated it, recovering from down more than 2% on the day to up more than 4%, following the FOMC's announcement of new trillion dollar-plus debt monetization plans (see "Ben Boldly Goes" March 19, 2009). With the stroke of a press release, the Fed can easily print more money than the IMF can give away to poor nations by selling gold.

In isolation, IMF sales can be seen as an extension of the deflationary impulses that seized global markets from September to November last year, when assets of all kinds -- including gold -- were dumped in a mad dash for liquidity -- that is, for money (see "Deflation Takes Center Stage" November 19, 2008). The Fed met that situation with the massive expansion of its balance sheet, and the monetary base (see "Why Isn't Gold at $1500?" December 10, 2008). As a result, of all the asset classes decimated in the late-2008 liquidation frenzy, gold -- the most inflation-sensitive -- recovered the most completely, nearly making new all-time highs in late February. Ultimately, as long as the world's central banks keep inflating, gold will keep appreciating, no matter what the IMF does. That was certainly the case in the late 1970s, when the IMF's sale of 50 million ounces was unable to prevent the gold price from appreciating by more than a factor of twenty, thanks to the intensely inflationary Fed policy that prevailed at the same time.

BOTTOM LINE: The uptrend in gold from its October 2008 bottom has been broken, as we expected it would be, on the catalyst of potential large sales from the IMF's reserves. Like other deflationary moves we have seen during the present crisis -- that is, distressed exchanges of tangible assets for money -- we expect this one will be met by accommodation by the Fed and other central banks. As long as such inflationary response functions continue to come into play, we expect that after some retrenchment gold will ultimately move to new all-time highs.