



The Gold of Spain's Central Bank: "Technical adjustment" or the sign of something more serious?

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In just two months, the Central Bank of Spain (Banco de España) has sold off 20% of its gold reserves, equivalent to 80 tonnes of pure gold, and worth about 2 billion dollars. Experts close to the Banco de España have characterized these sales as mere "technical adjustments of the reserves" but the fact is that the Spanish gold holdings, which in March of 2004 held eleventh place in the world's ranking with 523 tonnes, have been reduced to little more than 300 tonnes.

The vertiginous fall of gold reserves in Spain is not just another decline, because, since 2004, it has plummeted 60%; this drop can hardly be attributed to "technical adjustments" as the Banco de España claims.

It is necessary to clarify that it is an error to perceive the gold reserves as something obsolete and without strategic interest just because Spain is in the European Monetary Union and enjoys the euro's protection. None of the great economies inside the Eurozone has significantly altered their strategic holdings; indeed, they have kept them at full strength since the launch of the euro because each national bank must act as lender of last resort in the event of a crisis and the European Central Bank (ECB) may intervene only if an incidental crisis spreads across the eurozone.

This policy of selling off gold can only be understood if one considers that Spain's current account deficit has ballooned to 9.5% of GDP,

reaching almost 9 billion euros in March alone. The Spanish trade deficit is out of control. It is the worse deficit in the country's history and worse than in any other country in the world in relative terms.

But, why the gold reserves? The government could have used other more effective means to give liquidity to the current account balance without having to sell strategic assets. But that would damage the public's perception of Spanish Prime Minister Jose Luis Zapatero's economic management because the public deficit would increase and thus finish with the impression of a surplus, as well as with the fiction that the economy continues to go full speed ahead due to the government's good administration. Selling off the gold reserves looks more like a maneuver so that the unpleasant part of our economy, being that we spend much more than we produce, remains unnoticed - while in technical terms, we enjoy a fiscal surplus and have a government staging good economic management.

What the Banco de España has done is similar to the situation of a family that resorts to selling off jewels instead of requesting a loan. There are no debts, but neither is there any backup to face unusual situations.

The present government has always despised the trade deficit because they consider it like one disturbing and inevitable consequence of economic growth for which there is no cure. Spain, with better growth than the European average, has a negative foreign trade balance reaching

more than 7 billion euros every month, almost 10% of its GDP.

In spite of the growth, the Spanish economy is far from excellent and there are enormous risk factors that can accelerate the end of the growth and economic bonanza we enjoy:

The private sector has amassed the equivalent of 600 billion dollars in debts.

The mortgage debt is more than 120% of disposable income, being almost all of it, 96%, on floating interest rates.

The construction sector accounts for 20% of GDP according to Morgan Stanley (in the case of Germany after reunification, it was not more than 14% and, according to some analysts, this was the key to the German economic depression that it has just overcome.)

It is possible that the Banco de España, the bank of banks, may need liquidity to finance even further the credit expansion for financial institutions and that the bank does it by taking advantage of the attractive prices for gold right now. But it does not seem reasonable that selling off 20% of the reserves is a simple "adjustment" when, in addition, this happens at a moment when having strong strategic reserves seems more advisable.

In theory, the Banco de España is an autonomous entity, independent of the Executive branch. However, in practice, Miguel Ángel Fernández Ordóñez's appointment, ex-State Secretary for Economic Affairs of

the current government, casts a shadow of suspicion on this body and its potential performance.

If we take into consideration the meddling carried out by the Zapatero administration in all of the Spanish regulatory bodies during this legislature, it becomes very difficult to give the benefit of the doubt to the Banco de España. Indeed, it is startling to see that it has taken the decision to dump the holdings at a vulnerable moment, falling to 13.2 billion euros, equivalent to just 12 days of imports.

With those gold sales, Spain reduces its ability to face a financial crisis, something that could be a reality in the case of an abrupt housing slump that could affect the stock market and, with complete certainty, the banking system due to default in payments. In similar cases, for example in Japan during the 90's, the government could barely uphold its banking system but since it had strong holdings, it could guarantee deposits. That would not be possible in Spain because of its much-reduced reserves.

It would be convenient to get a clear explanation behind the reasons that have driven the Banco de España - which it is not this government's

bank - to sell part of the national assets that should have been managed in an effective and beneficial way for the Spanish people and not to finance the trade deficit. They should explain why they have sold off gold (at a time when Asian central banks, like those of China or Japan, continue hoarding gold) and above all, what they have done with the money and why they took such decision.

Neither does it seem logical that, since 2004, Spain has become the biggest seller of gold in relative terms with a volume drop of almost 60% (not in value, due to the continuous price rise).

The gold sale makes us think that perhaps the government's triumphalism when it comes to speaking about economic results is not justified. That is why one cannot understand actions that weaken Spain's standing in the face of a possible banking crisis.

It would be a real pity if, in order to solve the current account deficit, the government applies a simple measure such as the partial sale of gold reserves, instead of applying structural reforms that could produce more competitiveness for our economy.

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