

# Gold's initial lacklustre response to Turkey likely to be a red herring

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Turkey is going through an economic crisis, as seen on last week's blog the Lira has dropped to an all-time low, 34% over the week. The Euro also fell 2% in the past week as some of the Eurozone's largest banks are lenders to Turkey, as highlighted by the European Central Bank's financial watchdog department.

Gold has traditionally been seen as a safe haven asset, often sought after in times of investor anxiety. However, gold prices have declined 0.4% in the past week.

### So why hasn't gold reacted more strongly?

Well, gold doesn't always react quickly in times of stress. During the Argentine crisis, for example, the Minister of the Economy froze bank accounts on 1st December 2001 (a clear sign the writing was on the wall) and on 23rd December 2001 the government defaulted on its sovereign debt. In the month of December 2001, gold only rose 1%. But in the first half of 2002, gold rose 15% as the ramifications of the Argentine crisis (and dot-com bubble issues) introduced a clear geopolitical premium into gold. That indicates that even as a crisis unfolds it may not be too late to build a hedge.

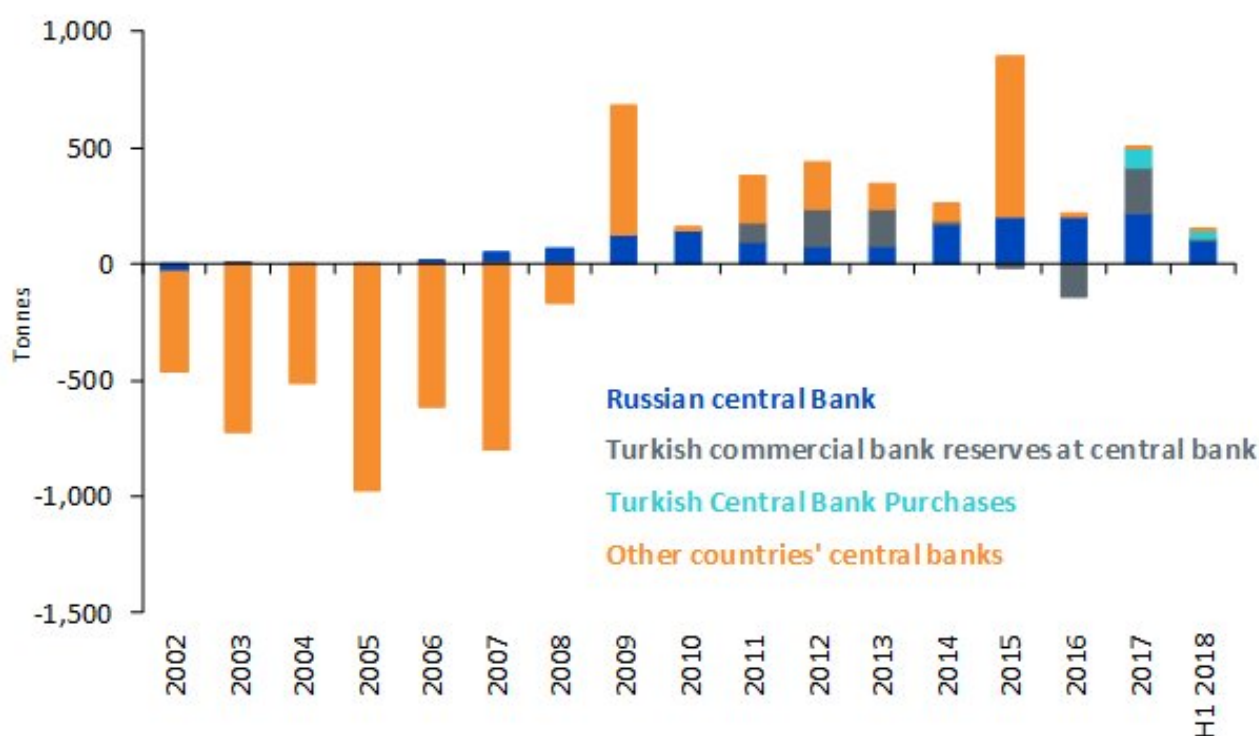
### Turkish Central Bank: largest gold accumulator in 2017

Gold's relative underwhelming reaction to Turkey's issues today may also be due to some of Turkey's unique features.

The Central Bank of the Republic of Turkey (CBRT) is a large purchaser of gold. When defending the Lira in this crisis, it may sell gold and investors may perceive this supply as price-negative. The CBRT bought 85.9 tonnes of gold in 2017, the second largest gold purchases of any central bank next to the Russian Central Bank (223.5 tonnes) in 2017.

Turkey has a somewhat unusual system, where commercial banks can use gold to meet reserve requirements with the central bank. In 2017 gold inflows into the Turkish Central Bank from commercial banks (held on reserve) amounted to 187.7 tonnes. Combining these two sources of flows to the CBRT, gold inflows into Turkey were the highest of any central bank.

### Figure 1: Central Bank gold purchases (annual)



Source: World Gold Council, WisdomTree, data available as of close 30 June 2018

**Historical performance is not an indication of future performance and any investments may go down in value.**

**How long is gold’s listlessness likely to last?**

Part of the answer will obviously relate to whether the stress in Turkey is transient or whether it will escalate. We can’t offer any meaningful precision here. However, if indeed the threat of Turkish gold being sold is weighing on its price, what could arrest that threat? The Turkish Central Bank could sell other currencies before touching gold, leaving little impact on gold supply. That could be a viable strategy for the CBRT, that is to punish currencies belonging to other countries rather than ‘stateless’ gold.

Commercial banks appear to have reduced their gold held in reserves at the central bank in recent months. The CBRT has seen an outflow from this source amounting to 27.5 tonnes between April and June 2018, wiping out most of the 30.7 tonnes of inflows from January to March 2018. If commercial banks and their customers withdraw more gold in the state of panic in the country, gold will clearly be playing its traditional role. This would be gold price-positive.

**Figure 2: Central Bank gold purchases (monthly)**

Source: World Gold Council, WisdomTree, data available as of close 30 June 2018 Historical performance is not an indication of future performance and any investments may go down in value.

There is also a chance that the government takes draconian action to prevent households hedging themselves with their gold. That is not without precedent. In 1933, the Roosevelt Administration in the US signed a presidential executive order "forbidding the Hoarding of gold coin, gold bullion, and gold certificates within the continental United States". That ban on gold lasted until 1974. Such actions would surely make gold a coveted asset elsewhere.

Turkey's president Recep Tayyip Erdogan's rhetoric has already been tilting in that direction. On Friday he stated, "If there is anyone who has dollars, euros or gold under the pillow, he should go and convert this at the bank." A seize on assets is not an unthinkable step for a leader with power-hungry tendencies.

### **Conclusion**

Gold does not always react quickly to stress events. Turkish-specific issues could be temporarily weighing on price more so than currency crises in countries where the central banks hold little gold. Today's low price could offer investors an attractive entry point.

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