CPM Group

Market Commentary

No. 1 11 January 2012

The Potential Effects on the Gold Market of a Greek Withdrawal from the ECB

The new year has dawned with continued market speculation about what the gold market implications would be if Greece were to withdraw from the European Central Bank (ECB) system and sever its use of the euro in favor of a new drachma. CPM Group views such a development highly unlikely, because it would be so utterly destructive in economic, financial, and political terms. Our opinions – and those of the seemingly like-minded vast majority of financial market participants – notwithstanding, the speculation continues. Since several clients have requested insights from CPM Group concerning the potential impact on gold of such a withdrawal by Greece or other member governments from the ECB and euro, CPM Group is issuing this **Market Commentary** on the subject.

Much of the speculation has focused on the potential that as part of a Greek withdrawal from the euro the Greek government might decide to sell gold from its monetary reserves. Some comments suggest that the Greek government, or some other government pulling out of the ECB, could be compelled to sell its gold reserves. Another strain of commentary suggests that the ECB might be required or forced to sell gold in such a situation.

First, there are no legal or contractual mechanisms compelling such a sale by the Greek central bank, the ECB, or any other central bank. The gold these central banks hold is in no way pledged against any of the sovereign debt of their respective governments. So, in the most superficial way, a withdrawal by Greece or another member would not necessarily or likely precipitate a government sale of gold that could have a direct negative impact on gold prices.

More important, the consequences for gold of the macroeconomic and financial fall-out from such a withdrawal would have a much more dynamic and forceful effect on the gold market and gold prices than any gold-focused actions by the Greek central bank or ECB.

If Greece were to withdraw from the euro system, its gold holdings would be the least of the issues to watch. Greece would immediately move into bankruptcy as a government, defaulting on all of its loans. Greece only holds 3.6 million ounces of gold worth $5.9 billion at today's price. Greece's government debt is around $485 billion, so only around 1.4% of it could be covered by selling gold – assuming the price would not plunge on the event.

In other words: Greece will be highly unlikely to sell any of its gold to pay its debt. It would seek to hold on to its capital stock. As discussed in a **Market Commentary** issued 6 December 2011 on issues related to the concept, that Europe and the United States could use their gold reserves to pay down their debt: for all of these countries the value of their gold reserves is a small fraction of what they owe. Selling their gold from their capital accounts would do nothing to fix the fiscal deficit problems that are the basis for the rising debt. If they sold their gold they would throw away some of their capital stock and leave themselves in much worse financial conditions. Also, as mentioned above, there are no laws, regulations, rules, policies, or anything else that would say Greece or any other country would need to or could be compelled to sell its gold or lease it.

Meanwhile, if Greece pulled out of the euro system, it could face dissolution, while Europe could face a massive economic depression worse than the 1930s and a series of political revolutions. (All of which is why one should not expect the euro and ECB to collapse: The costs are too high to allow and governments will do whatever is necessary to protect Europe, and its jobs, against such an inevitability.) So, again, the effects of a Greek withdrawal from the euro system on gold primarily would be felt much more through its effects at the monetary and macroeconomic level, and not related to its gold holdings.

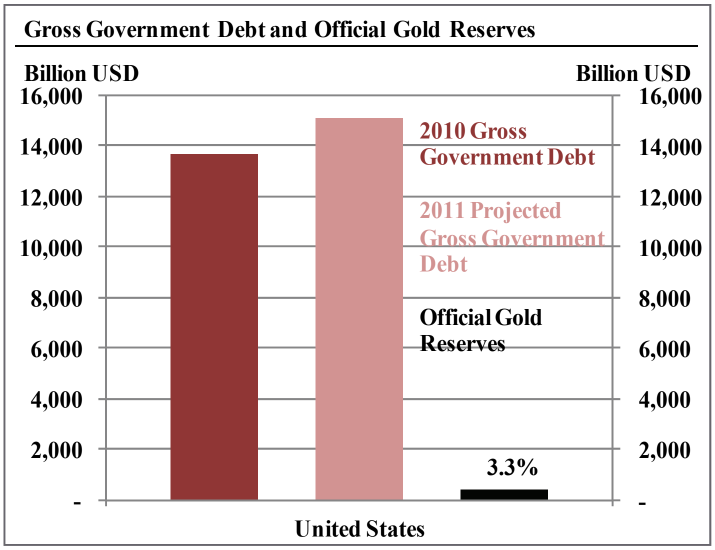
The ECB would not need to sell its gold to recapitalize. It would have to return a bit to Greece, which has deposited some gold with the ECB as part of its contribution, but the amount would be small. The gold held by the ECB is considered Tier 1 capital. It would rise in value. So, the ECB would want to hold on to its gold and not sell it, as it would help it immensely.

Another question related to whether the ECB could violate the European Central Bank Gold Agreement (CBGA),

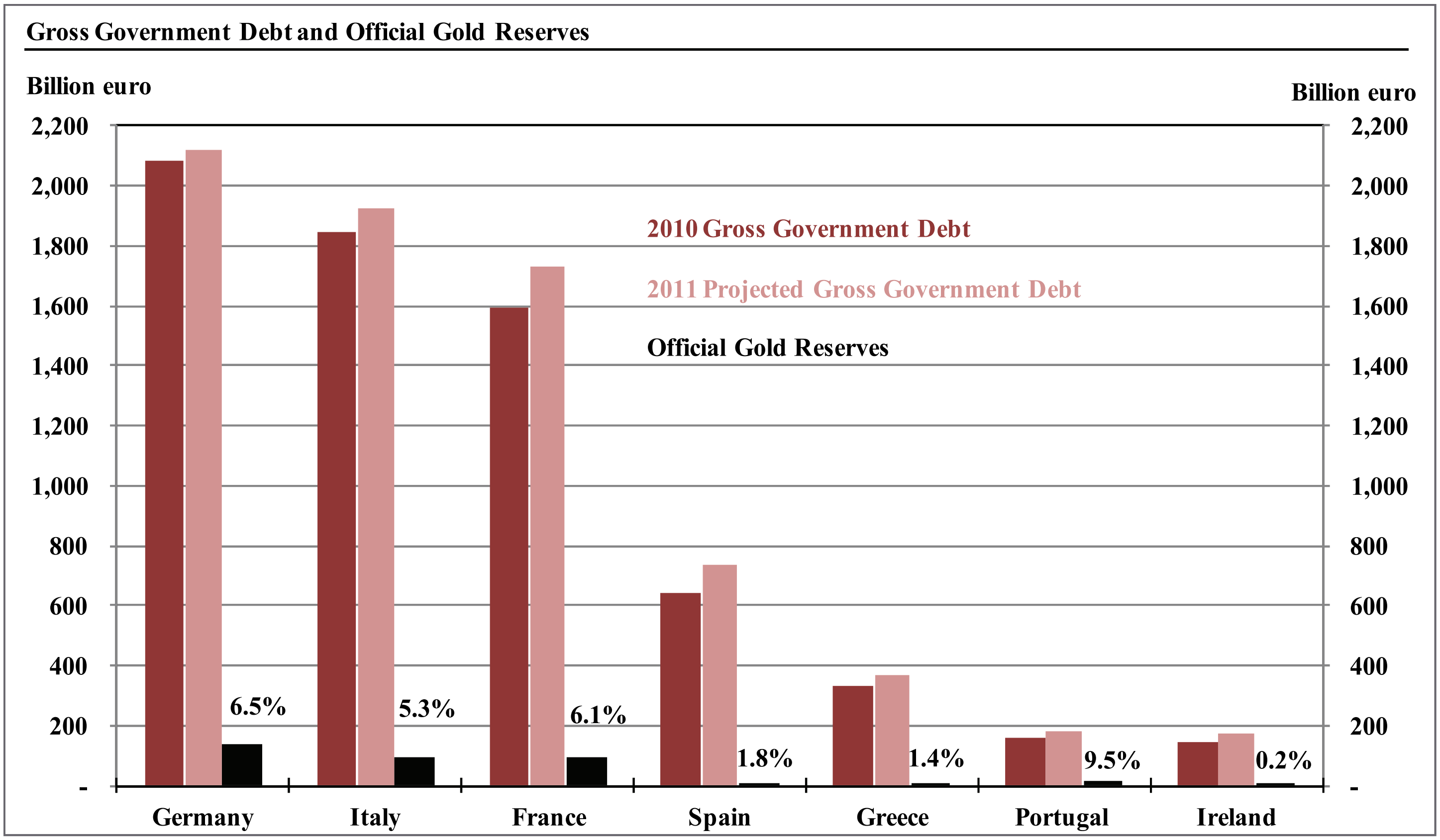
The Potential Effects on the Gold Market of a Greek Withdrawal from the ECB (cont.)

which includes a guideline for how much gold signatory central banks will sell in any given year. The European CBGA is non-binding. Central banks that are party to the CBGA can do whatever they want with their gold, at the end of the day, with total disregard for this agreement.

This Market Commentary is based in part on material contained in CPM Group's Gold Long-Term Outlook, released January 2012. The two charts on this page are taken from that report, and were used in Market Commentary 2011-3, released 6 December 2011.



Notes: Official gold reserves as of October 2011. Gold prices as of 31 October 2011. Gross government debt for 2010 is actual data. Gross government debt for 2011 are IMF forecast. Ratio of official gold reserves and gross government debt is based on 2010 gross debt.
Source: IMF, IFS, and CPM Group



Notes: Official gold reserves as of October 2011. Gold prices as of 31 October 2011. Gross government debt for 2010 is actual data, except for Portugal. Gross government debt for 2011 are IMF forecast. Ratio of official gold reserves and gross government debt is based on 2010 gross debt.
Source: IMF, IFS, and CPM Group