

GLOBAL ECONOMIC OUTLOOK - NOVEMBER

Monetary Department
External Economic Relations Division

2015

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Cut-off date for data

13 November 2015

CF survey date

9 November 2015

GEO publication date

20 November 2015

Notes to charts

ECB and Fed: midpoint of the range of forecasts.

The arrows in the GDP and inflation outlooks indicate the direction of revisions compared to the last GEO. If no arrow is shown, no new forecast is available. Asterisks indicate first published forecasts for given year.

Forecasts for EURIBOR and LIBOR rates are based on implied rates from interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizons). Forecasts for German and US government bond yields (10Y Bund and 10Y Treasury) are taken from CF.

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The November issue of Global Economic Outlook presents its regular overview of recent and expected developments in selected territories, focusing on key economic variables: inflation, GDP growth, leading indicators, interest rates, exchange rates and commodity prices. This issue also focuses on the role of gold in the reserves of central banks and the IMF in recent history. Despite having lost its unique status in the international monetary system, gold maintains a strong position not only with central banks, but also with private investors thanks to its ability to reduce systemic risk and preserve value. The article also presents the current efforts of India, China and Russia to change the role of gold in their economies and in the financial system as a whole.

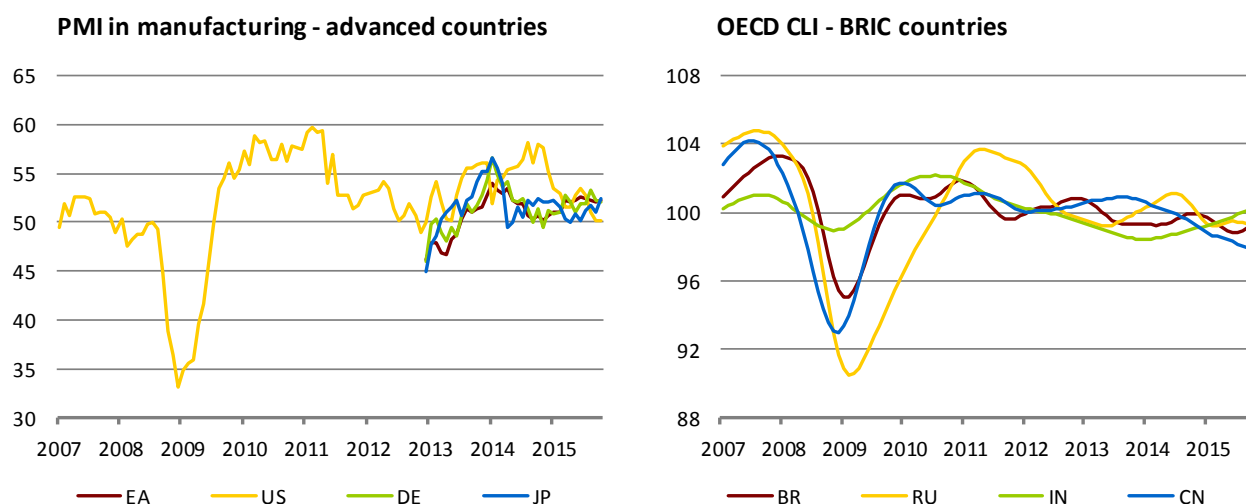
The economic growth outlooks for the major global economies for this year and the next were revised downwards to varying degrees in November. Despite these revisions, the US economy should maintain its growth rate, exceeding the current outlooks for the euro area by about 1 pp at the end of 2016. As the strongest European economy, Germany remains the engine of European growth, albeit a relatively weak one. The country is currently facing an escalating refugee crisis and the "Dieselgate" emissions scandal. The Japanese economy is expected to record growth of just over 1% next year after negligible growth this year. New figures on inflation in the main world economies reveal that consumer price inflation will be even lower this year than expected a month ago, reaching only a few tenths of a per cent in positive territory. Next year, consumer price inflation is expected to go up slightly in most of the advanced countries monitored, but none of these countries is expected to reach the 2% level generally perceived as price stability.

Compared to the previous month, the GDP growth outlooks for the emerging BRIC economies were revised moderately upwards and left unchanged for the Chinese and Indian economies respectively. However, leading indicators (see the chart below) reveal a gradual downward trend for China in the future, while India still has the potential to maintain fast growth. Consumer price inflation in China will gradually approach 2%. Visibly higher inflation is expected in India, slightly exceeding 5% at the end of 2016. In contrast to these two dynamically developing economies, Brazil and very probably also Russia will be in recession this year and the next. Moreover, the two countries will face high inflation, which is expected to reach double figures this year. Inflation is expected to drop to around 8% in Russia and to 6% in Brazil next year.

The euro area interest rate outlook remains at zero at the one-year horizon, mainly because the markets perceive an increased probability of the ECB extending its asset purchases or increasing their size as part of its ongoing quantitative easing. The Fed can be expected to raise interest rates; unlike the previous month, most analysts expect this to happen at the December meeting. According to CF, the dollar is expected to appreciate slightly against all the monitored currencies at the one-year horizon.

The oil price outlook remains very slightly rising, but its path moved downwards compared to the previous month. Oil prices are expected to be slightly above USD 57 a barrel at the end of 2016. Natural gas prices based on long-term contracts normally lag behind oil prices and are therefore expected to continue falling in the next few months and bottom out at the start of 2016 Q3. The non-energy commodity price index also fell slightly month on month. It will stay at roughly the current level at the one-year horizon owing to expected stability of both its sub-indices, i.e. food commodities and industrial metals.

Leading indicators for countries monitored in the GEO



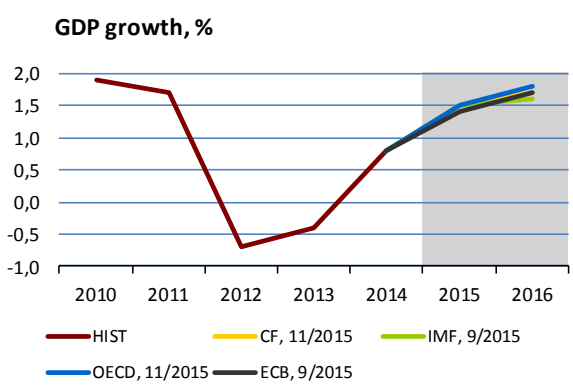
Zdroj: Bloomberg, Datastream

II.1 Eurozone

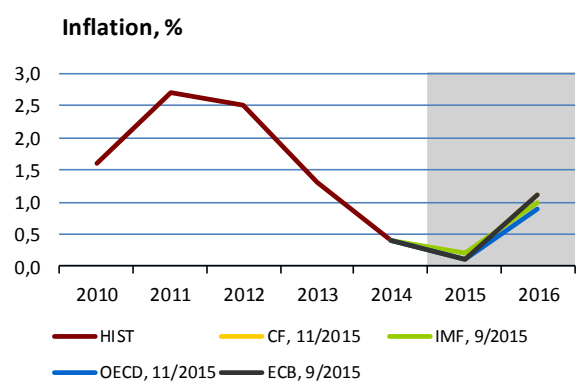
The forecasts of the monitored institutions expect the euro area economy to grow by 1.5% this year. In 2016, economic growth is expected to accelerate slightly further. In the first half of this year, annual GDP growth in the euro area reached 1.4%. According to Eurostat's flash estimate, it accelerated further to 1.6% in 2015 Q3. GDP growth is thus at its highest level since 2011. The growth is being fostered mainly by household consumption. The economy is still being favourably affected by low oil prices and the ECB's easy monetary policy, which is weakening the euro. In quarter-on-quarter terms, GDP growth slowed marginally to 0.3% in Q3.

Despite signs of an economic recovery, the consumer price inflation outlooks for this year remain close to zero. Inflation is expected to rise to around 1% only next year. Consumer prices were flat year on year in October after a 0.1% drop the previous month. Prices stagnated due to a significant annual decrease in energy prices, while food and services prices rose by 1.5% and 1.3% respectively year on year. Inflation excluding energy and food prices stood at 1% in October.

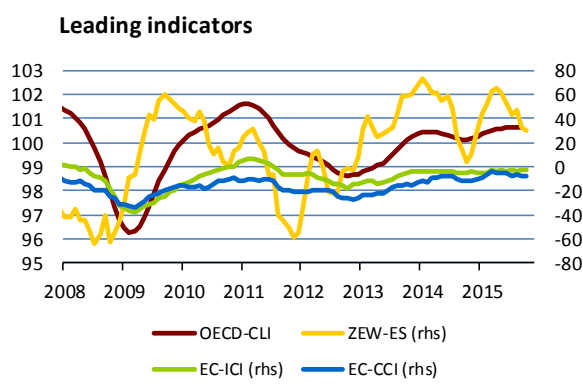
The ZEW economic sentiment indicator fell further in October. The PMI in manufacturing leading indicator stood at similar levels as in previous months, i.e. in the slightly expansionary band. This would indicate an improvement in the industrial production index, which, however, is currently unconvincing. Annual industrial growth was 1.2% in September, a moderate slowdown compared to the previous month. The 3M Euribor continued to decline to almost -0.1% and its outlook at the one-year horizon is slightly lower still. The 10Y German government bond yield is expected to rise to 1% at the one-year horizon.



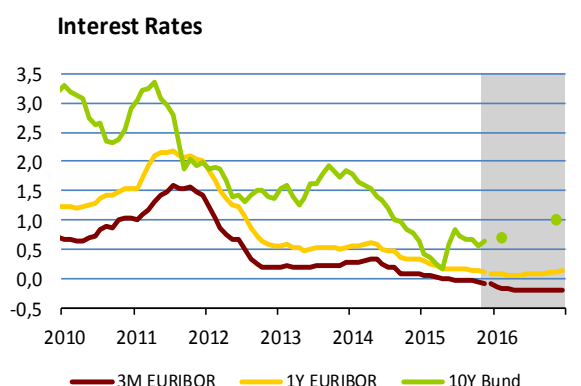
	CF	IMF	OECD	ECB
2015	1,5 →	1,5	1,5 →	1,4
2016	1,7 →	1,6	1,8 →	1,7



	CF	IMF	OECD	ECB
2015	0,1 →	0,2	0,1 →	0,1
2016	1,1 →	1,0	0,9 →	1,1



	OECD-CLI	EC-ICI	EC-CCI	ZEW-ES
8/15	100,6	-3,7	-6,9	47,6
9/15	100,6	-2,3	-7,1	33,3
10/15		-2,0	-7,7	30,1



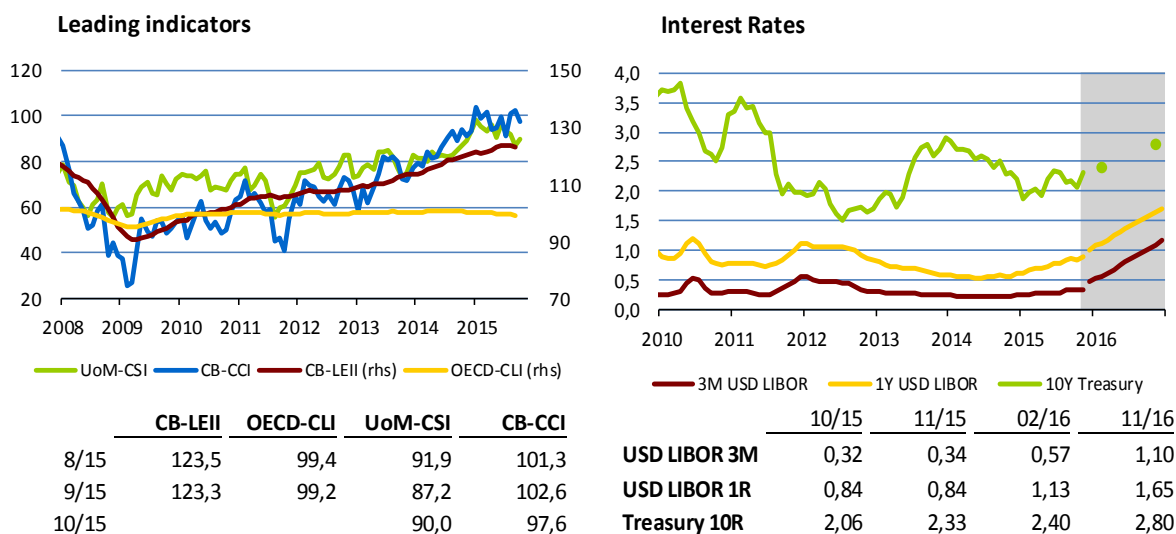
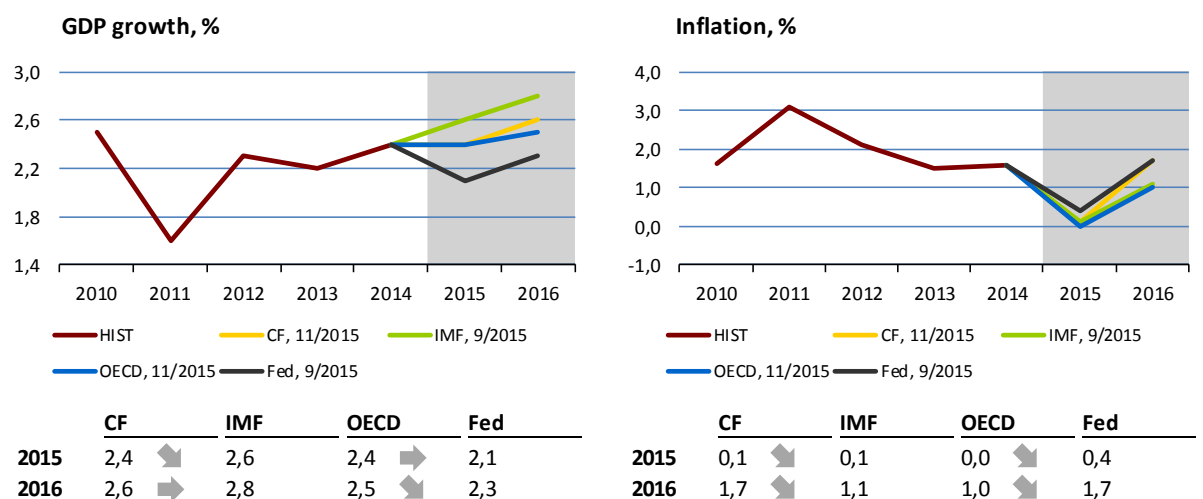
	10/15	11/15	02/16	11/16
3M EURIBOR	-0,05	-0,07	-0,16	-0,19
1Y EURIBOR	0,13	0,10	0,07	0,12
10Y Bund	0,55	0,66	0,70	1,00

II.2 United States

Economic activity in the USA slowed sharply in the third quarter. Quarterly GDP growth reached 1.5% in annualised terms after a 3.9% increase in the previous quarter. The decline was due to a slowdown in global demand and to economic and financial problems in China. Private consumption maintained a solid rate of growth (3.2%), but US companies significantly limited their re-stocking. Investment growth also decreased, indicating that companies are cautious in the current uncertain economic conditions. However, this should only be temporary and the growth should accelerate again in Q4. The published data on new jobs in the non-agricultural sector (seasonally adjusted) came as a positive surprise, reaching 271,000 in October. The unemployment rate dropped slightly further to 5.0% in October, but the participation rate stayed at its lowest level since 1977 in September and October (62.4%). In October, consumer confidence fell slightly for the first time since April 2015 and the PMI dropped to a level close to 50 points. Industrial production slowed further in September, with the energy and manufacturing sectors in particular recording a further slowdown in output.

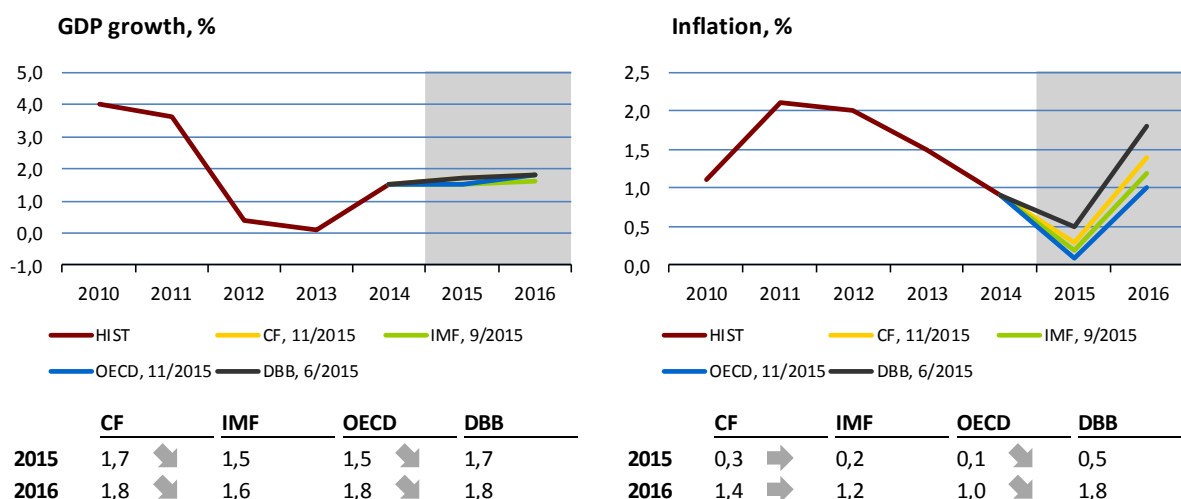
Annual consumer price inflation dropped to zero in September, while core inflation edged up to 1.9%. At its October meeting, the Fed decided not to raise rates yet, but a whole range of statements made by FOMC members indicate that the first increase in Fed rates could occur in December. The cited reasons include low unemployment, continued economic growth and an expected increase in inflation. According to the Chair of the Fed's Board of Governors Janet Yellen, however, the further increase in Fed rates will only be very slow. The CF panellists therefore changed their outlook and now expect rates to be raised at the Fed's December meeting with a probability of almost 70%. The expected interest rate path also shifted upwards.

The November CF lowered the GDP growth outlook for 2015 compared to the previous month while keeping the outlook for 2016 unchanged. The new OECD forecast also expects growth to accelerate slightly in 2016. The inflation outlooks of both CF and the OECD moved downwards for both years.



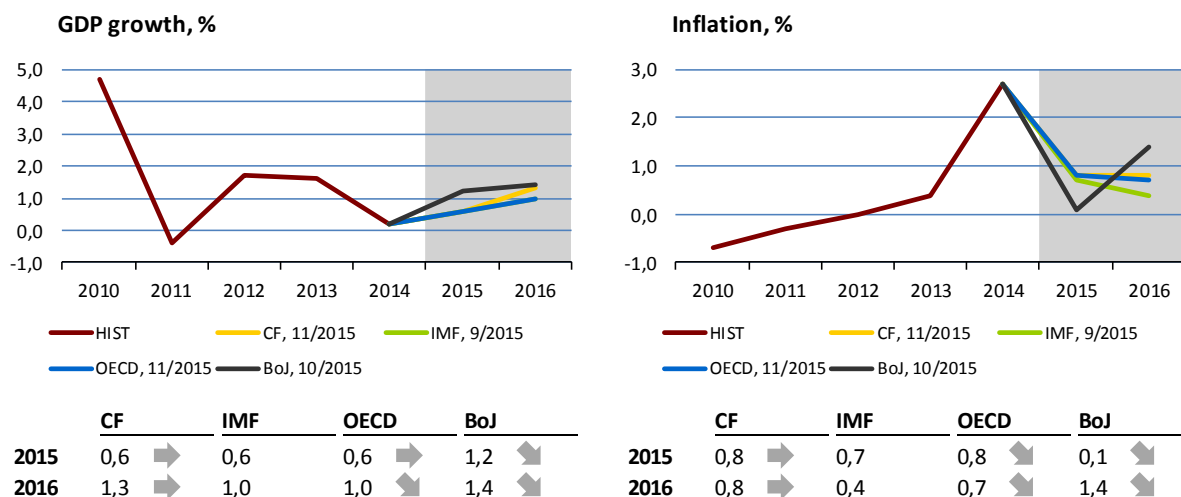
II.3 Germany

The quarterly and annual growth rates of the German economy both increased in 2015 Q2 (from 0.3% to 0.4% and from 1.0% to 1.6% respectively). However, industrial output dropped month on month in the past two months. Almost all leading indicators went down in this period as well. The flash estimate of GDP growth in Q3 confirmed the expected slowdown of the German economy (to 0.3% in quarterly terms, although the growth increased to 1.7% in annual terms). The November CF cut its GDP growth outlook for this year as a whole by 0.1 pp to 1.7%. However, even this lower estimate seems too optimistic. It can therefore be assumed that CF will reduce its future estimates further. German inflation rose to 0.3% in October after a fall lasting several months, mainly due to a smaller drop in energy prices and faster growth in food prices. According to CF, the average inflation rate will be 0.3% this year and rise to 1.4% next year.



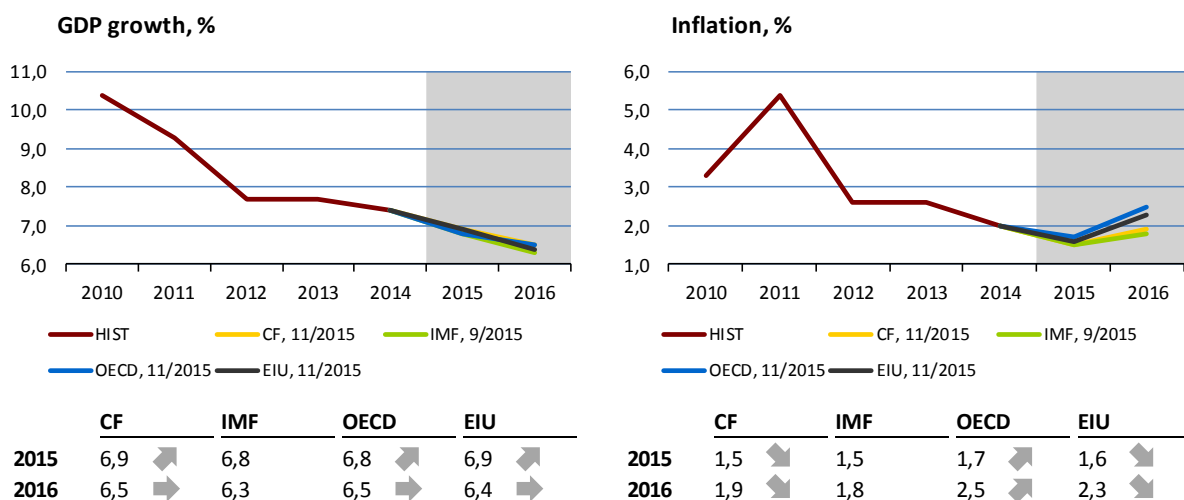
II.4 Japan

Japan's foreign trade seems to be hit by the drop in demand in the Asian region. The Japanese economy can therefore be expected to slow significantly in Q3. If GDP growth turns negative, the country will face recession. Total exports rose by a mere 0.6% annually in September. The annual change in exports to Asia, which account for one-half of total exports, was negative for the first time in seven months (-0.9%). Only car exports to the USA rose markedly. Also the leading indicators for domestic demand are not very optimistic on the whole. Annual core inflation excluding food prices was flat at -0.1% for the third straight month, while headline inflation fell to zero. The central bank left its monetary policy settings unchanged despite the worse inflation outlook and only postponed the expected moment of hitting the 2% inflation target until the second half of the fiscal year 2016/2017. While CF changed neither its GDP growth nor its inflation outlook in November, the BoJ cut its outlooks for both variables and both monitored years. The OECD's reaction was similar, although it has not changed its GDP growth outlook for 2015 yet.



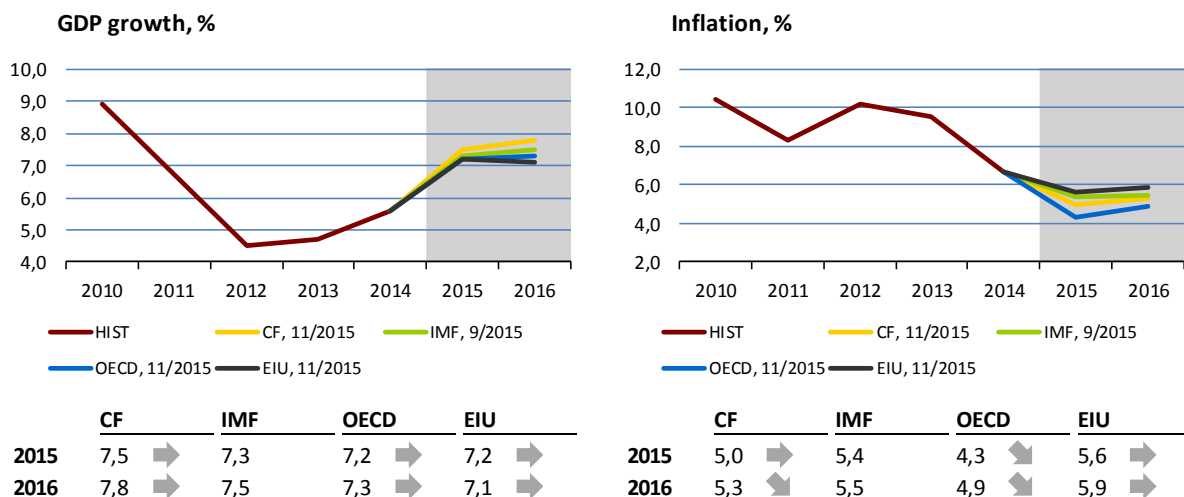
III.1 China

The Chinese PMI in manufacturing and PMI in services rose slightly in October compared to September, exceeding expectations. A halt in the decline in industrial output growth (at 5.6% in October, compared to 5.7% in September and 6.1% in August) was also good news. However, the Chinese economy remains weak compared to the pre-crisis years. GDP growth is being hindered by weak investment and trade. The decline in exports deepened to 6.9% in October (from 3.7% the previous month) and imports fell by almost 19%. The People's Bank of China further eased monetary policy in late October. Overall, however, this was generally good news, probably prompting CF, the EIU and the OECD to revise their GDP growth outlooks for this year upwards to 6.8%–6.9%. Inflation will stay well below the 3% target.



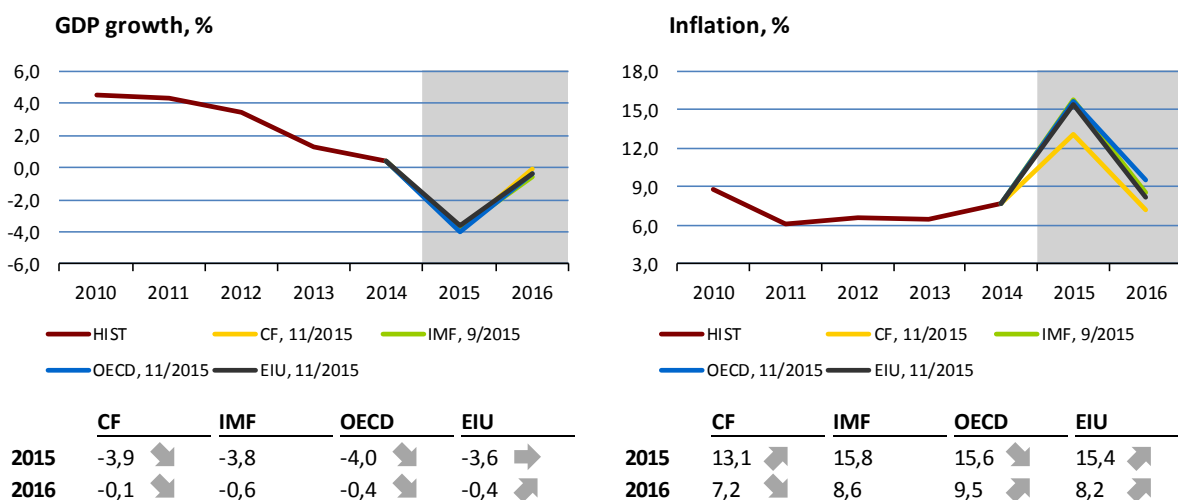
III.2 India

According to India's prime minister, the Indian economy has been doing better in the past 17 months. GDP rose by 7.3% in 2015 Q3, improving by 0.3 pp compared to the previous quarter. However, annual growth in industrial output slowed by almost one-half in September due to a drop in mining and production. The PMI in manufacturing dropped in October due to a slight fall in new orders, but remained above the 50-point level. Business and consumer confidence in India is nonetheless growing. The GDP growth forecasts for 2015 and 2016 were unchanged. Inflation rose by 0.6 pp month on month to 5% in October due to continued growth in food prices, particularly legumes, and other retail prices, but remains safely below the 6% inflation target. The EIU inflation forecasts stayed at their previous levels. CF lowered its forecast for 2016 by 0.1 pp. The OECD revised its outlooks for 2015 and 2016 down by 1.4 pp and 0.4 pp respectively.



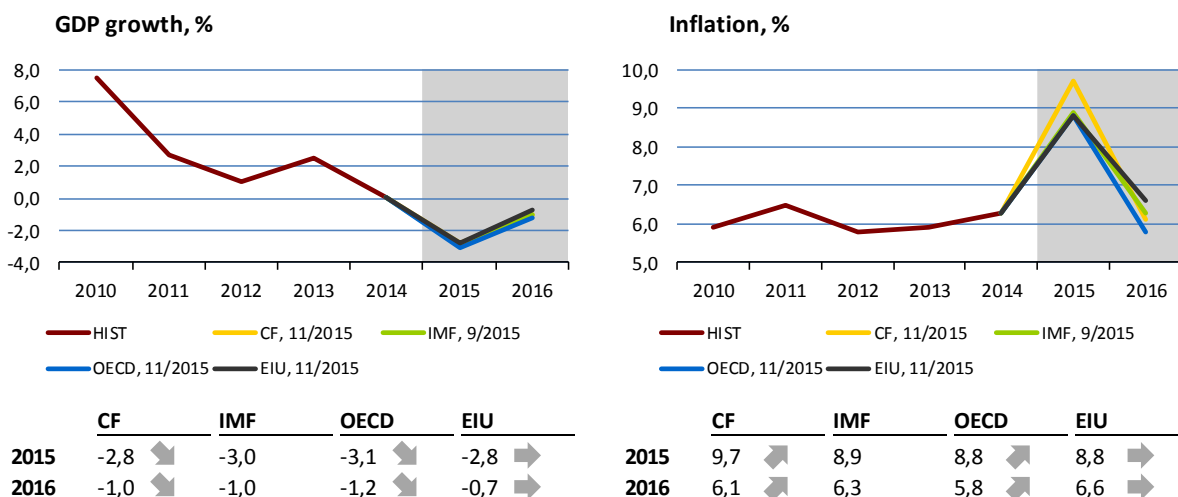
III.3 Russia

The decline in Russian industrial production slowed from 4.3% in August to 3.7% in September and unemployment fell from 5.3% to 5.2%, but retail sales and real wages are not indicating any improvement in the economic situation yet. The worst performer was again international trade, with both exports and imports falling by more than 30% year on year in September. According to Rosstat's preliminary estimate, GDP shrank by 4.1% in 2015 Q3. The latest CF and OECD forecasts indicate that the contraction of the Russian economy in 2015 as a whole will be bigger than previously expected. A decline in GDP of almost 4% is now predicted. The EIU left its 2015 outlook unchanged, but for next year it expects GDP to fall by 0.1%–0.4%. According to the European Commission's November forecast, the Russian economy will not return to growth until 2017. The new CF, EIU and OECD forecasts expect inflation to slow sharply to 7.2%–9.5% next year, but to remain above the CBR forecast of 5.5%–6.5%.



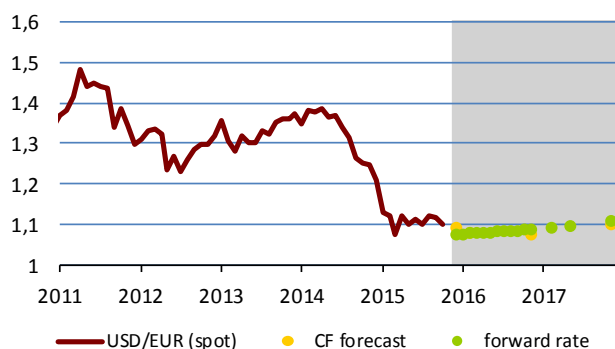
III.4 Brazil

The Brazilian recession seems to be much more serious than originally expected. Industrial output and retail sales dropped again in September, albeit at a slower-than-expected pace. Contrary to expectations, the unemployment rate stopped rising and remained at the August level. However, the PMI in manufacturing fell sharply to 44.1 points in October due to a contraction in output and new orders. As a result, the growth predictions continued to fall. CF and the OECD lowered their outlooks for this year and the next by 0.2–0.5 pp. According to the OECD, however, Brazilian GDP growth will return to a growth path next year and get back to its potential in 2017. Inflation rose by 0.4 pp to 9.9% in October, with housing, electricity and food prices recording the fastest growth. Government tax hikes are not helping inflation, either. The Brazilian central bank confirmed that inflation will be above its target until 2017 and may even exceed 10% this year. CF and the OECD therefore revised their inflation estimates upwards by 0.3–0.6 pp.



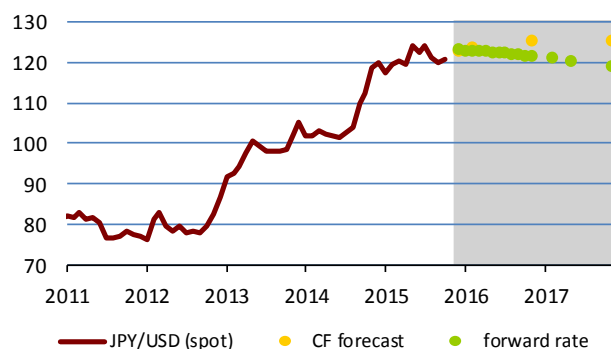
IV. Outlook of exchange rates vis-à-vis the US dollar

The euro



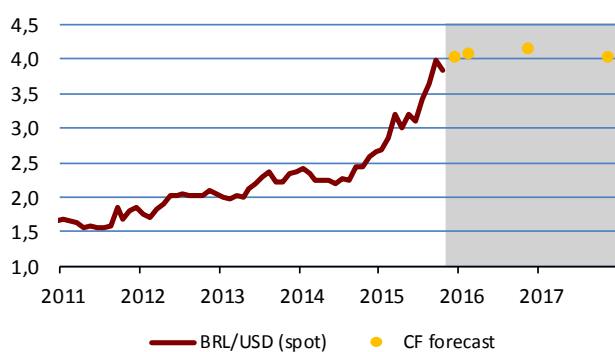
	9/11/15	12/15	02/16	11/16	11/17
spot rate	1,076				
CF forecast		1,091	1,080	1,074	1,100
forward rate		1,076	1,077	1,088	1,109

The Japanese yen



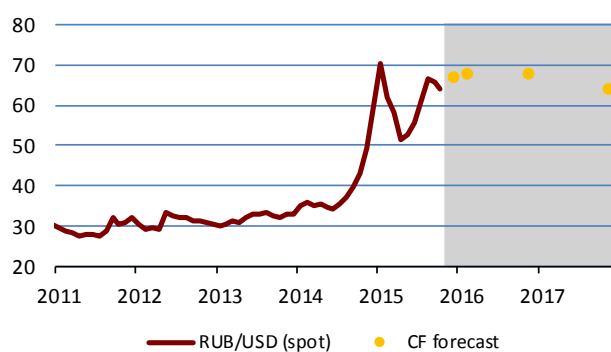
	9/11/15	12/15	02/16	11/16	11/17
spot rate	123,2				
CF forecast		122,6	123,7	125,3	125,4
forward rate		123,1	122,9	121,6	119,0

The Brazilian real



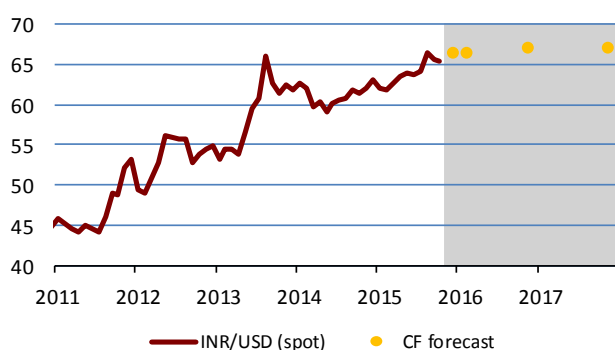
	9/11/15	12/15	02/16	11/16	11/17
spot rate	3,795				
CF forecast		4,026	4,090	4,161	4,037

The Russian rouble



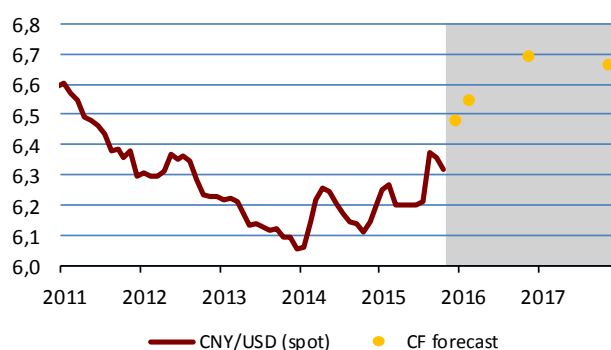
	9/11/15	12/15	02/16	11/16	11/17
spot rate	64,52				
CF forecast		67,13	67,67	67,57	64,20

The Indian rupee



	9/11/15	12/15	02/16	11/16	11/17
spot rate	66,40				
CF forecast		66,37	66,40	66,94	67,04

The Chinese renminbi



	9/11/15	12/15	02/16	11/16	11/17
spot rate	6,362				
CF forecast		6,483	6,550	6,694	6,664

Exchange rates as of last day of month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibility of hedging future exchange rate.

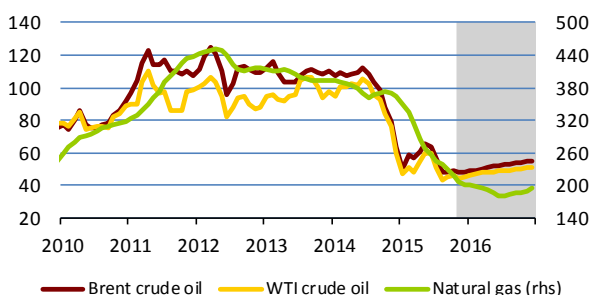
V.1 Oil and natural gas

After a calm-down in September, the Brent crude oil price was volatile again in October, rising by more than 11% to USD 53 a barrel (bbl) in five days at the start of the month in response to an EIA report saying that the oil surplus would shrink earlier than originally expected. However, the oil price fell for virtually the entire remainder of October. Another, albeit smaller, rise was recorded in late October and early November, when the price increased by almost USD 4/bbl to USD 50.5/bbl over a short period due to a significant drop in the drilling rig count in the USA. Since then, however, the Brent oil price has been following an exclusively downward trend, which gained in intensity in the second week of November. The faster decline in prices was due to continued strong growth in US oil stocks despite a falling extraction volume.

The market price forecast based on the 9 November futures curve shifted downwards by around USD 2/bbl, implying an average price of USD 52.4/bbl for 2016. The EIA also lowered its Brent price outlook for 2016 by the same extent, but still expects faster price growth (to USD 56/bbl on average; the expected WTI price is USD 5/bbl lower on average). The November CF expects a similar trend in 2016, mentioning a Brent price of USD 57.5/bbl one year ahead. The IEA's World Energy Outlook does not expect the oil price to exceed USD 80/bbl by 2020 despite a massive drop in investment in extraction and exploration in 2015 and 2016.

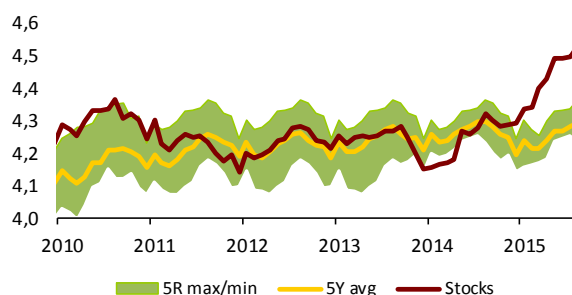
Natural gas prices fell in Europe and the USA (the price at the Henry Hub dropped below USD 2/MMBtu at the end of October for the first time since April 2012). This was due to high stocks, unusually warm weather and a large supply of pipeline gas and LNG.

Outlook for prices of oil (USD/barrel) and natural gas (USD / 1000 m³)

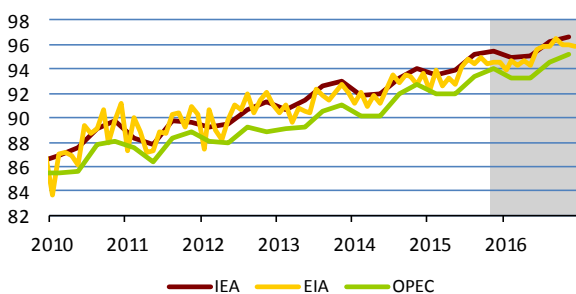


	Brent	WTI	Natural gas
2015	54,55 ↘	49,61 ↘	262,30 ↘
2016	52,35 ↘	48,88 ↘	189,36 ↘

Total stocks of oil and oil products in OECD (bil. barrel)

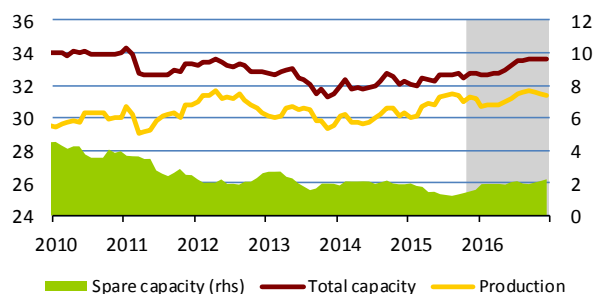


Global consumption of oil and oil products (mil. barrel / day)



	IEA	EIA	OPEC
2015	94,51 ↘	93,87 ↘	92,85 ↘
2016	95,72 ↘	95,26 ↘	

Production, total and spare capacity in OPEC countries (mil. barrel / day)



	Production	Total capacity	Spare capacity
2015	30,96 ↘	32,45 ↘	1,50 ↘
2016	31,19 ↘	33,19 ↘	2,01 ↘

Note: Oil price in USD/barrel, price of Russian natural gas at German border in USD/1,000 m³ (IMF data, smoothed by the HP filter). Future oil prices (grey area) are derived from futures and future gas prices are derived from oil prices using model. Total oil stocks (commercial and strategic) in OECD countries including average, maximum and minimum in past five years in billions of barrels. Global consumption of oil and oil products in millions of barrels a day. Production and extraction capacity of OPEC in million barrels a day (EIA estimate).
 Source: Bloomberg, IEA, EIA, OPEC, CNB calculation

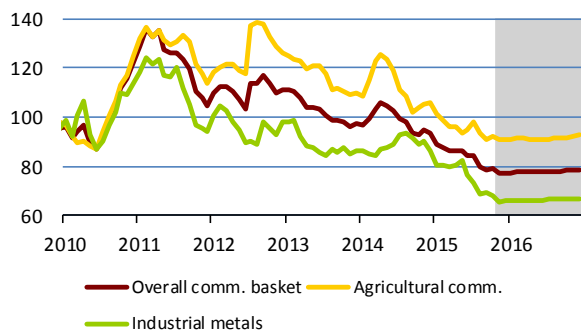
V.2 Other commodities

The average monthly non-energy commodity price index rose slightly in October, interrupting an almost 18-month-long downward trend, but in mid-November it dropped again. The food commodity price sub-index showed a similar pattern. The drop in the industrial metals sub-index came to a temporary halt in September, but started again in October. The outlooks for all three indices are modestly rising.

Wheat prices are flat with minor swings after a rise in September, while corn prices are slightly falling. The soy price has been flat at a more than eight-year low since September, held down by an estimate of high stocks after this year's harvest due to high production in Brazil. In contrast, the price of rice has been recording a strong growth trend since May. According to the USDA, this year's rice stocks will be the lowest since 2008 due to dry weather in Thailand and India. The rice price stopped going up in early October and reversed part of its previous gains during the month. Sugar prices have been rising sharply since mid-September due to dry weather and a lower expected harvest in India, China and the EU. Pork prices, by contrast, have dropped markedly since mid-October. The price of rubber also posted a significant decline.

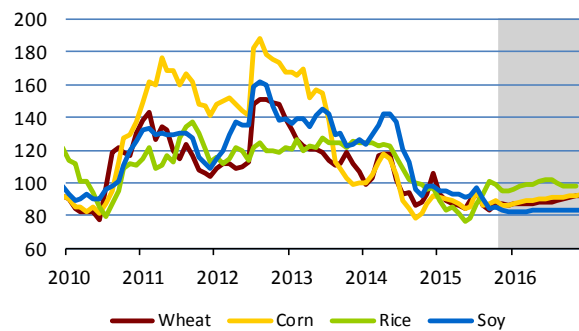
Aluminium prices started falling again after a temporary rise in September. Aluminium output remains high particularly in China despite the lowest prices since 2009. Copper, tin and zinc prices also fell slightly. Prices of iron ore also dropped at the end of October, with the three largest producers reporting annual growth in extraction in Q3, while global steel output fell year on year. Commodity prices have also been under pressure since the start of November due to renewed strengthening of the dollar.

Non-energy commodities price indices



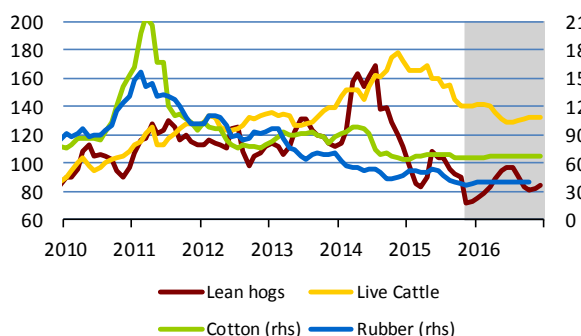
	Overall	Agricultural	Industrial
2015	83,0	94,8	74,3
2016	78,0	91,5	66,5

Food commodities



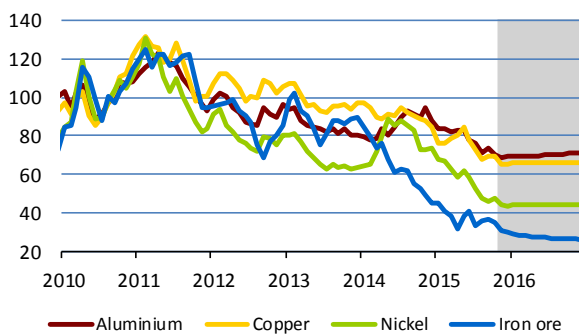
	Wheat	Corn	Rice	Soy
2015	87,9	88,2	88,7	90,2
2016	89,0	90,5	99,2	83,3

Meat, non-food agricultural commodities



	Lean hogs	Live Cattle	Cotton	Rubber
2015	91,4	155,1	67,4	46,2
2016	86,6	133,9	67,3	

Basic metals and iron ore



	Aluminium	Copper	Nickel	Iron ore
2015	76,8	73,6	54,9	36,4
2016	70,1	66,1	44,1	27,2

Note: Structure of non-energy commodity price indices corresponds to composition of The Economist commodity indices. All prices are given as indices, 2010 = 100 (charts) and percentage changes (tables).
Source: Bloomberg, CNB calculations.

Central banks' gold reserves¹

This article sets out to summarise the facts about the role of gold in central banks' reserves. Despite having lost its unique status in the international monetary system, gold maintains a strong position not only with central banks, but also with private investors thanks to its ability to reduce systemic risk and preserve value. The following paragraphs therefore outline the role of gold in the reserves of central banks and the IMF. Some countries – e.g. China, Russia and India – are currently seeking to change the role of gold in their economies and in the financial system as a whole. This phenomenon is therefore also dealt with in this article.

1 Introduction

Gold was the cornerstone of the international monetary system for hundreds of years. In modern history, it became the basis of the gold standard, whose era started in the early 1870s. However, the role of the gold standard was restricted significantly after the end of World War I. In the 1930s, central banks started to reduce the amount of gold in their reserves and gradually abolished their gold standards. Gold returned to the international monetary system after World War II as a key element of the Bretton Woods system, within which it was closely tied to the US dollar, to which other currencies were then linked. However, gold lost its role after the closure of the Gold Window in August 1971, a measure which ended the convertibility of the dollar into gold (Bott, 2013). Nevertheless, gold has maintained a significant position in the forex reserves of some central banks despite the fact that it bears no interest and is expensive to store. In addition to historical and reputational reasons, gold is currently used to reduce systemic risks to the financial system, and especially to strengthen the banking system and increase liquidity on financial markets (World Gold Council, 2015b).

Besides central banks, conservative investors include gold in their portfolios. In general, gold is seen as an important store of value due to its scarcity and durability. This perception of gold is especially prevalent in some Asian countries, where people often do not trust the state, banks and the current "fiat money".

2 Central banks and gold

Central banks remain the biggest holders of gold reserves. As of the end of 2014, they held about 30,900 tonnes of gold, i.e. about one-fifth of all the gold that has ever been mined. This gold is highly concentrated in the advanced countries of Western Europe and North America, the remnant of the gold standard from the last century. The IMF also has a substantial gold reserve (also a legacy of the Bretton Woods system).

Chart 1 shows the amounts of gold held by the monetary authorities of the ten countries with the biggest gold reserves. The biggest-ever holder of gold is the United States. However, according to the data below, Germany and France are also major holders of gold reserves. The IMF also owns a large amount of gold – more than 3,000 tonnes. Between 2000 and 2015, the biggest seller of gold was the Swiss central bank, while the largest buyer was the Chinese central bank.

As indicated in Chart 1, emerging economies such as China and Russia, which have started to rapidly accumulate gold in their reserves, have recently been catching up with the advanced countries as regards holdings of physical gold. They are amassing between 100 and 200 tonnes of the commodity a year. Their goal is so called de-dollarization of the world economy and introduction of a new monetary order. Both these countries would like to back their currencies with gold. The countries accumulating gold also include Kazakhstan, Ukraine and Belarus. Almost 50% of world demand for gold

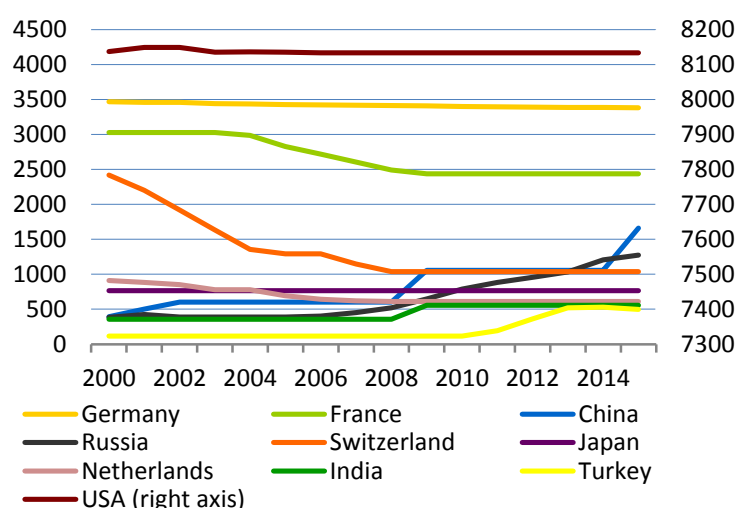


Chart 1 Gold reserves in tonnes

Source: World Gold Council (2015)

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comes from China and India. China is simultaneously the world's largest gold producer, followed by Australia and Russia (Nichols, 2015).

Moreover, China is trying to support gold trading directly in the Asian region. In May this year, it created a gold fund with the aim of allocating capital in physical gold, based on mining projects in 60 countries which have become members of the fund. These countries are part of the 21st-Century Maritime Silk Road and the Silk Road Economic Belt, which interconnect Asia, Europe and Africa (that is, China with the Gulf and Mediterranean countries via Central Asia and the Indian Ocean). The fund is administered by the Shanghai Gold Exchange. This will result in a partial shift in gold trading from London to Shanghai. For its member central banks, the fund provides easier access to gold, enables them to purchase it at a good price and ensures the supply of gold from West to East (O'Byrne, 2015). The gold fund opens the door for China to become a monetarily important destination for gold. The country also wishes to increase its influence on the gold price by partially opening up the Chinese gold market to foreign investors.

Trading in gold by central banks is very specific. In the past, the gold market recorded sharp price swings due to uncoordinated sales. It has become more stable and transparent thanks to gold agreements (Central Bank Gold Agreement), which central banks have been observing since 1999. These agreements are beneficial to all market participants – producers, industrial companies, investors, consumers and central banks. They limit the amount of gold which central banks can sell in any one year and are reviewed at five-year intervals. The agreements include several interrelated principles. The main benefit is that gold sales are now coordinated. In addition, the European Central bank has set a duty for euro area central banks to maintain 15% of their forex reserves in gold under these agreements. The most recent agreement, signed in 2014, confirmed the previous principles, with the signatories confirming that they do not have any plans to sell significant amounts of gold in the next five years (World Gold Council, 2015a).

3 The International Monetary Fund and gold

Gold was the cornerstone of the Bretton Woods monetary system, and hence also of the IMF. Following the official collapse of the Bretton Woods system in 1973, however, the position of gold in the IMF gradually diminished and its central role was later taken over by the SDR payment unit.² Still, gold maintains a specific position within the IMF's reserves.

The IMF currently holds around 90.5 million ounces (which is about 3,000 tonnes) of gold. This puts it in third place behind the United States and Germany. Chart 2 plots the IMF's gold holdings between 1948, when the fund incorporated gold into its reserves, and 2014. The amount of gold in the IMF's reserves was increasing while the Bretton Woods monetary system was in operation. After the convertibility of the dollar into gold was ended and the IMF switched from gold to the SDR, the IMF's gold reserves declined to a level which then stayed unchanged for more than 30 years. Chart 2 also shows the amount of gold reserves expressed in terms of the current gold price. It reveals that the gold price, and hence also the value of the IMF's gold holdings, has increased markedly in the last ten years despite further sales.

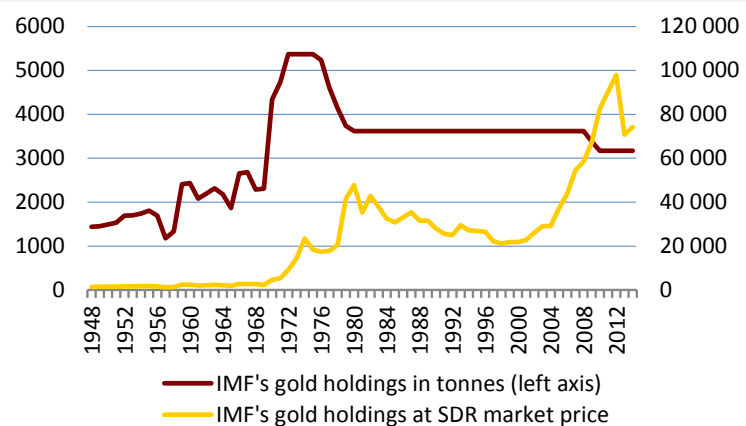


Chart 2 The IMF's gold holdings

Source: DataStream. IMF – IFS (2015)

The IMF obtained gold through four channels in Bretton Woods system:

- from quota payments (25% of total quotas were paid in gold)
- from payments of charges (interest on loans was usually paid in gold)
- from the sale of currencies (if countries wanted to exchange their currencies, they did so through the IMF by selling it gold, for which they then received the desired currencies)

² The SDR (Special Drawing Right) is an international reserve asset created by the IMF in 1969 to support the Bretton Woods fixed exchange rate system. It is used as a unit of account by the IMF as well as by some other international organisations. The value of the SDR is currently determined by a basket of currencies, namely USD, EUR, JPN and GBP (International Monetary Fund, 2015b). See the August 2015 issue of Global Economic Outlook for more details.

- from early loan repayments (such loans could only be repaid in gold)

Officially, the role of gold in the international monetary system ended in April 1978, when it was replaced by the SDR at the IMF. Moreover, restrictions were placed on the IMF's gold dealings at that time. This did not change until 2009, when the IMF was allowed to sell gold from its reserves under the above-mentioned central bank gold agreements.

The IMF decided to sell one-eighth of its gold, i.e. 403.3 tonnes (12.97 million ounces). The sales started in 2009, initially to central banks. Gold was sold to central banks of India (212 tonnes), Mauritius (2 tonnes) and Sri Lanka (10 tonnes). In 2010, the fund also began sales of gold on the market, where it sold 191.3 tonnes. The same year, the central bank of Bangladesh bought 10 tonnes of gold from the IMF (International Monetary Fund, 2015a).

4 Central banks' specific problems: The case of India

As indicated in the introduction, gold has a unique position among value-preserving assets. The case of India can be used to illustrate central banks' efforts to change the role of gold in the economy towards the model common in Western economies. Besides concentration of gold in the central bank, India's measures will lead to an increase in financial intermediation, and hence also to pressure for development of the financial system.

Indians are traditionally major investors in gold (mostly gold jewellery). They hold only 10% of their gold savings in bars and coins. Gold has more than just a traditional character for its owners. It also serves as a store of value for savings, can be used as a universal payment instrument, protects wealth in times of uncertainty and is very liquid. By contrast, its disadvantages include high transaction costs, the risk of theft unless gold savings are deposited in bank safes (which, however, is expensive), the volatility of the gold price, and potential debasement (i.e. reduction of the gold content relative to the stated nominal value) and the difficulty of determining the gold content of jewellery.

Strong demand for gold as a store of value has resulted in a surge in gold imports into the country. Between January and September 2015, more than 660 tonnes of gold were imported into India. At the current rate of growth, it is estimated that imports will reach 1,000 tonnes for the year as a whole. Even high import duties and other import restrictions have failed to prevent the high gold imports. The amount of silver imported has also been rising.

As a result, the Indian government unveiled two new programmes at the start of September – the Gold Monetization Scheme and the Sovereign Gold Bond Scheme. The main objective is to mobilise the surplus of gold reserves held by private entities (Indian Government, 2015). As a result, this gold will enter into circulation, giving jewellers a new way of obtaining gold for their products. Gold will thus not lie idle, but will generate tax-free interest for its owners. At the same time, the country's reliance on gold imports will drop and the current account deficit will decrease. Both programmes are scheduled to start in November 2015. Moreover, they will be accompanied by the issue of the first ever gold coins in India. Until now, India's inhabitants have been able to obtain gold coins and bars only by importing them from abroad. The coins will thus serve as an alternative to gold bonds.

The project is a revamp of a similar programme dating from 1999, which failed because of low interest rates. The amount of interest paid on gold deposits will thus be a key element of the current project. Moreover, the original plan met with apathy among the public, who prefer investment in gold to long-term deposits. The government estimates that it will obtain up to 20,000 tonnes of gold held by households under the mechanism. The revamped scheme is supported by the World Gold Council, the market development organisation for the gold industry.

Gold Monetization Scheme: The Indian government has introduced this scheme with the aim of putting gold held by households and investors into circulation. The project is divided into two interrelated parts: gold deposits for the public and gold loans to jewellers. Customers will be able to deposit a minimum of 30 grams of gold for 1–3 years, 5–7 years or 12–15 years. Jewellery and coin holdings will initially have to pass a purity test and will be melted before becoming a deposit on a gold account. Redemption will then be made in two ways. In the short term, the depositor may choose between gold and cash, but in the medium and long term redemption will only be in cash. The current scheme will offer higher interest rates than the previous 1999 effort (the government expects to pay interest of between 1.5% and 2%, and possibly even higher). Another key feature is that the risk will be transferred to a Gold Reserve Fund established by the government. Under the aegis of the central bank, the Fund will guarantee that the amount due is paid back and the payment is at least equal to the deposit value. Deposits will therefore not be jeopardised by any drop in the gold price. Jewellers will then be able to obtain this gold for their products thanks to gold loans from banks (Indian Finance Ministry, 2015a).

Sovereign Gold Bond Scheme: The Indian government also wants to shift part of the public's physical gold holdings into bonds. The bonds will use gold only as an underlying asset and could be attractive to investors due to their link to gold. The government expects up to 300 tonnes of gold to be invested every

year. Gold bonds will be issued in Indian rupees in denominations of 5, 10, 50 and 100 grams of gold, mostly for tenors of 5–7 years. An important part of the project is an investment cap of 500 grams of gold per person per year. The bonds will then be redeemed in Indian rupees. However, gold bonds are not hedged against the risk of a drop in gold prices, which is borne entirely by the investor. In this case, the Gold Reserve Fund is only responsible for paying interest and subsequently redeeming the entire amount due at the current rupee price of gold, and also for taking any steps necessary to maintain the sustainability of the system.

Five aspects of the scheme enhance its attractiveness. The first is the yield – fixed or floating. It is predicted that the government may opt for an annual yield of more than 3% given internal and external market conditions. Another attraction is the possibility of obtaining a loan against gold bond collateral, often at more advantageous terms. A third benefit is the distribution of costs, because all costs related to the distribution, sale and issue of the bonds will be covered by the government. Another indisputably positive aspect is the introduction of tax bonuses. The last factor is liquidity. The tenor will be 5–7 years, but the bonds can be traded at any time (Indian Finance Ministry, 2015b).

5 Conclusion

Gold formed the basis of the international monetary system for hundreds of years. The situation changed only after the dollar's convertibility into gold was ended and gold was replaced by the SDR at the IMF. Gold remains a part of forex reserves and serves for their diversification to this day. Many central banks thus continue to hold a significant amount of gold in their reserves. Some banks have even been increasing their gold reserves in recent years, despite the fact that gold bears no interest and is expensive to store. For private investors, gold is a store of value. Using the example of India, we demonstrated how the role of gold in the economy can be changed and private investments can be shifted from physical gold into bonds with gold as the underlying asset. However, it remains to be seen in the coming months whether India's gold monetisation and gold bond schemes will be successful.

Source:

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A1. Change in GDP predictions for 2015

	CF		IMF		OECD		CB / EIU	
EA	0	2015/11	0	2015/9	-0,1	2015/11	-0,1	2015/9
		2015/10		2015/7		2015/9		2015/6
US	-0,1	2015/11	+0,1	2015/9	0	2015/11	+0,2	2015/9
		2015/10		2015/7		2015/9		2015/6
DE	-0,1	2015/11	-0,1	2015/9	-0,1	2015/11	+0,7	2015/6
		2015/10		2015/7		2015/9		2014/12
JP	0	2015/11	-0,2	2015/9	0	2015/11	-0,5	2015/10
		2015/10		2015/7		2015/9		2015/7
BR	-0,2	2015/11	-1,5	2015/9	-0,3	2015/11	0	2015/11
		2015/10		2015/7		2015/9		2015/10
RU	-0,1	2015/11	-0,4	2015/9	-0,9	2015/11	0	2015/11
		2015/10		2015/7		2015/6		2015/10
IN	0	2015/11	-0,2	2015/9	0	2015/11	0	2015/11
		2015/10		2015/7		2015/9		2015/10
CN	+0,1	2015/11	0	2015/9	+0,1	2015/11	+0,1	2015/11
		2015/10		2015/7		2015/9		2015/10

A2. Change in inflation predictions for 2015

	CF		IMF		OECD		CB/EIU	
EA	0	2015/11	+0,1	2015/9	-0,5	2015/11	-0,2	2015/9
		2015/10		2015/4		2015/6		2015/6
US	-0,1	2015/11	-0,0	2015/9	-0,0	2015/11	-0,3	2015/9
		2015/10		2015/4		2015/6		2015/6
DE	0	2015/11	-0,0	2015/9	-1,1	2015/11	-0,6	2015/6
		2015/10		2015/4		2015/6		2014/12
JP	0	2015/11	-0,3	2015/9	-1,0	2015/11	-0,6	2015/10
		2015/10		2015/4		2015/6		2015/7
BR	+0,4	2015/11	+1,1	2015/9	+0,5	2015/11	0	2015/11
		2015/10		2015/4		2015/6		2015/10
RU	+0,7	2015/11	-2,1	2015/9	-0,7	2015/11	+0,1	2015/11
		2015/10		2015/4		2015/6		2015/10
IN	0	2015/11	-0,7	2015/9	-1,4	2015/11	0	2015/11
		2015/10		2015/4		2015/6		2015/10
CN	-0,1	2015/11	+0,3	2015/9	+0,1	2015/11	-0,1	2015/11
		2015/10		2015/4		2015/6		2015/10

A3. List of abbreviations

ABS	asset-backed securities	GDP	gross domestic product
bbl	barrel	HICP	harmonised index of consumer prices
BoJ	Bank of Japan	CHF	Swiss franc
BR	Brazil	ICE	Intercontinental Exchange
BRIC	countries of Brazil, Russia, India and China	IFO	Institute for Economic Research
BRL	Brazilian real	IFO-BE	IFO Business Expectations
CB-CCI	Conference Board Consumer Confidence Index	IMF	International Monetary Fund
CB-LEII	Conference Board Leading Economic Indicator Index	IN	India
CBOT	Chicago Board of Trade	INR	Indian rupee
CBR	Central Bank of Russia	IRS	Interest Rate swap
CF	Consensus Forecasts	JP	Japan
CN	China	JPY	Japanese yen
CNB	Czech National Bank	LI	leading indicators
CNY	Chinese renminbi	LIBOR	London Interbank Offered Rate
DBB	Deutsche Bundesbank	MER	Ministry of Economic Development (of Russia)
DE	Germany	MMBtu	million of British Thermal Units
EA	euro area	OECD	Organisation for Economic Co-operation and Development
EBRD	European Bank for Reconstruction and Development	OECD-CLI	OECD Composite Leading Indicator
EC	European Commission	PMI	Purchasing Managers' Index
ECB	European Central Bank	PPI	producer price index
EC-CCI	European Commission Consumer Confidence Indicator	RU	Russia
EC-ICI	European Commission Industrial Confidence Indicator	RUB	Russian rouble
EIA	Energy Information Administration	TLTRO	targeted longer-term refinancing operations
EIU	Economist Intelligence Unit	UoM	University of Michigan
EU	European Union	UoM-CSI	University of Michigan Consumer Sentiment Index
EUR	euro	US	United States
EURIBOR	Euro Interbank Offered Rate	USD	US dollar
Fed	Federal Reserve System (the US central bank)	USDA	United States Department of Agriculture
FOMC	Federal Open Market Committee	WEO	World Economic Outlook
FRA	forward rate agreement	WTI	West Texas Intermediate (crude oil used as a benchmark in oil pricing)
GBP	pound sterling		

A4. List of thematic articles published in the GEO

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