About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight, and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors. We provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

Based in the UK, with operations in India, the Far East and the US, the World Gold Council is an association whose members comprise the world’s leading gold mining companies.

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A Central Banker’s Guide to Gold as a Reserve Asset from the World Gold Council covers a very topical issue – the meaningful growth in central bank demand for gold in recent years. An increasing number of countries have decided to again designate a dominant role to gold. Preserving its historical role, gold continues to be one of the safest assets in the world, which enhances stability and confidence.

Magyar Nemzeti Bank (National Bank of Hungary), June 2019

Gold has a very long history as a reserve asset for most central banks, who have been major holders of gold since their foundation. This report is a very useful and practical guidance for any reserve manager who is interested in covering the key drivers of gold’s official demand and the main aspects to consider when managing and accounting a gold’s portfolio.

Mario L Torriani, CFA
Reserves Administration Senior Manager, Banco Central de la República Argentina (Central Bank of the Argentine Republic), June 2019

The Guidance on Accounting for Monetary Gold issued by the World Gold Council represents an excellent solution, as the accounting treatment of monetary gold in central banks is not regulated by IFRS but many central banks have to comply with it. This Guidance incorporates the IFRS principals and the specific role that monetary gold has as a part of FX reserves in central banks. The Central Bank of Bosnia and Herzegovina has applied the Guidance to set its new accounting policy for monetary gold.

Edis Kovačević, M.Sc.
Head of Accounting and Finance Department, Centralna banka Bosne i Hercegovine (Central Bank of Bosnia and Herzegovina), June 2019
Foreword

Given that Germany’s currency has collapsed twice in the past 100 years, the Bundesbank’s gold reserves have always enjoyed a high level of public trust. Not only do they guarantee stability and value, they are also an expression of the revitalisation of the German economy after the end of the Second World War.

Burkhard Balz  
Member of the Executive Board of the Deutsche Bundesbank

It is precisely this view of gold as a reserve asset and stability anchor that now appears to have been gaining acceptance in more and more countries around the globe since the financial and sovereign debt crisis. As this report highlights, in the past two years, just over a dozen of them have been substantially augmenting their national gold reserves. Storing government gold in secure vaults as an emergency reserve now seems to be the preferred option, rather than selling it.

When it comes to its gold reserves, the Deutsche Bundesbank’s recent main focus has been on enhancing transparency and fostering dialogue. Providing information on gold not only satisfies the curiosity and interest of the general public, but also awakens a new need for information. This has also been the Bundesbank’s experience, and the German public’s interest in gold is as great as ever. The Bundesbank met this public need for information by issuing a new publication, “Germany’s Gold,” in mid-2018, in which it gave the first detailed description of how its gold reserves came into existence and how they have been used since the end of the Second World War.

Other central banks and institutions have also made great strides in their initiatives to enhance transparency in the gold market, as outlined in this report. More and more central banks are now deciding to publish information on the storage volumes and locations of their gold reserves in their annual reports and to make such disclosures available to any members of the public who may be interested. Aggregated inventory data have been published regularly for some years now, and, since November 2018, this has also been augmented by transaction data from the world’s most important gold market, London, which has again significantly enhanced transparency and given further guidance to market participants. And, finally, significant efforts and attempts are now being made to ensure that the origins of gold can be traced with certainty along its entire value chain. In the years to come, blockchain technology will probably be able to offer further valuable assistance here. Even the gold market, previously thought to be such an analogue world, will not be left untouched by digitalisation.
Today, central banks own almost 34,000 tonnes (t) of gold, making it the third largest reserve asset in the world. The increase in central bank demand for gold reflects current geopolitical, political and economic conditions, as well as structural changes in the global economy. Gold is both a liquid, counter-cyclical asset and a long-term store of value. As such, it can help central banks meet their core objectives of safety, liquidity and return.

In response to their growing interest in gold, this publication is designed to serve as a comprehensive guide to reserve managers on the role of gold in international reserves. It explores the motives behind the strengthening and broadening of central bank demand for gold and examines how gold can help reserve managers to meet their policy objectives. The World Gold Council’s 2019 annual survey on Central Bank Gold Reserves (June 2019) and the World Bank’s inaugural Reserve Advisory Management Program (RAMP) Survey on the Reserve Management Practices of Central Banks (2019) provide further valuable insights in this respect.

Our report also considers key operational aspects of the gold market. These include the global Over-the-Counter (OTC) market, the benefits of buying gold from local producers and the upgrading of gold stocks. We also cover common active gold management strategies, along with technical illustrations, that demonstrate how to generate a return on gold holdings and how to deploy gold for liquidity management. Finally, the report describes custody options and provides expert guidance on accounting for monetary gold.

We would like to express our sincere gratitude to: the Deutsche Bundesbank for their Foreword; the central banks of Argentina, Bosnia and Herzegovina, and Hungary for their kind endorsement of our report; and the central bank of the Philippines for allowing us to publish a short case study on their local buying programme. Our advisory board members, Jennifer Johnson Calari and Isabelle Strauss-Khan have also been instrumental in helping us put this publication together.
The strategic objectives of international reserves

The International Monetary Fund (IMF) defines international reserves as: “those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy and serving as a basis for foreign borrowing”).

In summary, international reserves are held to help smooth short-term external balances and to serve as a bulwark against unknown future risks.

International reserves are generally, but not universally, owned and managed by central banks. In a few instances, reserves are owned or managed by the Ministry of Finance or Treasury Department. According to IMF reporting standards, international reserves must be held in convertible currencies or in gold, so they can be easily deployed during times of crisis. The eligibility of assets is typically determined by their creditworthiness, liquidity, and contribution to the risk profile of the portfolio as a whole.

Given the dual objectives of precautionary liquidity and a store of value for future contingencies, central banks often tranche their reserves into a “liquidity tranche” to meet potential short-term drawdowns and an “investment tranche,” which has a longer investment horizon and places a greater emphasis on portfolio returns. Tranching is typically used to facilitate communication amongst policy-makers about the appropriate trade-off between liquidity and return.

Some central banks meet both objectives by managing the portfolio on an integrated basis.

Whether the portfolio is tranched or managed holistically, the strategic asset allocation defines a target level of liquidity, typically invested in high-quality, countercyclical assets for potential drawdowns during times of instability. Reserves invested to generate return over longer horizons are typically pro-cyclical and may include fixed-income credit or equities. Gold is generally considered to be a strategic asset that can be deployed for both short-term liquidity management and as a store of value over time. As such, it is generally held in a non-discretionary stand-alone portfolio.

Central banks can actively manage their gold reserves, typically via deposits and swaps. To do so, reserve managers must ensure that their gold meets certain standards and the necessary legal agreements are in place, so it can be mobilised quickly during periods of crisis. Central banks also buy and sell gold as part of their regular rebalancing operations.

Evolution of international reserves

In times gone by, international reserves were effectively a proxy for gold. Before the Second World War, issuer countries guaranteed conversion of their currencies into the equivalent in gold at a pre-determined price. Following the war and the depletion of many countries’ gold stocks, the US dollar became the predominant reserve currency, as the US government continued to guarantee conversion of its currency to gold. This came to an end in 1971, when President Nixon severed convertibility of the US dollar to gold at a pre-determined price.

Nevertheless, the US dollar remained the dominant currency within the international monetary system and international reserves were mainly held in US government securities bearing the full faith and credit of the government. The role of gold within the new system was widely debated and advanced economies began gradual and measured net sales of their vast holdings. In Europe these took place under the Central Bank Gold Agreement (CBGA), which was first signed in 1999.3

Over the past two decades, however, international reserves management has undergone a sea change in response to important macro-economic trends and events, including:

- the rapid increase in central banks’ international reserves both in outright nominal terms and as a share of GDP from 2000 onwards;
- the launch of the euro in 1999;
- the gradual shift from a system of fixed exchange rates to one dominated by a form of floating rates, where central banks have more discretion if and when to intervene;
- the Global Financial Crisis (GFC) of 2007-08 and the Eurozone Crisis of 2010-12; and,
- the rise of China as a major economic force.

At the outset of this century, most central banks focused mainly on liquidity management, investing in high-quality, short-duration government debt and money market instruments. But the GFC, followed by the Euro Crisis and the ensuing period of negative interest rates, provided a catalyst for change.

Central banks’ steps to stimulate demand for credit led to negative interest rates on some of the main reserve assets, violating capital preservation objectives – in both nominal and real terms. This led some central banks – principally in advanced economies – to diversify into riskier asset classes to preserve capital. At the same time, advanced central banks elected to virtually stop selling their gold stocks and emerging market and developing economy (EMDE) central banks began to steadily increase theirs through a pattern of sustained and broadening gold purchases.4

4 The categorisation of advanced economies and emerging market and developing economies (EMDE) follows the classification of countries by the IMF. Source: IMF World Economic Outlook April 2019 report; Statistical Appendix, Page 133-138.
Recent trends in gold reserves

In 2018, central bank net purchases of gold totalled 651t, up 74% year-on-year,\(^5\) the highest level of annual net purchases since the suspension of US dollar convertibility into gold in 1971. Over the past decade, central banks have purchased more than 4,300t of gold, bringing total holdings to nearly 34,000t. The vast majority of demand has come from EMDE central banks and this remains the case today.

But the pattern of demand has changed. In 2016, demand was highly concentrated in Russia, China and Kazakhstan (Chart 1). By 2018, it had become far more diverse, with 19 individual central banks buying over one tonne of gold, according to IMF data. Countries that had been absent from the gold market for many years became notable buyers of gold. Even the European Union re-emerged as a net buyer, due to substantial purchases from Poland and Hungary (Chart 2).

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Central bank buying remained robust in H1 2019. The National Bank of Poland announced in July 2019 that it had accumulated a further 100t, following its 25.7t purchase in 2018. China, India, Russia, Kazakhstan, Kyrgyzstan, Uzbekistan and Turkey have also made large purchases this year.

In a further sign of central banks’ positive sentiment towards gold, the European Central Bank (ECB) announced that its 20-year old Central Bank Gold Agreement would not be renewed when it expires in September 2019. The ECB said that it and the 21 other central banks that are signatories to the agreement: “confirm that gold remains an important element of global monetary reserves, as it continues to provide asset diversification benefits and none of them currently has plans to sell significant amounts of gold.” The ECB also noted that: “signatories have not sold significant amounts of gold for nearly a decade, and central banks and other official institutions in general have become net buyers of gold.”

Despite the pace of buying, the share of gold in EMDE countries’ reserves remains relatively low. The overall allocation is 5%, compared with 16% for advanced economies (Chart 3), though there are large differentials between countries. This suggests there is ample scope for continued growth. The National Bank of Poland cited its hitherto relatively low share of gold to total reserves, in comparison to other European countries, as a key reason for its decision to buy gold.

Factors driving central bank gold demand

In June 2019, the World Gold Council conducted its second annual Central Bank Gold Reserves (CBGR) survey. 11% of EMDE central banks surveyed said they intend to increase their gold reserves over the next 12 months. This is similar to last year’s purchases, when 12% of the world’s 155 EMDE central banks bought gold. A number of factors lie behind their continued interest in gold.

The reserve management objectives of EMDE countries are focused on self-insurance against balance of payments crises. This makes gold especially well suited in the current environment given its tendency to rally during times of systemic financial stress (see: Safety, liquidity and return).

In its inaugural RAMP Survey on the Reserve Management Practices of Central Banks, the World Bank surveyed 99 central banks on their motives for holding foreign reserves. The banks were given five options: to provide self-insurance against potential external shocks; conduct foreign exchange policy; service external debt obligations; support monetary policy operations, and ensure savings for intergenerational equity. The results were categorised by: low-income; lower-middle income; upper middle-income; high-income non-reserve and high-income reserve countries.

One-hundred percent of respondents in the low and lower middle-income groups cited “self-insurance against potential external shocks” as highly relevant (Chart 4). This compared with 87% in upper middle-income, 81% in non-reserve high income countries and 44% in reserve high income countries. 100% of respondents in low-income groups also cited servicing external debt or obligations. Other motives were seen as much less important.

Chart 4: Lower middle and low-income countries hold reserves primarily for protection against shocks

<table>
<thead>
<tr>
<th>Motives for holding foreign exchange by country-income group</th>
<th>% of country-income group (N = 99)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide self-insurance against potential external shocks</td>
<td>81</td>
</tr>
<tr>
<td>Conduct foreign exchange policy</td>
<td>75</td>
</tr>
<tr>
<td>Service external debt or obligations</td>
<td>78</td>
</tr>
<tr>
<td>Support monetary policy operations</td>
<td>82</td>
</tr>
<tr>
<td>Ensure savings for intergenerational equity</td>
<td>100</td>
</tr>
<tr>
<td>Other</td>
<td>100</td>
</tr>
</tbody>
</table>


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For the second consecutive year, the World Gold Council has worked with YouGov to conduct a survey of central banks. The questionnaire was designed by World Gold Council and set-up on YouGov’s secure survey system before links to the survey were sent to central banks around the world. 39 central banks completed the survey.

The functional objectives of reserves, in turn, affect countries investment guidelines and their asset allocations. In June 2019, the World Gold Council conducted a review of the published investment guidelines of 65 central banks (Chart 5), 34 of which where EMDE and 31 were advanced economy central banks. The investment guidelines of EMDE central banks were found to be significantly narrower than their advanced economy counterparts. While all central banks’ investment guidelines permitted reserves to be held in gold, SDRs, IMF reserve balances, highly-rated sovereign debt and deposits, EMDE central bank guidelines are much more prohibitive around riskier assets, such as corporate debt and equities. Only one EMDE central bank said it was allowed to hold equities, and less than a third could hold corporate securities, derivatives, money market instruments or agency debt.

**Heightened economic and political risks**

The functional objectives of EMDE reserves and correspondingly tight investment guidelines means they are heavily exposed to the risks associated with advanced economy debt – and these are especially high at the moment. These include:

- Rising global inequality, which has fuelled social unrest and the rise of populist parties

- Greater polarisation of political parties, which increases the likelihood of large policy shifts from one administration to the next

- Deteriorating budget positions and ageing populations

- Growing trade disputes and protectionist policies

- Increasing challenges to central bank independence around the world and the threat of sovereign debt being monetised

- An increased threat of competitive currency wars.

Gold is the only reserve asset that bears no political or credit risk, nor can it be devalued by the printing presses or extraordinary monetary policy measures.

In addition, the structure of central bank portfolios is typically both short-dated – especially in EMDE countries – and US dollar centric. Negative interest rates and concerns about the outlook for the US dollar may also account for some of the gold demand from central banks.

The World Bank RAMP survey revealed that 69% of central banks sampled are limited to investment horizons of three years or less. In completing the picture, the IMF’s COFER data, shows that most foreign reserves are held in US dollars (61.82%), euros (20.24%) and Japanese yen (5.25%).

**Chart 5: EMDE countries have more restrictive investment guidelines than their advanced economy counterparts**

Permissible Investment Assets of 65 Central Banks (31 Advanced, 34 EMDE)

<table>
<thead>
<tr>
<th>Number of Central Banks</th>
<th>Gold</th>
<th>SDRs</th>
<th>IMF reserves</th>
<th>Sovereign debt</th>
<th>Deposits</th>
<th>Other</th>
<th>Repos</th>
<th>Corp securities</th>
<th>Money markets</th>
<th>Agency, MBS</th>
<th>Derivatives</th>
<th>Eurolands</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced economies</td>
<td>31</td>
<td>34</td>
<td>31</td>
<td>34</td>
<td>34</td>
<td>34</td>
<td>23</td>
<td>18</td>
<td>13</td>
<td>22</td>
<td>22</td>
<td>25</td>
</tr>
<tr>
<td>Emerging markets and developing economies</td>
<td>31</td>
<td>34</td>
<td>31</td>
<td>34</td>
<td>34</td>
<td>34</td>
<td>26</td>
<td>18</td>
<td>22</td>
<td>22</td>
<td>9</td>
<td>8</td>
</tr>
</tbody>
</table>

Source: The compilation of the central banks’ investment guidelines was done primarily through desk research focused on publicly available reserve management guidelines, as reported in the Central Bank Act/Charter of countries in question. When no such information was available, annual reports and other publications on reserve management guidelines were parsed for information.

This data set is a compilation of the international reserve management guidelines of 65 central banks that have made their reserve management guidelines publicly available and in the English language. Of the 65 central banks sampled, 31 are advanced economies, and 34 are emerging market and developing economies, as defined by the IMF.

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**A Central Banker’s Guide to Gold as a Reserve Asset**

10
Negative real and nominal interest rates
The short-dated nature of bonds held by central banks also means they are typically holding lower yielding – or more negative yielding – portfolios than other investors. This, in turn, reduces the opportunity cost of holding gold (Chart 6).

And for some, the outlook for the US economy is considered deeply uncertain. US policies are unpredictable, the US-China trade dispute is unresolved and the US budget deficit relative to GDP has reached a level previously seen during war time alone. Gold has a strong negative correlation to the US dollar (Chart 7) making it a good hedge against US dollar assets.

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Chart 6: The bunds' 3/10y spread is also at the lower end of its historical range
3Y and 10Y bund yields, and spread between 3Y and 10Y bund yields

![Chart 6: The bunds' 3/10y spread is also at the lower end of its historical range](source: Bloomberg, World Gold Council)

Chart 7: Gold is a good hedge against the US dollar
Correlation between gold and dollar index

![Chart 7: Gold is a good hedge against the US dollar](source: Bloomberg; data as of April 2019, World Gold Council)
The results of our 2019 CBGR survey validate these observations. When asked to rank the relevance of factors underpinning their decision to invest in gold, EMDE central banks put “long-term store of value” and “lack of default” in first and second position respectively. Gold’s role as “an effective diversifier” ranked joint third with “historical position.” (Chart 8)

Anticipation of changes in the international monetary system

Structural factors also seem to underlie central banks’ interest in gold. In the 2019 CBGR survey, 39% of EMDE central banks said that anticipated changes to the international monetary system were somewhat relevant to their decision to invest in gold. When the National Bank of Hungary increased its gold reserves tenfold last year, the bank said that gold may play a stabilising role and act as a major line of defence under extreme market conditions or in times of structural changes in the international financial system (Focus box 1).

Economic power is shifting from West to East. China is now the world’s largest economy on a purchasing-power parity basis. It is the largest trading nation in the world and has the third largest sovereign debt market. In recent decades, China has become a key driver of global growth and will play a major role for years to come.

The reconfiguration of the global economy and China’s rising global footprint will almost certainly have an impact on the international monetary system. China has already taken steps to internationalise its currency, by introducing a number of measures to promote renminbi cross-border settlements. An offshore renminbi market has been established and foreign investors have been given greater access to the Chinese bond market. In 2016, the renminbi was included in the IMF’s SDR basket, since then the share of the renminbi in international reserves has surpassed that of the Australian dollar and Canadian dollar, standing at 1.95% (as of Q1 2019). The inclusion of onshore Chinese bonds into global bond indices in April 2019 will provide a further impetus for foreign investment into onshore Chinese bonds.

The motivations for holding gold differ between advanced economies and emerging markets and developing economies. Advanced economies have large gold holdings as a legacy of the Bretton Woods system, which accounts for “Historical Position” being the primary reason for holding gold.

Emerging market and developing economy central banks cite gold’s long-term store of value as the top reason, while gold’s lack of default risk and its use as an effective portfolio diversifier are also main reasons. This perhaps highlights the fact that emerging market and developing economy central banks have much greater exposure to advanced economy sovereign debt and limited options to diversify.

Another stark difference between advanced economy views and emerging markets and developing economy views is that a significant portion of emerging market and developing economies (39%) anticipate changes in the international monetary system as a reason to hold gold while no advanced economies focused on this. Furthermore, 17% of emerging market and developing economies see their gold holdings as part of a de-dollarisation policy, while no advanced economies cited this.

Base: All central banks with gold holdings (32); Advanced economies (9); Emerging markets and developing economies (23)

<table>
<thead>
<tr>
<th>Factor</th>
<th>ALL</th>
<th>ADVANCED ECONOMIES</th>
<th>EMERGING MARKET AND DEVELOPING ECONOMIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical position</td>
<td>44%</td>
<td>50%</td>
<td>34%</td>
</tr>
<tr>
<td>Long-term store of value</td>
<td>50%</td>
<td>41%</td>
<td>28%</td>
</tr>
<tr>
<td>Effective portfolio diversifier</td>
<td>22%</td>
<td>22%</td>
<td>19%</td>
</tr>
<tr>
<td>No default risk</td>
<td>38%</td>
<td>25%</td>
<td>16%</td>
</tr>
<tr>
<td>Performance during times of crisis</td>
<td>28%</td>
<td>34%</td>
<td>25%</td>
</tr>
<tr>
<td>Lack of political risk</td>
<td>22%</td>
<td>22%</td>
<td>16%</td>
</tr>
<tr>
<td>Highly liquid asset</td>
<td>22%</td>
<td>19%</td>
<td>19%</td>
</tr>
<tr>
<td>Anticipation of changes in the international monetary system</td>
<td>22%</td>
<td>19%</td>
<td>19%</td>
</tr>
<tr>
<td>Policy tool</td>
<td>22%</td>
<td>19%</td>
<td>19%</td>
</tr>
<tr>
<td>Serves as valuable collateral</td>
<td>19%</td>
<td>19%</td>
<td>19%</td>
</tr>
<tr>
<td>Part of de-dollarisation policy</td>
<td>9%</td>
<td>19%</td>
<td>19%</td>
</tr>
</tbody>
</table>

Highly relevant | Somewhat relevant | Marginaly relevant | Not relevant

Most relevant | Second most relevant | Third most relevant

Base: All central banks with gold holdings (32); Advanced economies (9); Emerging markets and developing economies (23)
Focus box 1: Hungary’s gold reserves increased tenfold, reaching historical levels

Extracts from press release, republished with the kind permission of the National Bank of Hungary

Taking into account the country’s long-term national and economic policy strategy objectives, the Magyar Nemzeti Bank’s Monetary Council has decided to increase Hungary’s gold reserves significantly. As a result, the stock of precious metal rose from 3.1t to 31.5t, i.e. by a factor of ten, in October 2018. The Magyar Nemzeti Bank (MNB) purchased gold for the first time since 1986. Preserving its historical role, gold continues to be one of the safest assets in the world, which enhances stability and confidence even under normal market circumstances.

The Magyar Nemzeti Bank’s latest decision was driven by stability objectives; there were no investment considerations behind holding gold reserves. In normal circumstances, gold has a confidence-building feature, i.e. it may play a stabilising role and act as a major line of defence under extreme market conditions or in times of structural changes in the international financial system or deep geopolitical crises. In addition, gold continues to be one of the safest assets, which can be related to individual properties such as the limited supply of physical precious metal, which is not linked with credit or counterparty risk, given that gold is not a claim on a specific counterparty or country.

In recent years, an increasing number of countries have decided to again designate a dominant role to this precious metal functioning as a traditional reserve asset and to increase their gold reserves. Poland, for example, has followed this path recently, despite the fact that the country had previously held one of the largest gold reserves in the region. In increasing Hungary’s gold reserves to 31.5t, the MNB took into account the role this precious metal plays in central bank reserves both internationally and regionally. This meant that in Hungary the ratio of gold reserves to total foreign exchange reserves rose to 4.4 per cent, corresponding to the average of Central and Eastern Europe. With this step, Hungary moved from the bottom of the international ranking list to the middle, both in terms of the size of gold reserves and their ratio.

17 October 2018
According to a People’s Bank of China internationalisation report (2017)\(^\text{12}\) more than 60 countries hold renminbi as part of their reserve assets. In the World Bank’s RAMP 2019 survey, 49% of the 94 central banks surveyed said they held renminbi assets.

The renminbi’s use in international trade is expected to increase further once certain conditions are fulfilled, including currency convertibility and the continued opening of China’s capital account. While it will be difficult for the renminbi to rival the US dollar as the predominant global currency, Asia seems to be the natural habitat for the renminbi (Eichengreen, Lombardi, 2017). As such, the international monetary system is likely to shift from a US dollar-centric system to a more multi-polar system, with the euro and renminbi constituting relatively larger shares.

The shift to a new international monetary system could be both destabilising, due to speculative flows, and possibly weigh on the US dollar. Some central banks may be buying gold as a hedge against both. It is noteworthy that most recent gold purchases have been made by countries in Southeast and Central Asia, which have strong trade and investment links with China (Chart 9).

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**Chart 9: Many central banks who have recently purchased gold come from countries that are part of the Belt and Road Initiative**

Central bank with net gold purchases (2014-2018)

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\(^{12}\) ECNS Wire “60 countries and regions use RMB as reserve currency: PBOC report;” www.ecns.cn/cns-wire/2017/10-19/277645.shtml
A de-dollarisation policy

Other central banks are pursuing an overt policy of de-dollarisation. In the 2019 CBGR survey, 13% of central banks said de-dollarisation was highly or somewhat relevant to their decision to invest in gold. Russia exemplifies this. In 2018, Russia purchased 274.3t of gold,¹³ the country’s highest level of annual net purchases and the fourth consecutive year of +200t purchases. This enormous accumulation in Russian gold reserves is a direct response to the pressure of financial sanctions from the West. As the Bank of Russia’s First Deputy Governor Dmitry Tulin noted last year, gold has become a strategically important asset because it is a “100% guarantee from legal and political risks.”¹⁴ The substantial increase in Russian gold holdings has been accompanied by an equally substantial decrease in the country’s holding of US Treasuries.

Rising international reserves have led to re-balancing demand

Finally, central banks may be buying gold for more mechanical reasons (Chart 10). The gold price has been relatively flat over the past few years, so gold’s share of total reserves has fallen, from 13.5% at the turn of the century to 10.6% as of Q1 2019. Re-balancing to the preferred strategic level may therefore account for some of the uptick in demand. The National Bank of Poland cited strong and steady growth in international reserves as a key determinant behind its recent large accumulation of gold.

Chart 10: Total international reserves have grown sharply, but gold’s proportion has slightly decreased

![Chart 10](chart10.png)

Source: IMF IFS, World Gold Council as of Q1 2019

¹³ IMF IFS, ECB, weekly financial statement, national sources, World Gold Council

¹⁴ Bloomberg “Russian central bank buys more gold in face of tougher sanctions”

Safety, liquidity, return – and gold

In order to meet the main policy objectives of short-term intervention and preservation of value over time, the investment objectives for the international reserves fall under the broad headings of: safety, liquidity, and return. The relative importance of each of these objectives varies across countries, but safety and liquidity, particularly for international reserves held as precautionary balances, usually dominate. Thus, reserves assets have traditionally been comprised of safe, high-quality, liquid assets, including deposits with official institutions, investments in advanced economy government securities and gold.

Safety

Credit (or default) risk is perhaps the greatest risk faced by reserve asset managers. As such, when reserve managers invest in sovereign debt, they will typically hold only debt of investment-grade quality. But even that cannot fully mitigate credit risk. Over the past 100 years, many countries, even those thought to be safe, have experienced sovereign debt defaults or restructurings (Chart 11). Gold, held in a central bank’s own vault or on an allocated basis, is the only reserve asset that is entirely free from default risk.

Chart 11: Notable sovereign debt defaults or restructurings across major economies

Safety can also refer to how an asset performs during times of crisis, when a central bank is more likely to have to sell assets or raise liquidity. Precisely because gold has no credit risk, it often experiences safe-haven inflows during times of financial crisis, leading its price to rally (Chart 12). For example, during the Great Recession that began in 2009 gold returns increased 47%, while the S&P500 declined by an equal amount. In fact, gold returns were positive during eight of the last nine periods of systemic risk, highlighting gold’s important ability to preserve capital during times of crisis.

The fact that gold has little to no correlation with other major assets makes it highly effective as a portfolio diversifier, thereby reducing portfolio risk and volatility (Chart 13). Although gold is traditionally grouped with other commodities, its correlation to these assets is quite limited. Importantly, gold is not correlated with oil, a key consideration for central banks in large oil-producing countries (Focus box 2). Gold’s lack of correlation to other major assets transcends the economic cycle too, applying in periods of economic expansion and contraction. This means that gold is a valuable counter-cyclical asset.

![Chart 12: The gold price tends to increase in periods of systemic risk](image1)

S&P 500 and gold return vs change in VIX level*

![Chart 13: Gold behaves as an effective diversifier in periods of economic expansion and contraction](image2)

Correlation between gold and major assets*


Source: Bloomberg, ICE Benchmark Administration, NBER, World Gold Council
Focus box 2: Gold can be an effective diversification asset for central banks in oil-producing countries

International reserves play a vital role in a country’s armoury, helping to ensure that they hold sufficient foreign currency to meet import and debt service obligations during an economic crisis. This is especially important for countries that are reliant on a single asset for export earnings. Large oil-producing countries are a case in point, as their export earnings depend above all on the international oil price.

Gold’s correlation to oil is unstable, meaning it can serve as an effective diversification asset for an oil-focused economy. Whilst gold and oil are both strategic commodities, they have very different supply and demand dynamics, a difference that is reflected in their respective financial behaviour.

The oil market is subject to certain factors that are entirely absent from the gold market, including OPEC-imposed supply constraints, inventory build-ups due to infrastructure issues and the impact of geopolitical tensions on physical supply chains. Oil demand is also largely pro-cyclical, whereas gold displays pro- and counter-cyclical qualities.

<table>
<thead>
<tr>
<th>Country</th>
<th>Oil</th>
<th>Gold</th>
</tr>
</thead>
</table>
| Supply factors | • Supply adjusted by OPEC production quotas  
• High degree of political control over production decisions  
• Non-renewable commodity  
• Significant geographic concentration of production  
• Geopolitical tensions can have a direct impact on supply  
• New technology (such as fracking) opens up previously unavailable supply sources. | • Production is determined by market dynamics  
• Relatively little geographic concentration of production  
• Gold can be recycled and recycling constitutes a sizeable portion of supply. |
| Demand factors | • Demand is largely pro-cyclical and linked to economic performance  
• Ongoing pressure to reduce dependence on oil for environmental or political reasons  
• High correlation to global business cycle. | • Demand is driven by both pro-cyclical elements (jewellery, technology) and counter-cyclical elements (investment demand to protect against risk)  
• Demand comes from a broad and diverse range of end users  
• Lower correlation to the global business cycle. |

Chart 14: Gold’s correlation to oil is unstable
Five-year rolling correlation between gold and brent crude

Furthermore, gold behaves like both a commodity and a currency, responding to physical supply and demand factors, as well as financial influences, such as monetary policy. Between 2000 and 2008, for example, the commodities super-cycle boosted emerging market demand for both oil and physical gold, creating a temporary increase in correlation between oil and gold prices (this effect is seen, with a lag, in which shows 5-year rolling correlations (Chart 14)). But the 2008 financial crisis brought gold’s safe-haven characteristics to the fore, supporting the gold price even as the commodities super-cycle faltered and oil prices began to wane. Gold’s correlation to oil has returned to almost zero as the oil market undergoes major structural shifts, whilst increased geopolitical and economic uncertainties have supported gold.
Gold also enjoys certain unique demand characteristics, which reduce its correlation, not just with oil but with financial assets more broadly. Gold is not solely dependent on investment as a source of demand. Instead, demand comes from a wide range of buyers and sellers with different motivations, including Indian jewellery manufacturers, electronics producers in Asia, global pensions and endowments funds, and, of course, central banks (Chart 15a and 15b). This diversity – coupled with a stable or only slowly growing supply – enhance gold’s role as a portfolio diversifier.

Liquidity

For reserve managers, it is not enough to own safe assets. As the IMF notes: “reserve managers need to be certain that foreign exchange reserves can be liquidated in a prompt and efficient manner to provide the necessary foreign exchange for the implementation of policy objectives.”15 Although the concept of “liquidity” is often hard to define, it is widely recognised that high-quality, liquid assets tend to be those which benefit from large, deep markets with high daily trading volumes. The existence of an active repo or swap market, and the ability of the asset to be used as collateral, are equally important considerations, as they allow central banks to meet short-term liquidity requirements without making portfolio adjustments. For liquidity management purposes, however, it is important that gold is of a certain standard and located in a global trading centre (see “Adding gold to international reserves”).

A large market

Unlike almost every other financial asset, gold is virtually indestructible – all the gold that has ever been mined still exists in one form or another (even if some of it has been lost). Best estimates suggest that approximately 193,472t of gold have been mined throughout history, equating to approximately US$8.2tn.16 Much of that gold is held in the form of jewellery so these figures may not be the most appropriate way to compare gold to other financial assets, such as sovereign debt. Instead, the best proxy to “outstanding bond issuance” is perhaps the combined value of gold held by private investors and the official sector, often referred to as the “financial market” for gold. Currently, that equates to approximately US$3tn, suggesting that the financial gold market is similar in size to major sovereign debt markets across the globe (Chart 16).

16 Calculation of this figure used gold price of US$1,321.25/oz, as of 31 January 2019.
Deep trading volumes

The gold market is also characterised by strong trading volumes. Gold trades between US$50 billion (bn) and US$80bn per day through the OTC spot and derivatives contracts. Gold futures trade US$35–50bn per day across various global exchanges. Gold-backed exchange-traded funds (ETFs) offer an additional source of liquidity, with the largest US-listed funds trading an average of US$1bn per day.

This makes gold one of the most highly traded financial assets (Chart 17). Furthermore, if these trading figures are compared to the total outstanding market, the average daily turnover of gold is higher than all other major sovereign bond markets (Chart 18).

Using gold as collateral

Gold is universally accepted and therefore serves as valuable collateral during times of crisis. Gold also tends to increase in price during financial crises, adding to its appeal as a liquidity management tool during periods of crisis.

There is also an active gold swap market. During the GFC, the Swedish Riksbank swapped some of its gold to obtain US dollar liquidity to provide US dollar funding to Swedish banks shut out the US dollar market.17 Aggregate gold swap data is not available, but data from the BIS, a frequent swap counterparty for central banks, gives some insight into the depth of this market. (Chart 19).18

Importantly, gold used for swaps must be of a certain standard and located in a global trading centre.

Chart 17: Gold trades more than many other major financial assets

Average daily trading volumes*

<table>
<thead>
<tr>
<th>Financial Asset</th>
<th>Average Daily Trading Volume (in US$bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>German Bunds</td>
<td>200</td>
</tr>
<tr>
<td>UK Gilts</td>
<td>150</td>
</tr>
<tr>
<td>Dow Jones (all stocks)</td>
<td>100</td>
</tr>
<tr>
<td>Gold**</td>
<td>70</td>
</tr>
<tr>
<td>S&amp;P 500 (all stocks)</td>
<td>50</td>
</tr>
<tr>
<td>US Agencies</td>
<td>40</td>
</tr>
<tr>
<td>JGBs</td>
<td>30</td>
</tr>
<tr>
<td>US Treasuries</td>
<td>20</td>
</tr>
</tbody>
</table>

*Based on one-year average trading volumes as of December 2018, except for currencies that correspond to full-year 2016 volumes due to data availability.

**Gold liquidity includes estimates on over-the-counter (OTC) transactions, published statistics on futures exchanges, and gold-backed exchange-traded products. For methodology details visit Goldhub.com.

Source: BIS, Bloomberg, German Finance Agency, Japan Securities Dealers Association, LBMA, UK Debt Management Office (DMO), World Gold Council

Chart 18: On a relative basis, gold’s turnover outperforms sovereign debt markets

Average daily turnover (as % of total outstanding)*

<table>
<thead>
<tr>
<th>Financial Asset</th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
<th>FY15</th>
<th>FY16</th>
<th>FY17</th>
<th>FY18</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Treasuries</td>
<td>5.0</td>
<td>4.5</td>
<td>4.2</td>
<td>4.0</td>
<td>3.8</td>
<td>3.6</td>
<td>3.5</td>
<td>3.4</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>Gold</td>
<td>4.0</td>
<td>3.5</td>
<td>3.3</td>
<td>3.1</td>
<td>3.0</td>
<td>2.9</td>
<td>2.8</td>
<td>2.7</td>
<td>2.6</td>
<td>2.5</td>
</tr>
<tr>
<td>JGBs</td>
<td>3.5</td>
<td>3.0</td>
<td>2.8</td>
<td>2.6</td>
<td>2.5</td>
<td>2.3</td>
<td>2.2</td>
<td>2.1</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>UK Gilts</td>
<td>2.5</td>
<td>2.0</td>
<td>1.8</td>
<td>1.6</td>
<td>1.5</td>
<td>1.3</td>
<td>1.2</td>
<td>1.1</td>
<td>1.0</td>
<td>0.9</td>
</tr>
<tr>
<td>German Bunds</td>
<td>1.5</td>
<td>1.0</td>
<td>0.8</td>
<td>0.6</td>
<td>0.5</td>
<td>0.4</td>
<td>0.3</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
</tr>
</tbody>
</table>

*Based on data as of December 2018.

Source: BIS, Bloomberg, German Finance Agency, Japan Securities Dealers Association, LBMA, UK Debt Management Office (DMO), World Gold Council

18 It should be noted that BIS data does not cover the entire swaps market, only those operations conducted by the BIS.
Return

Although safety and liquidity are the most important objectives of holding international reserves, the return is also clearly a consideration, as positive returns contribute to building international reserves.

Since 1971, when gold began to be freely traded following the collapse of Bretton Woods, the price of gold has increased by an average of 10% per year. This means that gold’s long-term returns have been comparable to stocks and higher than bonds or commodities (Chart 20).

Among consumers, the combined share of global gold demand from India and China grew from 25% in the early 1990s to more than 50% in recent years. This is highly significant, not least because our research shows that expansion of wealth is one of the most important drivers of long-term gold demand with a positive effect on jewellery, technology, and bar and coins.

Gold returns have also outpaced inflation. During the Gold Standard and the Bretton Woods system, when the US dollar was backed by and pegged to the price of gold, there was a close link between gold and US inflation. But, once gold became free-floating, US inflation was no longer the main driver of price.

In subsequent decades, gold returns have outpaced the US consumer price index (CPI) over the long run. In fact, gold has not just preserved capital, it has helped it grow.

Gold has also protected investors against extreme inflation. In years when inflation has been higher than 3%, gold’s price has increased by 15% on average (Chart 21).

However, gold should deliver in periods of deflation too, as highlighted in research from leading global consultancy Oxford Economics.

Gold’s price performance can be attributed to several factors.

Gold trades in a large and liquid market, yet it is scarce. Mine production has increased by an average of 1.4% per year for the past 20 years. At the same time, demand has grown among consumers, investors and central banks.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

Adding gold to international reserves

Central banks have two main options for adding gold to international reserves – through purchasing gold in the global Over-the-Counter (OTC) market or through buying local production. Some central banks have conducted large off market deals, but these are rare. The most notable example occurred in October and November 2009 when the IMF sold 212t of gold in separate off market transactions to three central banks.21

The global Over-the-Counter market

A most common way for central banks to add gold to their international reserves is to purchase Good Delivery (GD) gold in the OTC market from a bullion bank. The London market is the most liquid OTC market in the world. The London Bullion Market Association (LBMA) sets GD standards. GD bars must weigh between 350oz and 430oz and have a minimum quantity of 99.5% gold. A full list of bar requirements can be found on the LBMA’s website (www.lbma.org.uk).

The London Gold Delivery (LGD) list is a list of refiners that are accredited by the LBMA to deliver gold into the London market. Gold settled into the London market is called “loco London.” Only LGD bars can be settled in the London market. A list of LGD refiners can be found on the LBMA’s website, as can a list of custodians offering vaulting services.

LGD gold is priced in US dollars per fine ounce and quoted on a T+2 settlement basis. It is the most widely quoted price in the world and serves as a benchmark for other locations, which are quoted at a premium or discount to this price.

Under IMF reserve reporting guidelines, central banks can hold gold on an allocated or unallocated basis. Allocated gold accounts, however, are generally preferred and more common, as they are free from credit risk.

Focus box 3: Allocated vs. Unallocated gold

Allocated gold
An allocated account is an account to which individually identified gold bars or coins owned by the account holders are credited. The gold bars or coins in an allocated account are specific to that account and can be uniquely identified.

Unallocated gold
In an unallocated account, the account holder does not own specific bars or coins but has a general entitlement to a set amount of gold. The central bank is not the legal owner of any physical gold, but rather is a creditor of the provider.

Focus box 4: An example of a spot trade in the loco-London market

At trade date (T+0) a central bank, that has an account at the Bank of England (BOE), requests a spot gold price from a bullion bank, that also has an account at the Bank of England.

The central bank agrees to buy 1,000oz from the bullion bank at US$1,309.19/oz for settlement in two days time (T+2).

The bullion bank instructs the BOE to debit its gold account with 1,000oz gold and credit the central bank’s account at T+2.

The central bank instructs its US dollar clearing bank to pay US$1,309,190 (1,000oz*US$1,309.19) to the bullion bank’s US dollar account in NY at T+2.

The gold leg of the transaction must be settled by 4pm London time on T+2. However, the US dollar leg of the transaction does not occur until 5 hours later at close of business in New York on T+2. This creates a credit risk exposure for central banks, until both legs of the settlement take place, and should be managed accordingly.

21 In October and November 2009, the IMF sold 212t of gold in separate off-market transactions to three central banks: 200t were sold to the Reserve Bank of India; 2t to the Bank of Mauritius, and 10t to the Central Bank of Sri Lanka. Source: www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/42/Gold-in-the-IMF
Local production

Some central banks acquire gold through local gold production. This way, a central bank can purchase gold using local currency instead of an international currency. There are several central banks around the world that operate local gold purchase programmes. Bangko Sentral ng Pilipinas (BSP), the central bank of the Philippines, has operated its Gold Buying Program since 1991.22 This programme buys unrefined gold directly from small-scale miners and guarantees the prevailing international gold price for transactions, converted to local currency. Similarly, the central bank of Mongolia has a gold purchase programme in place for local production. The bank acquired 21.9t of gold through local purchases in 2018.23 The Central Bank of Russia also buys locally produced gold, in its case from local commercial banks.

Focus box 5: Bangko Sentral ng Pilipinas, a Case Study in Buying from Local Production

Published with the kind permission of the Bangko Sentral ng Pilipinas

The government of the Philippines has long recognized the importance of the gold mining sector to its economy. In 1974, the government instructed the Bangko Sentral ng Pilipinas (BSP), the central bank of the Philippines, to establish a gold refinery to support domestic gold production. BSP’s refinery received accreditation from the London Bullion Market Association as a London Good Delivery refiner three years later. In 1991, the People’s Small-Scale Mining Act required that all gold produced by small scale miners in the Philippines be sold to BSP.

The central bank created the Gold Buying Program in accordance with the new law. Under the Program, the central bank directly purchases unrefined gold from domestic small-scale producers at prevailing international prices but in Philippine pesos. Gold producers can sell their gold at five BSP gold buying stations spread throughout the country. BSP would then refine the gold to LGD standards and retain it as part of its international reserves or sell it in the international market. The central bank publishes requirements for the physical form, dimensions, and fine metal content of the gold that is purchased through the Program.

BSP’s Gold Buying Program allows the central bank to add gold to its international reserves by paying in local currency instead of using a reserve currency to procure the gold on the international market. The Program is a way of increasing international reserves by taking advantage of the Philippines’ natural resource endowment. Former BSP Governor Amando Tetangco Jr. summarised the benefits of the Program by saying that “buying gold in pesos increases the country’s GIR [gross international reserves], whereas buying gold using dollars only changes the composition of the GIR but does not increase it. On the other hand, buying gold using dollars acquired from the market affects the money supply, which will require BSP to step up open market operations with cost to the BSP.”24

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Upgrading existing gold holdings

If central banks want to actively manage their gold reserves, it is important that their gold is in global trading centres and of the correct quality. As noted above, only LGD bars are accepted in the loco-London market and thus some central banks will need to upgrade non-LGD bars to LGD standard if they intend to trade in London. The Bank for International Settlements (BIS) and bullion banks both provide these services. A central bank can undertake a quality swap (i.e. swaps its non-LGD bars for LGD bars), work with one of these institutions to upgrade its gold or work directly with LGD refiners and specialist transportation companies to undertake its own upgrading programme. The Bundesbank and the Riksbank recently implemented gold upgrading programmes.

Custody options

The choice of custodian is an important consideration. Gold can be custodied at home or overseas, usually in another official institution offering these services. The Bank of England, the Bank for International Settlement (BIS), Banque de France and the Federal Reserve Bank of New York are the most important institutions offering these services (Table 1).

In recent years, a number of central banks have moved part of their gold reserves home. In some cases, the decision has been prompted by their populations expressing a preference for domestically-vaulted gold. Alternatively, the decision has been driven by security concerns and a desire for geographical diversification. Increased interest in the location of gold has led some central banks to start publishing the geographical distribution of their gold reserves. Of the 20 largest official holders of gold, half now publish their custody locations (Table 2).

Table 1: Gold custody and services

| Bank of England | The Bank of England primarily offers gold accounts to central bank customers (allocated gold accounts only). To facilitate, either directly or indirectly, access for central banks to the liquidity of the London gold market, the Bank of England will also consider providing gold accounts to certain commercial firms. |
| Federal Reserve Bank of New York | The New York Fed acts as the guardian and custodian of the gold on behalf of account holders, which include the U.S. government, foreign governments, other central banks, and official international organizations. No individuals or private sector entities are permitted to store gold in the vault. |


Focus box 6: Gold services for central banks at the Bank of England

The Bank of England provides a gold custody service specifically designed for central banks. It currently has around 70 central bank customers and is the second largest gold custodian (by weight of gold held) in the world.

The Bank’s gold custody service allows central bank reserve managers to benefit from the deep and liquid London gold market – but without being exposed to the credit risk on gold balances which they might incur if gold is held on an unallocated base using the normal commercial routes. Reserve managers holding gold at the Bank can therefore take positions in gold, or liquidate gold assets (either via swaps or outright) to create cash quickly and cost effectively.

Importantly, the Bank’s role in the gold market is purely as a physical custodian that offers trading between account holders. Although it did in the past, the Bank no longer makes markets. By operating the largest vault in London and allowing commercial banks to hold accounts, the Bank facilitates access for reserve managers to London gold market liquidity. The Bank only accepts gold bars that meet London Bullion Market Association (LBMA) Good Delivery standards which define purity, size, responsible sourcing and other variables. Central bank customers wishing to add to their gold reserves can either 1) purchase gold from other Bank account holders – either from other central banks or from commercial banks, or 2) deliver physical gold directly to the Bank – so long as that gold is LBMA Good Delivery.

The Bank facilitates credit risk free tradable gold by providing fully allocated accounts, where customers own specific bars. The wider London gold market relies primarily on unallocated gold accounts with the clearer banks that jointly operate a settlement system called Aurum. Because settlement takes place across accounts at commercial banks, any central bank wanting to use the system must hold gold balances at a commercial bank – introducing commercial bank credit risk for the entire gold balance. The Bank’s allocated service means that customers own specific bars – gold that the Bank holds on behalf of customers does not appear on the Bank’s balance sheet, and the gold balance does not entail a credit risk exposure to the Bank of England.

Central bank reserve managers wishing to trade gold are able to do so with any other Bank of England gold account holder – multiple commercial banks active in the wider London gold market also have accounts at the Bank of England. Settlement of the gold transfer is effected by book entry transfer across the gold custody accounts (the Bank of England is not involved in settlement of the cash) – the gold doesn’t move physically unless the customer instructs a withdrawal. The service is available same day and longer, so reserve managers can generate cash from gold holdings (either through swaps or outright sales) extremely quickly compared to self-custody services where the gold must be transported and physically delivered to a counterparty.
<table>
<thead>
<tr>
<th>Vaulting Location (% of Total Holdings)</th>
<th>Tonnages</th>
<th>Domestic</th>
<th>BoE</th>
<th>NY Fed</th>
<th>SNB</th>
<th>BoC</th>
<th>BdF</th>
<th>BIS*</th>
<th>Swaps</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States27</td>
<td>8,133.5</td>
<td>100.0%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany28</td>
<td>3,369.7</td>
<td>50.7%</td>
<td>12.6%</td>
<td>36.7%</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>IMF29</td>
<td>2,814.0</td>
<td>Held at designated depositories in the US, UK, France, and India. Breakdown is unknown</td>
<td></td>
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</tr>
<tr>
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<td>2,451.8</td>
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<td>5.8%</td>
<td>43.3%</td>
<td>6.1%</td>
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<tr>
<td>France31</td>
<td>2,436.1</td>
<td>91.0%</td>
<td></td>
<td>Remainder is held abroad, locations are not disclosed</td>
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<tr>
<td>Russia32</td>
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<td>China</td>
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<td>765.2</td>
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<td>India34</td>
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<td>48.2%</td>
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<td>Remainder is held abroad at the BoE and the BIS, breakdown is undisclosed</td>
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<tr>
<td>Netherlands25</td>
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<tr>
<td>ECB</td>
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<td>Store across several locations, breakdown undisclosed</td>
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<td>45.1%</td>
<td>15.9%</td>
<td>1.0%</td>
<td>5.2%</td>
<td>32.8%</td>
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<td>Uzbekistan</td>
<td>351.5</td>
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<td>Saudi Arabia</td>
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<td>310.3</td>
<td>100.0%</td>
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<tr>
<td>Lebanon</td>
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<td>Spain</td>
<td>281.6</td>
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*Vaulting location abbreviations: Bank of England (BoE), Federal Reserve Bank of New York (NY Fed), Swiss National Bank (SNB), Bank of Canada (BoC), Banque de France (BdF), Bank for International Settlements (BIS).

**Tonnage as of August 2019, source:** World Gold Council. Percentages may not add up to 100% due to rounding effects.

The gold holdings of the US held at the NY Fed, the gold holdings of the UK held at the BoE, and the gold holdings of France held at the BdF are classified as "Domestically Vaulted" and not as gold held at the NY Fed, BoE, or BdF, respectively. Switzerland reports that its gold holdings that are in Switzerland are "decentralized", so they are also classified as "Domestically Vaulted" and not as gold held at the SNB.

27 United States: www.fiscal.treasury.gov/reports-statements/gold-report/current.html US gold reserves consist of (a) 248,046,115.696oz of mint-held gold that is held in Denver, Fort Knox, West Point, or as working stock, or (b) 13,452,810.545oz of gold held by the Federal Reserve. All US gold holdings are classified as "Domestically Vaulted."


30 Italy: www.bancaditalia.it/compiti/reserve-portafoglio-risch/index.html?com.dotmarketing.htmlpage.language=1

31 France: www.lbma.org.uk/assets/S4_4_Gautier.pdf All of France’s gold holdings that are in France are classified as “Domestically Vaulted” and not as being held by the BdF.

32 Russia: http://archive.government.ru/eng/docs/13930/3

33 Switzerland: www.snb.ch/en/about/assets/id/assets_risks SNB states that it maintains about 70% of its gold in Switzerland, 20% at the Bank of England, and 10% at the Bank of Canada. The gold in Switzerland is “decentralised” so it is not classified as being held at the SNB.


37 United Kingdom: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/726309/EEA_Annual_Report_and_Accounts_2017-18.pdf All of the UK’s gold holdings are in the custody of the BoE. However, they are classified as “Domestically Vaulted” and not as being held at the BoE.
Active gold management

Gold can be actively managed in order to generate a return, to reduce credit risk or to raise foreign exchange liquidity. The most common instruments are gold deposits (to generate a return) or gold swaps (to raise foreign exchange liquidity or to generate return). As noted previously, gold must be of GD standard and be in a centre of global liquidity for active management purposes.

Gold deposits

Gold is a monetary asset held by central banks. As such, it can be lent out on term deposit in the same way as any other currency in the central bank’s reserve portfolio. By placing its gold on deposit with a bullion bank, a central bank can not only generate returns (the central bank earns the lease rate or deposit rate) from its gold holdings, but it also saves on storage fees, which are passed on to the borrower. The interest is generally paid in US dollars at the end of the term. It is important to note that when the bars are returned, they may be different bars than those originally lent out. If there is any weight difference, it is settled on the benchmark price on the day of redelivery.

The central bank bears the credit risk vis-à-vis the counterparty, a risk that must be accounted for in the central bank’s risk limit system. Due to this counterparty risk, central banks will only entrust their gold reserves to highly credit-rated bullion banks. The central bank can also mitigate counter party risk by negotiating collateralised gold deposits, although the return on such transactions will be smaller. Collateralised gold deposits require additional legal procedures in the form of a Global Master Repurchase Agreement (GMRA). The collateral management must also be processed.

Focus box 7: Example of a central bank gold deposit transaction in the loco-London market

A central bank that wants to lend its gold vaulted at the Bank of England (BOE) requests a gold deposit rate from a bullion bank for three months. The bullion bank quotes the loco-London deposit rate as 20 basis points (bp).

The central bank agrees to place a 1,000oz gold deposit with the bullion bank loco-London at 20bp for a value spot date of 4 February. The central bank and the bullion bank also agree the base price of the deposit as US$1,309/oz, which is the current spot rate.

The central bank requests the exact bar list and quantity of gold from the BOE. The BOE confirms the exact weight as 807.92oz.

The interest amount is calculated in US dollar value of gold deposited at the base price and will be paid on the maturity date (4 May):

\[ \text{Interest earned} = (807.92\text{oz} * \text{US$1,309} * 0.0020 * 90) / 360 \]
\[ = \text{US$528.78} \]

Two days before maturity the bullion bank instructs the BOE to allocate 1,000oz of gold to repay the central bank. The bullion bank informs the central bank exact amount of gold maturing e.g. 810.20oz.

The exact gold amount returned usually differs slightly, as the allocated gold bars are different. The difference should be treated as a purchase or sale of gold accordingly at the LBMA gold benchmark price two days before maturity of the deposit. In this example, an additional 2.28oz came back to the central bank’s account, (i.e. 810.20oz-807.92oz), which is treated as a purchase at US$1,309.30/oz, thus US$2985.20 (US$1,309.30x2.28 oz).

The central bank instructs its cash correspondent to receive or transfer the equivalent amount of net cash to the bullion bank. In this example, the central bank needs to send a money transfer order for US$2,456.42.
Gold swaps

Gold swaps can be used to raise foreign exchange liquidity or to generate return. Swaps are particularly popular during times of crisis, as they are a way to manage funding strains without gold liquidations. The fact that the gold price often increases during period of financial crisis, makes gold particularly attractive in this respect.

Gold swaps work in the same way as foreign currency swaps, in that the transaction is an exchange of a fixed amount of gold and US dollar between buyer and seller on an agreed spot and forward date. In a liquidity-generating gold swap, the central bank exchanges gold against foreign exchange with an agreement that the transaction be unwound at a future time at an agreed price. Because it is a collateralised transaction it bears little credit risk.

If the central bank decides to include gold swaps in its investment guidelines, then legal documents from the International Swaps and Derivatives Association (ISDA) need to be signed with eligible counterparties, a process that is fairly lengthy and can take 4-6 months to complete. Legal agreements are not necessary, however, if the swap is conducted with another central bank.

Focus box 8: Example of a central bank gold swap transaction against US dollar in the loco-London market

On trade date (T), a central bank that has an account with the Bank of England requests a three-month gold swap from a bullion bank (90 days, with a spot date of 4 February and a maturity date of 4 May).

The bullion bank quotes 2.56%/2.66%, for example. 2.56% is where the bullion bank lends gold and borrows US dollars; and 2.66% is where the bullion bank borrows gold and lends US dollars.

The central bank lends 1 LGD gold bar of 400oz and borrows US dollars at 2.66% from the bullion bank. The banks agree the basis price for the deal (i.e. the current market price, e.g. US$1,309/oz) and they calculate the forward price, as follows:

\[
\frac{(US\$1,309 \times 2.66\%) \times 90}{360} = US\$8.7049 + US\$1,309 = US\$1,317.705
\]

In this example, the central bank sells 400oz gold at US$1,309/oz to the bullion bank on 4 February.

And the central bank purchases 400oz gold at US$1,317.705/oz from the bullion bank on 4 May.

The deals are booked simultaneously as a sale and purchase.
Accounting for monetary gold

Most central banks are required to adopt the International Financial Reporting Standards (IFRS), but these do not provide appropriate guidance for monetary gold. IFRS states that gold is a commodity, not a financial instrument, and thus should be accounted for at the lower of cost and net realisable value.

This treatment is appropriate for jewellers and manufacturers, but central banks deploy their gold to raise foreign exchange liquidity, inter alia, during times of national crisis, at which point they need a fair value assessment of the resources at their disposal. Central banks require an accounting framework for monetary gold that matches their functional objectives.

In the absence of a suitable framework, central banks have adopted a variety of different treatments, making comparability difficult and weakening the central banks’ accountability framework. Several central banks approached the World Gold Council for assistance on this issue and, as a result, we produced guidance on the recommended practice for the accounting of monetary gold.

Guidance on the accounting for monetary gold

The World Gold Council guidance, which has already been adopted by some central banks, suggests that monetary gold be regarded as equivalent to a financial instrument denominated in the national currency, accounted for at fair value, with unrealised revaluation gains being reported as “other comprehensive income” in the statement of other comprehensive income (or equivalent statement).

The recommended approach is consistent with the functional rationale for holding gold as an element in central banks’ international reserves. At the same time, the guidance seeks to comply, where possible, with the principles found in the most widely adopted central bank financial reporting frameworks.

A full copy of the guidance can be found in Appendix.

Appendix: Guidance on the accounting for monetary gold

Objective

1 To provide a common framework for monetary authorities to recognise and account for monetary gold in an appropriate and consistent manner in their financial statements. The approach is to regard monetary gold as equivalent to a financial instrument denominated in the national currency. Other forms of gold are to be accounted for in accordance with the monetary authority’s adopted reporting framework.

Scope

2 This Guidance is designed to be applicable to all monetary authorities that hold monetary gold for meeting policy objectives specified in their relevant legislation. This includes, but is not limited to, monetary authorities responsible for managing their nation’s international reserves. Importantly, this Guidance represents recommended best practices in accounting for monetary gold, rather than a pronouncement on such practices. As such, there is no specific mandate, legal or otherwise, associated with this Guidance.

Recognition and derecognition

Initial recognition and classification

3 A monetary authority shall recognise the gold when it acquires the contractual rights to the economic risks and rewards of the gold ownership. On acquisition, it shall classify the gold as monetary gold, non-monetary gold or antique gold.

Derecognition

4 A monetary authority shall derecognise the gold when it surrenders the contractual rights to the economic risks and rewards of the gold ownership. A transaction that involves a transfer or encumbrance of gold does not constitute derecognition if the monetary authority will receive equal gold back at the end of the transaction or retains the economic risks and rewards of the gold ownership.

Measurement

Initial measurement

5 On initial acquisition, or recognition as monetary gold, a monetary authority shall recognise monetary gold at fair value, plus transaction costs that are directly attributable to the acquisition of the gold.

Subsequent measurement

6 For the purposes of measuring gold after initial recognition, this Guidance adopts three classifications:
   A monetary gold
   B non-monetary gold
   C antique gold.

7 Monetary gold – A monetary authority shall measure monetary gold after initial recognition at fair value without any deductions for additional costs, except in the situation described in paragraph 9 or the following situations:
   A the gold requires further refining to bring it to a form required in open markets
   B the gold requires transportation from its current location to a recognised gold market to enable its trading and delivery.

In these situations, the entity will reflect these costs in fair value.

8 No entity shall apply any discount to fair value to cover any perceived market risks.

9 In the situation where the entity’s overall accounting framework adopts amortised cost accounting, and the adoption of fair value would represent a material distortion of the financial position and performance of the entity, the entity may apply cost as defined in its accounting framework for subsequent measurement.

10 Non-monetary gold – A monetary authority shall account for non-monetary gold as a commodity as the entity does not hold such gold for policy purposes. Valuation may be the lower of cost and net realisable value.

11 Antique gold – If a monetary authority holds gold objects as part of art or museum collections, the accounting for these objects should follow the accounting policy for this function.
Reclassification

12 In the event of a change in classification of a gold holding, the monetary authority shall treat any previously unrealised revaluations related to that gold as per paragraph 16, and disclose the change in classification in the notes to the accounts.

Treatment of gains and losses

Unrealised gains

13 On recognition of unrealised revaluation gains, a monetary authority shall report the valuation gains as other comprehensive income in the statement of other comprehensive income (or equivalent statement). The revaluation shall combine the price and foreign exchange movements as a single valuation entry. The monetary authority shall allocate the gold revaluations to a dedicated gold unrealised revaluation reserve within equity.

Unrealised losses

14 On recognition of unrealised revaluation losses, a monetary authority shall report these as other comprehensive expense in the statement of other comprehensive income (or equivalent statement). The revaluation shall combine the price and foreign exchange movements as a single valuation entry. The monetary authority shall allocate the gold revaluations to a dedicated gold unrealised revaluation reserve within equity.

15 In the event that unrealised losses exceed the balance in the revaluation reserve, the entity shall charge the excess against the period’s profit available for distribution. A central bank shall account for any subsequent reversals of unrealised losses according to paragraph 13.

Realised gains and losses

16 On the sale or reclassification of gold, the entity will recycle existing unrealised gains and losses relating to the sold or reclassified gold through profit and loss, or in compliance with its policy on the definition of realised revaluations.

Other transactions

Gold swaps

17 Two approaches exist for accounting for gold swaps:

A The monetary authority shall account for the gold swap as a currency swap in accordance with its general financial reporting framework. Quoted gold swap prices provide data for pricing, revaluation and income recognition.

B The monetary authority shall account for the gold swap as a repurchase agreement in accordance with its general financial reporting framework. The entity retains the gold on its financial statements as an encumbered asset.

Location swaps

18 As the net holdings of gold of the two entities involved in the location swap remain the same, the accounting is to disclose the swapped gold as encumbered in the financial statements. Accounting for fees related to the location swap shall be in accordance with the monetary authority’s accounting framework accrual principles.

Gold deposits (loans, lending, leasing)

19 A monetary authority depositing the gold in a gold deposit transaction shall treat the transaction as a deposit. The financial statements will retain the gold holdings, but will disclose them as an encumbered asset. The entity will report revenue as interest on a deposit.

20 The accounting for any collateral received by the depositor under the gold deposit agreement shall be in accordance with the relevant accounting standard covering the conditions relating to the collateral as specified in the gold deposit agreement.

Gold commodity swaps

21 Where a monetary authority undertakes a gold commodity swap, it shall account for it as a commodity swap as prescribed under its general financial reporting framework.

Gold forwards, futures, and options

22 These are financial instrument transactions and should be accounted for under the relevant accounting standard.
Disclosures

23 The objective of this Guidance is to enable entities to provide disclosures in their financial statements to enable users to evaluate:

A the functional reasons for holding monetary gold and its significance
B the functional reasons for holding non-monetary and antique gold
C the accounting policies adopted when accounting for all classes of gold holdings.

24 The monetary authority should harmonise the disclosures recommended in this Guidance with those required in its general financial reporting framework for accounting policies, and those covering the nature and extent of risks arising from holding financial instruments, and how the entity manages these risks.

25 Within the notes to the financial statements, the monetary authority shall disclose information identifying the:

A purpose and intention of holding gold
B amount of gold holdings for separate functions
C basis of recognition of gold holdings
D approach to gold revaluations (frequency, source of prices, adjustments)
E classification of unrealised gold revaluation gains through Other Comprehensive Income (OCI)
F allocation of unrealised gold revaluations gains to a dedicated gold revaluation reserve, within equity
G treatment of gold revaluation losses, including when they exceed any previously accumulated gains
H basis for determining the cost of sales for any gold sold
I treatment of realised gains arising from gold sales
J reasons for, and effects of, changes in gold classifications
K swaps and gold lending transactions, disclosing encumbered assets.

Reconciliation with IMF reporting

26 In situations where the monetary authority is responsible for the reporting of the country’s international reserves arising from its IMF membership, the monetary authority shall provide sufficient information to allow reconciliation between the total monetary gold holding reported in the respective statements.

Initial adoption

27 On initial adoption of this Guidance, the monetary authority will apply the rules for changes in accounting policy as specified in its general accounting framework. Any reclassification arising from initial adoption will not qualify as reclassification under paragraph 12.
**Basis of conclusions**

This Guidance seeks to provide those monetary authorities that hold monetary gold with a common accounting framework for their holdings. The recommended approach is consistent with the functional rationale for holding the asset as an element in their international reserves.

At the same time, the Guidance seeks to comply, where possible, with the principles found in the most widely adopted central bank financial reporting frameworks. These are IFRS and the ESCB accounting guidelines. IFRS does not provide specific direction for the accounting of monetary gold and so the Guidance seeks to provide a consistent approach in accordance with the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* A consistent adoption of a departure from IFRS across monetary authorities will provide greater comparability and a stronger defence for central banks from audit qualifications.

The third point of reference is the requirements for reporting monetary gold specified in the IMF’s *Balance of Payments and International Investment Position Manual – Sixth Edition (BPM6).*

Detailing a specific set of disclosures covering monetary gold enhances transparency within financial statements and comparability between monetary authorities.

In conjunction with observing principles of recognised accounting frameworks, the Guidance also takes account of the most widely adopted practices covered in the World Gold Council’s previous discussion paper on this topic. Of the 70 monetary authorities studied, 61 accounted for their monetary gold at fair value – 57 of which held all or part of the revaluations in an unrealised revaluation reserve or provision. Thirteen (13) authorities adopted a “Fair Value to Reserves through Other Comprehensive Income (FVOCI)” approach, the treatment that most closely approximates the framework adopted by the Guidance. While the “Fair Value Direct to Non-Equity Revaluation Account,” the ESCB approach, was the most widely adopted (25), the Guidance prefers a more comprehensive disclosure of revaluations in statements of financial performance (or equivalent statement) and the holding of revaluations in an equity revaluation account. The Guidance considers this more consistent with the principles of other accounting frameworks that classify such accounts as an element of equity.

**Definitions**

*Monetary gold* – the definition reflects the functional criteria for classifying gold as monetary gold. It reflects the definition of monetary gold found in the IMF’s *Balance of Payments and International Investment Position Manual – Sixth Edition (BPM6)* as this is the definition widely adopted by monetary authorities in their financial statements.

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39 IAS 8, paragraph 10. In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users and
(b) reliable, in that the financial statements:
   (i) represent faithfully the financial position, financial performance and cash flows of the entity
   (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form
   (iii) are neutral, ie free from bias
   (iv) are prudent and
   (v) are complete in all material respects.

IAS 8, paragraph 11. In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements in IFRS dealing with similar and related issues and
(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.


41 The discussion paper can be found on the World Gold Council’s website at: www.gold.org/research/working-towards-common-accounting-framework-gold
Paragraphs in Guidance

Paragraph

2 The Guidance is limited to entities that carry monetary gold to meet delegated functional objectives, usually as a component of their international reserves portfolio.

3 The recognition criteria align with the moment the monetary authority assumes beneficial ownership of the monetary gold. It is consistent with the initial recognition criteria adopted by internationally recognised accounting frameworks.

4 Derecognition issues arise at times of any transaction involving gold. The Guidance believes that if the monetary authority retains the economic risks and rewards associated through the duration of the transaction, it should not have cause to derecognise the gold. This applies to gold deposits, swaps, and lending.

5 The Guidance adopts fair value for initial recognition, as it is consistent with other international standards, and with the manner of valuation for international reserves portfolios. The IMF’s BPM6 mandates the adoption of fair value for reporting monetary gold holdings.

6 The definitions of the three classifications reflect the three purposes for which a monetary authority may hold gold. Functional considerations determine the classification. Each classification represents a different class of assets with their own accounting criteria, rather than sub-groups of the same class of assets. Financial statement presentations should reflect these different asset classes.

7 Presenting monetary gold at its fair value conforms with the presentation of other assets in a foreign reserves asset portfolio. The fair value, which should reflect the costs of getting gold to market in a saleable form, represents the best measure of the value that the monetary authority may obtain from this asset.

8 While monetary authorities may sell monetary gold in volumes that can impact market prices, the scale of such movements, if they occur, is unknown. Also, a monetary authority may use the gold as collateral in a swap transaction that will produce no discounts. The Guidance believes that fair value, free of any arbitrary conservatism, presents the best presentation for transparency and comparability purposes.

9 In the situation where a monetary authority adopts an amortised cost basis for its financial reporting, the adoption of fair value just for monetary gold proposed in this Guidance may produce outcomes inconsistent with the broader accounting framework. In such a situation, the monetary authority should comply with its overarching reporting framework when accounting for monetary gold.

10 The Guidance seeks to align the accounting for non-monetary gold with IFRS.

11 Monetary authorities may maintain collections of antique gold artifacts within museums or art collections as part of a public good function. As gold is not necessarily the only exhibit in these displays, the Guidance aligns the accounting for antique gold with the broader accounting framework adopted for that function.

12 A central bank may reclassify gold holdings by removing existing holdings from the pool of assets qualifying as international reserves into non-monetary gold or antiques. Conversely, it may add previously non-monetary gold to its foreign reserve portfolio if it complies with monetary gold definitions. This may follow the processing of holdings of non-monetary gold, such as alluvial gold, to LGD form and recognising it as monetary gold.

A change in classification is a transfer of the asset between a financial instrument, a commodity, or an antique, each a different asset class. The Guidance considers this a sale and purchase within the monetary authority that requires the realisation of all related accumulated unrealised revaluations.
The Guidance adopts the combination of the price and foreign currency effects of the revaluation as a single total, as this represents how monetary authorities manage monetary gold. This reflects the default practice by those monetary authorities that hold monetary gold, and thus reflects the manner in which the holders manage this asset.

The requirement to disclose revaluations through OCI is consistent with the requirement for transparent reporting, and the function of OCI or equivalent statement to disclose the non-equity sources of changes in the balance sheet. The Guidance believes the requirement to disclose revaluations through OCI is important for transparency in understanding balance sheet movements.

Allocating the gold revaluations to a dedicated revaluation account is consistent with both IFRS and ESCB prohibitions of netting different asset valuation balances.

This approach seeks to maintain symmetry with the recognition of the revaluation gains process for as long as a positive (credit) balance exists in the relevant revaluation reserves.

Issues of capital maintenance justify this asymmetrical treatment of unrealised revaluation losses for the purposes of distribution. These adjustments occur after the determination of operating profit for the period. The net impact is on the relative balances of realised and unrealised reserves within equity.

Alternatives to the treatment specified allow the accumulation of debit balances in the revaluation account. The Guidance adopts the approach of offsetting excess unrealised revaluation losses against realised earnings for the following reasons:

A  The accumulation of unrealised revaluations is a capital maintenance strategy. The accumulation of debit balances, rather than netting them against distributable realised earnings, risks the distribution of realised gains, while accumulating negative equity balances in the revaluation reserve. This defeats the capital maintenance logic of accumulating unrealised revaluations.

B  Internationally recognised accounting frameworks do not support the accumulation of debit balances in equity reserves for anything other than temporary occurrences.

C  The asymmetric treatment of recovered revaluation losses does not impact recognised earnings from operations. Rather, its impact is on the timing of distributions to stakeholders and the accumulation of realised and unrealised capital reserves.

The sale or reclassification of gold represents the transformation of gold from one asset class to another. Reclassification also changes the functional rationale for a monetary authority retaining the asset. Neither the sale nor reclassification provides a rationale for a monetary authority’s retention of accumulated unrealised revaluations attaching to the asset, unless the sale occurs as part of a foreign reserves portfolio rebalancing.

A monetary authority may maintain an accounting policy on the treatment of realised revaluation gains and losses. This may contain specific provisions covering the treatment of realised evaluation gains arising from a restructuring of the foreign reserve portfolio. This Guidance allows alignment of the treatment of realised revaluation gains from the sale of monetary gold with any policy on the treatment of realised revaluation gains.