How Will Fed’s Bailout of European Banks Impact Gold & European Markets?

Meanwhile, the planned participation of central banks across the globe in the scheme is now prompting some to ponder how these efforts will impact the drive for gold, as well as the future of the European economy. The *Washington Post* reports:

> The initiative, which entails temporarily swapping dollars for foreign currencies, also involves the central banks of Britain, Switzerland and Japan, underlining the extent of international concern about Europe’s deteriorating financial system. By tapping the Fed for dollars, the other central banks are taking advantage of long-standing arrangements, first put in place four years ago at the outset of the global financial crisis to prevent bank lending from freezing up.

News of the planned Federal Reserve contribution to the European central banks caused stock markets to surge. The Standard & Poor’s 500-stock index in the United States rose nearly 2 percent on Thursday, while the German stock market climbed 3.2 percent. Asian markets also showed an increase in early Friday trading. Overall, the value of the euro rose on a wave of investor optimism.

Investors in Europe have been hesitant to lend money to struggling banks, particularly at low interest rates, because the banks currently hold hundreds of billions of dollars in risky bonds issued by governments on the brink of default such as Greece and Portugal.

While the announcement of increased revenue from the Federal Reserve has given investors a reason to be more optimistic, that revenue does not ensure that the European financial system is in safe territory. Banks may still default.

However, the injection of dollars may prove to be a temporary bandage for bank shortages. It is particularly significant as banks are approaching the deadline to submit their annual financial reports. The *Post* explains,

> Traditionally, as they get ready to publicly report their financial positions, banks have shifted into cash and away from riskier assets as a way of buffing their appearance. This year, however, cheap dollars are increasingly hard to come by.

Prior to the announcement that central banks across the globe will increase revenue to struggling European banks, two unidentified banks turned to the European Central Bank for dollar loans. Earlier this week, French banks considered raising their prices for lending dollars so as to offset the rising

costs of their funds — an effort that would likely have caused further problems by sending French banks' customers elsewhere.

Typically, when European banks face a shortage of funds, they turn to the U.S. money market; however, because American investors are equally anxious, the Federal Reserve felt compelled to interject itself.

Economist Peter Schiff contends that intrusion by the Federal Reserve into the market does not work:

> It will … prevent the things that need to be happening from happening. It interferes with the correction and postpones the pain and makes it worse.

He noted two possible outcomes of the European Union's economic woes:

> On the other side of the Atlantic, one way or another there is going to be a resolution to the European situation. Either the governments are going to have real cuts in government spending, accept austerity and the bailouts or they are going to default. They can either default and stay in the euro or they can default and leave the euro.

Following the injection of U.S. dollars into European banks, gold plunged. On Thursday, it dropped in the New York futures market 2.5 percent to $1,781.40. Gold reserved for immediate delivery fell $28 to $1,782.91.

As noted by the *International Business Times*,

> Some traders regarded gold's drop in price as potentially beneficial for gold investors, many of whom regard the fundamental bull-market case for gold as being unchanged by the day's central bank announcement.

George Cocalis, senior market strategist at PFG Best in Chicago, asserts,

> It could be good for gold to make a base that would help it go higher later in the year and test the $2,000 level. I think $1,750 is a key number, if it can hold there then I would expect gold to move sideways and consolidate for awhile under $1,800 before it moves higher.

According to Peter Schiff, all these efforts by the central banks around the world will ultimately "drive demand for gold because all of the governments solve the problem the same way, by printing money."

Eventually, he observes, countries will realize the harsh reality that there is no stability in fiat currencies, as they will continue "to lose purchasing power."

Similarly, *The Nation* notes that as the economic system crumbles, its fiat currencies will collapse as well. It cites the example of Thailand: "The 1997 crisis saw the Thai baht collapse from Bt25 to Bt56 to the US dollar in six months. The Thai banking system became insolvent."

Tangent Capital Markets senior managing director Jim Rickards predicts that eventually fiat currency will drive the global monetary system back to the gold standard:

> It will be very transparent that we're just replacing one kind of paper money with another kind of paper money, and that is going to accelerate the rush to gold.
>
> As soon as people do the math, this is where you start to see these $5,000, $6,000, $7,000 an ounce price targets for gold. That's coming sooner than people expect. Some time in the next couple of years we will see that radical transformation of the international monetary system into gold.

Meanwhile, the *Wall Street Pit* asserts that the announcement that the Federal Reserve and Central

banks in Europe and Asia will be funding struggling banks reveals that “despite years of rhetoric against bank ‘bailouts’ and ‘too big to fail’ institutions, this no-failure rule is still the policy.”

Germany is particularly concerned by the collectivized debt policy that has plagued the European Union. Even if Germany forces Greece and other unstable borrowers to do whatever is necessary to repay their debts, including higher taxes and less spending, most analysts agree that these countries will likely be unable to repay all their creditors. As observed by *Wall Street Pit*, “Someone else is going to have to to take a hit. That someone else will be a combination of bondholders and taxpayers, mainly but not solely in Europe.”

Taxpayers in Germany as well as other (relatively) stable nations are voicing increasing opposition to the notion that they may have to help make up debtor nations’ shortfalls, but that does not mean they will be able to avoid this fate.

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