OFF THE NEWS

Bernanke's Claims Unfounded

The result of quantitative easing on individual countries' economic growth and inflation is dreadful. In the four years between the second quarter of 2008 (just before the Lehman event) and the second quarter of 2012, the Federal Reserve expanded its balance sheet by 34 percent per year. Yet the United States' nominal GDP and GDP deflator rose by 2 percent and 1.5 percent respectively in the same period. Thus, real GDP grew by only 0.5 percent.

In the same period, central banks in Great Britain, Europe, and Japan were also printing money as fast as they could. The Bank of England inflated its balance sheet by 40 percent, the European Central Bank by 20 percent, and the Bank of Japan by 9 percent. Meanwhile, Britain's nominal GDP rose 1.5 percent, Europe's by 0.6 percent, while Japan's fell 1.5 percent. Britain's GDP deflator increased by 2.4 percent, Europe's by 1.1 percent, and Japan's deceased by 1.4 percent. This led Britain's real GDP to fall by 0.9 percent, Europe's by 0.5 percent, and Japan's by 0.1 percent.

Japan's results, while bad, are not dire. This contradicts claims made by Ben Bernanke. In dollar terms, Japan's growth rate of 5 percent far exceeded that of the United States.

By comparison, Japan's results, while bad, are not dire. This contradicts claims made by Ben Bernanke, chairman of the Federal Reserve, who said his "aggressive" approach to quantitative easing would be far more effective in the short- to mid-term than the Bank of Japan's "timid" approach. However, as the above numbers show, this is not the case. Rather, the opposite is true.

During the above period, the Japanese yen appreciated against the U.S. dollar, while the sterling and the euro depreciated against the dollar. In dollar terms, Japan's growth rate of 5 percent far exceeded that of the United States, which was 2 percent (Great Britain's was -3.8 percent and Europe's was -4.2 percent).

Quantitative easing has failed. Yet no one can exit because this means higher interest rates (too dangerous for banks which own huge amounts of government bonds, and too dangerous politically). The sizes of the balance sheets of the Federal Reserve, the Bank of England, the European Central Bank, and the Bank of Japan are already 18 percent, 23 percent, 32 percent, and 30 percent of GDP respectively (before they picked up the unfortunate habit of easing at the first sign of trouble, balance sheets used to be below 10 percent of GDP). As these get bigger, the quality of the assets they own rapidly deteriorates, leading to a decline in the central banks' credibility. As this starts to happen, the money they print will be rejected in favor of assets such as precious metals and real estate.

Thus, competition will not be between currencies but between money and these sorts of assets. Capital controls for large parts of the global economy will hardly be an issue.

—Tadashi Nakamae

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François Hollande, Call Your Office!

A study by the World Economic Forum has some bad news for France. With labor costs and public spending rising, France is falling behind its eurozone big brother Germany in the global competitiveness race. The study of competitiveness of the world's economies ranks Germany number six, with France far behind at number twenty-one. Not surprisingly, France's trade deficit has soared. As *The Economist* magazine recently noted, "The Netherlands, with a fraction of its population, now exports more than France."

The Passing of a Friend

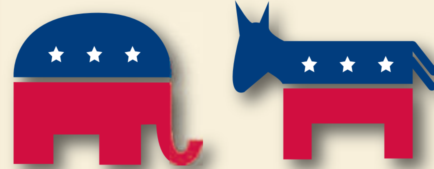
Helmut Sonnenfeldt, who passed away November 18 and was a supporter of this magazine, was one of Washington's great forces for good in the foreign policy arena. A Russian expert born in Germany, Hal made it to the United States after World War II and rose through Washington's foreign policy ranks to become by the early 1970s Henry Kissinger's key policy advisor on all matters relating to the Soviet Union.

By the mid-1980s, having long left government, Hal developed a new interest—international economics. He was instrumental in helping us start this magazine. Many of our writers through the years, from Lawrence Eagleburger to Kissinger himself, participated thanks to Hal Sonnenfeldt.

Perhaps most striking was the fact that for someone who had achieved so much professionally, Hal had a soft touch in his personal dealings. He deployed subtle arguments to persuade and had an uncanny ability to disrobe the inconsistencies of conventional wisdom without belittling his adversary.

He will be sorely missed by his wife Marjorie, his three children, and by the entire world policy community.

Helmut Sonnenfeldt



Counterintuitive Fact

For more than a century, the U.S. stock market has jumped an average of roughly 7 percent each year under Democratic presidents. Under Republican presidents? Only about 3 percent.

Are American High-Tech Firms Globally Vulnerable?

U.S. high-tech companies now earn nearly 54 percent of their revenue abroad. The average U.S. company earns less than 30 percent from overseas.

—*Bespoke Investment Group*

Germany's Gold at the New York Fed

Is it still there?

For a German public facing ever-larger rescue demands for the euro, the gold reserves of the Deutsche Bundesbank are touching raw nerves. Most Germans see the Bundesbank's stock of about 3,400 tons of pure gold as a national safety chest not to be touched.

Near the end of Chancellor Helmut Kohl's sixteen-year coalition government, his finance minister, Theo Waigel, tried to lower the federal budget deficit by revaluing the Bundesbank's gold reserves closer to market prices, causing a public outcry. Waigel gave up the idea. And when Paris, London, and Washington urged Berlin to permit the use of central bank reserves to bolster global rescue funds at the Cannes G-20 summit in July 2011, the Germans were clear: The Bundesbank's gold reserves were "untouchable."

In March, the German tabloid *Bild* let millions of German readers know how two members of the German parliament from the ruling Christian Democratic Union, Philipp Missfelder and Marco Wanderwitz, tried to view the German gold stocks stored at the New York Federal Reserve premises in downtown Manhattan, but were rebuffed. This caused another scandal. Whether the German gold that the Bundesbank hasn't checked for decades is still there is a question with far-reaching transatlantic implications.

Missfelder complained to *Bild* that the Bundesbank practice of not auditing its gold holdings at the New York Fed "apparently violates any applicable accounting law," and that this practice would be "a case for Parliament." When the two legislators wanted to see the German gold reserves at the Bank of England and the Banque de France, Carl-Ludwig Thiele, the Bundesbank's managing board member responsible for the gold, wrote them a letter arguing that "the central banks in London and Paris would not have suitable rooms for such visits."

So, since May of this year, under the campaign slogan "repatriate our gold," a citizens' initiative with ten thousand signatures called "Gold Action," backed by the German Association of Taxpayers, is lobbying to force the Bundesbank to prove to the German public that its gold reserves stored abroad are really still there and to bring them home as soon as possible. The initiative alleges that there is a real danger that Germany's gold could be expropriated as a result of the escalating financial and debt crisis.

Criticism from those in the Bundestag who are responsible for finance and the budget, from the accounting profession, and from Germany's federal auditors intensified into a storm of discontent. But Germany's independent central bankers, pointing to their confidential storage agreements with the foreign central banks, initially didn't see any reason to change their practices. Some defenders of the Bundesbank argue that the gold reserves were accumulated during the years when Germany had big current account surpluses, that returning the gold would be costly, and that repatriating the gold in a time of financial crisis could unsettle markets.

But eventually the Bundesbank's hard-line stance became untenable. Change came on October 22, 2012, when the German Federal Court of Auditors, which monitors the German government's financial management, presented a report requesting the Bundesbank to check Germany's gold reserves, a major part of which has been stored at central banks abroad since the Cold War. Germany's equivalent to the U.S. General Accounting Office found out that Germany's gold bars, stored in the United States, Britain, and France, "have never been physically checked by the Bundesbank itself, or other independent auditors, regarding their authenticity or weight." Instead, the Bundesbank relies on a "written confirmation by the storage sites."

The auditor's report confirmed that as of December 31, 2011, Germany had 3,396 tonnes of gold valued at some €133 billion ($173 billion) This is the second-largest national gold reserve after the United States. According to press reports, about 45 percent of the German gold reserves are stored at the New York Federal

Reserve with a market value of about €60 billion. That is more than at the Bundesbank headquarters in Frankfurt, where 30.5 percent of its gold reserves are held with a market value of €40.5 billion.

In the meantime, Germany's central bankers are signaling they will heed the federal auditors' plea, adding that the New York Fed will help them to audit their gold holdings. Before the federal auditors' report, the Bundesbank already had announced that in the coming three years they plan to bring home fifty tonnes of gold from the New York Fed each year.

In early November, Andreas Dombret, the Bundesbank's managing board member for international affairs and financial stability, was eager to calm emotions during a reception at the Bundesbank's New York representative office. With William Dudley, president of the New York Federal Reserve, present, Dombret denounced what happened in Germany as a "bizarre public discussion of the safety of our gold deposits outside Germany which is driven by irrational fears." And looking beyond the "phantom debate," Dombret expressed the hope that "following the statement by President Dieter Engels of the Federal Court of Auditors in Germany, the discussion is now likely to come to an end—and it should do so before it causes harm to the excellent relationship between the Bundesbank and the U.S. Fed."

—*Klaus C. Engelen*

FEDERAL RESERVE BANK OF NEW YORK

The gold in the vault of the Federal Reserve Bank of New York attracts more than 25,000 visitors a year. The vault rests on the bedrock of Manhattan Island—one of the few foundations considered adequate to support the weight of the vault, its door, and the gold inside—eighty feet below street level and fifty feet below sea level. As of early 2008, the Fed's vault contained roughly 216 million troy ounces of gold, representing about 22 percent of the world's official monetary gold reserves.