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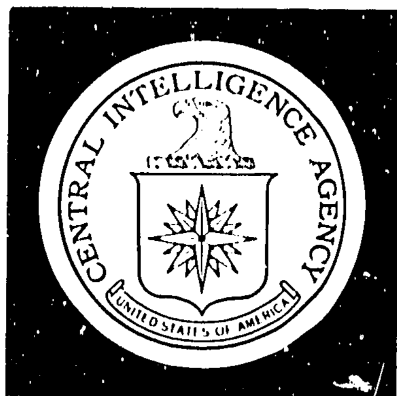
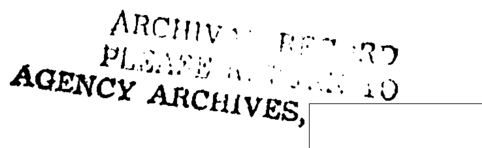


DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Recent Trends In The Free Gold Market

International Finance Series No. 25



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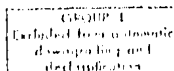

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1970

INTELLIGENCE MEMORANDUM

Recent Trends In The Free Gold Market

Introduction

After about a year of relative stability, gold prices on the world's free markets jumped nearly $3 per fine ounce in October. This memorandum attempts to explain the reasons for the recent sharp rise in free market gold prices and assesses the outlook for these prices in the near term.

Background

1. The world's major free gold market centers -- London and Zurich -- lost much of their lethargy in October when prices spurted above $39 per troy ounce of fine gold for the first time since early November 1969. For most of 1970, prices stabilized near the official level of $35 per ounce. Then in early September prices climbed above $36. After trending slightly upward through the remainder of the month, prices advanced another $3, reaching as much as $39.50 on 26 October; prices fell to about $38.00 on 29 October.

Analysis

2. South Africa has been marketing virtually all of its newly mined gold in an orderly manner in the free market -- 300 tons, worth some $347 million at $36.00 per ounce -- in the last three to

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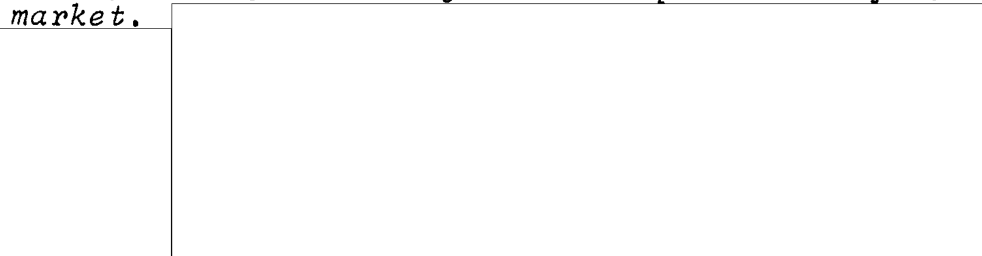
four months. In the absence of any monetary crises there seems to be no obvious explanation for the recent substantial price increases for gold. There is, however, strong circumstantial evidence that Zurich bullion dealers, under the leadership of the Union Bank of Switzerland, are again manipulating the gold markets. London bullion dealers had hoped that the 1969 "December Agreement" between the International Monetary Fund (IMF) and South Africa* would restore London to its former position as the focal point of the world gold market. It has not. We have no evidence whatever that South Africa during 1970 sold an ounce of gold to any free market dealer other than the Union Bank.**

3. Throughout October 1970, Zurich has been rife with rumors that the presence of large buyers in the market has resulted in heavy trading volumes. There is little basis, however, for presuming that trading volumes have risen substantially above the thin 15- to 20-ton weekly maximums quoted in mid-1969. (Zurich dealers discontinued their practice

* *This agreement enables South Africa to sell gold to monetary authorities, primarily the IMF (1) when the free market price drops to $35 per ounce or below, and (2) when South African balance-of-payments deficits exceed receipts from the free market sale of all newly mined gold. (It was under this first provision that about one-half of South Africa's $307 million sales during the first half of 1970 entered IMF repositories.) Because the price criterion has not been operative since early March, South Africa has been obliged to sell virtually all of its newly mined output on the free market.*



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** *It is not certain whether the Union Bank is currently acting alone or whether some form of the 1968-69 Zurich Consortium consisting of the Union Bank, the Swiss Banking Corporation, and the Swiss Credit Bank has been reestablished.*

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of posting weekly trading volume more than a year ago.) Several London dealers believe that the free gold market is reacting to moderate Continental buying and an almost complete absence of selling.

4. The present situation implies effective control of free market supplies by the Swiss commercial banks. For now, at least, Union Bank as the major influence in the Continental gold market is probably in a position to manipulate the market price. Furthermore, Union Bank's actions are well timed to coincide with a number of recent events, coincidental or otherwise, that provided the initial impetus for free market price increases in late August. In June 1970 the second of two recent studies on worldwide demand for gold was published by Charter Consolidated, an affiliate of South Africa's Anglo American Corporation. This study, like the one prepared some months earlier by Consolidated Gold Fields, concludes that gold demand from both industrial users and hoarders* already exceeds annual free world output. Gold demand from these two sources normally shows a seasonal increase toward the latter part of the third quarter when jewelry manufacturers rebuild their inventories for the coming year and when smugglers, following the monsoon season, again are active between Dubai on the Persian Gulf and the Indian subcontinent. Then, several less-than-disinterested, although respected individuals** made similar statements pointing to the inevitability of the free market gold price rising to as much as $100 per ounce by 1980.

5. The most recent attempt by Zurich to influence free market prices came in late October

* *This definition includes medium-term holders as opposed to speculators who seek relatively quick profits.*

** *The financial press cited the statements of individuals such as Dr. Nicolaas Diederichs, the South African Minister of Finance, Dr. Milton Gilbert, Economic Advisor to the Bank for International Settlements in Basle, and Paul Jeanty of Samuel Montagu, one of London's five bullion dealers, who have especially noted the sizable US payments deficit in 1970.*

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with the pronouncement that the "overhang"* created during the "gold rush" of late 1967 and early 1968, had been fully absorbed by the system. Prior to the establishment of the two-tier market in mid-March 1968, speculators and quasi-hoarders drained $3.2 billion in monetary gold from the London Gold Pool. This gold has indeed been gradually finding its way into industrial uses and permanent hoards.

6. It is difficult to estimate the present size of the overhang, although there clearly is a pool of privately held gold that will continually find its way into the free market as prices move upward. At the end of 1969, David Lloyd Jacob, author of the Consolidated Gold Fields report, estimated the overhang to be $1 billion (890 tons valued at $35 per ounce); other estimates made at the same time (none have been made more recently), including one by Alexander Hay of Switzerland's Central Bank, ranged as high as $1.8 billion. We believe that the latter figure is probably the more likely and that the overall private demand for gold now about equals annual Free World output. On this basis, industrial users and hoarders through mid-October would have purchased approximately 1,000 tons. This current demand exceeds the free market supply of newly mined gold by about 150 tons -- roughly the amount South Africa sold to the IMF under the December Agreement. The $1 billion overhang estimated by Jacob is more than enough to allow for increased speculative activity and cover the 150-ton shortfall.

7. What the Union Bank hopes to achieve by its manipulative activities is to stimulate speculative demand for gold; they may believe the free market price can be forced beyond the $50 per ounce level. In any event, the Union Bank and its associates clearly are desirous of recouping some of last year's losses accrued during the precipitous decline in free market prices in October and November 1969.

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* *The overhang is a catchall phrase covering potential free market supplies that have not yet gone into either industrial uses or permanent hoards such as those in France, the Indian subcontinent, and the Far East.*

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The Outlook

8. The long-term trend for free market gold prices is upward. Worldwide industrial demand, now estimated at between 800 and 900 tons annually, is growing at a rate of about 5% a year. The recent sharp rise in the free market price, however, appears to be a short-term aberration caused by tampering with normal market forces. The Swiss banks responsible for precipitating this development are presently faced with large and growing inventories of gold, which now could exceed $450 million -- 400 tons at $35.00 per ounce. While they probably have the resources to increase this stockpile further, the Swiss banks will almost certainly begin to sell some gold soon. The fall in free market prices during the last week of October may be evidence of this fact.

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