THE LONDON GOLD MARKET

Background London is the largest and most important gold market in the world. Its origins lie not too clearly defined in the history of the development of London as a financial centre. The firm of Mocatta and Goldsmid was founded in 1684, ten years before the granting of the Bank of England's Royal Charter. It was not until the nineteenth century, however, that London achieved its eminence, both for the refining and marketing of gold bullion and also for the exchange and disposal of gold coins of various countries. That eminence was in fact achieved before the discoveries of gold in Australia and South Africa, which made London's position ultimately even stronger.

Constitution In the English way, the London gold market has no written or formal constitution. Like so many other institutions which are now a normal part of London's daily life, it has developed in response to changing needs and demands over the years and has adapted and modified its rules and procedures as it went along.

There are at present five members of the London gold market:

Johnson, Matthey & Co., Ltd.
Mocatta & Goldsmid Ltd.
Samuel Montagu & Co., Ltd.
N. M. Rothschild & Sons.
Sharps, Pixley & Co.

Two (Montagus and Rothschilds) are merchant banks, one (Mocattas) is wholly owned by a merchant bank, one (Sharps Pixley) is a pure broker, and the fifth (Johnson Matthey) is a metallurgical firm of international repute. Two of the members (Johnson Matthey and Rothschilds) melt, refine, assay and process gold. Rothschilds act as chairman of the market and have done so since the market was constituted in its present form after the First World War, and the daily gold price fixing takes place on their premises.

All authorised banks under the Exchange Control Act, 1947, are also authorised to deal in gold. But in practice dealings are largely concentrated in the hands of members of the gold market, plus one or two others. The significance of membership of the market is that it confers the right to be present at the daily price fixing which is described below.

In an active market, gold changes hands in considerable quantities; and for this to be done efficiently there must be a recognised specification for bars which are regarded as 'good delivery'. The requirements of the London market list of good delivery bars are that the bar has been melted and stamped by one of the forty or fifty refiners or mints situated all over the world which have been approved by the market. It must also carry a similarly acceptable assay shown either by an impressed stamp or by an assay certificate which must accompany the bar. The bar must assay at least 995, that is to say, at least 995 parts in 1,000 must be pure gold, and it must contain between 350 and 430 troy ounces of fine gold (the fine gold content is the product of the gross weight multiplied by the assay).

Changes are made from time to time in the London market list of acceptable melters and assayers by way of either addition or deletion. The former occur only after stringent tests have been made on sample bars by two London refiners independently which have satisfied the members of the market that the bars produced by a melter can be relied upon to conform to London's standards. Deletions happen very seldom but have occurred, for example, as the outcome of war. History and the technical expertise to be found here have resulted in the London market's standards being the basis of acceptability for gold bars in most countries in the world. One exception is the United States, where the authorities will accept only the stamp of the U.S. Assay Office; this means in effect that all gold tendered for sale in that country has to be re-melted, unless it happens to consist of a complete 'melt' of U.S. Assay Office bars which has not left the country.

Bars of sizes smaller than the good delivery bars described above are also produced by British refiners to meet the requirements of customers on the Continent of Europe and in other places throughout the world. Dealings in all kinds of gold coins also take place.

The London fixing price The daily fixing of the gold price, which takes place at Rothschilds beginning at 10.30 each morning, is the only daily international gold price fixing of its kind in the world. There is no fixing on Saturday or on New Year's Day; but on all other working days a representative of each of the five members of the gold market attends in person at the 'fixing room' at Rothschilds, a member of which firm takes the chair. Each of the five persons present is in communication, by direct telephone, throughout the course of the fixing with his own trading room, where, again, there may be direct communication by telephone or telex with operators in foreign centres who may be interested in dealing at the fixing if the price is right. The chairman will suggest a price, in terms of shillings and pence down to a farthing; this price will be chosen at the level where it is thought that buyers and sellers are likely to be prepared to do business. When the tentative price is proposed, all present declare the nature of their interest at that price, *i.e.*, as sellers or as buyers (or having no interest either way) with the sellers stating their amount but without, at this stage, the buyers declaring their actual requirements. If all present should declare themselves as buyers and no selling interest appears, business clearly cannot be done and the price is then moved up; conversely if all are sellers and there is no buying interest the price is moved down. At the new tentative price interests are again declared and this goes on until there are the possibilities of business, that is to say until there are both buyers and sellers in evidence. At this stage the extent of the buying interest is declared and a count is taken. If, for example, there are buyers of 400 bars and sellers of 250 bars, those present must decide whether the 250 bars will be shared out amongst the buyers or whether the price shall be bid higher. Anyone has the right to bid a higher price or, if the selling interest is uppermost, to offer at a lower price. Finally a point is reached where buyers and sellers come together at a price, and that is the fixing price of the day.

It may be sensed from the foregoing that there is a subtle difference between the attitude towards the seller and that towards the buyer. This difference stems from a tradition that, while a large buyer may have to face a sharp increase in price if he wants to see his demands satisfied in full at the first time of asking, the market should always be slightly biased in favour of endeavouring to absorb all new production or other gold which may be offered at the fixing.

Operations on the London market Operations on the London market are not confined to the amount of gold changing hands at the fixing price in the fixing room. It frequently happens that any one or all of the five members of the market have in hand both buying and selling orders to be executed at the fixing price; if so each member will offset buying orders against selling orders and will only go into the fixing room to transact the net balance of purchases or sales. There is no obligation for any member to declare or fulfil all his orders in hand at the fixing; he may, if he judges it to be more advantageous, execute part at the fixing and postpone the balance until later. A good deal of business is frequently done after the fixing has taken place at prices which may vary considerably during the course of a day. The amount turned over at the fixing can represent as much as 90 per cent. of the day's business or as little as 10 per cent. Some international dealers prefer to operate at the fixing; others prefer to wait until the fixing has taken place and they can see what is the trend of the price for the day before doing their business. Operations whether at the fixing or afterwards are ordinarily for delivery of gold loco London and for payment two working days later. A commission of $\frac{1}{4}$ per mille (minimum ten shillings) is charged on all deals at the fixing. Transactions effected at times other than the fixing, transactions for value dates other than the normal two working days ahead and those in currencies other than sterling are a matter of negotiation and may be dealt in at net prices without commission being charged separately. There is no organised or regular market in gold for forward delivery as there is in foreign exchange, though forward operations do take place, often for large amounts: those are however a matter of negotiation each time. While ordinary transactions are in gold for delivery loco London, deals can be arranged in the London market for delivery in other centres; (conversely a good deal of international business transacted in other centres or on the international telephone is in gold for delivery loco London).

The factors operating in the London market are broadly the following:

On the supply side

New production
Central bank sales
Other sales (including from time to time important amounts on Russian account)
Dis-hoarding

On the demand side

Central bank purchases
Purchases for industry and the arts
Hoarding purchases

The line of distinction between industrial and artistic consumption on the one hand and hoarding on the other is one which is not very clearly defined since increased demand for gold jewellery can, varying from one country to another, be either a disguised form of hoarding or a normal concomitant of inflation or just a result of a rising standard of living.

Hoarding is a term of art. In certain countries in the East, gold is the traditional manner of storing wealth, while in conservative-minded agricultural communities in various parts of the world it is a normal method of saving. Furthermore, in a number of countries throughout the world, a holding of gold has come to be regarded as a status symbol. In other countries, particularly on the Continent, gold may be held as an alternative to cash for balance-sheet purposes. So hoarding has come to mean all demand for gold which does not derive from central banks for reserve purposes or from industry and the arts in the stricter and literal sense of those terms.

The Bank of England's part The Bank of England are not physically represented at the fixing. But they are able, like any other operator, effectively to participate in the fixing by passing orders by telephone through their bullion broker and at the fixing they use exclusively the services of the chairman of the market, namely, Rothschilds. The Bank operate for a number of different parties; they are first the managers of the Exchange Equalisation Account, which may be a natural buyer or seller of gold: secondly, they are the agent for the largest single regular seller of gold in the world, namely, the South African Reserve Bank, which is responsible for the disposal of new production in South Africa: thirdly, they execute orders for their many other central bank customers: fourthly, the Bank aim, as in the case of the foreign exchange and gilt-edged markets, to exercise, so far as they are able, a moderating influence on the market, in order to avoid violent and unnecessary movements in the price and thus to assist the market in the carrying on of its business.

Other markets There are gold markets in other places. Leaving aside Paris, which is a domestic market, and Bombay which, since gold dealings were banned at the end of 1962, is no more than a black market, markets of varying importance exist in Switzerland, Belgium, Beirut, Aden, Cairo, Kuwait, Bahrain, Dubai, Bangkok, Saigon, Macao, Hong Kong, and in a number of other places as well, including more recently Johannesburg. During the period when the London gold market was closed (from September 1939 to March 1954) most of the international gold traffic was centred in Switzerland, Beirut and Tangier—which has now lost its international status and no longer has an organised gold market—or in the East. The effect of reopening the London gold market in 1954 was to introduce a greater degree of stability into international dealings and to moderate fluctuations in the price of gold.

The gold pool The so-called gold pool is a kind of gentlemen's agreement which has been evolved experimentally and by consultation over the past two or three years with the aim of co-ordinating the gold operations in London of certain European central banks and of the Federal Reserve Bank of New York. Its origin can be traced back to the autumn of 1960.

In that year the demand for gold in the London market had been strong on both private and central bank account. In the late autumn uncertainty about the U.S. dollar increased, partly because of the continuing U.S. balance of payments deficit and partly because of doubt about what American official attitudes on economic and financial questions would turn out to be after the November Presidential election. Thus a number of different factors conspired towards an increase of tension, which ultimately led to the flurry in the gold markets towards the end of October when gold dealings took place at or above the price of $40 per fine ounce. This state of affairs threatened the whole structure of exchange relationships in the western world. In these circumstances, the Bank of England, with the full support of the U.S. monetary authorities, intervened in the market as substantial sellers of gold in order to bring the price down to more appropriate levels.

Because of their potential effect upon confidence in the existing international exchange system, the disturbances in the gold market were of concern to the monetary authorities of many countries. It was natural therefore that they were discussed at Basle, where the monthly board meetings of the Bank for International Settlements provide a convenient forum in which representatives of certain European central banks and of the Federal Reserve Bank of New York meet regularly. The European central banks recognised that, as central banks can purchase gold freely through the Federal Reserve Bank of New York at $35 plus commission, there was no financial reason why any central bank requiring gold in London should pay a higher price on the London market than the effective New York price, after taking into account the cost of shipping gold from New York to London.

President Kennedy's pledge in January 1961 to maintain the existing gold value of the dollar had the effect of diminishing speculative demand for gold and, with additional supplies, especially Russian, coming on to the market, the free market price had declined to the level of the U.S. selling price by the early spring of 1961.

Then followed a period, lasting until about mid-1961, when conditions in the gold market were easy. Against the residue of demand which persisted for some while after the flurry of October 1960, gold supplies were increased by three important factors which roughly coincided at that time : substantial Russian sales, offerings from private U.S. holders required by law to dispose of their stocks, and large sales out of the British gold reserves during the sterling crisis which was touched off by the German and Dutch revaluations.

This respite did not however last very long. The special factors referred to on the supply side of the market tapered off in the summer of 1961 at about the same time as the two main western producers, South Africa and Canada, began to build up their gold reserves. Simultaneously the U.S. deficit began to widen and political uncertainty increased as the Berlin crisis developed. So with supplies tending to diminish and demand strengthening, the market price of gold came under pressure again. By the end of August it had risen to nearly $35·20 and it remained not far below that level until mid-November.

It was during this period that further progress was made in developing international co-operation in relation to the gold market. With the price above the inward shipping parity from New York, none of the more important continental central banks was in the London market as a buyer. But other demand was building up so as to threaten the possibility of either another steep and alarming rise in the free market price in London or else of a concentration of gold purchases in New York which might have led to a sharp and equally disturbing fall in the U.S. gold stocks. The monetary authorities in the United States, the United Kingdom and on the Continent clearly had a common interest in taking any action they could to maintain orderly conditions in the gold and exchange markets. So in October 1961, the U.S. financial authorities proposed the setting up of an informal kind of arrangement, the object of which would be to share the burden of the cost of intervention on the London gold market to keep the price within reasonable limits in the event of exceptional and concentrated demand for gold arising either from an international political crisis or from speculative movements of funds. This proposal was accepted and the central banks of Belgium, France, Italy, the Netherlands, Switzerland, Western Germany and the United Kingdom agreed, in case of need, to co-operate with the Federal Reserve Bank of New York in a sales consortium for the purpose of stabilising the gold market. The Bank of England were to act as operating agent for the group, with authority to draw on a pool of gold to which the European central banks undertook a commitment to contribute according to agreed quotas, the United States undertaking to match the combined contributions of the other participants, thus taking a 50 per cent. share in the consortium. In November 1961, this arrangement was given a trial run for a period of a month and then put back into suspense; the moderate amounts sold were recovered from subsequent purchases of gold in London, after the trend of the market had changed, and were repaid to those concerned by the end of February 1962.

Early in 1962, the trend in the price being downwards, it began to appear that a surplus of gold might soon arise in the market. This prompted another proposal from the United States to the Basle group of central banks, this time for co-ordinated buying of gold on the London market, which was adopted experimentally in February 1962 and confirmed in April of the same year. Under this arrangement the participants, who were not natural buyers of gold in London when the price there was out of line with the U.S. official selling price, agreed to co-ordinate their purchases whenever the London price was below that level. Separate purchases of gold in London by individual participants in the group have thus been replaced by Bank of England buying, for the joint account of the group, of whatever gold is available at or below the U.S. selling price, with purchases being periodically distributed on an agreed basis amongst those who are interested as buyers.

By the late spring of 1962, total purchases made on behalf of the pool had reached the equivalent of about $80 million. But before any of this had been distributed, sentiment changed, following the break on Wall Street and other stock markets and the speculative flight from the Canadian dollar in May. One repercussion of these two events was to revive the demand for gold and by mid-July the pool's accumulated surplus had all been used to stabilise the market.

Demand for gold continued to grow and towards the end of July the sales consortium was brought into operation. Although President Kennedy's "Telstar" broadcast on the 23rd July brought some temporary relief to the buying pressure for gold, by the time of the annual meeting of the International Monetary Fund in September the pool had put a net amount equivalent to nearly $50 million into the market. After the I.M.F. meeting there was a lull until the third week in October, when the Cuba crisis broke and led to record demands for gold on the London market, in face of which substantial sales from the pool were made. The price did not rise above $35·20. Then large Russian sales took place and within a very short period the Cuba crisis itself eased, so that by the end of October net sales to the market from the pool since the reactivation of the sales consortium in July were well under $100 million; by December all of those sales had been recovered and repaid to the participants, and the sales consortium was again put into suspense and has not since been reactivated. But it remains there for use in case of need.

In 1963 experience was much more favourable. Though industrial demand continued to increase and other private demand was persistent from some quarters, there was from time to time a perceptible amount of dis-hoarding, particularly of speculative positions taken up at the time of the Cuba crisis. In addition supplies of new production coming forward for marketing showed a steady increase and Russian gold sales were larger than usual in order to provide finance for purchases of wheat.

From the beginning of co-ordinated operations in November 1961 until the end of 1962, amounts of gold contributed by the participating central banks to support the market and amounts distributed to them at other times out of the surpluses arising were roughly equal. But during 1963, while no contributions had to be made by the participants to support the market, gold amounting to rather more than $600 million was shared out amongst the central banks participating in the pool.

The gold pool thus in principle consists of two parts. First, there is a selling consortium which is not in operation all the time, but which may be invoked, when conditions demand, in order to stabilise the market. Secondly, there is a buying syndicate, which is nothing other than co-ordinated, instead of independent, purchasing on the London market by a group of central banks. The gold pool is not a rigid, cut and dried scheme. It originated to meet a practical need, developed in response to the behaviour of the markets and in accordance with the spirit of co-operation existing between a group of central banks whose interests lie closely together, and is operated in a flexible and informal manner. The underlying objective has been to avoid unnecessary and disturbing fluctuations in the price of gold in the free market, which might have, and probably would have, undermined confidence in stability of the exchanges, the maintenance of which is a common objective of all of the participants. The gold pool has done much towards achieving this objective. From the practical standpoint, the operations of the pool, which has both bought and sold, have shown a considerable balance in favour of the participating central banks, that is to say a considerable addition to monetary reserves. Whether the accrual of gold to central bank reserves would have been smaller without the existence of the gold pool is impossible to prove. But there is little doubt that the knowledge that central banks were working together in the gold, as well as in the exchange, markets has helped to maintain public confidence in the existing international monetary structure.