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Intelligence Memorandum

INTERNATIONAL FINANCE SERIES NO.1

Competition for South African Gold

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Foreword

This memorandum is the first of a series of occasional publications on international financial problems. A related series on gold markets is planned to be published monthly.

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
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INTELLIGENCE MEMORANDUM

INTERNATIONAL FINANCE SERIES NO. 1

Competition for South African Gold

Summary

The battle for domination of the new free gold markets has been joined. Two powerful private groups, one of which is a combination of Swiss banks and the second a consortium of international interests, are actively seeking exclusive control of the marketing of South African output, which accounts for about 75 percent of all gold mined in the Free World. South Africa, in an attempt to push the price level higher, has refused to market gold for the past two months. While an immediate marketing channel is not at issue, South Africa will not be able to suspend gold sales indefinitely, since gold pays for about 40 percent of its imports. South Africa can, however, maintain a gold embargo for many months if it chooses to do so, at least through the remainder of 1968.

If the marketing contest were restricted to these two private groups, the Swiss banking combine might well emerge victorious. However, the London bullion dealers may well enter the contest before South Africa makes a marketing decision. Also, South Africa probably will avoid making an exclusive dealing commitment with any single group in order to preserve its own flexibility.

London bullion dealers represent the strongest potential rival to the Swiss group in the competition for control over purchases and resales of South African gold. Unless restrained by the Bank of England, they can be expected to enter the contest

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for new gold once South Africa is ready to resume sales on a large scale. Paris dealers are not likely to become a major force in the competition for South African gold unless the French government exerts pressure and provides subsidies to support such a venture. Although rumors abound, there is no firm information that the French government is so engaged.

Introduction

1. The structure of international gold markets has been in flux since 17 March 1968, when the heads of seven major central banks meeting in Washington decided to stop supplying gold to private buyers from their reserves and, at least temporarily, to cease purchasing privately held or newly mined gold. This decision, in effect, established two separate markets -- one for monetary and another for nonmonetary gold transactions. Monetary gold continues to be traded among central banks at the fixed price of $35 per ounce, while producers, industrial consumers, speculators, and hoarders trade in a free market at prices determined by supply and demand.

2. Since the establishment of the new "two-tier" system, gold prices in the principal free markets have been held down by a large "overhang" ($2 billion to $3 billion) of bullion purchased during the recent monetary crises. Many speculators who bought heavily are now not willing to sell at prices yielding only a modest gain over their $35 per ounce purchase price, and liquidation has been slow.

3. The existence of the overhang is a temporary phenomenon, although its duration is uncertain. How long it will persist depends on three factors: (1) the expectations of speculators on the extent of the price rise; (2) the time required for industrial and artistic demand for gold, as well as purchases for long-term holdings in hoards, to absorb the excess supplies; and (3) the rate at which newly mined gold (and any gold from official reserves) enters the market.

4. In these circumstances, the major suppliers have been reluctant to enter the market. The USSR, the world's second largest producer, has not been selling gold because it has currently no need for larger supplies of foreign currencies and prefers to build up its gold reserves. South Africa, whose annual output constitutes more than 75 percent of the Free World's gold production, also has ceased exporting gold. The South African Finance Minister announced on 9 April 1968 that South Africa would market no gold for the time being. Although gold normally pays for about 40 percent of its imports,

South Africa can hold its gold production off the market for months without detrimental effects on its economy. Trade deficits have been covered by a large inflow of private foreign capital, and foreign bank credit is readily available if needed. Nevertheless, South Africa may choose to resume gold sales at any time. Anticipating a resumption of South African gold sales, two private groups -- one Swiss, the other international -- have begun an intense competitive scramble for major customers and for exclusive rights to sell South African gold.

The Swiss Group

5. Three of Switzerland's largest commercial banks -- the Swiss Bank Corporation, the Swiss Credit Bank, and the Union Bank of Switzerland -- have formed a group to manage the Zurich gold market and to acquire exclusive rights to sell South African gold. Even before the London gold market suspended operations for a two-week period beginning 15 March, the Union Bank of Switzerland, acting for the group, sent a representative to South Africa to negotiate arrangements for gold purchases and shipments. A bid was submitted to the Reserve Bank of South Africa on 14 March, but was turned down. Meanwhile, the Union Bank had instructed its representative in Johannesburg to obtain the personal assistance of officials in Union Acceptances, Ltd., of South Africa, a financial house with extensive contacts in the Reserve Bank. All these efforts failed.

The International Consortium

6. On 19 March, a competitor entered the picture -- a consortium consisting of two French commercial banks, a major US trader and industrial consumer of gold, Union Acceptances, Ltd., of South Africa, a small Swiss financial house, a London bullion dealer, and several individuals. None were members of the Swiss group, except Union Acceptances, which appears to have a foot in both camps at the same time.

7. The consortium expressed its goal unambiguously: to establish itself as the sole outlet for South African gold. On the selling side, the consortium hopes to achieve control of the market for industrial and artistic uses and then to supply speculative and hoarding demand from its surplus gold holdings.

8. A major effort was made to persuade the South Africans that the consortium controlled all of the industrial outlets in Europe and, therefore, that it was uniquely suited to market all South African gold. The consortium did not possess the degree of control it claimed, but it was making a systematic and energetic effort to gain such mastery. It laid plans to enter every available market with a price quotation $0.25 per ounce below that of the lowest bidding competitor. The consortium probably was prepared to meet these commitments either with gold on hand or with gold newly purchased at a higher price, the prospect of market control compensating for temporary losses that might be involved.

9. At this point, the South Africans expressed their displeasure with the absence of other bidders. The consortium thereupon decided to have various members enter the bidding individually to create an aura of competition. Whether or not any members actually entered individual bids is not known. In any event no sale is known to have resulted.

Further Competitive Moves

10. During late March and early April, both groups engaged in active competition for the South African gold account. The Swiss group issued public statements claiming that the volume of gold transactions on the Zurich market was large and confidently predicting that Zurich would replace London as the principal international gold market. It continued to press this argument, without success, in a high-level personal visit to the head of the Reserve Bank of South Africa. On 25 March, its representative was informed that no South African decision had yet been made. The continued failure of the Swiss group apparently was discovered quickly by the consortium. Indeed most moves of the Swiss group were made known to the consortium, probably by Union Acceptances. During the final week of March, the consortium formally presented its marketing proposals to officials of the Chamber of Mines, a private association that contols production and refining of gold in South Africa.

11. South Africa continued to delay a decision. Then on 27 March, the Reserve Bank of South Africa requested both the Swiss group and the consortium to

place formal bids for about three tons of gold. On the same day, the Prime Minister announced that South Africa would sell gold on the free market, but he did not say when. Since no gold transactions are known to have resulted, the request for formal bids probably was a tentative probe by South African authorities to test the price expectations of major free market dealers. Indeed, on 9 April the South African Prime Minister stated that his government would continue to withhold gold and would remain open-minded about future marketing arrangements. Then on 7 May a representative of the Swiss banks reported from Johannesburg that a meeting with a high official of the Reserve Bank of South Africa would result in a decision (probably on gold sales through Zurich) the following day but that Zurich was to expect nothing firm until the end of May.

London and Paris

12. The financial press has created the impression that the contest for control of free gold markets in Western Europe is a three-way affair among dealers in Zurich, London, and Paris. The major gold dealers in each of these three cities are organized to conduct retail transactions in their own markets. But so far, only those in Zurich also have actively sought control of South African sales, which is essential to secure future control of the wholesale function for all markets in Western Europe.

13. For almost seven years -- May 1961 through mid-March 1968 -- the Bank of England, acting as agent for Gold Pool members and operating through London gold dealers, controlled the wholesale function. During that period, the main suppliers were the US Treasury and the South African Reserve Bank. London lost its control of wholesaling in mid-March 1968, when Gold Pool operations were abandoned in favor of the two-tier market. The US Treasury no longer supplies gold to the free market. The Bank of England, in support of the new system, has relinquished its role of agent for South African sales, at least for the time being. So far, the London dealers on their own have not actively sought to regain control of South African sales.

14. Paris dealers on 9 May announced that, henceforth, trading would be conducted throughout the day rather than be limited to an hour or less as had been the practice for years. They also announced, however, that prices would be set at 11:45 A.M. and 3:30 P.M., well after the morning and afternoon "fixes" in London and after trends are established in Zurich. This time lag suggests that, at least for the present, they do not see Paris as the leading market in Western Europe. Moreover, the principal dealers in Paris, like those in London, have not actively sought control of South African sales.

Outlook

15. The struggle between the Swiss group and the international consortium is likely to continue for at least as long as South Africa withholds the bulk of its supplies from the market. The Swiss group's three principal members are located in the same city and operate under the same liberal laws. Moreover, they have numerous active accounts and continuous market contacts. The international consortium is not yet a going concern and could not sustain profitable operations on a large scale unless it acquired substantial quantities of South African gold.

16. Unless they are restrained by the Bank of England, London bullion dealers can be expected to enter the contest for new gold once South Africa indicates a readiness to resume sales on a large scale. Possessing many advantages, the London dealers represent the strongest potential rival of the Swiss group. Their position would be even more formidable if the Bank of England reinstituted arrangements with the Union Castle Steamship Lines for transporting bullion from Durban to London at exceptionally low rates. Moreover, because a major London dealer is a member of the international consortium, a community of interest could quickly develop, combining the London dealers' cost advantage and the consortium's access to major industrial users.

17. Paris dealers are not likely to become a major force in the competition for South African gold unless the French government exerts pressure and provides whatever subsidies are needed to support such an effort. Although rumors abound, there is no firm information that the French government, acting with or without the Paris dealers, is so engaged.