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DIRECTORATE OF
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Intelligence Memorandum

International Finance Series No. 6

The World Gold Market

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
September 1968

INTELLIGENCE MEMORANDUM

The World Gold Market

Summary

During August 1968 the United States bought more gold than it sold, price fluctuations in gold markets were narrow, and South Africa established a mechanism to continue selling gold clandestinely on the free market.

In August the United States acquired, on balance, $5 million in gold. Nineteen countries purchased a total of $84.8 million, but sales to the United States totalled $89.8 million. Algeria was the principal buyer ($49.9 million) and France the principal seller ($80 million). Many small countries continued to shift their reserves from sterling and dollars into gold, and purchases from the United States by small nations that are planned for the remainder of 1968 were $124.3 million as of the end of August.

The outstanding development in free gold markets during August was the conclusion of an arrangement whereby South Africa can continue [redacted] 25X1 gold sales. A consortium of European commercial banks, headed by the Swiss "Big Three" (Union Bank of Switzerland, the Swiss Credit Bank, and the Swiss Bank Corporation) have arranged a credit line of $140 million, with drawings to be repaid by South African gold shipments to Europe. Deliveries of gold under this agreement already have begun, with three air shipments of 8.5 tons each recorded in August and two shipments of 11.4 tons each scheduled for September. Thus total shipments delivered and scheduled through September aggregate 48.3 tons.

Earlier issues in this series have featured background sketches of major world gold markets. This issue focuses on the organization and operation

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Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research.

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of the Beirut market. Unlike the main European gold markets (London, Zurich, Paris, and Frankfurt), the Beirut market owes its position of importance to smuggling. Lebanon permits gold to be imported legally and offers excellent banking and commercial facilities. Beirut has become one of the world's principal centers for gold smuggling and the most important in the Middle East.

Most of the gold for the Beirut market is imported legally from London and Zurich (imports recently have run from about 10 to 15 tons per month) by three commercial banks -- Société Bancaire du Liban, Banque Credit National, and Banque Sabbag. These banks function as agents for a variety of commodity and foreign exchange brokers and export-import houses, which in turn operate as intermediaries of the smuggling trade. Unknown, but probably smaller, quantities of gold are also imported illegally outside banking channels. The major clandestine customers of the Beirut dealers are Israelis, Turks, and Persian Gulf sheiks.

There is no evidence that gold purchased officially from the United States by the Lebanese central bank is in any way connected with the free gold market in Beirut. Lebanese authorities have purchased about $95 million in gold from the United States in 1968, as part of an avowed policy of maintaining an 80 to 85 percent gold cover for Lebanese currency. The central bank appears to adhere carefully to the intent of the Washington Agreement which established the two-tier gold market system.

The Official Market for Gold

1. During August 1968 the United States acquired, on balance, $5 million in gold. Nineteen countries purchased a total of $84.8 million, but this was more than offset by French and Philippine sales to the United States of $80 million and $9.8 million, respectively (see Table 1). Algeria led the list of buyers, taking $49.9 million. Much of this amount probably represented an unloading of French francs from Algerian reserves in a period when the weakness of the franc on the exchanges made it unattractive as a reserve currency. The Algerians clearly had no great confidence in dollars either, preferring to shift all the way to gold. The August transaction brought Algeria's total purchases of gold from the United States in the past 12 months to $200 million. As in every month since crisis conditions abated in mid-March, the other buyers of US gold were small countries pursuing a deliberate policy of shifting their reserves from sterling and dollars into gold. Kuwait and Singapore, for example, purchased $15.2 million and $8.0 million, respectively. As of the end of August, small countries were known to have planned additional purchases of gold from the United States totaling $124.3 million during the remainder of 1968.

2. Only one official gold transaction in August could be interpreted as a violation of the intent of the Washington Agreement. Under an agreement concluded in June 1968, the Bank of Portugal contracted to buy 100 tons of gold from South Africa at $35 per ounce ($112.5 million) plus a small shipping charge. Thirty tons were delivered in July, and another 40 tons were shipped early in August. The final 30 tons were to be shipped on 21 August, but for unknown reasons the shipment was split and only 15 tons were actually delivered on that date. The remaining 15 tons will be sent in September.

3. Among the principal financial powers, the key question of possible official purchases of South African gold remains unresolved. South Africa now makes fairly regular sales of gold to the free

Table 1

Actual and Planned Transactions in Gold with the United States August-December 1968

Million US $

Purchases from the US (1-31 August)		Sales to the US (1-31 August)		Planned Purchases from and Sales to the US (1 Sep-End of Year)	
Country	Amount	Country	Amount	Country	Amount
Algeria	49.9	France	80.0	Afghanistan	5.1
Argentina	5.0	Philippines	9.8	Kuwait	23.0
Chile	0.9			Muscat and Oman	1.2
Indonesia	0.3			Portugal	95.0
Ireland	3.0				
Kuwait	15.2				
Singapore	8.0				
Sudan	0.3				
Yugoslavia	1.0				
Other	1.2				

market* -- a fact of which most governments other than the United States Government probably are unaware. An objective of US policy has been to induce the South Africans to follow precisely such a course in the hope that free market gold prices will decline. There remains, however, a strong feeling among European central bankers and financial officials that South Africa's wish to sell gold to official buyers ought to be accommodated, at least in part, possibly through purchases by the International Monetary Fund (IMF). [redacted] 25X1 25X1
the questions whether to resume official purchases of South African gold, by what means, and at what price, may be forced to issue during the forthcoming IMF/IBRD annual meetings in Washington. European officials are adamantly opposed to setting a "floor" price below $35 per ounce, reasoning that a price under $35 would amount to a *de facto* undervaluation of their own gold reserves.

4. In the event that these questions do come to the forefront during the IMF/IBRD meetings, it is a foregone conclusion that the United States could marshal the necessary votes to block authorization of IMF purchases of gold from South Africa. Such an action, however, would be highly unpopular with the United States' monetary allies in Western Europe. Many leading financial policymakers on the continent currently feel that such action would risk a serious split among the monetary authorities of the major Western countries. Such a split might induce other Western central banks to purchase gold directly from South Africa and could jeopardize prompt implementation of the SDR (special drawing rights) scheme.

The Free Market for Gold

5. During most of August, gold prices in London and Zurich fluctuated around $39 per ounce on normal daily volumes. On 21 August, increased demand related to the Soviet invasion of Czechoslovakia pushed the London gold price to its highest level since 9 July. However, prices in Zurich remained

* *New information and data on these sales are presented and discussed below in the section on "The Free Market for Gold."*

slightly below those in London, largely because the bank group operating the Zurich market made a determined effort -- using its control of market supplies -- to keep the price from rising too quickly. As the crisis subsided, prices and volumes fell slightly. But an increase in industrial demand for gold in a generally thin market kept prices above levels set earlier in the month. (Weekly ranges of gold prices in London and Zurich are shown in Table 2.)

Table 2

Price Range in the London and Zurich Gold Markets
29 July-30 August 1968

US $ per Fine Ounce

Week	London a/	Zurich b/
29 Jul-2 Aug	38.80 to 39.30	38.62 to 39.12
5-9 Aug	38.35 to 39.00	38.50 to 39.00
12-16 Aug	38.55 to 39.30	38.50 to 39.25
19-23 Aug	39.10 to 40.30	39.00 to 40.00
26-30 Aug	39.40 to 39.85	39.37 to 40.00

a. Based on the morning and afternoon fixes.
b. Not exactly comparable with London; these data consist of the lowest offer to buy and the highest offer to sell during the week.

6. The outstanding development in the free markets in August was the conclusion of an arrangement whereby South Africa over the next twelve months can continue [redacted] sales of gold to the free market.* Under the leadership of the Swiss bank group, several European banks will together provide South Africa with credits equivalent to at least $140 million, at an interest rate of slightly more than 6 percent, with a small 25X1

* *Initial sales by South Africa occurred, according to an official South African announcement in July, during May and June.* [redacted] 25X1

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commitment fee being charged for unused portions of the credit line. Repayments are linked to South African shipments of gold to Switzerland. Drawings against the South African line most likely will be liquidated with the proceeds from the sale of this gold. The European banks involved are the Swiss "Big Three" -- Union Bank of Switzerland, Swiss Credit Bank, and Swiss Bank Corporation -- plus several others, which probably include the Deutsche Bank and Credit Commercial de France.

7. Deliveries under this agreement already have begun. On 7, 16, and 21 August, shipments of standard (12.5 kilogram) bars, each shipment totaling 8.5 tons, were flown from Johannesburg to Zurich on a flight chartered through Balair, a subsidiary of Swissair. Two similar flights, scheduled for 3 and 11 September, will each carry 11.4 tons of gold to Zurich, bringing to 48.3 tons the total delivered and scheduled.

8. The shipments to the Swiss and the purchase of gold by the Bank of Portugal appear to be the only South African gold sales undertaken during the period 1 July through 30 August. South Africa reported gold reserves of $974 million at the end of June and $1,028 million on 30 August, an increase of $54 million. From 1 July through 30 August, known gold sales were about $128 million -- $96 million to Portugal and about $32 million to the Swiss banks. To cover these sales and increase reserves by $54 million, South African gold production would have had to be $182 million -- a figure consistent with the estimated average monthly gold output of about $90 million.

9. It is clear that the consortium led by the "Big Three" Swiss banks has outmaneuvered the consortium headed by the Engelhard interests in the competition for South African gold.* Engelhard representatives in South Africa have learned through an unidentified contact of the second and third Balair charter flights to Zurich. While their guess of

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10 tons per shipment is close to the actual amount sent, they do not know the name of the consignee and apparently are unaware of the first and the scheduled fourth and fifth shipments. Moreover, they are unsure as to whether the South African sales are destined for official or free market buyers.

The Beirut Gold Market

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11. Frequent political and economic uncertainties stimulate strong demand for gold from Middle Eastern and other customers. Most Middle Eastern governments, except for the Persian Gulf sheikdoms, prohibit the free import and export of gold. Beirut is a logical source of gold for smuggling into Middle Eastern countries because of its excellent banking and commercial facilities and the fact that the Lebanese government permits gold to be imported legally, without taxes or other restrictions. The major sources of supply for the Beirut market are London and Zurich, although dealers in Frankfurt now are trying to acquire a share of this market. The exact amount supplied from each European center cannot be determined accurately, because much of the gold eventually destined for Beirut can be traced only as far as Brussels, where transshipments totally obscure the gold's ultimate destination.

12. Judging from the amount of gold imported legally into Lebanon, the volume traded in the Beirut market is smaller than that traded in the four major European markets. Prior to the establishment of the two-tier price system in mid-March, the largest amount of legal gold imports recorded in recent years was 13 tons, in December 1967. Fragmentary information on transactions since mid-March indicates that the average monthly volume

of gold flowing into Beirut has remained high -- on the order of 10 to 15 tons. Of the gold entering Beirut, about 600 kilograms per month are used in the manufacture of jewelry. The remainder is purchased by speculators and smugglers, at which point the gold leaves overt markets and passes from sight.*

13. In addition to its gold imports, which are either retained in Lebanon (for processing or hoards) or subsequently exported via illegal channels, Beirut also runs a fairly considerable transit trade. During the height of the international gold crisis in mid-March, as much as 15 tons of gold passed through Beirut in transit to other Middle Eastern countries. The amount of gold now transiting Beirut is substantially below the March level.

14. Since mid-March, prices in the Beirut market have varied anywhere from a few cents to several dollars above those prevailing in London and Zurich. This spread reflects only partly the cost of transporting the gold from European centers, and is mainly the result of local and regional fluctuations in demand. These factors tend to introduce discontinuities in demand, to which supplies cannot always rapidly adjust, thus causing wider price fluctuations than occur in the European markets.

15. The major customers for Beirut gold are Israelis, Turks, and the Persian Gold sheiks (particularly of Kuwait, Qatar, and Bahrein). Gold sovereigns are in particular demand in Israel, although one-kilogram bars also have been purchased in quantity. The Israelis pay for their gold in large-denomination US notes [redacted] 25X1

* *Nearly all of the gold imported by Beirut dealers and sold to Lebanese speculators, hoarders, small industrial users, and smugglers is in the form of 1-kilogram bars (2.2 pounds). One-kilogram bars are standard in markets catering to numerous small buyers. By contrast, 12.5-kilogram bars are standard in large, international markets like London and Zurich, which cater to fewer but much larger buyers.*

16. Banks, commodity and foreign exchange brokers, and export-import houses are the major dealers in the Beirut market. Most Beirut banks currently engage only in legal gold transactions on their customers account, but a few banks and many of the nonbank intermediaries actively participate in the illicit gold trade for the high profits involved. Gold import transactions of any size normally are consigned through a bank to minimize risk. [redacted] 25X1

17. Three Beirut banks -- Société Bancaire du Liban (formerly Banque Zilkha), Banque Credit National (formerly Banque Safra), and Banque Sabbag -- presently control most of the legal gold traffic in Lebanon.* An official of Banque Sabbag recently estimated that Societe Bancaire du Liban controls 80 percent of the gold trade in Beirut. Banque Sabbag, however, is also deeply entrenched in the Beirut gold market, in part because it is the Beirut representative of Samuel Montagu (one of the five London gold dealers) and also because of its affilation with the Banque de l'Indochine -- a large international gold dealer.** Under present arrangements, Banque de l'Indochine appoints the president-director general of Banque Sabbag. Since 1961, this position has been held by Paul Antoine Milhomme, a French citizen, who in addition to his

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* *Société Bancaire du Liban and Banque Credit National are Beirut's two Jewish banks, owned respectively by the Zilkhar and Safra families. As a result of Arab-Israeli tensions, some pressure has been placed on the two families because both have indicated a strong desire to leave the Middle East.*

** *The Sabbag heirs control 50 percent of the Banque Sabbag while a second partner, Banca Commerciale Italiana, owns 25 percent and Banque de l'Indochine the remaining 25 percent.*

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duties at Banque Sabbag also runs the Beirut office of Bullion Exchange and Trading Company, Ltd. -- a small precious metals, commercial financing, and foreign exchange firm headquartered in Lausanne, Switzerland.* 25X1

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23. Thus far in 1968 the Lebanese central bank (Banque du Liban) has made four purchases of gold from the New York Federal Reserve Bank totaling $94.7 million. The stated purpose of these transactions is to maintain a gold cover of 80 to 85 percent for Lebanese currency. There is no evidence that any of this gold has been sold on the free market or that Banque du Liban has purchased gold in the free market. As evidence that the central bank was adhering to the principles drawn up at the Washington Conference, one central bank official cited the bank's support of the dollar in the Lebanese market during late March when Lebanese citizens showed a decided preference for gold-backed Lebanese pounds. Among members of the Lebanese financial community, there is strong disagreement regarding the economic soundness of a policy designed to provide such a high gold cover for the currency. The most vociferous dissenter is Pierre Edde (recently appointed Minister of Finance), who feels that large purchases of gold are costing the government of Lebanon substantial amounts of sorely needed income which could have been earned by placement of funds in interest-bearing foreign accounts.