



Office Memorandum

TO : Secretary Anderson

FROM : Frank A. Southard, Jr. *FAS*

SUBJECT : The London Gold Market

DATE: October 24, 1960

1. Size and nature of the market

(a) The market is open to transactions by any non-resident. Since payment must be in dollars, purchases (e.g., from Switzerland) can be accompanied by some strengthening of the dollar against other currencies. For example, on October 21 the dollar moved up against Swiss francs, French francs, and the deutsche mark. The United Kingdom acquires the dollars and sooner or later converts some or all of them into gold if they are not currently needed. The United Kingdom can and does supply gold to the market when the price becomes "too high"--using newly-mined (chiefly South African) gold as far as it goes and then dipping into reserves.

(b) The market is ordinarily not large--but it has been growing and it could expand greatly. In the seven weeks before September 25 transactions averaged \$25 million per week of five days. On October 20 turnover was \$20 to \$25 million. The extent of U.K. net intervention in the market is not known to me, but on October 20 it was \$10 million, partly from reserves.

(c) The market is not nearly as closely linked to the dollar-sterling market as in the period 1931-1939, when sterling was unpegged and when gold transactions were in sterling. In that period, the Bank of England (or the Exchange Equalisation Account) could alternatively operate in gold or in dollars with generally equal effect. Now, with the dollar-sterling rate pegged, and with the gold market limited to dollars, the effect on the dollar (aside from the slight strengthening of rate mentioned above) is to put dollars into U.K. hands, and directly or indirectly lead to a drain of U.S. and U.K. gold reserves into private hands.

2. The question of intervention to influence the gold price

(a) The U.K. view, as expressed by Maurice Parsons, is that there should be some intervention. The aim should be to minimize the loss of reserves through the market into private hands. I take this to imply that as the price rises, more speculative demand will develop and hence intervention will be necessary.

(b) Messrs. Hayes and Coombs agree with Parsons. Neither they nor he would select a pegging price. They favor relatively small and regular intervening sales, with larger sales at opportune moments to trap speculators. I believe Per Jacobsson has about the same policy in mind when he says he would avoid pegging but would not "starve" the market.

(c) My first view was that intervention was not necessary. But it is evident that active speculation in gold will be interpreted as weakness in the dollar. The result may be to induce outflows of funds from the United States

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into other currencies and hence cause gold losses not only to the United Kingdom but to other countries. I have therefore concluded that cautious intervention is a prudent policy.

(d) From the U.S. point of view, a policy toward the gold market may include these elements.

(1) Cautious intervention is desirable to avoid price gyrations and to reduce the danger of speculative impact on the U.S. balance of payments.

(2) The market is under U.K. control, and the United States should not intervene directly. Close contacts between the U.S. and U.K. authorities of the sort which exist or are being developed are desirable. Parsons says that "if at any time the United States thinks we are not acting wisely, the United States has only to say so."

(3) Formal agreement on policy should be avoided. This rules out Jacobsson's suggestion of gold sales by the United States to the International Monetary Fund and by the International Monetary Fund to the United Kingdom, since, apart from other objections, this would presuppose agreement on policy by the Executive Board.

(4) Admittedly, U.K. sales of gold and replenishment from the United States at a profit is a touchy aspect. Possibly agreement could be reached to share the profits, but full responsibility would also have to be shared. For the time being, it would seem preferable to adopt a pragmatic view. If intervention for a month or so is successful and both gold losses and profits are small, it should be unnecessary to go beyond the informal contacts and general agreement on aims which now exist. If not, much more difficult decisions will be ahead.