The London Gold Market

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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 recognized 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

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United States, where the authorities will accept, without melting and assaying, only unmutilated United States Government-stamped bars when tendered in the exact form in which originally issued.

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 ¼ 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.