Gold by Alice Roth

Central banks stabilize price

Europe's gold reverses continue to boost the EMS base for credit expansion.

European and Arab central banks were behind the secret rebound in the gold price, according to a reliable source at a major West German bank. The central banks have effectively placed a $600 floor under the gold price, much to the dismay of some New York speculators who had expected gold to fall below that level.

On Aug. 11, gold for August delivery fell $24 on the Comex to $603.20 an ounce, its lowest level in four weeks. On the following day, however, the bears were knocked off their feet by a wave of heavy buying, which many attributed to Swiss banks.

"The Swiss don't just buy for themselves," the German source said. "They simply execute orders that the central banks have placed with them in advance to buy at a particular level. For example, a central bank may leave orders to buy, say 10 tons, when the price comes down to $600." The central banks stop short of fixing a trading range, however; they set floors, but they do not attempt to establish a ceiling. The next move in the gold market, this source said, could be to the $650-700 level, at which point the central banks may decide to make $700 their new floor.

This new report of central bank trading activity confirms what *EIR* has been saying for over two years; namely, that the major continental European governments and some oil-rich Arab nations are committed to the restoration of gold's role in the international monetary system. Although the West Germans and French are reluctant to confront the U.S. openly on this question, they have been quietly intervening to steady the market so as to preserve the value of their gold reserves.

With the creation of the European Monetary System (EMS) in 1979, the Europeans set up a mechanism which conveniently translates these gold reserves into new liquidity without necessitating central bank gold sales. As part of a revolving three-month swap agreement, the central banks deposit 20 percent of their dollar and gold reserves with the EMS, and receive in return European Currency Units (ECUs). The gold component of these reserves is revalued every three months based on market prices, so that any increase in the gold price is automatically translated into increased holdings of ECUs.

As a result, the total ECU holdings have mushroomed to some $60 billion. The existence of this gold-ECU mechanism permitted Belgium this year to obtain the funds required to support its weak currency, enabling the country to avoid a trip to the International Monetary Fund. The second phase of the EMS, the creation of a full-blown European Monetary Fund (EMF), could turn Western Europe into a major supplier of credits to the developing sector, free of the stringent conditionalities associated with the IMF.

Many New York analysts, including the well-known gold bug James Sinclair, have become increasingly pessimistic about gold in recent weeks. Ignoring the central banks' role in the market, these analysts argue that the election of Ronald Reagan will find favor with European investors and boost the dollar by maintaining the Fed's commitment to tight monetary policy. Under these conditions, they say, gold will either collapse or stay flat for the next 12 months. In reality, many European government and business leaders are horrified at the prospect of Reagan, viewing him as an inexperienced "cowboy."