Archived World Gold Council Document

World Gold Council Review of:

The Washington Central Banks Agreement on Gold
26 September 1999

The Agreement

· A new gold market

The WGC believes the Washington Agreement radically transforms the gold market for a number of reasons.

· Explicit agreement

First, it is an explicit signed agreement among the European central banks, which goes well beyond earlier 'clarifications' about their gold holdings by central bank governors.

Although it is still a 'Gentleman's Agreement' in that it does not have the legal force of an international treaty, it has been signed by each central bank governor, all of whom (except the Bank of England) have legal responsibility for their gold reserves. Eddie George, governor of the Bank of England, signed on behalf of the Treasury.

It is our understanding that the Agreement will be monitored by the Bank for International Settlements (BIS).

· Comprehensive

Second, the Agreement is comprehensive. The central banks participating hold (see attached table) 15,998 tonnes, nearly 50% of the world's official gold holdings. The US has already announced its intention not to sell or lend gold and Japan followed suit the day after the Agreement was announced. The International Monetary Fund and Bank for International Settlements are to abide by the 'spirit' of the agreement. In addition Australia has said it will not sell any more gold, and South Africa is unlikely to sell part of its reserves given the government's vehement opposition to the UK sales.

These institutions account for another 36% of world holdings, bringing the total amount of official gold covered to 85%.

· It covers lending

Third, an unexpected and important part of the statement was the limit on gold leasing (lending).

The signatories to this agreement have agreed not to expand their gold leasing and their use of gold futures and options over this period.

The words used are not totally clear on whether gold leasing is to be frozen at current levels, or whether some leeway will be allowed as long as the total at the end of the period equals that at present.

But together with the fact that neither the USA nor the IMF can lend gold, this implies that
the supply of additional gold for lending will be very substantially reduced in the next five years.

Lease rates jumped to 10% in the first few days after the agreement, and though they have fallen back, they remain at a still high level of 4-5%, more than two times the rate the 1-2% the market is historically used to. The market remains tight, with very little gold coming onto it.

The restriction on lending will underpin the recovery in the spot price; the sharp increase in the net volume lent in recent years undoubtedly played a part in depressing the price as most gold that is lent is sold on the spot market. Over the last five years many analysts estimate that leasing has increased by 400-500 tonnes a year, in effect increasing available supply by that much. In future there will be no net increase in lending or in the central banks' use of gold futures and options.

**Market credibility**

The jump in the price shows that the market fully expects the central bank agreement to be observed.

In our view, the central banks will pay no notice to calls for a "rethinking" of the Agreement.

The main reason for believing that the Agreement will hold is that it has been signed by the central banks which have (except for the Bank of England) legal control of their nation's official gold reserves. Twelve of the 15 central banks are part of the European System of Central Banks, and their gold reserves are already controlled partly by the ECB. The UK and Sweden, although not members of the EMU, are also legally members of the European System of Central Banks.

**Who will be selling the 2000 tonnes?**

The Agreement limits gold sales to a maximum of approximately 400 tonnes a year and a total of 2000 tonnes in the five-year period. Only sales that have already been decided on can go ahead.

Of this total, 1,300 tonnes is allocated to the Swiss and 365 to the UK, with approx 335 tonnes for a country or countries that have already decided to sell but not as yet made an announcement. Market speculation currently suggests this is likely to be the Netherlands, or Belgium.

We understand that the quotas are not transferable, i.e. if the Swiss decide not to sell 1300 tonnes in the next five years but instead only 1000 tonnes, then no other institution can sell the remaining 300 tonnes. On the other hand, we have also been informed on good authority that the intention to sell 2,000 tonnes will be fulfilled.

**What will happen after five years?**

The Agreement stipulates that it will be "reviewed" after five years, not that it will end at that time. The WGC believes that there will be another agreement after five years. By then both the UK and Sweden may be either in or preparing to be in the euro-zone, thus bringing their reserves under ESCB control. It is also possible that Switzerland will at least have some associate membership of the grouping.

Thus the WGC believes the agreement will last for the foreseeable future - although it is too early to say whether the next agreement will continue to allow limited sales.

**New Gold Market**
We have now entered a new era. In effect, more than 26,000 tonnes of official gold (about 28,000 tonnes of countries covered by or associated with the agreement less 2,000 tonnes of permitted sales) has been taken out of the market, in the sense that there is no question of any of this being available either as a result of sales or lending. Much of the price falls over the last three years have been due to the fear that at least some of this official sector gold would come onto the market, a fear that has now been removed.

Of the estimated 5000-6000 tonnes on lease, about one-half is now subject to tight restriction. Many of the gold holders not covered by the Agreement are already thought to be "fully lent" or are barred from lending by domestic legislation.

- **The remaining 4,500 tonnes**

There are around 75 countries outside the agreement that have official gold reserves (see attached sheet), and they hold nearly 4,500 tonnes (13% of the world total). The largest is Taiwan (422 tonnes) followed by Russia (411 tonnes), China (395 tonnes), India (357 tonnes), Venezuela (301 tonnes) and the Lebanon (287 tonnes).

These form a very varied group which hold gold for many different reasons. India's reserves have fallen in the last few years, but Russia, the Philippines, Poland and Romania have substantially added to theirs. The apparent decline in Venezuela's reserves is a reflection of swap activity; Venezuela has made clear it has no intention of selling.

The latest developments have greatly strengthened the case for holding gold as a reserve asset - showing that the major central banks wish to retain all of their massive gold stocks. In their view, gold clearly retains its traditional role as a store of value. With the threat of massive European central bank sales lifted, the portfolio argument for holding gold can be advanced with renewed vigour.

- **Implications for WGC policy on Switzerland and the UK**

The WGC will continue to promote the advantages of holding gold as a reserve asset in both Switzerland and the United Kingdom, the two countries accounting for the bulk of the 2000 tonnes allowed by the Agreement.

The WGC will continue vigorously to develop and present the basic arguments for countries to hold gold. WGC's case will be strengthened now the European central banks have so explicitly demonstrated their continued belief in gold as a reserve asset.

- **Implications for gold demand**

The impact on gold demand of the rise in the gold price should not be overstated. The WGC expects little change in the long-term trend for gold demand to rise in line with income. This view has been bolstered by the rapid recovery of Asian demand after last year's economic and financial crisis, highlighting gold's continued role as a store of value.

Therefore the current well-known imbalance between mine supply and demand will continue at over 1000 tonnes per year. With the perceived threat of central bank sales now to a great extent lifted from the market, the strength of demand should continue to underpin the market in the years to come.

See:  [Table of World Gold Holdings](#) (Adobe Acrobat PDF file)