



The New Central Bank Gold Agreement

On Monday, 8th March 2004, the European Central Bank and 14 other central banks announced the renewal of the Central Bank Gold Agreement (CBGA). The new agreement's terms are similar to the one due to expire in September. For instance, the new agreement even maintains the cap on lending and derivatives activity at levels lower or equal to the ones "prevailing at the date of the signature of the previous agreement". Indeed, the only substantive change to the existing CBGA is that the maximum level of sales has been increased from 400 to up to 500 tonnes per year, with an overall total of no more than 2,500 tonnes permitted during the five-year life of the new agreement. Although a little towards the upper end of expectations, the increase in the sales quota is no great surprise given the far stronger market today than was the case in the third quarter of 1999. Since September 1999 gold has risen by a massive 50% in US dollar terms and, perhaps more significantly, is no less than 25% higher in euros. It is probable that policymakers would have drawn the conclusion – correctly in our view – that the market could absorb an additional quantity of central bank gold. The relative lack of price response to news of the CBGA's renewal and its terms would also seem to confirm this supposition.

What is a good deal less clear, is precisely which countries will dispose of sufficient gold in order for 2,500 tonnes to be sold by the signatories over the five year period from September 2004. Prior to the first CBGA, Switzerland and the United Kingdom had already announced their intentions to sell large shares of their respective gold reserves. This time round, the Swiss will have a residual 130 tonnes to sell and the United Kingdom is out of the picture altogether (indeed the UK Treasury in not signing up to the second CBGA has explicitly ruled out any further sales). Germany is Europe's largest single holder of gold reserves and the Bundesbank has announced its intention to sell 600 tonnes over the life of the new agreement – a relatively small quantity in the light of its more than 3,400 tonnes of reserves. According to a statement made by the Netherlands central bank in February, it will have 65 tonnes left over to sell from September 2004 onwards from its original 300 tonne target announced in December 1999. At this point, the Netherlands would still hold around 712 tonnes and we suspect that some of this could be released for sale under the second CBGA. Similarly, Austria, which sold 90 tonnes over the first three years of the current CBGA, indicated on 20th February this year that they would consider further reducing their gold holdings, which currently stand at 318 tonnes.

The total level of sales by Germany, Switzerland and, probably Austria and the Netherlands, are however, not going to be sufficient to reach the 2,500 tonne five-year limit that has just been established under the second CBGA. It would seem for that to occur France (3,025 tonnes) and/or Italy (2,452 tonnes) would have to change policy

and initiate gold sales programmes. This is because excluding these two countries' holdings and those of Germany, Switzerland and the ECB itself, the other ten signatories' aggregate gold reserves amount to only some 2,800 tonnes. Although arithmetically possible, it is highly improbable that, in practice, close to two-thirds of this quantity would be mobilised for sale in the five years from September 2004. Of course, the other intriguing and alternative possibility is that sales will fall short of the 2,500 tonnes limit. This would seem to us an unlikely but not impossible outcome given prevailing attitudes in Paris and Rome.