## Gold by Montresor

# French elections could mean price rise

*A strong mandate for Giscard after the May 10 elections could renew European central bank support levels.*

Virtually ignored by the American press, a series of quiet developments in Europe points toward a renewal of central bank support levels for the price of gold. During 1980 European central banks bought gold at first $600 an ounce and later at $550 an ounce, stalling for some months the sharp price decline that eventually came this year.

Europe agreed to a partial remonetization of gold under the rules of the European Monetary System, which began operations early in 1979. Under the EMS the central banks pledged 20 percent of their total gold reserves, and in return may draw against this gold in the form of European Currency Units, presentable to other central banks for currency to employ in foreign exchange market intervention. The success of this system, despite its detractors in the U.S. press and in the Anglo-Belgian-Dutch circuit in Europe, has been virtually absolute. The Belgian franc's easy passage through the crisis that peaked early in April, largely due to BF 23 billion drawings from the EMS, confirms this.

Despite the relatively low profile of European leaders on this subject, fairly detailed preparations are under way for the completion of the delayed *second phase* of the EMS, which involves an extension of the uses of the EMS gold-backed credit mechanisms to the field of long-term development credit. The various pieces of the program have already been *prefabricated*, such that the full European Monetary Fund—the second phase—could be erected very quickly indeed.

The premise is that the Fund will have as a byproduct the return of the French and German current account balances to stability, as the result of 1) continued inflows from the Persian Gulf and 2) expansion of exports. This has a direct bearing on European interest in gold. When the European current accounts turned sharply into the red toward the end of 1980, the policy of supporting the gold price ceased, because the banks found that their dollar reserves had become less superfluous than previously, and were less willing to exchange them for a currently illiquid asset such as gold. However, the rate of Persian Gulf investment into West Germany has already doubled this year (in the first quarter) from last year's $10 billion, more than exceeding Germany's current account deficit.

On the export side, the premise of the European Monetary Fund is that Western Europe will have additional low-interest, long-term credit resources with which to modernize its own industry, with a view to export competitivity and energy savings through technology improvement, and also additional export credits.

The European Monetary Fund itself would, in some form, involve further issuance of credits against gold, simply extending the current mode of functioning of the EMS. Whether the EMF will actually create long-term ECU loans to be converted into national currencies is open to question; a variety of technical means could be found.

However, the entire process is evident in the recent Franco-German *Gemeinschaftsanleihe* of $6 billion, to be subscribed principally from the Saudis. France and Germany will lend these funds out long-term at subsidized interest rates to their industry, emphasizing the high-technology sectors. This establishes a precedent for the same use of Saudi funds, which would otherwise be left to languish in short-term Eurocurrency deposits, through a central fund. Schmidt and Giscard had initially wanted to employ the ECU, the numeraire of the European Monetary System, in the present loan, but were prevented by the opposition of the German central bank (see page 6).

Similar funds could be raised in the future by a number of methods. One would be to peg the value of future European loans to a fixed volume of gold, backed by EMS gold reserves, and thus obtain loans at the real rather than the nominal rate of interest (or about 2 percent). Another would be to draw the Saudis directly into the European Monetary System, by encouraging them to accumulate central bank portfolio assets in the form of ECUs or ECU-denominated paper of the EMS. Whatever methods are eventually employed, the currency stability and credit features of the Franco-German monetary superpower are on the verge of a breakthrough, one of whose side effects will be to increase the attractiveness of gold as an official reserve asset.