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Gold in 1979

During 1979 free-world gold production decreased slightly. Jewelry demand decreased markedly mostly because of higher gold prices, but demand for other types of fabrication was virtually unchanged from a year earlier. The price of gold rose to a record $523 on the last trading day of the year, nearly $300 higher than a year earlier. Official gold sales increased to 18.5 million ounces, but private demand for bullion also increased substantially during the year to 14.5 million ounces. All major paper currencies decreased markedly in value in terms of gold during 1979, but we are unable to determine whether this represented the start of a flight from paper currency.

For the gold market 1979 was a remarkable year. The price of an ounce of gold rose from $226 on December 31, 1978 to $523 a year later, a 131 percent increase. The price of gold averaged $304 during 1979 compared with $193 during 1978.

Free-world gold production during 1979 was estimated to be 31.0 million ounces, slightly less than the revised figure of 31.5 million ounces during 1978. Table 1 reveals that free-world gold production has remained near the same level during the past 3 years. Chart 1 shows annual world gold production since 1850, including estimates of production in the Soviet Union. Consolidated Gold Fields, Ltd., in its annual review of world gold production, estimates Russian gold production between 280 to 350 tons (9.0 million to 11.3 million ounces) last year. The midpoint of this range, 10.1 million ounces, would put 1979 total world gold production at 41.4 million ounces, which is the value plotted on the chart for 1979. However, estimates of gold production in the Soviet Union are highly questionable because Soviet officials provide no official statistics on gold production and, in any event, such data might be "altered" by officials for some political purpose.

Gold Fields' 1979 estimate, which was based on an extensive review of Russian press reports and technical papers concerning mining at particular sites, satellite photographs, and other data, was the first major study of its kind since 1974. The new study indicated a much lower level of Soviet gold production than indicated by its predecessor, but revised estimates for years prior to 1979 were not given. The data in Chart 1 and Table 1 for such prior years are those based on the 1974 study. If the earlier estimates were indeed too high (or if the recent estimate is too low) then the decrease in world gold production during the 1970's may have been smaller than that shown in the chart.

In any event, the data given in Table 2 indicate that "free world" mine production has changed little since 1975. This might be considered surprising inasmuch as the marked increase in the price of gold, both in terms of currency and in terms of other things, should have spurred greater production. The reason for this recent stability in gold production (and for the decrease in gold production from its peak in 1970) is, of course, the usual mining practice of shifting to lower grade ore as it becomes economic to do so. This practice is designed to prolong the useful life of a given mine, and in South Africa, at least, it is mandated by the government as a condition of mining concessions. In other words, although the rapid increase in the gold price has spurred an increase in ore extraction and milling capacity, gold production has not increased because existing operations have processed lower grade ores.

That this process can continue indefinitely is improbable. If the gold price stabilized or decreased, the trend to lower grade ores would eventually end. If the price of gold continued to increase in real terms, vast deposits of gold would become profitable to exploit. Either development would be reflected in an increase in gold production.

Other Supplies

During 1979 the International Monetary Fund sold a total of 5.5 million ounces at twelve monthly auctions. By May 1980 it had completed its 4-year sales program of 25 million ounces of gold. An additional 25 million ounces were sold back to member countries at the official price of $42.22 during that period. The IMF now has 100 million ounces of gold remaining in its possession, and the future use of this stock remains unclear. At last October's annual IMF meeting in Hamburg, preliminary discussions were held regarding the implementation of a "substitution account" and the utilization of the Fund's gold to finance such a scheme. Although no final decision has been made, there appears to be a greater awareness on the part of some central bankers and finance ministers that gold may be able to serve as a valuable asset in the evolving international monetary system. Nevertheless, the substitution account seems like another "patch-up" attempt to shore up the

Table 1
WORLD GOLD PRODUCTION
(Millions of ounces)

Country	*1950*	*1960*	*1970*	*1977*	*1978*	*1979p*
South Africa	11.7	21.4	32.2	22.5	22.7	22.6
Canada	4.4	4.6	2.4	1.7	1.7	1.6
United States	2.3	1.7	1.7	1.0	1.0	1.0
Other free world	5.9	6.0	4.7	5.7	6.1	5.8
Total free world	*24.3*	*33.7*	*41.0*	*31.0*	*31.5*	*31.0*
Soviet Union e	4.5	5.8	11.1	14.3	14.3	10.1
Total world e	*28.7*	*39.5*	*52.1*	*45.3*	*45.8*	*41.1*

p Preliminary. e Estimated.
Note: Individual figures may not add to totals due to rounding.

Table 2

ESTIMATED FREE WORLD SOURCES AND USES OF GOLD
(Millions of ounces)

Sources	*1970*	*1971*	*1972*	*1973*	*1974*	*1975*	*1976*	*1977*	*1978*	*1979*
Mine production	41.0	39.7	38.0	36.0	32.3	30.6	31.1	31.1	31.5	30.9
Sales by communist countries	–0.1	1.7	6.9	8.8	7.1	4.8	13.3	12.9	13.2	7.4
	40.9	41.5	44.9	44.9	39.4	35.4	44.3	44.0	44.7	38.3
Uses										
Jewelry	34.1	34.1	32.0	16.5	7.1	16.7	29.9	32.0	32.2	23.7
Electronics	2.9	2.8	3.4	4.1	3.0	2.2	2.4	2.5	2.7	3.0
Dentistry	1.9	2.0	2.1	2.2	1.8	2.0	2.4	2.6	2.8	2.8
Industry & arts	2.0	2.2	2.3	2.3	2.2	1.9	2.1	2.2	2.4	2.4
Official coins	1.5	1.7	2.0	1.7	9.2	7.8	5.9	4.4	9.2	9.3
Medals & medallions	1.7	1.7	1.3	0.7	0.2	0.7	1.5	1.5	1.5	1.1
Change in Bullion Holdings										
Official	7.6	–3.1	4.9	–0.2	–0.6	–0.3	–1.9	–8.7	–11.6	–18.5
Private	–10.8	.1	–3.1	17.6	16.6	4.4	1.8	7.5	5.0	14.5
	40.9	41.5	44.9	44.9	39.4	35.4	44.3	44.0	44.2	38.3
Memo:										
Average of daily prices in London*	$36	$41	$58	$97	$159	$161	$125	$148	$193	$304

* Dollars per ounce. 1980 average through June: $587.74. Source: Consolidated Gold Fields, Ltd.
Note: Total may not add due to rounding.

paper money system rather than a return to sound money (see *Research Reports,* November 5, 1979).

During 1979 the U.S. Treasury sold 11.7 million ounces of gold as compared with a total of 4.1 million ounces sold during 1978. The 185 percent increase in U.S. gold sales during 1979 from that a year earlier reflected the monetary authorities' claim that the gold auctions were consistent with the Treasury's efforts to "demonetize" gold and to improve the U.S. balance of payments. However, the last *regular* monthly auction was held on October 16, at which time the Treasury announced that subsequent auctions would be held at irregular intervals. The Treasury would publicize the auction's date and the quantity of gold to be offered. Two weeks later, on November 1, the first and so far the only "surprise" gold auction was held; the U.S. Treasury sold 1.5 million ounces of gold at an average price of $372.30.

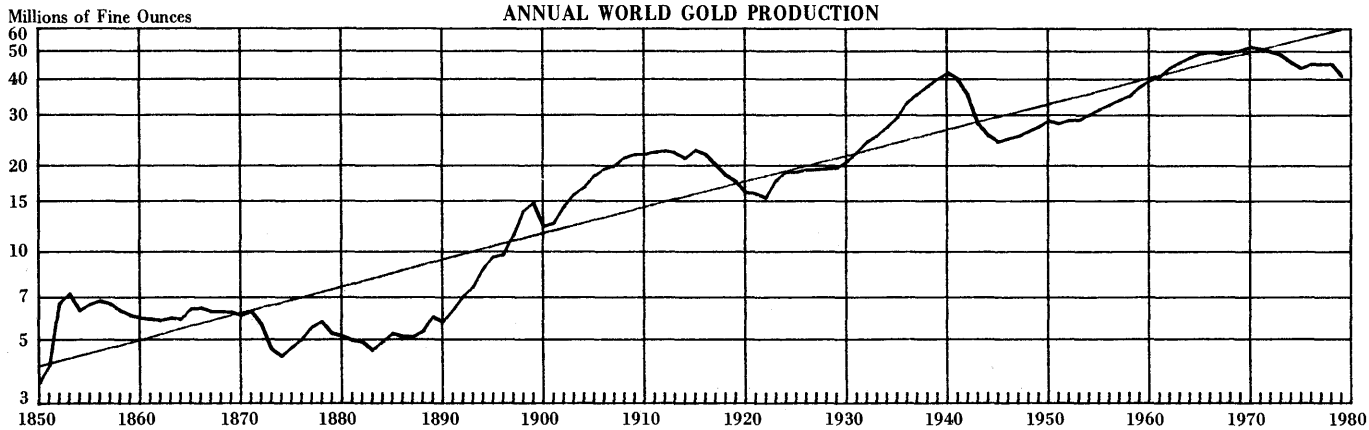
South Africa purchased gold from countries that "swapped" their currencies for bullion during the mid-1970's. By paying for the gold at the "swap" price plus interest, South Africa made a substantial profit when it sold some of this gold in the market during 1979.

Net gold sales by communist bloc countries during 1979 are estimated at 7.4 million ounces, most of which, according to Consolidated Gold Fields, Ltd., is from the Soviet Union. During 1978 this figure was estimated to be 13.2 million ounces. The sharp reduction in gold supplied to the market during 1979 is attributable to the substantial foreign exchange earnings received by the Russians due to higher gold and oil prices. Therefore, last year the Soviets had less reason to sell gold to meet their foreign exchange needs. Moreover, the new estimates of Soviet production suggest that their 1976, 1977, and 1978 sales included some liquidation of their gold holdings and, as Consolidated Gold Fields has noted, "there is always the possibility that Russian stocks of gold have reached a minimum acceptable level because . . . of the high level of sales . . . in the 3-year period from 1976 to 1978."

Gold Uses and Prices

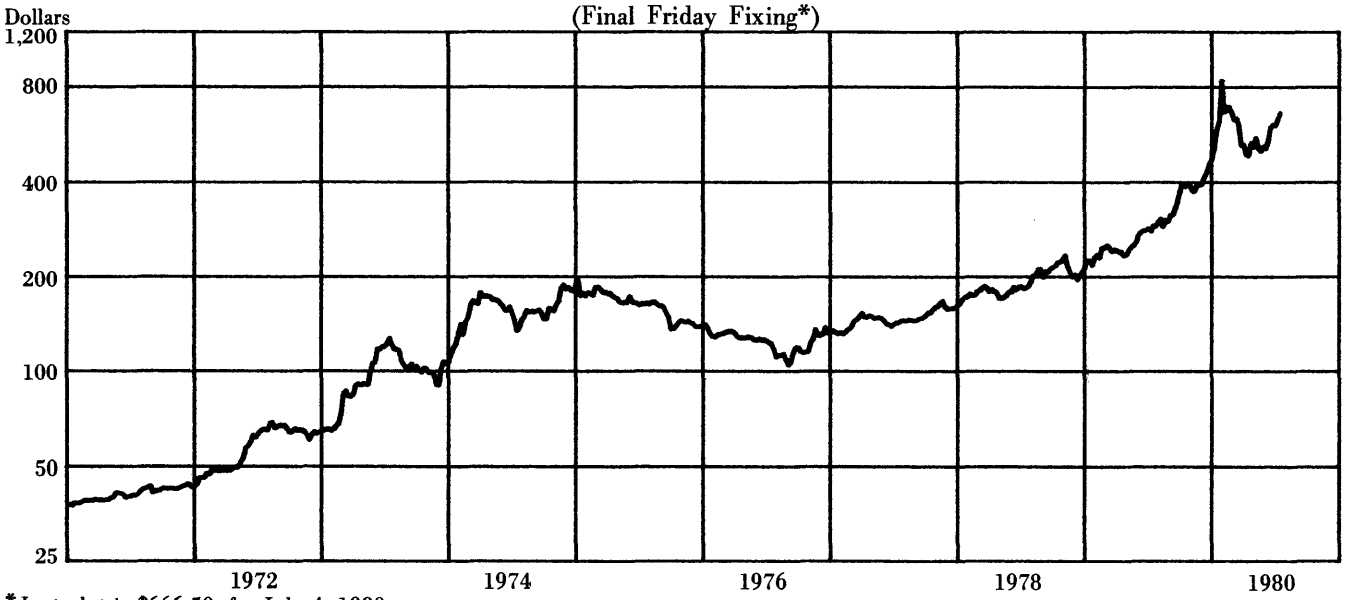
Official sales during 1979 included those by the International Monetary Fund, U.S. Treasury and the Soviet Union. The amount of gold sold from official stocks plus the bullion sold from new mine production

Chart 1
ANNUAL WORLD GOLD PRODUCTION



Note: Includes estimates of production in the Soviet Union by Consolidated Gold Fields, Ltd.

Chart 2
PRICE OF GOLD IN LONDON
(Final Friday Fixing*)



* Last plot is $666.50, for July 4, 1980.

equals the total amount of net private gold purchases in the market. During 1979, this total was 56.8 million ounces, which was slightly more than the total for 1978 and the largest total since 1968, when 59.0 million ounces were sold.

According to Table 2, jewelry use decreased markedly during 1979. The increase in the average price of an ounce of gold to $304 had a profound effect on jewelry demand. This phenomenon occurred during 1974 when the average price of gold rose to $159 an ounce from $97 a year earlier; jewelry demand decreased from 16.5 million ounces in 1973 to 7.1 million ounces in 1974. Gold jewelry demand decreased substantially during 1979 in the Middle East and the Indian subcontinent. In the Middle East, gold used for jewelry fabrication decreased to 2.1 million ounces during 1979 from 7.3 million ounces a year earlier. In India and in neighboring countries gold jewelry use dropped to slightly more than 400,000 ounces, while a year earlier 1.7 million ounces were used in gold jewelry fabrication. The reduction in gold jewelry demand from these two areas accounted for approximately two-thirds of the decline that the industry experienced during 1979. Gold jewelry demand, however, varied widely in other parts of the world. In Europe it decreased 4.5 percent; in North America, Canada had a 105 percent increase in demand, while in the United States there was a very slight reduction. Gold jewelry demand increased by 38 percent in Latin America. It rose substantially in Mexico and moderately in Brazil. Far Eastern demand, including Japan, decreased as did demand from Africa.

Table 2 reveals that the amount of gold used for electronics, dentistry, industry and the arts was virtually unchanged during 1979 from that of a year earlier. However, the price of gold may have reached levels where substitutes, when practicable, will be used in place of gold, and some decrease in these uses may be expected this year.

Gold used for official coins during 1979 was 9.3 million ounces, virtually identical to the amount used during 1978. South Africa was the leading producer of coins; a total of 4.7 million ounces of gold was used in the minting of Krugerrands, each containing one ounce of pure gold. During 1978 South Africa used 6.2 million ounces of gold to mint coins, 1.5 million ounces more than during 1979. The decrease in South African coin production was offset by increased minting of coins by Mexico, the United Kingdom, and Canada. In Canada one million "Maple Leaf" coins, each containing one troy ounce of gold, were minted during 1979. The Royal Canadian Mint plans to produce two million coins both this year and in 1981. Demand for Mexican gold coins that range in size from .05 to 1.2 ounces of gold was high during 1979, and output of these coins increased to 1.5 million ounces compared with 740,000 ounces a year earlier. The United Kingdom used 1.6 million ounces of gold to mint sovereigns and another 225,000 ounces to strike proof sovereigns for sale overseas and coins for other countries. The production of gold medals and medallions decreased by 34 percent during 1979. The sharp reduction in "fake" coin production in the Middle East accounts for most of the decrease in this sector of the gold market.

Individuals and private institutions purchased 14.5 million ounces of gold during 1979, compared with 5.0 million ounces purchased in 1978, the highest amount since 1974. A major impetus for the private purchase of bullion last year was the political uncertainty in the Far East and the Middle East. Gold inflows to Taiwan and Turkey are estimated to be 2.2 million ounces and 514,000 ounces, respectively. In these areas small gold bars serve as "flight" insurance in times of political turmoil.

Latest Developments

The U.S. Treasury will begin accepting orders for one-ounce and half-ounce gold medallions this month. This program will use one million ounces of the Treasury's gold stock each year until 1984. Besides the U.S. Government, private mints also are producing coins to meet American demand for gold. But as the price of gold increases, the price of a one-ounce gold piece be-

comes too expensive for the average buyer. The private mints offer the alternative of "fractional" gold pieces as does Mexico. South Africa too is planning to offer half-ounce and smaller size coins later this year or early in 1981, as well as continuing to market its popular one-ounce Krugerrand.

The South African Government announced that it plans to withhold newly produced gold from the market for brief periods in order to "stabilize" the price and market conditions. From the producers' viewpoint, this approach seems sensible inasmuch as a steady or slowly rising price for gold will keep their incomes at a relatively high level. For users, a fairly stable price of gold will make planning for the future easier. Jewelers, for instance, must make commitments months ahead of time. Inasmuch as jewelry fabricators are the major users of gold, they may welcome South Africa's new policy in preference to the price gyrations of the past year.

Chart 3
PRICE OF GOLD IN SELECTED CURRENCIES
(London PM Fixing)

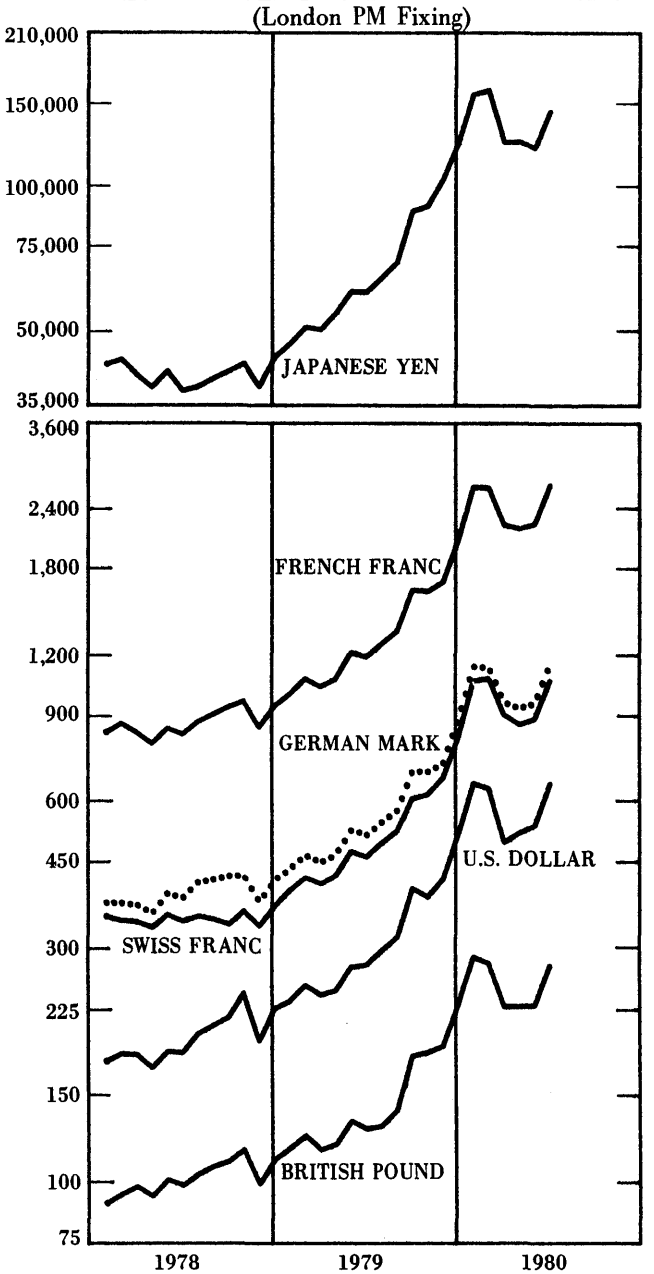


Table 3
RELATIVE APPRECIATION OF GOLD AGAINST SELECTED CURRENCIES

	1978	*1979*	*1980**
Gold/Dollar	+37.0%	+131.1%	+24.9%
Gold/Yen	+13.7	+185.0	+14.3
Gold/F Franc	+24.4	+122.6	+27.2
Gold/D Mark	+21.8	+119.2	+27.1
Gold/S Franc	+13.6	+125.7	+28.5
Gold/Pound	+30.3	+117.0	+17.7

* Through June 30.

As Chart 3 and Table 3 reveal, during 1979 the price of gold increased markedly in terms of *all* major currencies. The appreciation of gold during the first 6 months of 1980 implies further loss of confidence by holders of paper money. But does this indicate that the initial stage of a flight from paper currency is underway? At present, we have no means of knowing. The rise in the price of gold to $850 an ounce on January 21, 1980 and the decline to $484 on March 17, two months later, attest to the volatility of the gold market. Furthermore, to the extent that gold is a "barometer" of world monetary conditions, such movements in the gold price reflect the instability of the international paper money system since President Nixon severed the dollar's final link with gold on August 15, 1971. At that time all national currencies became fiat money.

Nevertheless, during the past year several references regarding a role for gold in the international monetary system have appeared in the financial press. Gold has attained some measure of respectability in the eyes of former critics who once believed managed paper currency to be an ideal monetary arrangement. However, although gold is being discussed by central bankers and finance ministers at IMF meetings and at informal gatherings, "hard money" advocates do not appear to hold key decision-making posts. Many monetary officials may be willing to talk about gold now because the paper money system is crumbling. By mentioning the possibility of utilizing gold in a future monetary system, these officials merely may be trying to instill confidence in paper currency for a while longer. As long as governments have the power to inflate, the temptation to increase expenditures by this process is irresistible. In the short run, politicians may appear to have the best interests of their constituents at heart, while they actually perpetrate a great hoax upon the public. There indeed is no such thing as a free lunch, nor a free breakfast or dinner. In the long run, the price of gold will reflect how many free meals the politicians attempt to serve by inflating.

PRICE OF GOLD

	1979	*1980*	
	Jul. 12	*Jul. 2*	*Jul. 10*
Final fixing in London	$290.75	$661.50	$656.50

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