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Fear fills London's fortress of gold

Somewhere within the M25 lies Europe's largest bullion vault — filled with bars owned by nervous private investors. We have a look inside

Danny Fortson Published: 9 December 2012

JON SPALL breezes through the cavernous interior of Europe's largest bullion vault with the casual air of a greengrocer checking his veg.

A pile of silver catches his eye. He stops to run his finger along the burnished surface of one of the bars, which are neatly stacked in head-high towers — the stash of a single client.

How much is it worth? More importantly, whose is it? Spall smiles and shakes his head. As keeper of the riches of the world's elite, he is paid to be discreet. Based on an eyeball estimate of the number of bars and the market price of silver, the pile is likely to be worth almost $1bn (£625m). And it occupies just a small corner of the ultra-high-security facility.

Barclays, where Spall is director of commodities, opened the vault three months ago. It has the capacity to hold precious metals worth many tens of billions of pounds.

The Sunday Times was allowed inside only on condition we would not reveal too many of its wonders. There is, however, a basic question to answer: why go to the trouble of building it at all?

The answer is simple: fear. The world is a scary place. America is teetering on the edge of a fiscal cliff, Europe is in slow-motion meltdown and the 2008 financial crisis is still fresh in the collective consciousness.

Investors are worried about the viability of the financial system itself so they are turning to the ultimate safe haven: gold. And they want a safe place to store it. Hence Barclays' mini Fort Knox — which, The Sunday Times can reveal, lies somewhere within the M25 London orbital.

Good luck to villains pondering an Italian Job-style heist. The building has been designed to appear unobtrusive; it looks like any other in the area, until you notice the electrified fence and CCTV cameras studding its exterior.

The roof is electrified. Plinths have been sunk to keep out anyone ambitious enough to try to tunnel in. The front door can withstand "a direct hit from a rocket- propelled grenade", one of the managers says with glee.

Thank goodness for that.

It is what the manager calls a "six-sider" — a giant box of reinforced steel and concrete so heavy that the pilings to support it had to be driven 100FT into the ground. Nothing has been left to chance. The fingerprint identification system detects blood supply — severed digits won't open the doors. Anti- ramming bollards can stop a lorry travelling at 55mph.

There are half a dozen other vaults dotted around the capital. Why did Barclays feel the need to build another one?

"With all the problems that have arisen in recent years, the universe of gold buyers has become much wider. Gold is unique in that it is inside and outside the financial system simultaneously," Spall said.

And, unlike currency, you can't print more of it and manipulate its value. "It's as about as uncomplex as it gets," he said.

The yellow metal has had an incredible run. Its price has fallen from more than $1,900 an ounce, the peak it reached last year, but at just above $1,700 on Friday it is still over four times more valuable than it was a decade ago, when it fetched $400. Even adjusting for inflation the rise is an impressive 320%.

As interest in the metal has grown, space in other vaults is running short. "London is the centre of the gold market," Spall said. "The vast majority of transactions are cleared here. So if you need to buy or sell gold quickly, it makes sense to keep it here."

Small investors looking to stash their nest eggs here will be disappointed, however. The minimum deposit is one 400-ounce bar, which at Friday's closing price is worth a cool £420,000.

In 1933, America was in the grip of the Great Depression when Franklin D Roosevelt signed executive order 6102. The decree amounted to a mass confiscation of gold.

It forced everyone from the biggest companies to individuals to sell their gold to the government — under threat of a 10-year jail sentence — at the price of $20.67 an ounce.

The move was meant to goose the economy back into action by forcing people to stop hoarding what they had. An inflationary bubble followed as people rushed to buy goods with their new cash. The surge, of course, was shortlived; the hoped-for rise in employment never materialised.

Fast forward to today, and investors fear the worst again. A fund manager said: “Some investors are saying, ‘Obama is the most socialist president since Roosevelt.’ To be safe, they want to move what they have, or at least part of it, out of America.”

Admittedly, such doomsdayers are on the fringe. They nonetheless reflect a wider shift in sentiment.

The giant money-printing programme that has been launched by America to keep the economy from cratering has led to fears that, sooner or later, the dollar will devalue.

For rival governments that once would have held their reserves in dollars — for decades the world’s chosen reserve currency — gold looks a better bet.

Natalie Dempster, head of government affairs at the World Gold Council, said: “In the 20 years to 2010 central banks were [selling] 400 to 500 tons of gold into the market every year.

“In 2010 they just barely turned net buyers, and in 2011, they took up just short of 500 tons. That is a huge shift.”

It is the emerging countries, from China and Turkey to Kazakhstan and South Korea, that are making the difference. “They are building up their buffers to deal with crisis,” Dempster said. “Countries that have been forced to go to the International Monetary Fund don’t want to have to go back again.”

Consider China. It holds less than 2% of its reserves in gold. America’s hoard is 76%. Last year, however, Beijing passed India to become the largest buyer, although it is also the world’s top producer.

Dave Govett, head of precious metals at Marex Spectron, the commodities broker, said: “If China decided to take its reserve levels to 10% or even 20%, the effect would be phenomenal. It would be more than the market could handle. So they are buying gently, building up bit by bit.”

At the moment Barclays has plenty of space in its vault. There are factors at work, however, that mean it could rapidly start filling up.

There are two ways to hold gold. Many big investors, such as hedge funds, hold “unallocated” gold. This means they own securities that are underpinned by the physical asset. They don’t own the actual bullion; they own the rights to it.

This can be a problem if the bank or broker with whom you hold it goes bust. Because the gold isn’t actually yours, in the case of a bankruptcy you become a creditor like everyone else.

Spall says that increasingly investors such as sovereign wealth funds, which look after pots of cash on behalf of their governments, often in the oil-rich Middle East, insist on holding “allocated” gold.

Barclays charges them more for the privilege, but the bars are theirs. If the bank went bust tomorrow, the bullion would not be affected. It is like keeping your valuables in a very expensive safe-deposit box.

Marwan Shakarchi runs MKS in Geneva, one of the largest independent gold refiners in the world. As a seller to everyone from sovereign governments to wealthy individuals, he has seen the shift first-hand.

“There has been a transition in the past 10 years. Since September 11, and the implosion of the internet bubble, people have started wanting more gold in their portfolio,” he said. “It’s like buying insurance, and if it’s insurance they want to go all the way. That means physical rather than paper gold.”

That is not to say the market for “paper” gold isn’t growing. The first fund that allowed retail investors to bet on the commodity itself was launched eight years ago. Before, investors were largely confined to making indirect investments by, say, buying shares in a gold miner.

Today, there are more than 30 so-called exchange-traded funds, or ETFs. They account for only about 8% of the overall market, but that 8% has materialised from nowhere in less than a decade. The funds account for a third of the growth in demand from investors, who in turn account for a third of total demand.

Investors in ETFs are the ultimate paper investors, yet as the values of the funds increase, the physical holdings underlying them must be bolstered accordingly. And that gold has to be kept somewhere.

Peter Hambro, chief executive of Petropavlovsk, the Russian gold miner, said: “The whole thing about owning gold is that you own it not because you want to but because you need to, because you are frightened. You want to know the bar numbers, and that they are in a safe place.”

The stormier the world becomes, the better it is for Barclays’ newest, and most anonymous, building.

“The [gold] bulls take the view that you can’t trust anyone,” said one fund manager. “The end of the gold standard has led to a 40-year experiment, premised on the printing of money, that hasn't worked. It has led to all kinds of instability and crises.

"Gold, on the other hand, has for thousands of years been a very simple, and very effective, exchange mechanism."