Alchemist

LBMA

LONDON BULLION MARKET ASSOCIATION

ISSUE 6

January 1997

Towards Transparency

Editorial Comment by Alan Baker, Director, Head of Bullion, Deutsche Morgan Grenfell, and Chairman, LBMA

The bullion market is often criticised by observers for being secretive and lacking in information and data. Unfortunately, to an extent, this is inevitable given the need for a duty of care to clients which dictates that a high level of discretion is an essential element in so much of the business that takes place in the market, particularly for gold.

While discretion and integrity will always be bywords in the London Bullion Market, the LBMA is nevertheless conscious of the general call for greater transparency. With this in mind we have considered ways in which to enhance transparency in the market while in no way compromising integrity, something perhaps of a delicate balancing act. We do believe, however, that the publication of data reflecting the levels of activity in London demonstrates the prominence of London in the world of bullion, a fact of which we have long been aware but which until now it has been difficult to demonstrate with statistics.

This sixth issue of the *Alchemist* therefore marks a major turning point for the LBMA covering as it does five new initiatives.

(continued overleaf)

In this issue:

First, within the London Bullion Market we have always been aware of the high level of gold and silver cleared through London in settlement of trades in bullion conducted by traders all around the world between each other, with clients and with London dealers. London is to gold what New York is to dollars and Tokyo to yen, home for the settlement of international transactions. We have, therefore, begun the regular monthly compilation of clearing turnover statistics and we believe that their publication gives both an indication of global activity in bullion as well as a reflection of the part that London plays in it. Great care has been taken in determining the criteria for data to be included and the structure under which it is to be confidentially collated. This development is highlighted in an article in this issue by Peter Smith, Chairman of the LBMA Physical Committee, who has co-ordinated the development of this initiative. In future, clearing turnover figures will be published monthly on one of our new Reuters pages and in our quarterly *Market Statistics*.

Secondly, the market is generally aware that the Bank of England, as part of its regulatory function conducts a biennial turnover survey of business transacted by Market-Making Members of the LBMA. Some data were first made public in 1995 following the May 1994 survey. A new survey was conducted in May last year and the results are now discussed in an article by Terry Smeeton and Andy Murfin of the Bank of England.

These provide an interesting comparison with the LBMA clearing statistics. Both sets of figures are published on a daily average basis from the figures compiled over a month and are thus easily compared. The Bank of England survey shows that, in May 1996 a quiet month, the 14 Market-Making Members traded around 7 million ounces of gold and 120 million ounces of silver each day. The LBMA statistics show that in October, November and December of last year an average of nearly 30 million ounces of gold and 250 million ounces of silver were cleared through London each day by the eight Clearing Members as a result of transactions from all around the world – a reflection surely of the significance of London in international bullion.

Thirdly, following the gyrations in gold forward and interest rates over recent months, the GOFO page on Reuters whose forward gold swap rates are the basis of so many long-term gold funding agreements is complemented by a new page, LGLR, which will give a mid-market indication of gold lease rates. Martin Stokes expands on this development in this issue.

Fourthly, on 19th February 1997, the LBMA is to hold its first overseas function. This is to be a Westminster style debate held in Johannesburg during the Société Générale Frankel Pollak Annual Investment Conference on the motion, "This House applauds the practice of hedging by gold producers". We are privileged to have an international panel speaking for and against the Motion, including Graham Birch of Mercury Asset Management, Brett Kebble of Randgold, Guy Manuell of Normandy Group and Kelvin Williams of Anglo American. The scene will be set by Stewart Murray of Gold Fields Mineral Services in what promises to be a worthwhile as well as an entertaining debate.

And, finally, the LBMA has instigated a suite of pages on Reuters which will expand on the single current GOFO facility. These pages will be for historic and factual information on the LBMA, as well as displaying updates for new data we are introducing and which are explained in this issue. The pages can be found under the codes LBMA 1 to 9.

New Year is the time when market forecasters revel in predicting the paths of markets over the year to come. How notoriously wrong they can be though!

Gold went into 1996 in a state of great optimism and with aspirations for higher levels and, indeed, we saw the highest fixing prices in dollar terms for five years within the first five weeks. This was followed by a lacklustre market right through to the last two months of the year when the lowest fixing prices since 1993 were seen. The only promising conclusion to come from this is that with an annual range for the Gold Fixing of $48.85 the market broke a declining trend in respect of price range which had lasted for three years.

But what of more worthy commentators than myself? We are pleased to publish on pages 6 to10 a collage of opinion from some of the leading observers in the market with predictions for 1997 and we are grateful for their contributions. Looking back in 12 months' time should prove an interesting exercise. ■

London Bullion Market: Survey of Turnover

by Terry Smeeton, Head of Foreign Exchange Division, and Andy Murfin, Senior Manager, Capital and Wholesale Markets, Bank of England

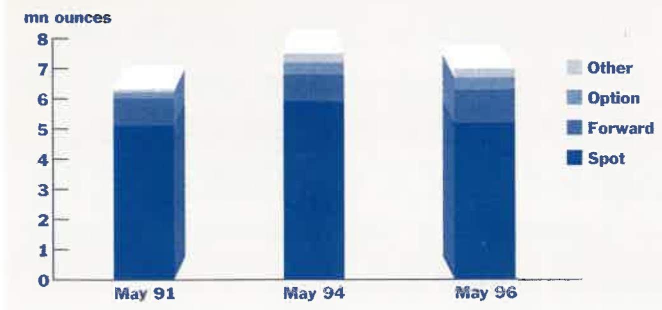
A relatively recent feature of the Bank of England's oversight of the London Bullion Market has been a survey of turnover among the Market-Making Members of the LBMA. The Bank has conducted four such surveys during the last six years, which have served as a useful illustration of the size and depth of the London market and as a means to track the development of the market over time. The survey data have also supplemented the routine supervisory information reported to the Bank by each of the Market-Makers. The most recent survey recorded activity during May 1996. This summary records the key findings and reviews, albeit briefly, some of the trends that are identifiable from this and two of the previous surveys (in 1991 and 1994).

In terms of product coverage the survey sought data on a range of gold and silver products, including spot transactions, forwards and options. Institutional coverage was limited to the Market-Making Members of the LBMA (14 in May 1996), so the survey is not representative of the total activity in the London market. The significant amount of business undertaken by the 50 or so Ordinary Members of the LBMA, for example, falls outside the scope of this survey. Furthermore, London is home to a significant amount of 'over-the-counter' business that is conducted outside the UK but on a Loco London basis and similarly this is not captured by the survey (but see the article on clearing turnover on pages 4 to 5). There is also a growing tendency across a range of financial markets for firms to centralise certain middle and back office functions in a small number of locations. A number of international bullion houses, for example, choose to book deals that are traded in London in a single overseas centre to facilitate their risk management function. These deals are recorded in the Bank's survey which encompasses trading undertaken in both an agency and principal capacity.

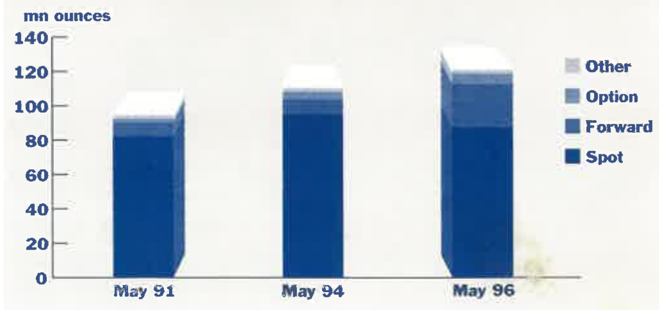
The last five years have seen some notable developments in the composition of the market, not least the increasing participation and sophistication of central banks in the leasing and swap markets and an increase in the amount of gold that they have put into the market. This has occurred alongside an increasing appetite among some gold producers to engage in large hedging programmes. These developments have, however, had little impact on the gold price which, for most of the period under review, remained in quite a narrow range. This was particularly true in May 1996 when, according to a majority of Market-Makers, activity was reported to be significantly 'below average' in a range of products. The latest turnover figures need to be considered against this background.

With one or two exceptions, the profile of the market which emerged from the 1996 survey was remarkably similar to that in 1994. In volume terms, average daily turnover in gold was only marginally below that reported in 1994, whereas daily turnover in silver was some 10% higher. Taken together, the combined value of gold and

Chart 1: AVERAGE DAILY GOLD TURNOVER



Charts 2: AVERAGE DAILY SILVER TURNOVER



silver activity (in US dollar terms) just exceeded that recorded two years ago.

In the gold market, approximately 7 million ounces of the metal were traded daily during May 1996, compared with 7½ million ounces in 1994 (see chart 1), which represents a similar dip in turnover to that experienced on Comex. A higher gold price in May 1996 than in May 1994 meant that the value of these transactions – almost $3 billion each day – remained largely unchanged. Spot transactions continued to account for approximately three-quarters of total turnover. The volume of OTC options contracts also remained at a similar level, but there was a small rise in forwards' share of turnover. Activity in the London silver market continues to show steady growth (see chart 2). Average daily turnover exceeded 120 million ounces in May 1996, representing an increase of more than 10% on 1994. In value terms this equates to turnover of approximately $650 million a day. In contrast, exchange-traded activity in the US was rather subdued, with turnover in silver contracts significantly below that recorded in 1994. One of the most significant features to emerge from the survey was a greater concentration of silver business in the forwards: more than 20% of silver trades were forward transactions, representing a substantial increase on the share – less than 10% – recorded in 1994. It is likely that the increase in business in the forwards – from 10% of activity in 1994 to around 20% of all gold and silver transactions in 1996 – is a trend that will become more entrenched. Anecdotal evidence also suggests that the market is seeing increasing demand for longer dated forwards. This may pose a greater challenge for existing liquidity management techniques, as it appears that among those central banks which do participate in the London gold market there are few willing to make deposits or to undertake swaps with an initial life of more than one year. The long maturity of some of the forward sales programmes means there is something of a maturity mismatch in the market and this in turn has prompted some houses to seek to develop innovative methods to cope with the relatively short-term commitments made by central banks.

Looking ahead, there is quite a lively debate about the challenges facing the market in the short to medium term and how it will respond. The prospect of EMU and the possibility of gold sales by the IMF are creating considerable uncertainty. This turnover survey throws no direct light on these questions but it does provide confirmation of the depth and liquidity available in the London market and its significant volumes of business as they arise. ■

Clearing Volume
on the London Bullion Market

by Peter Smith, Vice President, Morgan Guaranty Trust Company of New York, and Chairman, LBMA Physical Committee

"Loco London" is a phrase added routinely at the conclusion of a bullion deal or used by commentators when analysing the importance of the London bullion markets. Not everyone perhaps will be familiar with what lies behind this phrase or with its significance in comparison to the volume of bullion business worldwide. The reality is that London is the global clearing centre for gold and silver in much the same way that all US dollar transactions are ultimately cleared in New York or Japanese yen in Tokyo.

Now, for the first time, the LBMA is lifting the veil to quantify the volume of bullion business cleared in London by publishing statistics provided by the eight Clearing Members*, for whose co-operation we are most grateful. This article introduces and explains the statistics.

The figures shown in the table below are now being collected each month. Subsequent figures on the same basis will appear on the new LBMA Reuters pages described in this issue and in the LBMA's quarterly *Market Statistics*. The expectation is that over a period they will both give a useful insight into trends in the volume of global bullion business and provide a measure of the prominence of London in the international bullion market.

The figures show, for gold and silver separately, the volume (in millions of troy ounces) transferred on average each day, the US dollar value of that volume (applying the monthly average London pm fixing price for gold and the average London spot fixing price for silver) and the average number of transfers recorded each day.

Thus, over the last quarter of last year, when the LBMA began to collect the statistics**, some 30 million troy ounces (say 930 tonnes) of gold were transferred on average each day, with a value of over $10 billion in something over 1,000 separate transfers. The figures for silver were some 250 million troy ounces (nearly 8,000 tonnes), valued at over $1 billion in just under 500 separate transfers each day.

London Bullion Market Clearing Turnover
(Daily Averages)

		Gold	Silver
TROY OUNCES TRANSFERRED (MILLIONS)			
1996	October*	27.5	279.4
	November	31.0	244.3
	December	29.8	248.8
VALUE† (US$ BILLIONS)			
1996	October*	10.5	1.4
	November	11.7	1.2
	December	11.0	1.2
NUMBER OF TRANSFERS			
1996	October*	1,086	481
	November	1,124	484
	December	1,172	493

*Partly estimated
†Using the monthly average London pm fixing price for gold and the monthly average London spot fixing price for silver.

For these figures to be correctly understood it is necessary to give some definitions. The figures contain:

- Loco London book transfers from one party in a Clearing Member's books to another party in the same Member's books or in the books of another Clearing Member.
- Physical transfers and shipments by Clearing Members.
- Transfers over Clearing Members' accounts at the Bank of England.

In order to minimise double-counting, only the debit side of each transaction is recorded by each Clearing Member. To this extent, we can be confident that the figures are not over-inflated. However, in the opposite direction, many individual transfers are the result of the netting of multiple debit and credit transactions. It is not possible to gross the figures up for such transfers and to this extent, therefore, the figures are an under-estimate, possibly sizeable, of the actual volume of bullion business.

Excluded from the statistics are:

- Allocations between Clearing Members where the sole purpose is for overnight credit.
- Physical movements arranged by Clearing Members in locations other than London.

What, then, do these figures mean?

First, they are large by any standards, but just to put things into a modicum of perspective, the average daily turnover in the London foreign exchange market in April 1995 – the date of the last Bank of England survey – was $464 billion, some 40 times larger than the daily bullion clearing turnover in the last quarter of last year. However, the level of bullion turnover is very comparable with turnover in some individual currency pairs on the London foreign exchange market.

Secondly, it is important to differentiate these figures from those in the Bank of England's survey of volume turnover as described in the article in this issue. The latter gives a measure of the trading turnover (spot, forward, options, etc.) of the then 14 Market-Making Members of the LBMA in May 1996. If one adds the approximately 7 million ounces of gold shown in the Bank of England's survey to comparable statistics of average daily turnover on Comex and Tocom (roughly 3 million and 1 million ounces respectively), then an indication begins to emerge of London's significance as the clearing centre for international bullion business.

Finally, to add further perspective, the volume of gold cleared daily in London is almost twice the annual production of South African mines and closely equivalent to the average level of gold holdings among EU central banks. For silver, the 8,000 tonnes transferred each day would require some 400 articulated trailer lorries to transport. Imagine the nightmare such a convoy would create on the M25 in the rush hour! ■

** The eight Clearing Members are: Credit Suisse First Boston – London Branch, Deutsche Morgan Grenfell, Midland Bank plc, Morgan Guaranty Trust Company of New York, Republic National Bank of New York, N M Rothschild & Sons Limited, Standard Chartered Bank – The Mocatta Group and Union Bank of Switzerland.*

*** Note that the figures for October 1996 are partly estimated because not all reporting institutions' computer systems were fully set up. However, the results are thought to be not substantially different from those that would have appeared from a wholly computerised system; they can, therefore, be taken as reasonably comparable with subsequent figures.*

Global Forecast: 1997

by Susanne Capano, Precious Metals Trader, Commerzbank AG, London Branch

Shortly before Christmas, the *Alchemist* turned to some of the most glittering names in our industry for a look forward to 1997 – before the year had even started. Their considered opinions follow.

Quick fix: Gold: $330–$405. Silver: $3.80–$5.00. Wide ranges, perhaps, but then there are a dozen individual opinions from nine centres.

So, read on, and then let us know what you think. We'll be printing your letters in upcoming issues.

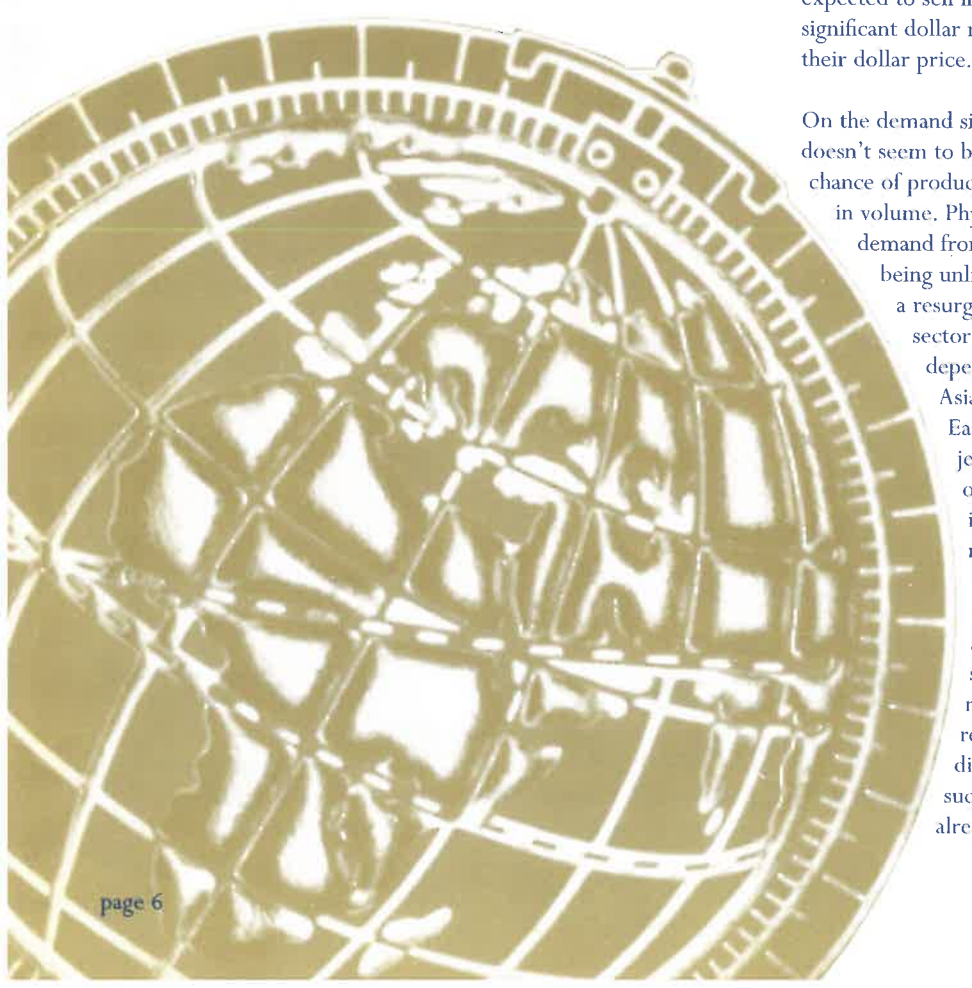
Ted Arnold

Merrill Lynch & Co
London

GOLD
Range: $330–$390

Expect a much more volatile year for gold in 1997 – now that it has finally broken out of its option stranglehold. The clear message is that we are heading south. On the supply side, there is and will continue to be increased potential for selling from central banks and from South African producers. If and when they feel the Rand has stabilised, they can be expected to sell into any significant dollar rally to lock in their dollar price.

On the demand side – there doesn't seem to be much chance of producer buybacks in volume. Physical demand from the West being unlikely to stage a resurgence, this sector is heavily dependant on Asian/Middle Eastern/Indian jewellery offtake which, it must be remembered, is all very price sensitive. Any substantial rally is likely to result in rapid disinvestment, such as we have already seen in the past. This year has seen an overall decrease in demand of 15–17% as gold has become expensive in local currency terms. Gold is a buyers' market – and while they can be expected to stand back and wait for the price to come to them, at some point they will help stabilise the market and help it to form a new, lower range.



SILVER
Range: $4.00–$4.90

Indians have had the strongest appetite for silver, taking in roughly 20% of all demand, and it looks like they are starting to have indigestion. The last monsoon was not great, and the economy appears to be slowing down, all of which will lead to consumer caution. Indians are very price sensitive and could already be seen backing off at $5.25 in 1996. Look for a coming increase in supply as new copper mines due to come on line in Chile will boost silver production as well. Increasingly, rallies over $5.00 will bring out both primary and secondary producer selling. Silver is a commodity with considerable oversupply and the market will have to find the right level to draw demand out.

Bruce Ikemizu

Mitsui & Co.
Tokyo

GOLD
Range: $350–$390

We think gold is still out of focus of the speculator's interest. We are seeing small but steady physical demand out of our area, so hopefully this will support the market. There seems to be not much reason to look at the upper side, but if the NY stock market, which looks as if it has no ceiling, crashes (or at least sees some correction on its price rise), gold may have a chance to see the $390s. But again, it looks unlikely. Furthermore, many Australian producers are eager sellers if Aussie gold comes back at all from its historical low prices. We just say there is always more gold than we really need. Basically, we expect just another range-bound year, only lower.

SILVER
Range: $4.20–$5.20

Silver could be a bit choppier than the gold market. We see good physical demand below the market from film makers, and would expect a steadier market.

Andy Smith

UBS
London

GOLD
Range: $350–$400

'Been down so long, looks like up to me' seems gold's best hope in the early New Year. For everything that could go wrong did go wrong in 1996: producers buying back their hedges only to see prices fall, central banks selling and the market selling the rumour of more (EMU-linked) official sales, and the perpetual growth machine of physical demand stalling badly. Beyond a New Year blip – sharpened perhaps by the current silence of the bulls and call-option positions above the market – and EMU postponement is the best chance of avoiding the abyss (paranoia over official sales could ease, a little). Without a little help *sur le continent*, rallies will be sold, hard.

SILVER
Range: $4.25–$5.25

As to silver, there is no reason, in principle, why it should suffer the structural fatigue of gold – permanently heightened fear of official sales: silver gave up its monetary pretensions a century ago. But silver is suffering speculative fatigue - repeated, abortive attempts to conjure itself through $6. The Indian rope trick – nine favourable monsoons boosting demand – is also now longer than the proverbial piece of string. And despite vacuous talk of gaps, low lease rates suggest more liquidity than the average brewery. Still, perhaps a better each-way bet than gold for the perennial Wall Street bears.

Brendan McCarthy

MKS Finance SA
Sydney

GOLD
Range: $345–$390

Our outlook for gold in 1997 is from an intraday/short-term trader's perspective: little economic research, supply/demand analysis or technical viewpoint.

The last quarter of 1996 saw the gold market weakness reacting to fears or expectations of central bank sales, producer selling and little sign of global inflation.

AVERAGE GOLD PROJECTIONS

	Low $/oz	High $/oz
London	351	398
Tokyo	350	390
Sydney	350	389
Johannesburg	350	400
New York	350	390
Zurich	360	390
Paris	350	395
Hong Kong	360	400
Toronto	350	405

The inflation argument has some merits, and producer selling will be there, but central bank selling and the related talk of Maastricht and gold becoming just another commodity, losing its reserve currency premium, is the real fear during price weakness.

If gold is to be sold, must it be done this year or lose it forever? This fear will probably spill over into early 1997 until the markets begin to question its validity. Can we really believe the European process will suddenly transform hundreds of years of history into a single currency? Even if it does, what can we say of a system that would allow central banks to sell hard gold reserves to fudge the national books in order to meet strict entry requirements.

The lower price expectations of producers and this fear we see as lowering the upper side of gold range for 1997 to $390. The spillover of fear into the first quarter of 1997 leads us to believe that the low side of a range will be tested and established initially at $345, before questions about current fears and their validity are asked.

Higher oil/energy prices are a reality of the past 18 months and these cannot be absorbed forever. Consumption fundamentalists will prevail: investment jewellery demand is good and looks to get better. India continues with its run of good monsoonal seasons; large populated Asian countries are where real sustained economic growth is occurring and looks set to continue well into the next century; and higher oil prices have brought increased revenue to the Middle East. These will take check and see us testing the upper boundary of our estimated range of $390 by last quarter 1997.

David Giese

Smith Borkum Hare
Merrill Lynch
Johannesburg

GOLD
Range: $350–$400

Apart from a short period at the beginning of 1996, the gold price in US dollar terms has been on the decline. I do not believe that this trend is likely to continue in 1997, but the price could stabilise around the year-end price and trade in a band of between $370 and $385 per ounce. This does not remove the possibility of the price collapsing to around $350 (or lower!) or spiking to $400 per ounce (or above!), but the seven-year mean of $372 per ounce is a reasonable basis. Rumours of continuing central bank selling connected with restructuring in the European Union, declining Chinese interest, world demand exceeding supply and low levels of inflation in the major economies should ensure that the gold price does not move too dramatically in either direction.

As a major producer, South Africa's supply to the market is expected to consolidate around the level of 500 tonnes for 1997, before commencing a gradual increase as new production from developing mines becomes evident. The improving labour relations in the gold mines, coupled with black ownership of a significant South African gold mining company, Johannesburg Consolidated Investments, should remove speculation about a further cut in gold output from South Africa.

In addition to the above-mentioned factors, low price volatility in a balanced gold market should assist to maintain a flat gold price during 1997.

Tom Griffo

Cargill Investor Services, Inc.
New York

GOLD
Range: $350–$390

With gold prices sitting at three-year lows, bearish sentiment is understandably strong. Sales by producers are said to be heavier than usual as miners have seen the $390, $380 and $370 levels all fall by the wayside. Meanwhile, with world financial markets seemingly setting record highs almost daily and inflation a non-story, investor interest in gold is poor, to say the least.

Further, the market is now awash with speculation that European central banks will soon sell gold in order to meet the debt criteria of the pending European Monetary Union. This threat – real or imagined – is probably the single biggest factor behind the gold market's most recent woes.

So, what's next?

Before gold can break out of its current depression, the aforementioned issue of central bank gold sales must be resolved. Until or unless the European central bankers make a policy statement about their gold holdings related to the pending EMU, gold's upside will be extremely limited. Ironically, the gold market has shown that it can efficiently absorb official sales, especially since the sellers have usually been extremely prudent in their operations: what the market cannot deal with is the uncertainty surrounding the details of any such sales.

Gold is therefore likely to gravitate toward $350, although the sheer magnitude of the short position held by the funds suggests a $10 short-covering rally is possible in the interim. Unless there is an unforeseen change in the fundamentals as depicted above, the $385–$390 area would appear to be an optimistic projection for the upside of this troubled market over the next three to six months.

SILVER
Range: $4.50–$5.50

Given gold's rather uninspiring outlook, can silver be expected to perform any better? Well, unlike gold, silver is unencumbered by fears of producer or central bank sales. And while silver has a well-documented stock overhang, the market, for the most part, has long discounted this surplus (which has been significantly reduced over the past several years). Furthermore, silver inventories are generally not viewed as a source of ready supply at current low price levels. Meanwhile, physical demand should remain steady, reflecting the generally healthy state of the G7 economies, and it seems reasonable to expect Indian offtake to continue to be strong.

Still, there is simply too much historical linkage between the two metals to conceive that silver and gold prices could trend in opposite directions. The two are married, for better or worse. Therefore, a range of $4.50 to $5.50 is plausible for silver looking out three to six months.

Hanspeter Hausheer

SBC Warburg
Zurich

GOLD
Range: $360–$390

After three years with rather disappointing developments in the gold market, if we exclude January and February 1996, there are reasons to believe that not much will change in 1997. I expect the gold price to remain in a range between $360 and $390.

Although the economic recovery in the G3 countries will have some upward impact on inflation, especially in the USA, where growth is already above inflation-neutral levels, the possible price effect on gold will be compensated by ongoing fears over possible sales from central banks. On the other hand, producers seem quite satisfied with the present gold price level, especially those with total production costs around $300. Overall, there will be more attractive alternatives to gold for investments in 1997.

SILVER
Range: $4.60–$5.80

I have a more positive opinion on silver than on gold. Since silver fundamentally is an industrial metal, it should profit from the economic recovery worldwide. In addition, contrary to gold, there are no big potential sellers looming over the silver market. Furthermore, silver has proved in the past to be the most volatile of the precious metals.

For these reasons I give silver a good chance that it can loosen its close tie to the movements in gold, which has been the case in the past, and go a more independent way. Price-wise, I expect to see a range between $4.60 and $5.80. Considering the present level of $4.80, the risk is clearly to the upside.

AVERAGE SILVER PROJECTIONS

	Low $/oz	High $/oz
London	4.10	5.10
Tokyo	4.20	5.20
Sydney	3.80	5.20
New York	4.50	5.50
Zurich	4.60	5.80
Paris	4.00	4.70

Serge Topolanski

Société Générale
Paris

GOLD
Range: $350–$395

Gold has been trading in a bearish trend since February 1996. This downside move accelerated recently and will continue in 1997. The target of the pattern is a long-term support line located around $350. An intermediate recovery at the beginning of 1997 is possible towards $390–$395 (representing a 50% retracement from $417 to $367), but prices should drift lower from the beginning of Q2 1997 to eventually reach the $350 target.

SILVER
Range: $4.00–$4.70

Silver has also been in a similar bearish channel since February 1996. Currently, there is strong support at $4.70. If that is broken, we should head much lower – towards $4.30. In fact, the trend indicated a possible target at $4.00 for the end of 1997.

Rhona O'Connell

T Hoare & Co. Ltd
London

GOLD
Range: $375–$405

As we write, the mood in the gold market is overwhelmingly bearish, with every feasible reason (and a few infeasible ones) being cited for price weakness and expectations for further falls. The market has been under pressure from speculative short trading coupled with some mine producer activity ahead of the year's end. Persistent rumours of central bank activity are always difficult either to confirm or deny, but they have not helped sentiment. Equally, fears of European sales in order to meet budget/GDP criteria ahead of EMU have not helped.

Meanwhile, the physical market is steady on an underlying basis, but as is always the case when the price is running (in either direction), individual buyers have stood aside.

This gloomy background will not persist forever. Physical buyers will have to return ahead of India's Festival and Wedding seasons and this should be enough to stem the falls. The fundamental physical outlook for the market balance in 1997 suggests that there will once again be a shortfall in the region of 400 tonnes, which will have to be filled by central banks, hedge activity from the miners or physical disinvestment. The first two seem to be more likely than the latter.

The key to a market re-rating will be the extent and timing of any short-covering from the professionals. It is important to remember that the short position overhanging the market is of considerable size and any short-covering rally could produce substantial gains in price.

A reasonable forecast for gold's price range for 1997 would be for a floor of $375 and a high of $405, with an average of roughly $390/oz.

SILVER

Silver is notoriously fickle: fun to analyse, but this analyst is very glad not to trade it!

There are only two places where the gold: silver ratio has any significance: Comex/NYMEX and India, where if the two go out of kilter it is not unusual for Indian holders to sell (relatively expensive) silver in order to buy (relatively cheap) gold.

This said, gold may well have an influence on silver next year, if we see the upward re-rating that we expect (albeit only a small one). Silver appears to have been in the grip of the speculators of late and despite the fact that London vaults are full to overflowing, the shorts would seem, so far, to have the upper hand. If gold pulls back into the $380+ band, then silver should regain the $5.00–$5.25 level.

Raymond Chan

President
The Chinese Gold & Silver Exchange Society
Hong Kong

GOLD
Range: $360–$400

Hong Kong can be expected to grow in importance as a retail gold centre for Chinese customers as traffic from China increases during and after 1997. In 1996, there has already been a 30% increase in tourism over the previous year. Currently, an average of 270 tonnes a year pass through Hong Kong, with about 50-60 tonnes of that being used for local consumption and the rest re-routed throughout Asia. After 1997, local consumption could increase to 70-80 tonnes/year.

There is a growing divergence between attitudes towards gold in different areas of China. In the interior, people still view it as an investment hedge – one which can be worn, as individuals ar still not allowed to own bars, and have to purchase gold in the form of jewellery. On the coastline, investors are likely to turn to a variety of investment options. These areas still have an interest in precious metals, however. Gold and platinum jewellery is a good way to show off wealth when one has cashed in an investment.

During 1997, gold's trading range is unlikely to fluctuate widely. There should be support around $360 – the recent break of $370 is already leading to an increase in demand. But having said that, it's difficult to see much upside potential. The market is not likely to move above $400.

John Israel

Macquarie Bank
Sydney

GOLD
Range: $355–$388

I'm expecting gold to continue the downward trend through 1997, as investor apathy remains, and with no signs of inflationary pressure, world stock and bond markets will attract further funds. At a point not too far away, I also see producer selling intensifying after a period of inactivity on their behalf this year. The perceived threat of large central bank sales still looms above the market, enabling speculative commodity funds to keep up the downward pressure.

SILVER
Range: $3.80–$5.20

I look for silver to continue its decline from the highs of early 1996, with only occasional short-covering providing selling opportunities, as it is led lower with the other precious metals.

Egizio Bianchini

Nesbitt Burns
Toronto

GOLD
Range: $350–$405

Gold faces an assortment of negative and positive influences and questions marks (Will EMU come off smoothly? Will there be another currency crisis?) The chief threat hanging over the market is any talk of large selling from one or more central banks. What we consider to be the leading influence, however, is the level of interest rates, especially in developed countries. The low rates currently prevailing can prove positive for gold for two reasons: one, low opportunity cost when holding gold or other hard assets and, two, low rates mean lower contangos, and this discourages producer forward selling.

Looking then at a likely range for gold during 1997, we are basically there on the downside at current levels at around $368. This forms the lower end of a reasonable range. But that doesn't rule out a sharp plunge to the downside – a drop to $350 or even $340. However, the market would be so oversold at that point that it would rapidly snap back. On the other hand, there is no reason to be overly bullish. Over the past few years, we have considered $415 to be a reasonable upside limit. For 1997, we would lower that to $405. That doesn't exclude the possibility of a sudden upwards spike through to $430 but, again, the market would not be able to sustain that level and would reverse itself very quickly. ■

Transparency in Gold Lease Rates

by Martin Stokes,

Vice President, Commodities, Morgan Guaranty Trust Company of New York

Before 1989, the gold forward market was, to quote Winston Churchill, "a riddle shrouded in mystery wrapped up in an enigma". Transparency was non-existent and price levels could only be ascertained by direct contact with market practitioners. The LBMA took the first step towards improving this situation in July 1989, with the development and introduction of the Gold Forward (GOFO) page on Reuters. Now, GOFO – which shows gold swap rates – will be joined by LGLR, which will provide market participants with an indicative benchmark for gold lease mid-rates.

History

GOFO was originally inspired by a request to the Market-Making Members of the LBMA by N M Rothschild & Sons Ltd., who saw a commercial advantage in providing a Forward Rate Agreement service in gold interest rates to their clients. At that time, a new word was incorporated into the language of gold traders, though the Oxford English Dictionary has yet to give due recognition to "GOLDFRA". This is a simple forward rate agreement which determines the interest rate that will apply to a notional future loan or deposit of an agreed amount of gold for a single interest period of up to one year. Other traders soon saw the possibilities afforded by the daily gold interest rate benchmarks and responded positively to a concept which allowed the market to create more specialised, tailor-made structures for clients.

How the GOFO benchmark is calculated

Although most readers are probably already familiar with GOFO, the following is a quick review.

The GOFP and GOFQ pages on Reuters show the rates – expressed in US$ interest rates – at which the contributors are prepared to give gold and take dollars on a swap basis; the quotes are for one, two, three, six and 12 months respectively. In order to be accepted as a contributor, an institution must be a Market-Making Member of the LBMA.

These pages feed through to a "headline" page on GOFO which indicates the most recent updates. At 11.00am London time each day, the mean rate is calculated for each period by taking the average of all the contributors' quotes after discarding the highest and the lowest quote for each period.

The new LGLR page

This page will show the effective mid-rate for gold leases for all periods currently quoted on GOFO. Generally speaking, gold swaps are quoted in the market with a bid/offer spread of approximately 25 basis points. Furthermore, when a gold lease is calculated, then the spread on the currency deposit component must also be taken into account; this has been taken as 12.5 basis points. Therefore, under normal conditions, a mid-rate for gold leases can be calculated by reference to the following formula:
US$ LIBOR – (GOFO + 19 bp) = Gold lease mid-rate.

Should extreme market conditions prevail, a committee comprising three experienced market professionals has been established in order to calculate a best estimate of the true mid-rate during such periods of high volatility.

We must emphasise that this published mid-rate is purely for indication and should not be taken as the basis for any business. Most importantly, credit considerations are not taken into account.

The greatest long-term benefit of the new page should be to provide a service which will assist accountants and auditors in marking to market oustanding forward and options positions. Chartists will also find the mid-rates a useful tool for taking historical data.

The Management Committee of the LBMA is pleased to have taken this initiative to create further transparency in the market and feels sure that publication of these rates will be of benefit to the whole spectrum of market participants. ■

London Bullion Market Association
Implied mid-market gold interest rates

	Mean GOFO	BBA LIBOR	Gold Mid-Rate
1 Month	3.81	5.44	1.44
2 Months	3.83	5.50	1.48
3 Months	3.84	5.56	1.53
6 Months	3.87	5.69	1.63
1 Year	3.89	5.91	1.83

These are not dealing rates but indications derived from the GOFO mean and BBA USD LIBOR adjusted by a factor to reflect current market spreads.

London Interbank Forward Bullion Rates GOFO
Loco London Gold Lending Rates (vs US$)

Time	Contributor	Rate		Mean (LDN 11AM)	
1347	ROTHSCHILD	1m	3.75	1m	3.81
1348	MIDLAND	2m	3.85	2m	3.83
1248	CHASE	3m	3.85	3m	3.84
1058	MORGAN	6m	3.85	6m	3.87
1054	DEUTSCHE	12m	3.85	12m	3.89
	GOLD DLR OZ	LONDON FIX			
1355	350.70/351.20	AM 350.10		PM 350.50	

LBMA News

by Chris Elston, Chief Executive, LBMA

Membership

With effect from 1 November 1996, Brambles Securities Services UK Limited became an Ordinary Member.

With effect from 1 January 1997, First National Bank of Boston, London Branch and Sucden (UK) Limited became Ordinary Members.

With effect from 17 October 1996, Lehman Brothers Inc withdrew from its Market-Maker Membership. It continues, however, as an Ordinary Member.

With effect from 1 January 1997, the name in which Credit Suisse holds its Market-Maker Membership changed to Credit Suisse First Boston, London Branch.

Committees

Management Committee

Following the departure of Philip Clewes-Garner to UBS, Robert Ashley of NM Rothschild & Sons Limited has joined the Committee. Alan Baker put on record the Committee's thanks for Phil's work on its behalf and, in particular, for his efforts in fostering a closer relationship between the LBMA and the LPPM, a process which it is hoped will continue.

The Bullion Addendum to the ISDA Master Agreement is still under discussion. We are into a fourth- and we hope near-final draft. The latest date for completion is expected now to be around the end of February.

Physical Committee

Changes to Good Delivery List

Addition to Silver List: Uzbekistan, Almalyk Mining & Metallurgical Complex ("AMMC") with effect from 23 October 1996.

Mr Vitaliy N Sigedin, General Director of Almalyk, together with Mr B M Dadakuziev, Chairman of Uzbekistan's Committee for Precious Stones, visited the LBMA on Tuesday, 26 November when Alan Baker, Chairman LBMA , presented them with the LBMA's letter of accreditation (see photograph).

Silver Transfers to Former List: Norway, K A Rasmussen Hamar A/S with effect from 21 October 1996.

Germany, VEB Mansfield Kombinat Wilhelm Pieck with effect from 21 October 1996.

Public Affairs Committee

Jeffrey Rhodes, of Standard Bank London Limited and LBMA PAC Chairman, left for Dubai in the New Year, where he is heading Standard Bank's branch. He has promised us a "Letter from Dubai" for the next issue of the *Alchemist*. At the December meeting of the PAC, Jeffrey handed over the Chairmanship to James Dobell of Sumitomo Corporation (UK) plc and the Editorship of the *Alchemist* to Susanne Capano of Commerzbank AG, London Branch. James expressed the Committee's thanks for Jeffrey's work on the Committee, which with the publication of the LBMA Brochure, the *Alchemist* and *Market Statistics*, has had a high and handsome profile.

People

The LBMA notes the recent "semi-retirement" of Julian Baring as Head of Mercury Asset Management's Mining Department. We take this opportunity to pay tribute to Julian for his always cogent and entertaining contributions over the years to thought and debate in the world of bullion. We wish him well for the future. We feel sure that "semi-retirement" means that he will not exactly be disappearing from the scene. At the same time we give a warm welcome to his successor, Graham Birch, who is of course already well known to the LBMA.

Social

The LBMA Christmas Disco was held at the Elizabeth Suite on 11 December. More than 350 people attended and had, quite literally, a thumping good time. Our thanks to Stella Thompson of the Executive for her usual brilliant organisation.

DIARY OF EVENTS

16–21 February 1997
Société Générale Frankel Pollak 20th Annual Investment Conference, Johannesburg and Cape Town

19 February 1997
The LBMA Debate on Hedging at the above Conference, 4.00–6.00pm, followed by Reception, Michaelangelo Hotel, Sandton, Johannesburg

13–16 May 1997
Mining Finance Congress
AIC Conferences, Marina Mandarin, Singapore

20 May 1997
London Platinum and Palladium Market Reception, Stationers' Hall, London

21 May 1997
London Platinum and Palladium Market Annual Dinner, The Savoy Hotel, London

16–17 June 1997
The FT World Gold Conference, Prague

17–19 September 1997
3rd European Precious Metals Conference – Eurometaux, Sheraton Firenze Hotel, Florence, Italy

For further information please call
Susanne Capano
Commerzbank AG
London Branch
Telephone: 0171 570 0470
or
Chris Elston or Stella Thompson
LBMA Executive
6 Frederick's Place
London EC2R 8BT
Telephone: 0171 796 3067
Fax: 0171 796 4345