LBMA-i

Trade Volumes in the London Gold Market - What do they Show?

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Introduction

Greater transparency has been introduced to gold and silver markets in recent years, with the publication of import/export data for leading gold trading countries, better central bank data, daily information on key investor flows and the London vault holdings.

But one big piece of the jigsaw has been missing – a reliable measure of the volume and nature of trade in the huge London over-the-counter (OTC) market. Until now, that is, with today's publication of LBMA-i trade reporting data.

All LBMA Members, almost all trades

Before delving in to what the numbers show, it is important to be clear on what the data is and what it isn't. For both gold and silver there are two reports. One covers the **daily trade volumes** by product of LBMA Members globally in the OTC market settling Loco London and Loco Zurich. This will be initially available as an average over the (usually 5) UK business days in a calendar week[1], published weekly, later in Q1 2019 becoming available daily. The other shows at a particular time a**ll open trades by product and duration**, somewhat analogous to an exchange open-interest report.

All LBMA trading Members are required to contribute their spot, forwards and options trades (exotic trades are excluded), unless below a certain (small) threshold. Currently the 13 market makers and 29 other reporting entities are included, with 15 more due to join in January 2019. It does not include other OTC trading platforms nor trades by non-LBMA members. As such it represents *the LBMA Members' share of the London OTC market*, not the entire London OTC market or global OTC market.

The data

The first week's volume data (Nov 12-18) shows LBMA Members traded 30.2 million ounces (Moz), or 939t/day of **gold** on the London OTC market, with a notional value of $36.9 bn/day. 63% of those were spot transactions, 31% forwards, 6% loans and options.

[1] If a bank holiday falls within the 5 day period then the number of days is reduced accordingly.

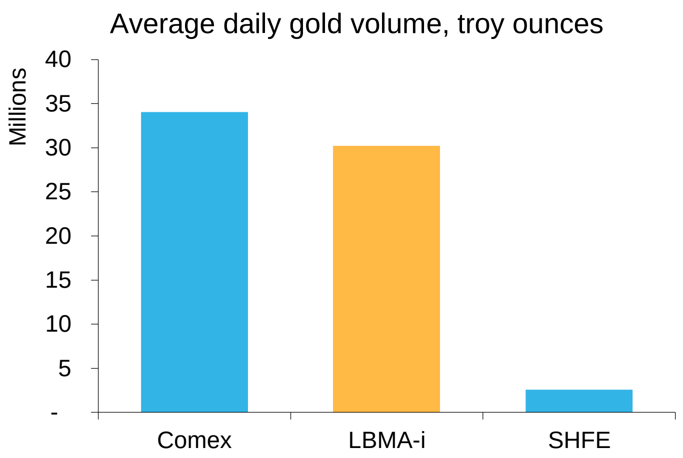
In **silver** they traded 359.3 Moz, or 11,174t, worth around $5.2bn a day. The split of products was similar to gold: 59% spot, 36% forwards, and 5% loans and options.

Comparisons to other bullion and metal markets

How big is the LBMA Members' London OTC trading compared to other gold markets? Pretty big. The obvious comparison is with the CME's US-based Comex futures and options exchange. Their gold contracts last week traded the equivalent of ~34 Moz/day. This is about 13% higher than the LBMA-i volume of 30.2 Moz/day. We cannot be sure that is the relative size of the two markets, for Comex volumes are volatile week-to-week, and early data suggests LBMA-i volumes will be too, meaning the true picture will become clear only as more information becomes available in the coming months, especially as LBMA-i continues to add more Members. After these two markets the next largest is China's Shanghai Futures Exchange (SHFE), around 2.6 Moz/day over the same period.

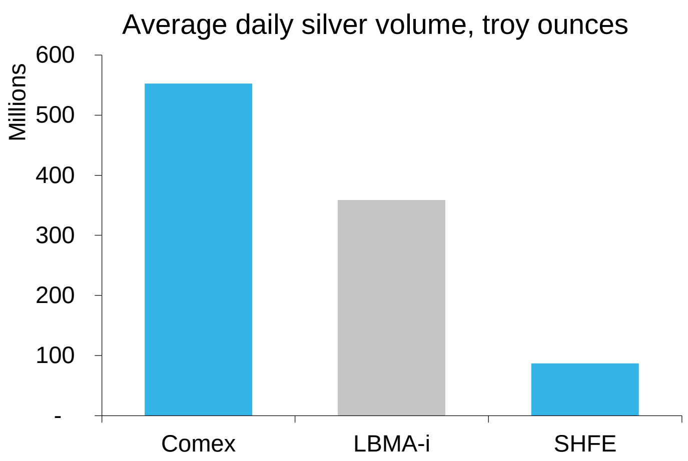
Silver tells a similar story. There the LBMA Members' 359.3 Moz/day of volume traded London OTC last week compares to Comex's daily trading volume of 552 Moz over the same period. This means Comex was proportionally larger relative to LBMA-i than it is in gold, though the same caveats (non-members, late joiners, only one data point) again means we cannot assume this will always be the case. China's SHFE is again the third largest, at around 62 Moz.

Comparison across gold markets



Source: LBMA-i, Bloomberg, Macquarie Strategy, November 2018

Comparison across silver markets



Source: LBMA-i, Bloomberg, Macquarie Strategy, November 2018

As we are talking about *London* trading, we could also compare the LBMA-i data with that from the London Metal Exchange (LME). There the gold and silver contracts are relatively new and small – in October 0.3 Moz/day of gold and just under 2 Moz of silver. But the far longer established copper contract had a daily trading volume of nearly $22bn/day in 2017, followed by aluminium at nearly $11bn/day. Collectively the "big five" base metals – adding in nickel, zinc and tin – saw daily volumes of just over $50bn/day, roughly 1.5x that of gold. Interestingly their annual mine production was worth $155bn, also 1.5x that of gold, a useful sense-check.

Comparisons further afield

We can also cast our net wider, comparing London's gold trading volumes to non-commodity assets[2].

An obvious one, given both the London and safe-haven comparison, is the UK government bond market (Gilts). This is also an OTC market. In 2017 average daily trading volume in Gilts[3] was around $44bn, larger but in the same ballpark as the LBMA-i numbers for London OTC gold. Again as a sense-check we can compare the annual "production" of gilts (i.e. the net issuance), which at $124bn over the last ten years, is

[2] Note comparisons across assets, or even within assets and across geographies, are fraught with difficulties.

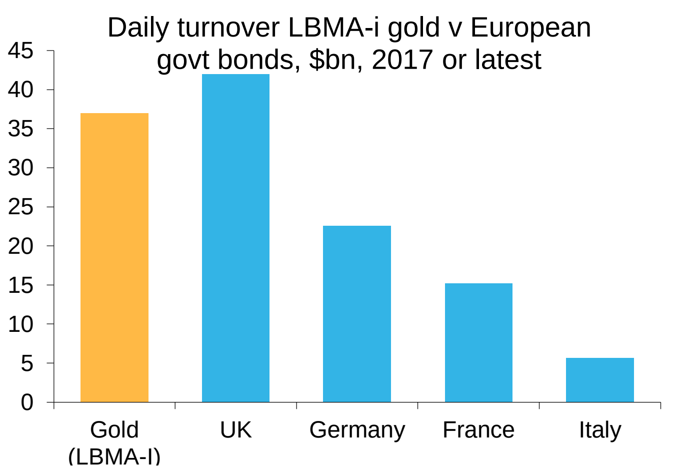
[3] https://www.dmo.gov.uk/data/gilt-market/turnover-data/

not that dissimilar to that of global gold mine production, around $100bn. Only the stocks seem different – there are $2.7 trillion of gilts outstanding, which compares to $7 trillion of gold in above-ground stocks, or the rather smaller $300bn of gold held in London vaults.

While on the theme of government bonds[4], note that (again with the proviso that comparisons are complicated) UK Gilts are highly traded in comparison to other European government bonds. German Bunds, for example, trade only ~$20bn/day, and French $14bn/day. On the TRAX platform EU28 government bonds, including the UK, trade only around $78bn/day.

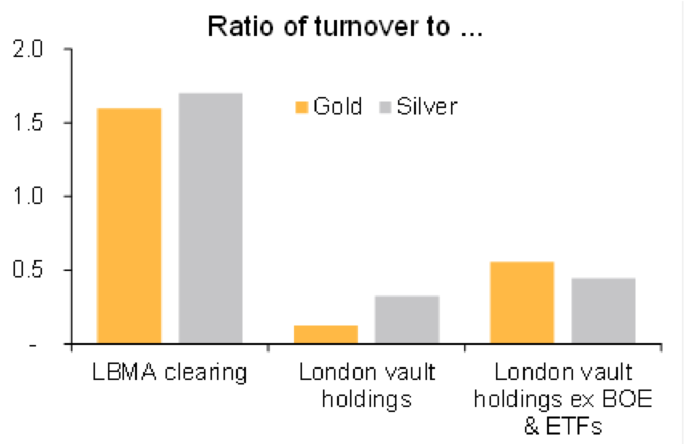
FX trading volumes are in a league of their own. The BIS's triennial survey[5] shows the daily turnover of USD/EUR, for instance, is some $1,172bn/day. More comparable to gold would be one of the non USD pairings, such as EUR/CHF, at $44bn/day, or JPY/AUD, at $31bn/day. Of course FX volumes are global, not just in London (though that is the largest centre), and while that is also true of the OTC gold market a complete comparison would need to take into account the liquidity of other gold centres and exchanges.

Comparison to European bond markets



Source: AFME, Macquarie Strategy, November 2018

Ratio of turnover to clearing & vault holdings



Source: LBMA-i, BoE, ETFs, Macquarie Strategy, November 2018

Comparisons to the LBMA's clearing and vaulting data

Finally, bringing our analysis back home, we can also look at the new LBMA-i data relative to other published LBMA data. There are two regularly published statistics – monthly net clearing and vaulting data. With respect to clearing, in October, the latest available print, 18.7 Moz/day was 'cleared'. If last week was similar it would mean volume traded on the London market is around 1.6x that which is cleared. This ratio will raise some eyebrows given market lore has suggested the ratio is 3x, or 5x, or even 10x. For silver the October clearing figure was 211 Moz, making the ratio of volume traded to that cleared higher than in gold, and more in line with lower market assumptions.

Of course LBMA-i covers only the trade of LBMA Members (and not quite all Members), whereas clearing is used by Members and non-members alike. And once again having only one week's data means we cannot assume this is the normal ratio– next week could be much higher or lower[6]. But the LBMA-i exercise has also shown that a reasonable proportion of clearing does not see a trade – transfers within metal accounts, across customers, novations and so on.

Turning to vault data again there are problems of timing, but as of July the London vaults (and here measurement is usually quoted in metric tonnes) had 7,632t of gold (245 Moz), and 34,453t (1,108 Moz) of silver. This means the LBMA Members' daily volume last week was equivalent in gold to 12% of the stock and in silver 32%. These percentages for each metal would be higher and more similar to each other if measured against only the unallocated stock given a significant proportion of both is allocated for ETFs, and

[4] For information on all EU government bond trades see https://www.afme.eu/globalassets/downloads/data/government-bonds/afme-prd-govt-bond-data-report-q2-2018.pdf
[5] See https://www.bis.org/statistics/derstats3y.htm
[6] It is also possible that the clearing numbers in November, the week for which we have volume traded data, were much lower than in October, though they tend to be quite stable.

in gold held by the Bank of England mostly on behalf of central banks. An earlier estimate[7] suggests London's pool of gold liquidity might be around 1,700t (55 Moz), in which case daily turnover would be about 50% of the stock; silver's once ETFs are accounted for would be similar.

A snapshot…next a story

The release of turnover data marks another step forward in giving greater transparency on the activities of London gold and silver market, adding to that provided by the release of vault holdings data in 2017 and clearing statistics many years ago.

Its importance should not be understated. For the first time in the long history of the London gold market its size is not guesswork but a reliable measurement, a notable achievement given the variety of participants and products that it encompasses.

But this is just the beginning. After all a snapshot can only tell us so much. The real benefit of data is seeing how it moves over time, especially once we have daily publication in 1Q 2019 and data on the platinum and palladium markets. Not only will this enhance participants' understanding of market size and liquidity, but for analysts will let us tell a story of how volumes shift in response to changing underlying market conditions and prices.

Matthew Turner is the Precious Metals Strategist at Macquarie Bank and he has been analysing gold and silver market data for 20 years. He has been responsible for Macquarie Bank's coverage of precious metals research since January 2013, and takes the lead on economic research within the highly-rated Commodities Strategy Team. Prior to joining Macquarie, Matthew spent three years on the trading desk as a global precious metal strategist at Mitsubishi Corporation, and before that he produced research and advice in precious metals and economics for governments, mining companies, banks and trading houses.

About LBMA: LBMA is the international trade association that represents the wholesale over-the-counter market for gold and silver bullion. LBMA undertakes many activities on behalf of its Members and the wider market, setting industry standards including good delivery and refining standards, ownership of the precious metal benchmark prices as well as serving as a point of contact for the regulatory authorities. For more information, please visit www.lbma.org.uk.

[7] Demystifying London's Gold and Silver Vault Holdings By Joni Teves, Precious Metals Strategist, UBS http://www.lbma.org.uk/assets/blog/DemystifyingLondonvaultholdings.pdf