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CHINESE GOLD LEASING (NOT WHAT IT SEEMS) v1

Chinese Gold Leasing Not What It Seems

May 22, 2015

Welcome to another episode of understanding how mainstream consultancy firms (the World Gold Council, GFMS, CPM Group, Precious Metals Insights) understate Chinese gold demand. One of their main arguments is that hundreds if not thousands of tonnes are tied up in Chinese Commodity Financing Deals (CCFDs). As it was first stated by the World Gold Council (China's Gold Market Progress And Prospects, April, 2014):

No statistics are available on the outstanding amount of gold tied up in financial operations [CCFDs] linked to shadow banking but ***Precious Metals Insights believes it is feasible that by the end of 2013 this could have reached a cumulative 1,000t.***

Many mainstream news outlets, such as Reuters and the Financial Times, copied this segment, writing something along the lines of "1,000 tonnes is tied up in financing deals, it's all a fraud and when this will be unwound the gold will flush the Chinese market". In reality there was not 1,000 tonnes tied up in financing deals in 2013, as was portrayed by the WGC report.

The Details

Since 2013 I have been writing Chinese wholesale gold demand, measured by SGE withdrawals, is roughly twice as much as what the WGC discloses in their Gold Demand Trends. Since then I've been trying to reflect all arguments presented by the WGC against reality; most have proven to be misleading.

The primary reason mainstream gold analysts think the gap between SGE withdrawals and WGC demand is caused are CCFDs. Although, the mainstream media is not obliged to explain anything about what they write, CCFDs can be either round tripping (gold trade between China mainland and abroad through processing trade in free trade zones by speculators to acquire cheap funds) or gold leasing in the Chinese domestic gold market (to acquire cheap funds). In a previous post I've explained why round tripping has absolutely nothing to do with the Chinese domestic gold market and the SGE system (click here to read the post). That leaves gold leasing.

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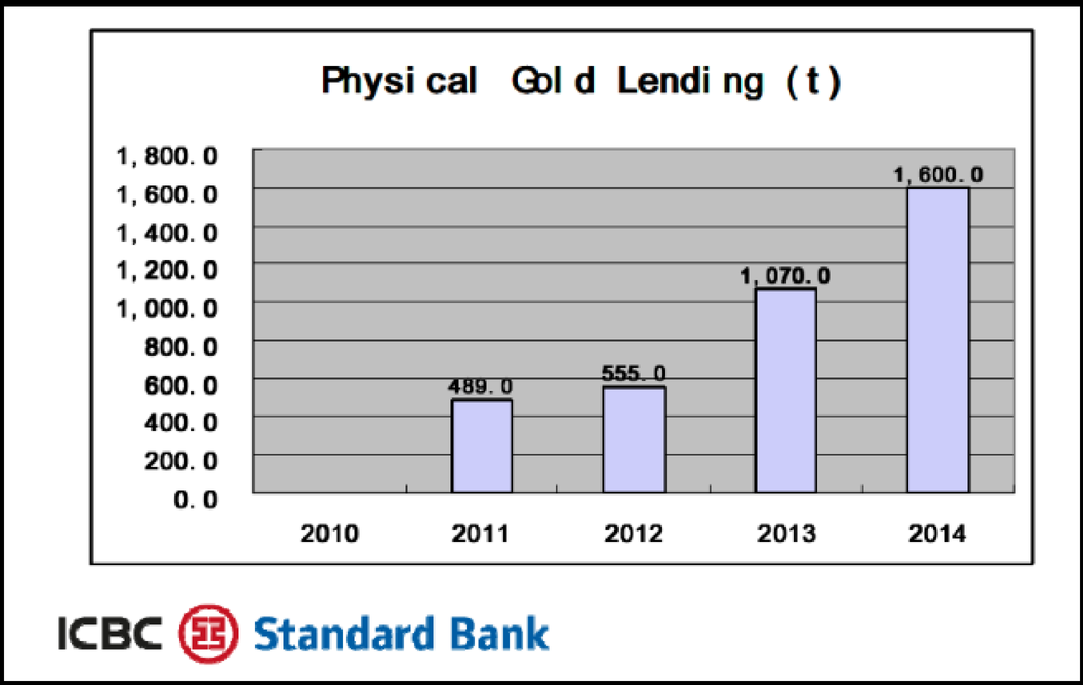

ICBC presented the above slide at a congress in Dubai last April. We can see gold lending, in China done through the SGE, was 1,070 tonnes in 2013 and in 2014 it reached 1,600 tonnes – **without a doubt 1,070 tonnes was used by the WGC as the volume "tied up" in CFFDs.**

I've expanded on the workings of the Chinese gold lease market in one, two, three, previous posts.

First of all, the WGC itself wrote me the majority of the leases are for genuine gold business, so not much of an argument after all – speculative leasing is not likely to be withdrawn from SGE vaults and thus can't explain the SGE withdrawals vs WGC demand gap. But, I have more information on Chinese gold leasing. Some numbers on 2013 leasing were disclosed in a post from April 8, 2015 (Minsheng bank):

Among various tenors of lease contracts, 1 year leasing accounted for 44.26 % of total contracts, 6 to 12 months was 35.24 %, 3 to 6 months was 10.38 % and less than 3 months 10.12 %.

These percentages raised the question, was 1,070 tonnes leased out at 31 December 2013, or did all leases conducted in 2013 summed up at 1,070 tonnes? A few emails with an employee of the precious metals trading desk of a Chinese bank pointed out the latter is correct, **aggregate leases in 2013 were 1,070 tonnes.** To illustrate the difference, if a refinery borrows 10 tonnes of gold for 1 month and the loan is rolled over 11 months, total lease volume is 120 tonnes. **There was no 1,000 tonnes "tied up" in CFFDs.** For sure some gold was "tied up" in round tripping and speculators are leasing gold to acquire cheap funds, but the truth is completely different than what is written by mainstream media and the WGC.