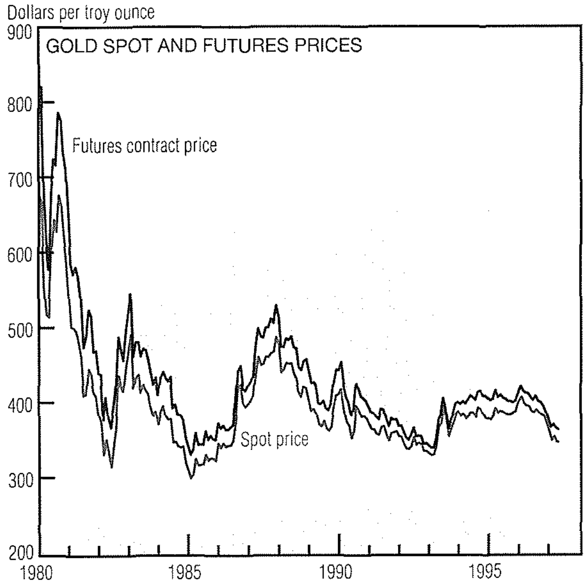
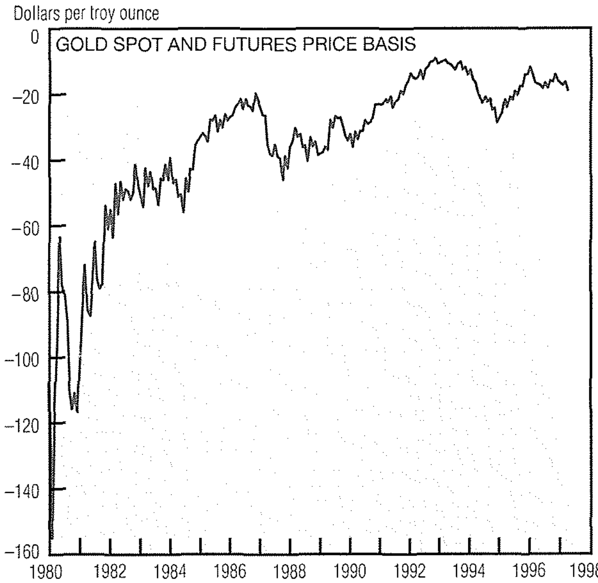
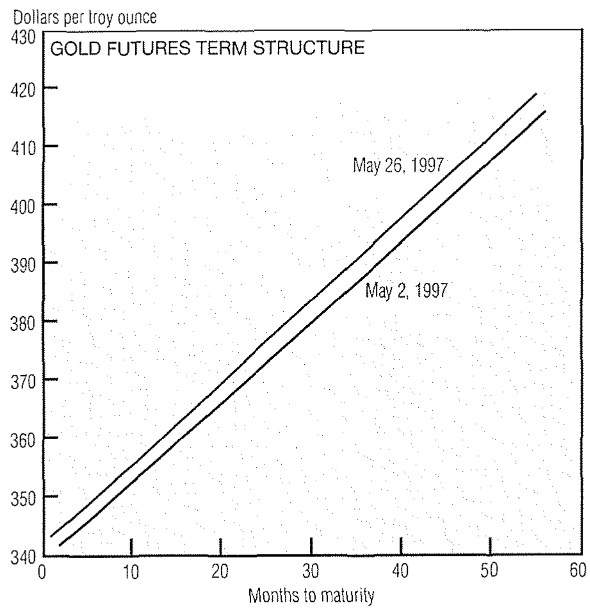
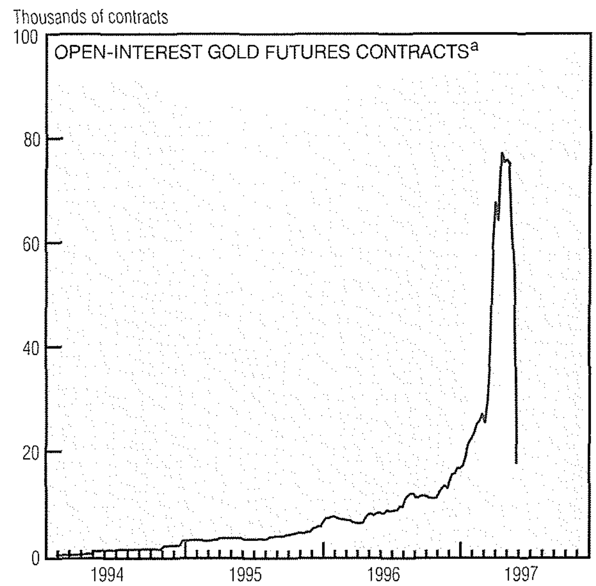
Gold Markets









a. Contracts are for July 1997.
SOURCES: DRI/McGraw-Hill; and *The Wall Street Journal*, various issues.

Having long ago settled down after the turmoil of the early 1980s, gold prices have continued to decline steadily from their recent peak of February 1996, as have prices on the futures market. The difference between the spot and futures price, called the basis, has shown less movement (as expected), although the futures price has exceeded the spot price by a wider margin since late 1996. Normally, the ease of storage and large outstanding stock of gold make it a full-carry market, that is, one in which the futures price equals the spot price plus the cost of carry (storage and financing). This implies that futures prices exceed spot prices, producing a negative basis, a situation known to futures traders as a contango.

Despite the contango, other gold futures indicate a normal market, where longer futures contracts have higher prices. This term structure of gold futures remains quite linear (compared with that of interest rates) and has recently shifted upward. The shift represents an increase in the spot price of gold since early May, although this is not apparent from the monthly averages of the first chart. The spot price increase dominated falling interest rates (which reduce the cost of carry, since storage rates are unlikely to change much).

One important measure of activity in any futures market is open interest—the number of contracts for which delivery is obligated. Open interest builds slowly, reaching its peak about three months before expiration of the contract for delivery in July 1997. The decline occurs when traders close out their positions to avoid taking delivery.