

# Prospects for the Chinese Private Gold Market

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Distinguished guests, good afternoon. I feel greatly honoured to have the opportunity to discuss some issues on gold investment. I would like to discuss the current situation in the Chinese gold market and make some projections for private investment.

## **A brief history of the development of the Chinese gold market**

In the 1930s, the Shanghai Gold Business Exchange was one of the biggest gold centres in the Far East. At that time, gold was very popular as an investment.

After the new China was founded, the government conducted a consolidation in gold trading for over 50 years. A publication produced in 1950, *Managing Methods for Bullion*, stated that the People's Bank of China (PBOC) held a monopoly on bullion trading. Private transactions in gold and silver were banned among the population. At the beginning of 1963, the state stopped providing raw material to gold and silver fabricators, and reclaimed gold and silver jewellery could only be kept in banks.

In 1982, China opened a retail market for gold jewellery. That was also the year that China Gold Coin General Corporation started issuing the famous Panda gold coins. In 1993, the state changed the price-fixing method for gold from a state-determined price to a floating one. In 2000, the Chinese government included the establishment of an open gold market in its five-year economic plans. In April 2001, the governor of the PBOC announced the abolishment of the gold monopoly with a planning management system. In June of that year, the weekly quotation system for the gold price officially came into operation, which adjusted the domestic gold price in accordance with the price on the international market. The Shanghai Gold Exchange (SGE) officially opened on 30 October 2002, representing an important breakpoint in the revolution of China's gold system, and reflected the great progress being made.

## **I. The basis of private investment**

- 1) According to statistics from the central bank, the balance of domestic savings stands at 12,000 billion yuan. Such a high level suggests great potential for individuals to invest in gold.
- 2) History shows that Chinese people have a special interest in and love for gold. In Chinese tradition, gold stands for wealth, luck and happiness. Thus there is a local custom of holding gold as a household reserve (we say "put gold in the bottom of the case"), which came about due to gold's stable value, protecting holders from heavy losses even when there is sharp currency depreciation.
- 3) Current investment channels for gold for individual investors in China are quite limited, though it is becoming an important alternative to stocks, bonds and the fund market. Research by a related department showed that 20% of respondents would like to invest in gold, with the preferred amount being 10%-30% of their financial assets. It is estimated by some media that the next emerging investment market will be gold, after real estate, stocks and open-end funds.
- 4) Gold price fluctuations provide opportunities for profit. In addition, the gold price is inversely correlated to the stock price. As part of a portfolio, gold could help residents to hedge risks.
- 5) The domestic gold price moves in the same direction as that of overseas markets, so the stability of our market is strengthened.

The current investment market is not very satisfactory: the savings interest rate is relatively low, the stock market is bearish, there have been bubbles in real estate, the futures market is quite risky. Once a private gold market is opened, it will draw a great deal of investors to trade and hold gold as an asset.

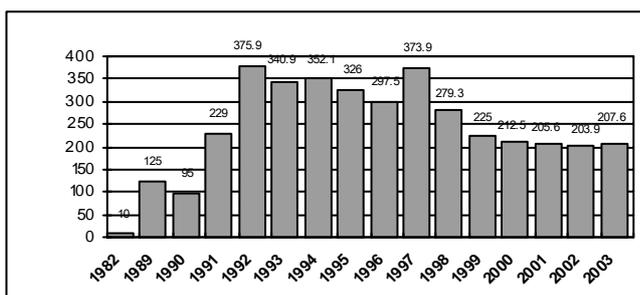
- 6) There is great potential for gold demand. As stated in *China Gold Report*, in 2002 China’s average amount of gold holdings per resident stood at only 0.16 grams/person, much lower than the global average of 0.49 grams/person, which shows China’s great potential for gold demand. If that amount could increase by an average 0.01, domestic gold demand would increase by around 1,300 tonnes, and if all the demanded gold were released, that would be a “gold mountain”.

**II. Products for private investment in gold**

- 1) Jewellery: The Chinese gold jewellery market has been open to the public since 1982. Because of the jewellery’s artistic aspect, its practical value is higher than its investment value. Although in recent years China’s average annual consumption of more than 200 tonnes of jewellery places it third worldwide, investing in jewellery is a low-yield option because of the lack of price volatility.

The following diagram shows sales of gold jewellery for the past 15 years, given by the World Gold Council:

**China’s Gold Jewellery Consumption**

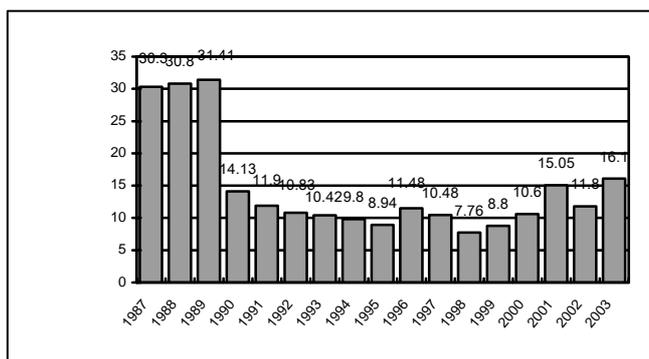


- 2) Coins: These can be split into two categories: investment and commemorative. There are many options for investment coins (e.g. Pandas), which can be sold in the market, although there are costs for holding them. The limited range of subjects, high-standard artistic design and manufacturing and small-scale circulation help characterize commemorative gold coins as artwork. Coins with attractive images or special meaning can demand a higher premium,

and the premium on gold and silver memorial coins is usually very high in the secondary market, far beyond the content value of the gold or silver, so there is a higher risk of price fluctuation. This type of investment is only suitable for experts on monetary coins; therefore, involvement in them is quite limited.

The diagram on the following page shows sales of gold coins in China from 1987 to 2003, provided by China Gold Coin General Corporation:

**Gold coin sales, 1987-2003**



- 3) Bars: These are the most common type of gold investment, referring to processed standard bars with specifications for purity, weight and shape marked on the bar when smelted. Currently many types of bars are in circulation in the Chinese market, such as the Yearly Gold Bar of China Gold Coin General Corporation, the CGS gold bar from China Merchants Bank and Gao Saier Corporation (CGS), and a 50-gram gold bar traded on the Shanghai Gold Exchange.

As opposed to commemorative bars, the price of investment bars is in line with the international gold price. Investment bars have good benefits for investors in that they can easily be bought, sold and traded globally, but their delivery cost makes bar price higher than the trading price of gold. There can also be problems with counter-purchases.

- 4) Gold Account (Paper Gold): This does not aim to deliver the physical gold, but to win the spread through trade. Along the trading, investors do not conduct taking and delivering of gold, but only take down the transaction to the specially opened gold account, and pay and take through the assigned capital account. Investors could easily operate their gold accounts, so it is the most suitable type of private investment

with high capital efficiency and low procedure fee.

### III. The Prospects for Private Investment

- 1) During the initial stage, demand for physical (bar) gold will greatly increase.

At the initial stage of private gold investment, due to low limitations to entrance, price transparency and convenience in trading, the number of people involved in gold investment and demand for physical gold would increase substantially. There would be a portion of people to receive gold. That would influence both supply and demand for gold both domestically and internationally. We expect the development of the Chinese private gold market to provide gold producers and suppliers with good opportunities for growth, especially in terms of physical demand. There are currently 15 refineries that have been qualified from the Shanghai Gold Exchange to produce standard gold bars, and their products are of good quality and widely accepted by investors.

- 2) Gold accounts would become the mainstream trading product in the market.

From the viewpoint of investment, the best choice for individuals is a gold account that is not aimed to deliver physical metal. When investors identify a trading opportunity in the market, they can take advantage of the price fluctuations with relatively low risk.

Now the Shanghai Gold Exchange, taking advantage of being China's central gold exchange, with its dominant price, information and circulation, is developing its sub-trading system, offering a channel for commercial banks to act as agents for individual gold investment. Subsequently, an investment market will be gradually established.

- 3) The market should be cultivated and supported.

The establishment of any market requires efforts from all aspects, active cultivation and support. It should be a gradual process from the start of a private gold investment market and its subsequent boom, unlike the stock market boom and fluctuations over such a short period of time. The Shanghai Gold Exchange, as the organiser of the Chinese gold market, should promote the market with support from relevant national departments and policy guidance, and let the market finally embrace a truly private investment era. ■

