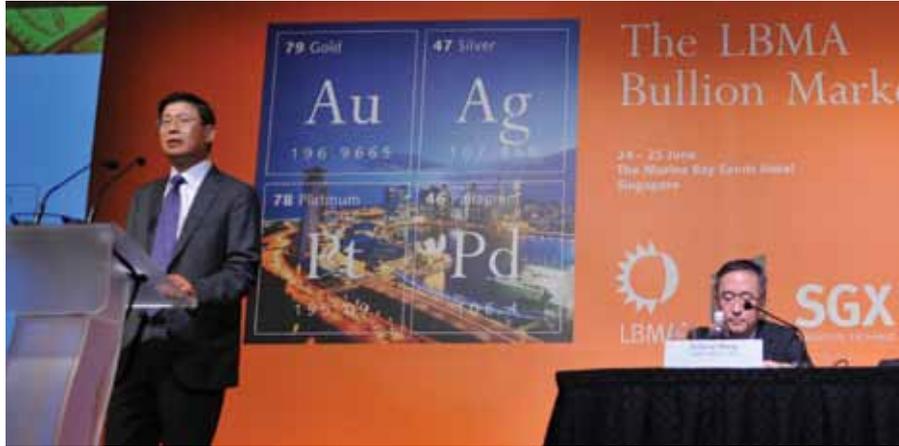


# The Development and Opening of China's Gold Market

By Xu Luode, Chairman, Shanghai Gold Exchange



**This is a translation of a speech delivered by Xu Luode, Chairman of the Shanghai Gold Exchange, at the LBMA Bullion Market Forum in Singapore on 25 June, 2014.**

Thank you for inviting me to attend the LBMA Singapore Forum. It's my great pleasure to be here. So now let me give you a brief introduction on our country's gold market.

First of all, let us all have a look at China's current gold production. For seven consecutive years, gold production in China has been the largest in the world, with nearly 430 tonnes produced last year. China has the second-largest gold reserves in the world. This is the latest figure. Before that, China had been ranked third.

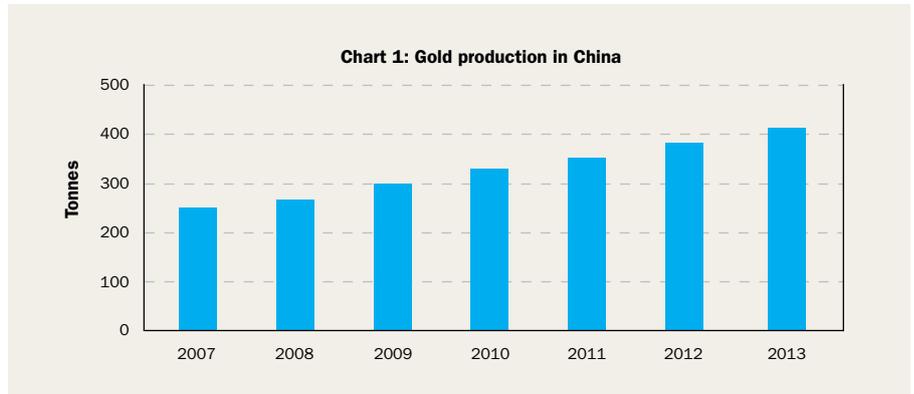
Next is our consumption of gold. According to the statistics compiled by Mr Zhang Bingnan, gold consumption reached 1,174 tonnes last year, and that is also the largest in the world. I slightly disagree with Mr Zhang, as I think we might have consumed even more than that. I think that it is always a good thing to have a higher figure, rather than a lower one. There are two factors supporting consumption in China's gold market. One of them is jewellery. China has an extremely high level of jewellery consumption. Such growth in jewellery consumption shows that China's level of consumption, as in gold consumption, is in a very healthy state. The other one would be gold bullion, as residents are now allocating gold to their asset allocation, and this volume is currently also high.

Next is imports. Data on China's gold imports has not previously been made available to the public. However, gold has historically been imported through Hong Kong, and Hong Kong is

highly transparent, disclosing details such as the number of tonnes of gold imported on a monthly basis. Last year, China imported 1,540 tonnes of gold. Such imports, together with the 430 tonnes of gold we produced ourselves, means that we have, in effect, supplied approximately 2,000 tonnes of gold last year.

The 2,000 tonnes of gold were consumed by consumers in China. Of course, we all know that the Chinese 'dama' [middle-aged women] accounts for a significant proportion in purchasing gold. So last year, our gold exchange's inventory reduced by nearly 2,200 tonnes, of which 200 tonnes was recycled gold.

Seeing such a tremendous market in China last year, many of you are very concerned about what will happen not only this year but also in the future. In my opinion, there will certainly be some differences this year compared to last year. One factor is that the growth rate is



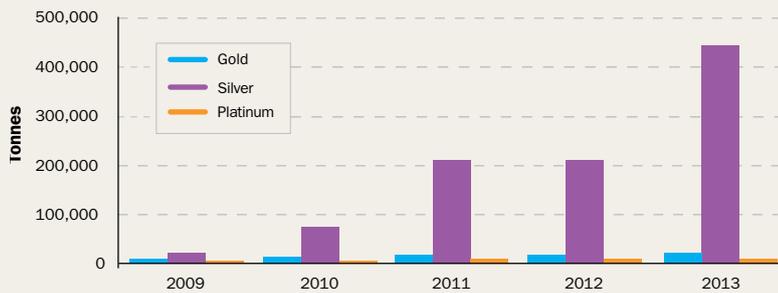
**World Gold Production 2013 (tonnes)**

Rank	Country/Region	Gold production
	World	2,770
1	China	428
2	Australia	255
3	United States	227
4	Russia	220
5	Peru	150
6	South Africa	145
7	Canada	120
8	Mexico	100
9	Uzbekistan	93
10	Ghana	85

slowing down. In the first quarter of this year, gold consumption was still increasing and the import volume remained steady. In terms of the general trend, Mr Albert Cheng from the World Gold Council has estimated that the per capita gold consumption is only 4.5 grams in China whereas it is as high as 24 grams worldwide. The difference of nearly 20 grams represents the potential growth of the physical gold market in China. So I think that China still has a significant growth potential.

Many of you are very concerned about the structure of the gold market in China at the moment. China is a country that is undergoing a significant degree of market transformation. China's gold market has only undergone 10 to 12 years of development, but has its own distinctive features. There are differences when compared with the gold markets of some of the developed countries and even with

Chart 2: Transaction volume of SGE's products



Transaction volumes (tonnes)

	Gold	Silver	Platinum
2009	4,711	16,248	57
2010	6,052	73,615	55
2011	7,439	247,058	65
2012	6,350	208,950	64
2013	11,614	430,501	90

Singapore's gold market. So I call it 'One Body with Two Wings', where 'One Body' refers to our Shanghai Gold Exchange, and 'Two Wings' refers to the sub-market of our commercial banks, as well as the sub-market of our futures exchange. Many of you asked if I have seen ourselves as being too important. Why are we One Body, while others are Two Wings? It is not that I have seen ourselves as too important. I have always held the opinion that any market must have physical commodities as the basis. Be it bulk commodities or other trading markets, transactions are based on physical commodities, and our gold exchange is one based on physical commodities. An exchange with no physical commodities as the basis may grow to a gigantic scale, but there will still be some restrictions when it comes to supporting the physical economy or wielding influence on other aspects of the market. Therefore, I think that as a market trading mainly physical commodities while also trading derivatives, our gold exchange should indeed be playing the role of a central hub in China's gold market. As for the current gold market of our commercial banks, Mr Zhou Ming will be providing an explanation later in his presentation. Our futures exchange is not represented here today, but I can tell all of you that China's futures exchange has also been doing very well in many aspects. Many of you here today are their members.

At the SGE, trading of physical commodities accounts for 35% of total transactions, and investment trading, or rather, derivatives trading accounts for 65% of the total transactions. I believe there will still be changes to this ratio in the future, as in the percentage of transactions accounted for by derivatives may increase further. In my opinion, the desired ratio should be something like 20%/80% or 10%/90%. As for our exchange, let me give a brief introduction to all of you as some of you are familiar while others are unfamiliar with it. The SGE was established in 2001 and officially commenced operations in 2002. Chart 2 shows the transaction volumes of the SGE's products since 2009. As at the end of last year, we have traded more than 11,000 tonnes of gold and 430,000 tonnes of silver. Despite relatively large fluctuations in gold prices this year, we have still managed to maintain a 17% growth in our gold trading volume compared to the corresponding period last year. So the momentum is still healthy. Besides, we have established a system

for logistics, delivery and distribution, as well as a funds clearing system. It should indeed be said that the development outlook is still promising.

In terms of development opportunities for the entire gold market in China, I have mentioned earlier that there is a tremendous potential for our physical gold market. However, we think that our market as a whole is facing three critical opportunities. The first one is a critical period of strategic opportunities. The keynote speaker, Jeremy East, from Standard Chartered, explained this point very well earlier today (Jeremy's speech is reproduced on page 10). He talked about the impact of China on the world economy, the global impact of RMB internationalisation and the global impact of China's gold market. China's economy is developing at a medium to high speed, with an annual growth rate of 7.5%. I think this level of growth is sustainable for many years to come. Therefore, such a rate is a significant factor supporting the development of China's gold market, as well as a fundamental factor supporting the flow of gold from West to East. So in this regard, China's gold market is currently still in a period of strategic development. The second one is a period of accelerated development. With China's investors becoming increasingly mature, participants in China steadily increasing in number and our products getting richer day by day, especially our continually enhanced innovation capabilities, our market is experiencing a period of accelerated comprehensive development. The third is an increasing international presence. Until recently, China's gold market was a closed market. Other than imports, China's gold is invested in by domestic investors and onshore funds. We think that China's gold market has reached a new phase of opening up. It is because the extent of China's economic openness is getting increasingly larger, and our RMB internationalisation is accelerating, especially when we have set up a free trade zone in Shanghai in which free conversion of RMB is possible. Another reason is that China's gold market has now developed to a reasonable size. That is why we think that the time has come for China to open up its gold market to the world.

As well, we should have an overall goal for the opening up of China's gold market. Just as

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Singapore's Minister for Trade and Industry told us today that Singapore has an overall goal and overall plan for its gold market, China also has an overall goal for the opening up of our gold market to the world. First of all, we should leverage the opportunities presented by RMB internationalisation to open up China's gold market gradually to the world. Secondly, we have technically implemented such opening up through the establishment of our Shanghai Gold Exchange International Board. So how do we open up to the world? The international board will help to open the door and invite everyone into China's gold market. Thirdly, we find that we should have a target of serving global investors to create an influential international gold market in China. In other words, China should still have the opportunity to become a prominent gold market, and Shanghai should become a global centre for gold trading. I think we are rather confident about this. This is our goal. So has such a goal obtained the support of the Chinese government, or rather, the support of our regulatory authorities? I am very pleased to say that this is indeed the case. The international board has obtained approval from our central bank, the PBOC, and received support and made the relevant institutional arrangements. Many of you were very concerned about whether you can trade with US dollars or offshore RMB, and how to participate in trading. Let me tell you, we have now completed the design such that you can trade on the international gold board with your offshore RMB and offshore foreign currency through a free-trade account in the free trade zone. One week before I came here, we signed an agreement with the regulatory authorities for the use of free-trade accounts.

So what are the specific details of the design of our international gold board? I have thought for

a long time about how best to explain this clearly to all of you. It is, in fact, very simple. First of all, who are the participants, as in the ones who can participate in trading on our international board? Well, any foreign legal entity or any legal entity that will be established in the Shanghai Free Trade Zone is eligible to apply to become a member of our gold exchange. Of course, there will be many applications, and there will also be some criteria and qualifications for the admission of members. Similarly, there are strict requirements for those wanting to become members of the LBMA. There would still be some requirements in order to participate. We welcome anyone meeting these requirements to join us. Those who cannot meet our requirements can still participate in trading through any of our future international members who can act as brokers.

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Secondly, the transactions on our exchange are priced in RMB. I believe that such a design will enrich the international gold market and make it more credible. We have US dollar pricing. We have London gold pricing. And we can also have RMB pricing. Earlier, I have reported on the data that physical gold consumption in China's gold market has, in effect, reached more than 2,000 tonnes last year. All of you here are experts in this industry and are very clear about the percentage accounted for by these 2,000 tonnes of physical gold in the global market. So I think that RMB pricing should enhance the entire price mechanism. After fixing the price in RMB, you can participate in transactions on our international board with your offshore RMB or even offshore foreign currencies. These days, I often have friends asking me whether we have two boards, one called the international board, and the other called the domestic board. We have, in effect, only one board where domestic and foreign investors trade together with onshore and offshore funds based on a single price. So they are, in fact, together, not separate. If that is the case, what is the purpose of setting up the SGEI? It has three main responsibilities. The first one is to serve as an IT system interface enabling international members to trade on our main board. The second role is to implement the clearing of funds. I mentioned earlier that trading would be done through an FT account. Incoming offshore funds should still be subject to regulation, meaning that incoming funds can only be used to invest in the trading of products on our gold exchange. You cannot use these funds to do any other thing, such as to buy properties or stocks in China. So the account is needed for you to place your money in it. This account will

be opened in the name of our SGEI. Therefore, it serves the role of the clearing and management of funds. And what is the third role? We have created the role of transshipment trade. Many international gold experts have mentioned that Shanghai could serve as a centre for the transshipment of gold. In other words, countries in Southeast Asia or certain parts of East Asia could import gold through Shanghai. So we have, in fact, adopted this suggestion. As such, we designed an important function on our international board for it to be equipped with the ability to conduct transshipment trade. This is an institutional arrangement. For the purpose of such an arrangement, we have set up a 1,500-tonne gold vault in the Shanghai Free Trade Zone. This can serve as a delivery store for both gold imported into China and transhipped to other destinations.

So what is the current status of preparations for the international board? As our market is now transforming from an entirely domestic market to an international market, some of our rules have been adapted. We are also soliciting opinions on this matter from some of our participants, and this is more or less completed. Secondly, the IT system has been built and is now technically online, with the capability to conduct transactions. What we are doing right now is to invite international members to become members of our exchange. Many of the banks, corporations and investment companies or funds that are present here today have established very good relations with us. I might also have sent our invitation to many of you. At this stage, we are only engaging in discussions. We would like to see all of them become members of our exchange, and their responses have been encouraging. They said that they would be very willing to participate in China's market and become a member of our exchange. We expect to launch this international board officially before the end of 2014.

Another thing I would like to elaborate on is that, as our international board is priced in RMB, there are many other opportunities involved. As we all know, there is a difference in interest rates between onshore and offshore RMB funds, or between onshore RMB funds and foreign-currencies. Furthermore, as transactions are quoted in RMB, you are, in effect, using RMB during settlement. So there is an exchange rate difference involved here. We all know that China's exchange rate has appreciated continually over the past few years. However, the RMB exchange rate is now fluctuating more flexibly in both directions, sometimes appreciating and sometimes depreciating. The degree of daily exchange rate fluctuations in China was 1%, but it has now relaxed to 2%. If the exchange rate fluctuates by 2% daily, I suppose this is not a small amount. In other

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words, investing in such a product from our gold exchange would involve gold price fluctuations, as well as interest rate and exchange rate fluctuations. Therefore, it is, in effect, a three-in-one product that provides investors with the potential for profit.

I think China's gold market is developing very well. So I am very confident about the launch of our international board. I am also very optimistic about the development of our gold market as a whole. So I would like to take this opportunity to thank all of you for your support and welcome your participation in our market. Together with all of you, we will take our global gold market to greater heights! Thank you for listening.



**Xu Luode, Chairman of the SGE**

Mr Xu Luode, Bachelor of Economics and senior accountant, is the Chairman of Shanghai Gold Exchange.

He is also the Vice Chairman of China Gold Association, the Vice Chairman of China Payment and Settlement Association, the Executive Member of China Society for Finance & Banking and the Executive Member of China Numismatic Society.

Before taking the current position, Mr Xu Luode served successively as the Deputy General Director of the General Office in People's Bank of China, the Director General of Payment and Settlement Department in People's Bank of China, and the President of China UnionPay.