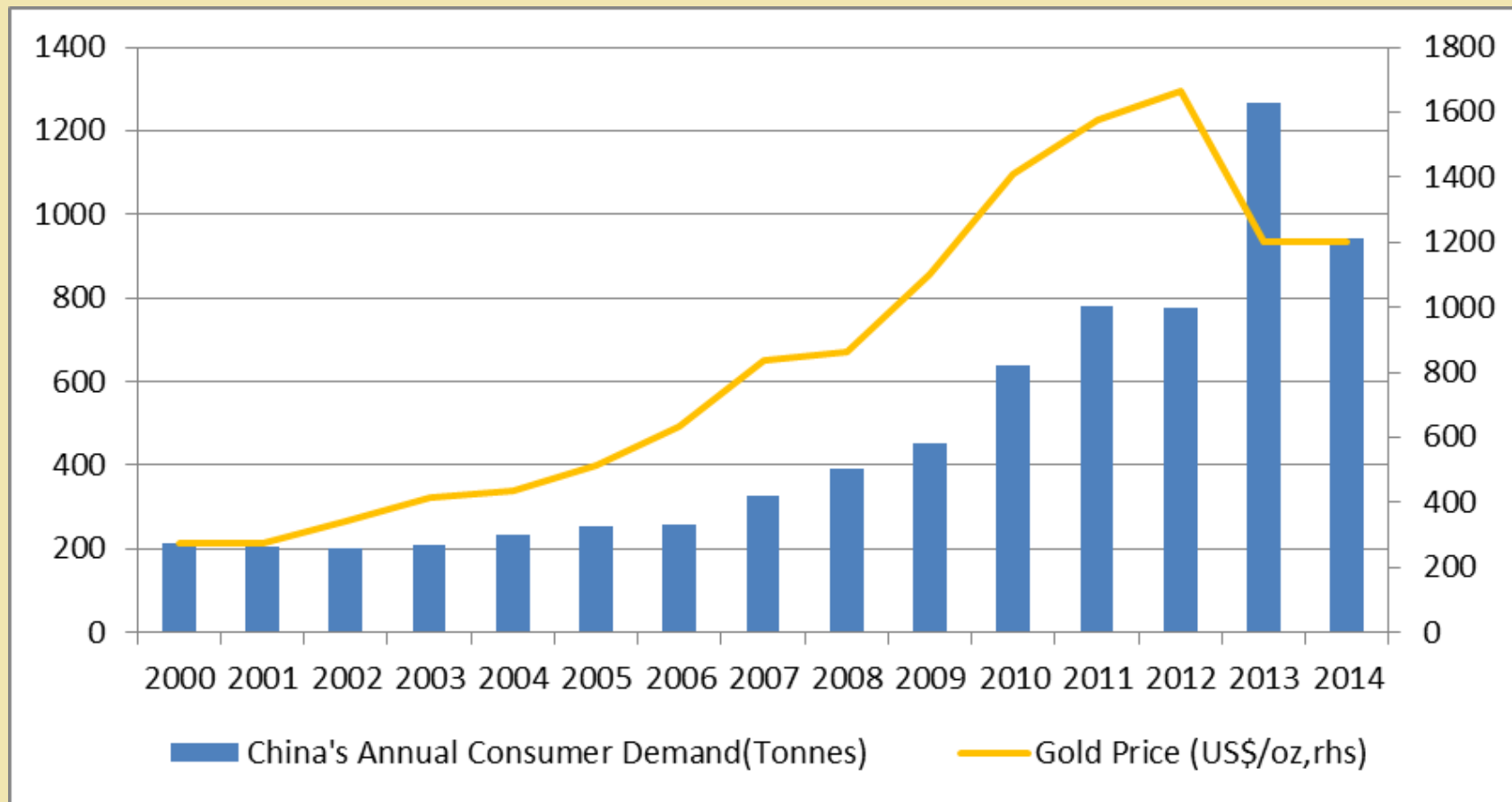




Which is inflated, China's demand or China's influence?


**Shu Jiang ,Chief Analyst of Shandong Group
2015.10.20 Vienna**

Figure 1 China's Demand and Gold Price



Source : World Gold Council, Bloomberg, Shandong Group

China's Demand is Thought to Be Inflated: Two Possible Sources

 One is large-scale commodity financing deals which use the imports and exports of gold to gain the spread between USD's low interest rate and RMB's high interest rate and RMB's appreciation.


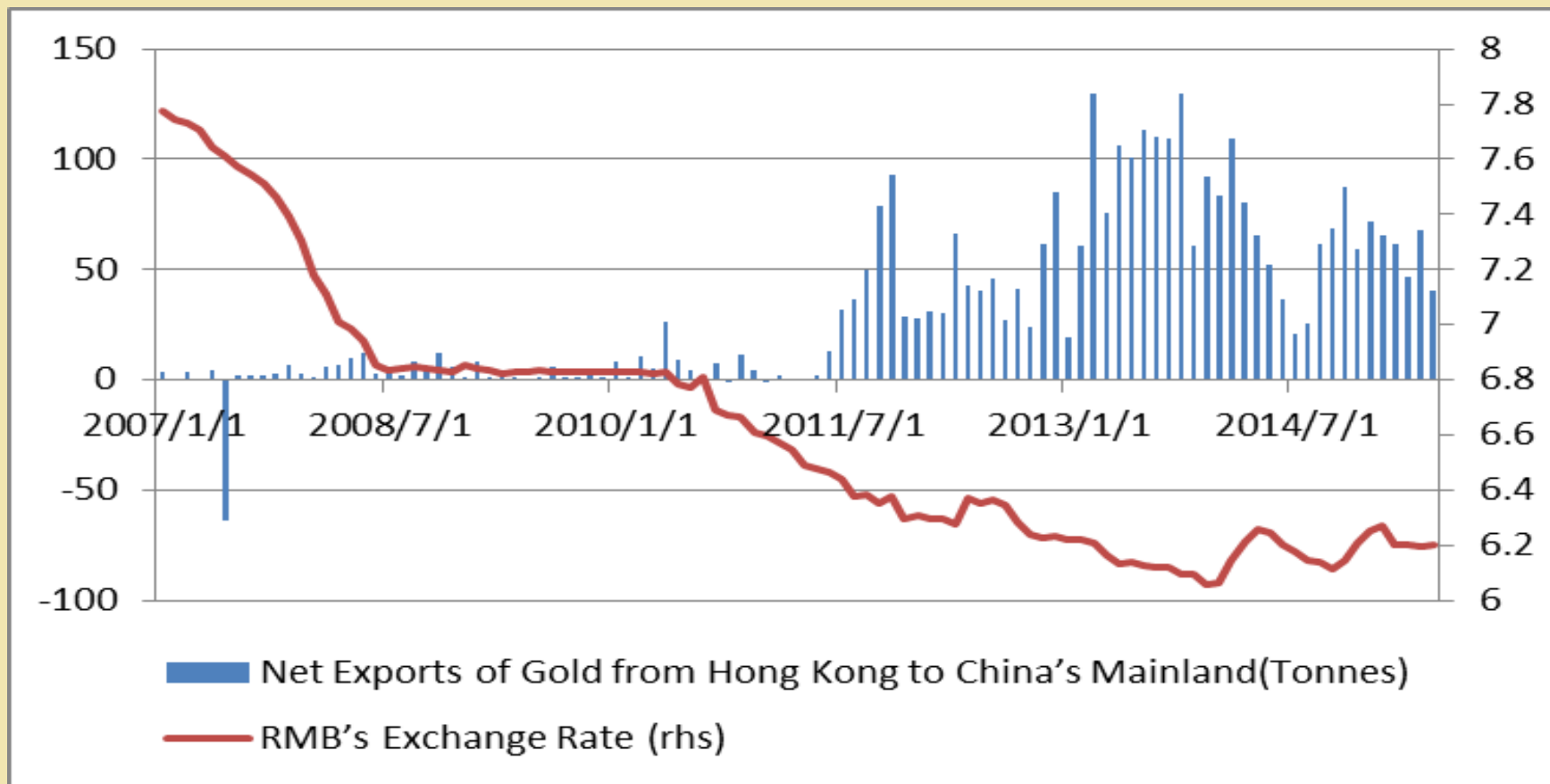
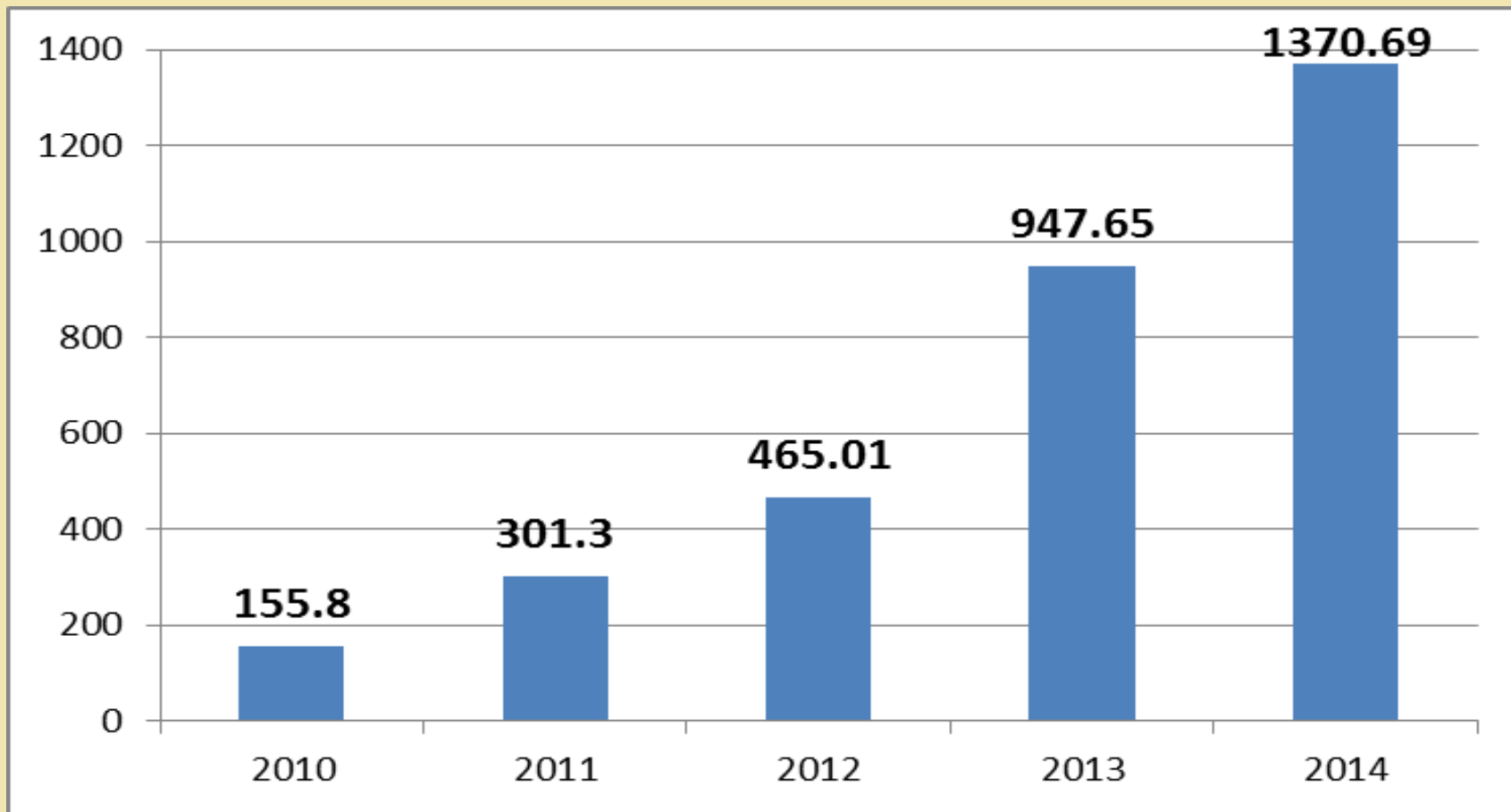
 The other is gold leasing transactions between gold-related enterprises and Chinese commercial banks which keep a large portion of China's gold from real demand.

Figure 2 Net Exports of Gold from Hong Kong to China's Mainland and RMB's Exchange Rate



Source : Bloomberg, Shandong Group

Figure 3 China's Gold Leasing Volume(tonnes)





Source : China Gold Market Report 2014


Chinese Gold Financing Deals are Thought to be Processed in the following four steps:

- 1. Onshore gold manufacturers pay LCs to offshore subsidiaries and import gold from Hong Kong to mainland China – inflating import numbers
- 2. Offshore subsidiaries borrow USD from offshore banks via collateralizing LCs received
- 3. Onshore manufacturers get paid by USD from offshore subsidiaries and export the gold semi-fabricated products – inflating export numbers
- 4. Repeat step 1-3


But in China Gold is Different from Copper


 For general trade around fifteen domestic and foreign banks enjoy a PBOC license to import gold. A few jewelry companies also have a gold trade license for general trade, but this is insignificant.


 All bullion imported through general trade is required to be sold first through the Shanghai Gold Exchange(SGE), and consequently all gold flowing through the SGE is prohibited from being exported.

 So most of net exports of gold from Hong Kong to China's Mainland are not the result of arbitrage based on RMB's high interest rate and appreciation.

China's Gold Leasing Business does not “lock” too much Gold

 Currently most gold leasing transactions take the form of gold-related enterprises borrowing gold from banks.

 When gold-related enterprises got gold they would sell gold through SGE immediately and at the same time buy futures or forwards to hedge price risk when they would buy gold back and return it to banks in the future.

 Gold leasing in China has become a standardized loan-like product of banks. So just like the effect of money multiplier China's 1370 tons gold leasing volume needed much less gold.

Chinese Gold Leasing Deals are Processed in the following three steps:

- 1. Any gold-related enterprise which wants to borrow gold in must have the qualification approved by SGE and get the credit line from the commercial bank which lends it gold.
- 2. The commercial bank lends the gold-related enterprise gold from its own stock or gold borrowed from SGE's inter-bank lending market.
- 3. The gold-related enterprise's gold leasing value should not exceed the credit line which the commercial bank gives and at a specific future date the gold-related enterprise must return gold plus interest rate to the commercial bank.

Table 1 China's Gold Leasing Rate and Bank Loan's Rate

| | One-year Gold Leasing Rate | Gold Leasing Rate Plus Hedging Cost | One-year China's Bench Lending Rate |
|-----------|----------------------------|-------------------------------------|-------------------------------------|
| 2015/3/2 | 3.60% | 4.00% | 5.35% |
| 2015/3/12 | 3.00% | 4.80% | 5.35% |
| 2015/3/16 | 3.00% | | 5.35% |
| 2015/3/19 | 3.00% | 4.80% | 5.35% |
| 2015/3/24 | 3.00% | 4.60% | 5.35% |
| 2015/3/25 | 3.25% | 4.70% | 5.35% |
| 2015/3/26 | 3.00% | 4.60% | 5.35% |
| 2015/6/17 | 3.00% | | 5.10% |
| 2015/6/29 | 3.00% | | 4.85% |
| 2015/7/22 | 2.90% | | 4.85% |
| 2015/7/28 | 2.90% | | 4.85% |

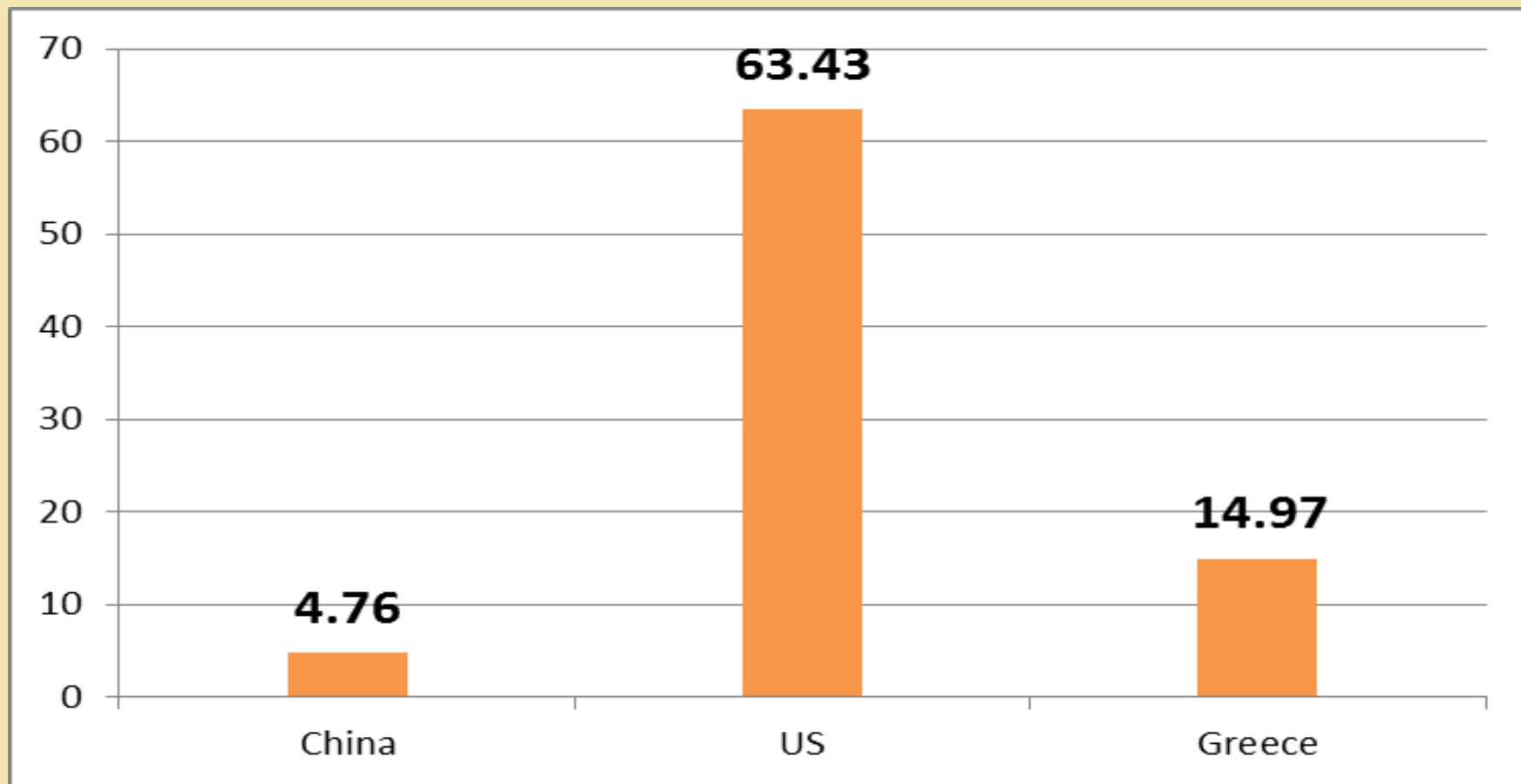
Source : Bloomberg, Shandong Group

Table 2 Gold Leasing's RMB and USD Hedging Cost

| | Gold Leasing's RMB Hedging Cost | Gold Leasing's USD Hedging Cost |
|-----------|---------------------------------|---------------------------------|
| 2015/3/2 | 0.40% | |
| 2015/3/12 | 1.80% | |
| 2015/3/16 | | 0.52% |
| 2015/3/19 | 1.80% | |
| 2015/3/24 | 1.60% | |
| 2015/3/25 | 1.45% | |
| 2015/3/26 | 1.60% | |
| 2015/6/17 | | 0.51% |
| 2015/6/29 | | 0.59% |
| 2015/7/22 | | 0.55% |
| 2015/7/28 | | 0.55% |

Source : Shandong Group

What 588 titles From Gold Analysis Segment of Hexun Tell Us? (%)



Source : www.hexun.com, Shandong Group

Table 3 Quarterly Change of China's Consumer Demand and Gold Price

| | China's Consumer Demand | Gold Price |
|------------|-------------------------|------------|
| 2010/3/31 | 24% | 1% |
| 2010/6/30 | -20% | 12% |
| 2010/9/30 | 31% | 5% |
| 2010/12/31 | 15% | 9% |
| 2011/3/31 | 26% | 1% |
| 2011/6/30 | -30% | 5% |
| 2011/9/30 | 19% | 8% |
| 2011/12/31 | 6% | -4% |
| 2012/3/31 | 23% | 7% |
| 2012/6/30 | -29% | -4% |
| 2012/9/30 | 7% | 11% |
| 2012/12/31 | 12% | -5% |
| 2013/3/31 | 45% | -5% |
| 2013/6/30 | 21% | -23% |
| 2013/9/30 | -27% | 8% |
| 2013/12/31 | -13% | -10% |
| 2014/3/31 | 9% | 7% |
| 2014/6/30 | -31% | 3% |
| 2014/9/30 | -5% | -9% |
| 2014/12/31 | 0% | -2% |

Source : World Gold Council, Bloomberg, Shandong Group

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