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China – the emerging gold super power

Mention Gold and international analysts normally think of India first and China and Japan next. While the Japanese are avid jewellery buyers and contribute a hefty percentage to the global jewellery sales, it's the Chinese that will emerge as the global super power in terms of both demand and supply of Gold. Consider this –

- The average Chinese citizen was banned from holding investment grade gold (bars / coins) till a few years ago, and could only buy jewellery. The Govt has lifted these controls and Chinese investors can now buy bars and coins from their banks, much like Indian investors. A higher disposable income and savings rate will propel bullion demand at a geometric rate.
- China beat South Africa as the largest producer of Gold in 2007, and has maintained that leadership status well into 2011. The first quarter output of Chinese Gold was 4.6% higher in 2011 to 73.41 tons, well on target to fulfill the govt's ambitious plan to produce 400 tons and above annually over a sustained period of time.
- Chinese Gold reserves are estimated to be approximately 6328 tons (source – Global Times), which makes China the third largest reserve Country after South Africa and Russia.
- In 2010, the Shanghai Gold Exchange (www.sge.sh) boasted of 6046.06 tons of Gold being traded on it's floor in the spot segment, totaling US $ 248.45 Bn, thereby making the exchange the largest worldwide in terms of Gold transactions by weight. Considering the fact that the SGE was incorporated in 2002, the figures make it one of the fastest growing bullion exchanges in the world. The SGE turnover overshadowed figures of regional exchanges like the Istanbul Gold Exchange in the first year itself.
- The SGE is aiming to beat bullion turnover of TOCOM (Tokyo Commodity Exchange) in the coming few years and challenge the domination enjoyed by the London Bullion Market over the next few decades. The London market controls 43 % of the global bullion turnover.
- China produced 340.876 tons of Gold in 2010 (highest worldwide) and consumed 571.51 tons, the consumption being behind only India (largest consumer in the world) at 783.4 tons. China thus accounts for 20 % of the global gold consumption. The Shanghai Gold Exchange officials estimate Chinese demand to overtake Indian consumption figures in the coming few years, thereby making China the dominant influencing factor in world bullion markets.
- With the SGE focusing on providing derivatives, futures and deferred delivery products, the volume of transactions on the Chinese exchange can only rise geometrically.
- The SGE is offering Gold ETF's (exchange traded funds) to retail investors which will provide an excellent low cost mechanism to hedge against spiraling inflation and wealth creation.
- The Chinese administration is keen on forging tie ups with global entities to expand the reach of the SGE and has already managed to rope in the Hong Kong Gold and Silver Exchange Society (estd 1910 www.cgse.com.hk)

- to start trading Gold in Yuan denominated contracts. Not only will the HK bourse act as an offshore currency / bullion center but will also provide strength to the RenMinBi as the local currency is expected to strengthen by as much as 4% in the coming year as Gold contracts are traded in the local Chinese currency. Thus the Chinese authorities will achieve higher turnover in Gold bullion as well as building a secure wall around their currency to relatively insulate it against global turmoil. The Bank of China and Wing Hang Bank will be the clearing banks for all transactions on the HK gold and silver exchange trading floor.
- Western analysts tend to categorize Gold into “retail investment” and “jewellery” demand and tend to make provisions for scrap sales returning supply to the bullion markets. Unfortunately, the markets in India and China are unique in that the buying is purely “saving” and not trading and / or investment buying. Rarely do Indian and Chinese buyers turn net sellers of bullion. If they do sell due to financial compulsions or perceived ceiling in prices, they rush to buy back at lower levels. Therefore, these sales are more of short sales than actual divestment by the retail investor. An average Chinese and Indian buyer is expected to remain a perpetual investor.

Taking into account the above factors and keeping in mind the Chinese Govt’s policy decision to shore up their bullion reserves over time, China is likely to emerge as a force to contend with in the coming decades. The reform process in the retail domain to free the public from shackles denying them access to derivatives / ETF products will spur a huge latent demand that will cushion the price of Gold in case of central banks selling in the open markets to meet financial short falls. While India has been enjoying a leadership status as the world’s topmost consumer of bullion, that domination is clearly under threat in the foreseeable future.

Should the Chinese physical demand for Gold rise at the current rate of growth, there exists a possibility of a global short squeeze (forcing bears to cover their shorts) over time as the ETF’s are backed by physical delivery of the underlying asset. Thus Chinese buying may result in some cushioning of price declines in Gold in case of hedge funds imploding or large scale de-leveraging in the global markets.

The Chinese have “arrived” on the bullion scene, and in customary style and scale.

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The author of this piece is the author of “A Traders Guide to Indian Commodity Markets” – India’s first commodity trading manual. The book has received sponsorship from the NCDEX – the leading Indian agri commodity exchange, another first in the Country.