

CHINA : A PARTNER IN TRANSITION

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INTRODUCTION TO CHINA

- China is a nation not well understood by the west
- Our views and opinions are generally founded in terms western economic theory which tends to be short dated in nature.
- Understanding the long term direction or guiding hand of China's economic policy can help us understand the transitioning of the gold market
- As recently reported in China daily:
- As the downward pressure on economic growth has eased, china's policy focus will shift toward maintaining stability while continuing to promote structural reforms.
- According to a research note from China International Capital Corp (CICC).
- "Instead of counter-cyclical management to fight deflation, the government will put more emphasis on structural reforms to lift the long-term potential growth of China,"
- Over next few minutes, I'll highlight some examples in the context of financial reform, which I hope will help explain the past development of the Chinese gold market and also point to what the future might hold

HISTORICAL CONTEXT

- I have been a regular visitor to China for many years
- This is where the first transition started back in 2002
- PBOC had just divested responsibility for gold to the SGE
- SGE job = Develop, Build, Run Integrated Domestic Physical Gold Market
- SGE engaged the international community in this task
- Maybe you can spot some familiar faces; Sunil; Albert; Bill
- Great success: the SGE became the largest physical gold market globally
- Over 200 members; 15 underlying products; vaults for delivery across China
- Growth predominantly driven by growing participation across the industry – banks, miners, fabricators, investors and jewelers.



- This is my first example of the interrelationship of gold with monetary policy i.e. Market reform
- First transformation – until 2002 gold activities in china were undertaken solely by PBOC. We then witnessed a fundamental development in the gold market i.e. The launch of the SGE. Additionally and just as important the general public were permitted to buy gold.
- This change should be seen in the context of general policy of structural reform rather than an one off decision to open the gold market.
- Today the market is run by the SGE albeit under the auspices of PBOC. PBOC oversee the market through a system of reporting, licensing and quotas

INTERNATIONALISATION

- The second major transition of the gold market is related to the policy related to the currency, the RMB: IE market reform and internationalisation
- By 2014 the time came for China to step onto the global stage – this was done through the launch of the SGEI
- International participants were now able to transact gold in the FTZ in offshore RMB
- The transition of the gold market away from a purely domestic market into the international arena, not only opened the market to international players, but also supported and promoted the use of offshore RMB.
- It should be seen as a milestone in China's path to internationalise its currency and for RMB to have a larger share in the pricing of trade flows
- The platform has the ability price gold imports and other gold products in CNH rather than USD
- However- despite the obvious market opportunity , the participation of the international community has been lower than anticipated.
- I expect this to change over time as the market becomes more familiar with the platform.

MODERNISATION AND PRODUCT DEVELOPMENT

- The LLAST and most recent transition is related to the policy of structural reform: to develop new financial markets in China e.g. The recent establishment of a capital market:
- Overseeing process of modernisation of financial markets:
- The gold market is in transition from purely physical into a wider modern sophisticated market i.e. Growth of a derivatives market :
- Key enablers
 - a) the launch of gold options and
 - b) the gold benchmark.
- In 2016 China launched its gold benchmark : fair , transparent ,well regulated mechanism for price discovery. Now the flows of all domestic gold market participants could be valued
- Although it was mainly for the pricing of physical gold ,it also provided a benchmark price for the settlement of derivative contracts. I.E. Gold options
- The door was now open for the development of gold investor products in China
- China has a huge and growing asset management business and with the current hunt for yield , the relative returns on gold linked products are very appealing to investors
- Both domestic and international banks and securities companies are at the forefront of this market.

WHATS NEXT?

- As we have seen: with government policy guidance and oversight , China has put in place the stepping stones for growth - with three key transitions
- Firstly: opening the market to the public, and putting in place a liquid, well regulated domestic market run by the SGE
- Secondly: a platform with international access and growing RMB participation in international trade flows
- Thirdly: launching a benchmark and new financial products – widening and modernising the market
- What's next?
- I expect to see sharp growth of the onshore gold derivative market with products matching the sophistication of international markets. This will have increasing impact on the pricing levels in international markets.
- I expect increased participation of international players in the world`s largest gold market as the perceived road blocks to entry are overcome - can they afford to stand by?
- I expect more Chinese players moving offshore to compete in the international markets.
- I expect the bond between west and east will strengthen, with global collaboration across markets interlinking products from physical to derivatives and across currencies.
- Global clients will have access to greater liquidity in the markets and in the currencies of their choice