

The Shanghai Gold Exchange – The Dawn of a New Era

Shen Xiangrong

Chairman of the Board, Shanghai Gold Exchange

Ladies and gentlemen, it's my privilege and great pleasure to make this speech on such an important occasion. At the outset, I wish to extend, on behalf of the Shanghai Gold Exchange, and also in my own name, our cordial greetings and best wishes to all those, present or not, who have helped us and will, as always, support us in the future.

I would also like to take this opportunity to express my sincere appreciation to the host for their invitation and I am delighted that this Conference has given me an excellent opportunity to make our Exchange more famous and popular within the international gold community.

The year 2002 witnessed a breakthrough in China's reform of its gold administrative system. Under the supervision of the People's Bank of China and with the full support of the State Council and Shanghai Municipal Government, SGE started its official operation on October 30, a milestone in China's move towards a free and open bullion market. The official opening of SGE heralded the start of a brand new era in the gold market in China, and is further evidence of the intention of our government to deregulate its precious metals market.

The Profile of the SGE

Approved by the State Council and founded by the People's Bank of China, the SGE stands as a not-for-profit and self-disciplined legal entity and organises transactions in precious metals, including gold, silver and platinum in accordance with the principle of "open, fair, just and honest".

The SGE has 108 members, all of whom are Chinese, including banks, producers, manufacturers and refineries registered in the People's Republic of China, ratified by the PBOC to produce, smelt, process, wholesale, import and export precious metals including gold, silver, platinum, etc. Each company has had to pass stringent credit and probity requirements before becoming eligible for membership.

Currently, the SGE's members include 13 commercial banks, 24 gold producing corporations, 61 gold consuming corporations and three mints. Spread across 26 provinces, autonomous regions and cities, all these members enjoy three distinct categories, namely, financial, general and principal membership in terms of different business scope.

Trading in the SGE is limited to physically-settled spot trading, executed between members either on the trading floor or on a computerised trading platform. Trading is also limited to standardised quantities of designated fineness designed around the needs of the physical rather than the speculative or investment market.

Following the principle of "price priority and time priority" in making deals, the SGE assigns ICBC, Bank of China, China Construction Bank and Agricultural Bank of China as its four clearing banks and conducts the clearing activity under the principle of "concentration, directness and net valuation". The unit of quotation is RMB yuan/gram and the minimum delivery amount is six kilograms.

Prior to each transaction, the buying member must deposit cash in an exchange-specified account, and the seller should deposit gold in one of the 42 appointed warehouses across 32 cities around China. Members are allowed to stock or withdraw gold from any of these

locations and the SGE is responsible for ensuring that liquidity exists where required.

Having achieved the goal of trading gold as a commodity, satisfying the needs of business supply and demand and ensuring the safe and steady operation of spot trading, the SGE is aiming to do even better in the coming future.

Market Review

Since the opening day on October 30, the market witnessed a satisfactory performance with the system operating smoothly and its functions fulfilled for the first half-year.

As of 30 April 2003, all 108 members have been online with a total transaction volume of 89,984 kilograms for a turnover of RMB 8.219 billion in all and the average daily trading volume reached 731.58 kilograms.

At a rate of approximately one tonne per day, SGE's gold volumes are already equivalent to the 220 tonnes per annum of Chinese national gold demand. It is clear that not all of these transactions are associated with physical bullion, since, although it is really largely a physical market, some members must have used SGE for speculation. But with the central bank's much-diminished role in this market, all of these transactions will soon gravitate to our Exchange and will probably lead to incremental growth in turnover.

The Shanghai gold price has become an indispensable reference for China's gold manufacturers and consuming enterprises in the process of selling, clearing and price fixing. Being the most authoritative price revealing the demographic gold supply and demand, it has received great attention from overseas markets. The price has risen from RMB 83.53 yuan/gram at the beginning of SGE's operation to RMB 92.37 yuan/gram at the end of 2002 by 10.58% (the international gold price rose 8.86% during the same period of time), showing that the Chinese gold price has been quite close to that of the international market.

Four major domestic commercial banks have partly fulfilled the function of gold trading. Their active involvement in gold trading has been of great importance in establishing the market, matching supply and demand and improving the liquidity of the market. Furthermore, by taking advantage of their advanced networks and good credit, these commercial banks will effectively make an

even bigger contribution to the development of the market.

The number of capital clearing increased from 50 per day to around 700 per day. Up to the end of April 2003, the clearing turnover of Shanghai Gold Exchange has reached 15.8 billion yuan, among which principal clearing turnover reached 12.187 billion yuan, or 77%, and agency clearing turnover reached 3.613 billion yuan, or 23%. ICBC and Bank of China occupied a large proportion of it by accounting for 87% of the total clearing turnover. All the clearing was accomplished in accordance with the principle of "T+O", and there was no delay in the process of capital clearing.

The SGE aimed to provide first-grade services to its members as well as other market participants and support the market to realise its function in allocating gold resources. In this sense it has made contributions to the sound development of the physical gold market in China. Largely due to the initiative we displayed in our routine work, the market has been performing smoothly in a general sense, with the trading, storage, and clearing systems all operating in a stable manner and the end-of-the-day management of storage and clearing is also accurate and timely, therefore T+O delivery has been realised in all our warehouses.

Future Plans

The SGE is a young Exchange, and its development will take time and effort. Problems of all sorts may arise in the process of growing. The formation of a mature market requires our intelligence, diligence and innovation, and we should clearly recognise that spot transactions are only the very first step. As time goes on and the environment is enhanced, we shall expand strategically, first within the domestic market, then to markets abroad by developing brand-new trading methods and products step by step. Only with unremitting efforts and persistence in innovation can we gradually achieve our goals.

The SGE is getting bigger, certainly, and we will never forget to play our role as the vanguard of the deregulation of China's bullion market. While the task is demanding, the future is bright. We will adhere to the theme of the "16th Chinese Communist Party Congress", and continue to be driven by pioneering verve, a strong sense of spirit, and a commitment to generating sustained value for our members and all market participants. As always, our quest to create exceptional returns remains unabated.

The SGE is on the move upward. We can and will do even better. At this epoch-making age, we are proud to be the first and the only gold Exchange in mainland China, and we are ready to stride over the threshold of a most prosperous and rewarding future.

In order for our Exchange to increase its turnover by more than just small increments, structural changes are still required. Next, I'd like to outline some of the steps that we have identified as part of a development roadmap for our Exchange.

Step One:

Open up the gold market to investment by offering a deferred delivery service. I believe it will be our ongoing mission to establish what domestic market participants need. The Hong Kong Gold & Silver Exchange Society has provided deferred trading for almost half a century and has made a great contribution towards satisfying their customers' needs and activating the local market.

Step Two:

Attract individual investors by offering new products. Other major trading forums – COMEX, TOCOM and the London Bullion Market – allow investors, speculators, gold producers, physical consumers and the bullion banking community to transact a wide variety of financial products that are not limited to spot physical sales. Therefore our Exchange will, itself, need to provide a wider range of financial products than are currently on offer.

Meanwhile, products and international access are not the only factors behind gold market liquidity, as is evident from the small volumes trading on the Istanbul Gold Exchange. Since liquidity begets liquidity, growth in domestic trading volumes is a very important precursor to attracting higher volumes. We believe that the most likely source of this growth in liquidity will be generated from domestic investment and speculative demand, for which individual investors will be a rich source. Boasting the biggest population in the world, and at around one trillion U.S. dollars, Chinese savings are vast and growing at double-digit rates. So if even a small portion of this remarkable pool of savings were to be directed towards gold trading, this would swiftly lift trading volumes.

Due to booming demand, over the past few years China has become one of the largest gold consumers in the world. We see the individual

market as a natural complement to the physical market, and are planning to develop new products for individual investment under the upcoming "Management Rules on Commercial Banks' Gold Business" regulated by the PBOC in the appropriate future and we have every confidence to foresee boosting the individual market then.

Step Three:

Integrate the Exchange into the international gold market and transform it into a financial market focused on financial investment business.

We believe that the most challenging issue facing us is interconnection with the international market. Although four large domestic banks were granted approval to import and export gold back in 2002, they have not yet started these cross-border activities, and the PBOC still remains the only bridge connecting the international bullion market with China.

The opening up of gold imports by banks will have a major impact on bringing imports into the official market and virtually eliminating the unofficial market. In the inexorable march towards capital account convertibility, it must be recognised that a freeing of the gold import-export trade – with an abolition of the import duty on gold – is a necessary concomitant of meaningful capital account convertibility.

The authorisation of four domestic banks to import and export gold has been a step in the right direction, but eventually this permission should be granted to a much wider group of market participants. Ultimately we believe that membership of the SGE should be opened up to international companies or their Chinese subsidiaries, although this may require a fully convertible currency regime first.

Volumes on the SGE have already surpassed those of the Hong Kong Gold and Silver Exchange and (just) the Istanbul Gold Exchange. However, compared to the large markets of TOCOM in Japan, COMEX in New York and the over-the-counter clearing volumes recorded by the LBMA, the challenge for the SGE is rather daunting. In order to compete on a global scale, turnover needs to grow between 100 and even 1,000 fold.

The SGE has quickly turned into a successful domestic exchange for gold, and these developments will be remarkable milestones if

our Exchange is to one day take its place at the top table of gold exchanges around the world.

We believe that the developments outlined here will lay the foundations for a larger and more important marketplace for precious metals.

Last but not the least, I wish the 2003 LBMA Precious Metals Conference in Lisbon complete success. Thank you all. ■