Comment : The Struggle between East and West for Control of the Gold Price

(by Keith Goode : 3 October 2014)

Figure 1. The Gold Price over the past month and past 10 years to 30 September 2014

a. The Gold Price over the past month to 30 Sept 14

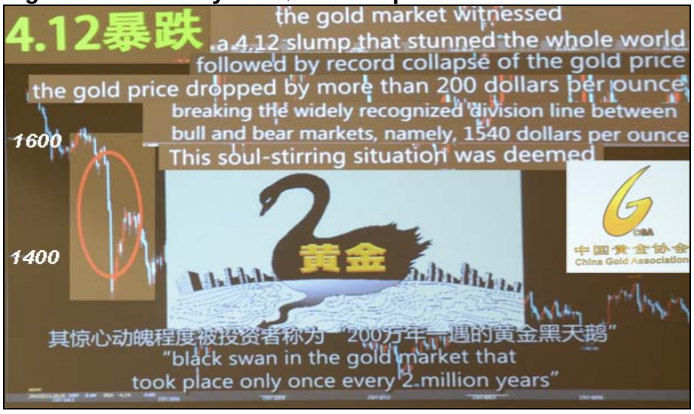
b. The Gold Price over the past 10 years to 30 Sept 14

What happened in September 2014 ?

- **The gold price tumbled down about US$100/oz** from ~US$1320/oz as shown in Figure 1a , with Goldmans re-iterating their forecast (in early Sept 2014) of $1050/oz by y/e December 2014, and stating "short" gold, based on a stronger US economy and strengthening US$.
- As a delegate commented at China's (Govt participated, first) Gold Congress in Beijing from 10 to 12 Sept 2014, "Everyone knows that **Goldmans talk their own book**. If they have the financial power to cause (manipulate?) that to happen & make money for their clients,what's wrong with that?"
- At the Congress, China was clearly **frustrated with the gold price**. More than one presenter stated "in 2013 : we (China) produced the most physical gold (~428t in 2013), consumed the most gold (~1100t), and traded the most gold in Asia (>40kt in 2013), but yet we have little control over the gold price, especially outside of our normal trading hours (ie Comex)".
- China believes one of the main issues affecting the gold price is the **strength of the US$**,with gold showing a classic inverse correlation to it. The US$ index has continued to strengthen because there is **no alternative reserve currency,** with the € (Euro), £ (GBP) and ¥ (JPY) all in trouble.
- ICBC (and China) appears to **firmly believe that in the long term, gold has to rise**, simply from its direct correlation with the combined world **central bank's balance sheets** as shown in an ICBC presentation, with the current movements in the gold price shown in Figure 1b, described as "a short-term fluctuation in a long-term rising chart". It has to be recognised that China does not think of gold from a < 1-year viewpoint, it takes more of a **5, 10 or 20-year outlook and beyond**.
- Aside from the **significant rising jewellery and investment demand** for gold and silver in China and its manufacture into **everyday objects** such as plates, cups, goblets and tea-pots with a **further 200m** people expected to **join the middle class** to form 500m **by 2020**; current gold holdings in China are apparently ~5g/capita, compared to the world average of ~23g/capita.
- Against this background, **on 29 September 2014** (being the one-year anniversary of the official launch of Shanghai's FTZ [free trade zone]) the **International Board** was to be formed by China in Shanghai's FTZ. The two initial aims of the International Board are the establishment of a **recognised daily world gold benchmark in RMB/g** (with physical trading backed by a 1000t gold vault) and the internationalisation of the ***RMB as a reserve currency.***
- **However, on 18 September, China's Premier Li Keqiang** launched its international gold bourse 11 days earlier than planned (due to the weak gold price ?). All gold transacted within the FTZ has to be physically backed and held in the currently 1000t FTZ vault. Known as "Shanghai Gold" contracts they are **denominated in RMB/g**. The main contract was expected to be the 25kg bars. ***Gold control was targeted to be first, then silver, then platinum and then spot.***
- **China has planned for this** internationalisation, and the rest of the western world is scrambling to catch up. Singapore announced it was having trading difficulties with its 25kg US$/oz launch now delayed from September to "sometime in October". At the Congress, the CME (Comex) stated in a presentation that they would be launching a new 1kg US$/oz physical contract in Hong Kong later this year (date not specified) - *which all infers that the western world were not fully prepared for it.*

The congress had about 1500 to 1700 delegates or about the same as Diggers, which was quite impressive for a maiden conference.

Fig 2. The 1 in 2m year >$200/oz Apr 2013 Gold Price fall



In the last panel/forum discussion of the congress, the April 2013 >$200/oz fall in the gold price through US$1540/oz was described in a China Gold Association video as a "black swan, 1 in a 2-million-year event", which although something of an exaggeration, was an interesting description.

But was there a second meaning?

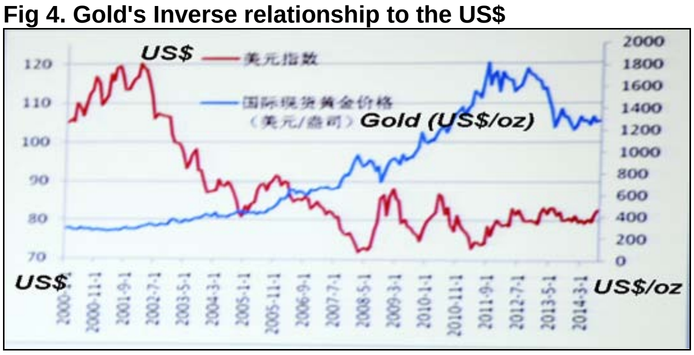
- In that China does not intend to allow it to happen again (in April 2013, Shanghai was not trading when Comex was open - now it is).

Fig 3. And then it fell further despite the demand surge

At the Congress, China was clearly **frustrated with the gold price**. More than one presenter stated "in 2013: we (China)

- Produced the most physical gold (~428t in 2013),
- Consumed the most gold(~1100t in 2013),
- And traded the most futures (in Asia, 2nd or 3rd in world) at >40kt on SHFE [Comex is 147kt]), with physical currently ~4kt.
- But yet we have little control over the gold price, especially outside of our normal trading hours (Comex)" - *which is changing as a number of Chinese companies now trade 15 to 24 hours/day.*

Fig 4. Gold's Inverse relationship to the US$



China perceived that one of the main problems facing the gold price was the strength in the US$.

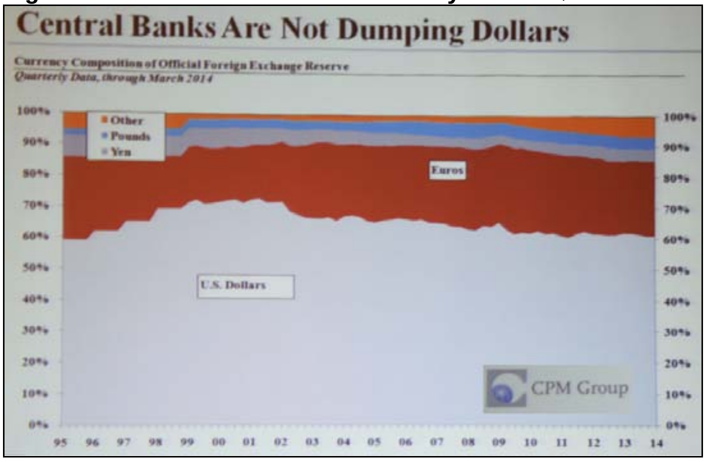
The gold price rose as the Euro rose against the US$, and has fallen in a classic inverse correlation as the Euro (post GFC) has fallen.

The US$ index has continued to strengthen because there is **no alternative reserve currency,** with the € (Euro), £ (GBP) and ¥ (JPY) all in trouble.

Gold was observed to have strengthened as the Euro rose and has weakened along with the falling Euro. The Euro (€) is still in a mess with Germany not wanting to keep propping up the weak southern countries (mostly west and south of Switzerland/Austria), especially the still unaddressed debt of Greece, Italy, France etc. France now has >€ 2trn in debt or >100% of its GDP (the European target is <60% GDP). Unfortunately for the Euro, it seems that any member can print Euros. However, Germany cannot afford to break away and reform a new mega strong DMK because that would make its goods too expensive for its major European trading partners, and there are the linked inter-country unrepayable €bn or $bn debts owed to Germany.

The GBP (£) has been mired for some time in the Scottish referendum, which though voted on and decided is apparently semi-undecided and reputedly Scotland can declare independence without another referendum. As for the YEN (¥), having created so much public debt following Japan's earlier economic collapse, the regarded only choice open to Japan is rising interest rates which it cannot afford - hence another mess. Both France & Japan seem to think that printing their reserve currencies won't have an impact, like the US$, - sorry, wrong, it appears to be making them weaker than the US$. *The **strength in the US$** was hence regarded as largely due to it being the only reserve currency that **does not have** significant underlying issues.*

Fig 5. The World's Central Banks Mostly hold US$



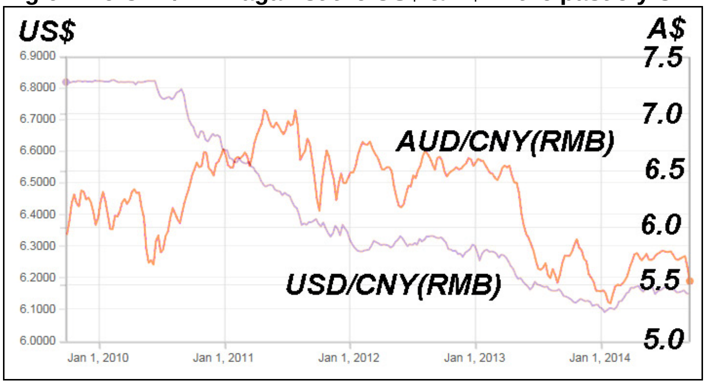
Note: The increasing "other" forex may be RMB

World central banks (and the US Fed) can never allow the US$ to fail, as their highest forex holdings (~60%) are in US$ (so they have a vested interest).

That is partly how the US has been able to print $3trn and retain a strong currency with apparently negligible impact on inflation.

A material fall or collapse in the US$ could destroy the western world's financial system - *and that simply, cannot be allowed to happen.*

Fig 6. The CNY/RMB against the US$ & A$ in the past 5 yrs



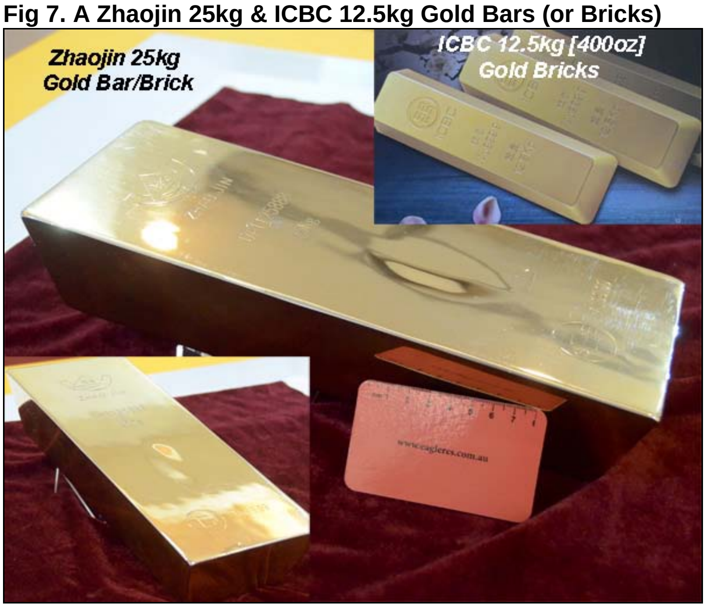
The RMB or CNY (Chinese Yuan) is a strong currency as shown in Figure 6, against the US$ and A$ over the past 5 years.

However, the RMB is not a reserve currency

On 29 September 2014 (being the one-year anniversary of the official launch of Shanghai's FTZ [free trade zone]) the **International Board** was to be formed by China in Shanghai's FTZ. The two initial aims of the International Board are the establishment of a **recognised daily world gold benchmark in RMB/g** (with physical trading backed by a 1000t gold vault) and the internationalisation of the ***RMB as a reserve currency.***

However, on 18 September, China's Premier Li Keqiang launched its international gold bourse 11 days earlier than planned (due to the weak gold price ?). All gold transacted within the FTZ has to be physically backed and held in the currently 1000t FTZ vault. Known as "Shanghai Gold" contracts they are denominated in RMB. There are 8 contracts mostly between 100g and 1kg with a 99.99% purity, a 12.5kg bar and a 25kg bar - the main contract was expected to be the 25kg bars.

Fig 7. A Zhaojin 25kg & ICBC 12.5kg Gold Bars (or Bricks)



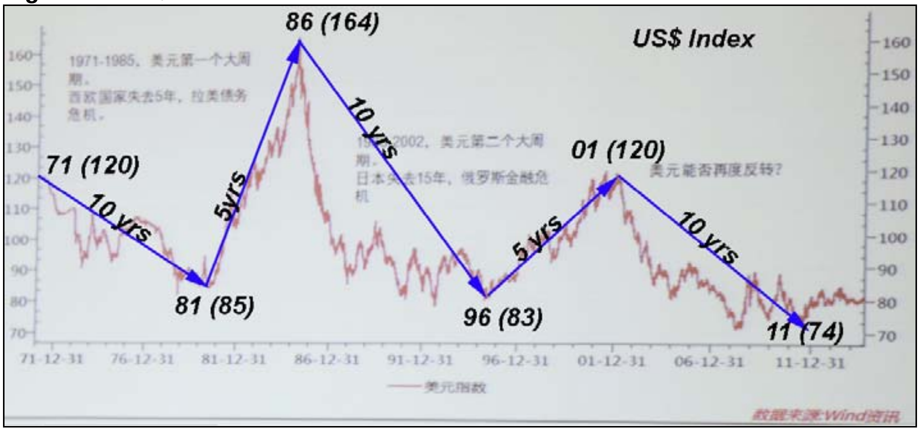
Clearly China had planned for this internationalisation, and the rest of the western world appears to be scrambling to catch up.

Singapore announced it was having trading difficulties with its 25kg US$/oz launch now delayed from September to "sometime in October".

At the Congress, the CME (Comex) stated in a presentation that they would be launching a new 1kg US$/oz physical contract in Hong Kong later this year (date not specified) - *which all infers that the western world were not fully prepared for it.*

An ICBC presentation stated that it had to be recognised that the US$ could now have a 5-year "turn in the sun", based on the US$ index possibly having 12 to 15 year down periods followed by 5-year up periods. However, another interpretation (and possibly a better fit to the 1971 to 2012 chart shown in Figure 8), **could be 10 years down and 5 years up** (as in 1971 [120] to 1981 [85] down, 1981 to 1986 [164] up, 1986 to 1996 [83] down, 1996 to 2001 [120] up, 2001 to 2011 [74] down, and *now 2011 to 2016* up [currently 85 in 2014] {which could "tie-in" to the possible timing of the RMB becoming a reserve currency in 2 to 3 years' time}). That's the problem with charts, there are a number of patterns that can reduce the US$ strength to <2016.

Fig 8. The US$ Index since 1971



For all the "$" strength, it actually has not appreciated that much, if anything it has been relatively rangebound between ~80 & 86.

Currently (2 October 2014) it is ~85.7

If the cycle is 5 years up again from 2011, then the US$ has until 2016, before another 10-year fall.

China may still take 2 to 3 years (or longer) to become a reserve currency, however, it believed that it was on the correct path to do so, it simply needed more recognition and tradeable derivative forms. However, China sees the convertibility of the RMB/CNY to a reserve currency as also dependent on the quantity of gold in its reserves.

Fig 9. Central Bank Gold Holdings as at 2013

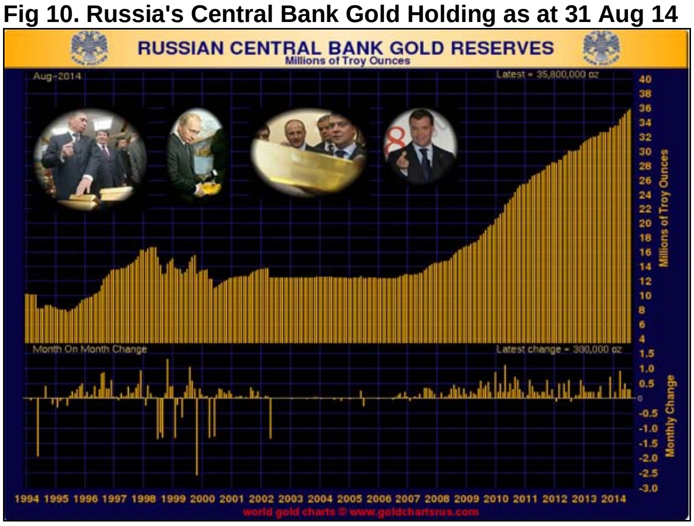
国家	黄金储备（吨） t	GDP（10亿美元）	(holding)
Europe 欧元区	10786.3	12716.3	3.5%
America 美国	8133.5	16799.7	2%
Russia 俄罗斯	1068.4	2118.01	2.1%
India 印度	557.7	1870.65	1.2%
Japan 日本	765.2	5997.32	0.53%
China 中国	1054.1	9181.38	0.5%

Simply because despite everything, the US has not sold any of its gold and still has 8134t as shown in Figure 9.

China last reported its gold holdings as 1054t as at 2009, previously they had been 600t as at 2003.

When China does report them again, they are expected to be more than the US (in order for the RMB to be No.1), possibly ~9,000t. As for the current holding, China may have been adding 1000t of gold per year and currently hold ~6,000t.

Fig 10. Russia's Central Bank Gold Holding as at 31 Aug 14



Source:
www.24hgold.com/english/contributor.aspx?rss=true&article=5847106500H11690&redirect=false&contributor=Mark+OByrne

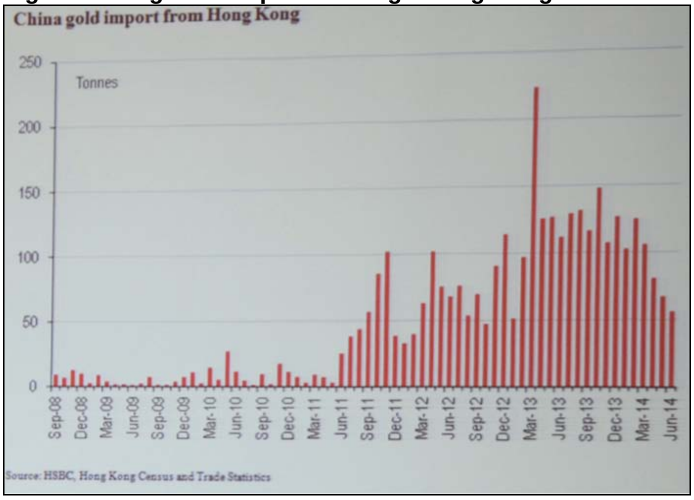
Russia has accelerated buying gold, and now holds ~1112.5t (35.8moz) of gold as shown in Figure 10, having added another 7t in August.

Kazakhstan also bought heavily: 24.7t in August to now hold 181.9t, and Turkey added another 3t to increase its total holding to ~511.6t (the 12th highest in the world).

With the increased level of co-operation between Russia and China, does Russia know China's intentions and is adding gold reserves as fast as possible? - maybe.

At the Congress, Russia stated that it welcomed gold exploration JVs in Russia from China with no holding level restrictions.

Fig 11. Falling Gold Imports through Hong Kong

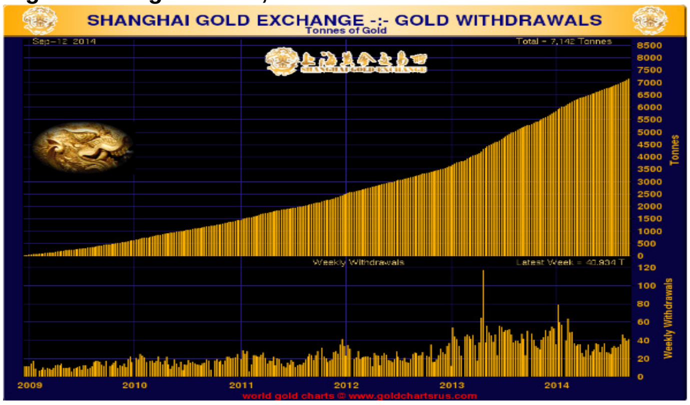


The bears have been trumpeting the falling gold imports in Hong Kong as a clear sign that China's gold consumption is dramatically falling....

...but have failed to realise that with the Shanghai FTZ, China no longer needs to import through Hong Kong. (Also Shanghai is the pilot FTZ, other FTZ's (poss total of 5) are planned too, such as Tianjin & Guangdong).

Instead China can import in a much less transparent way through Shanghai's FTZ. Although the trading on the Shanghai exchanges is visible to some, as in Figure 12.

Fig 12. Shanghai GE 7,142t of Gold Withdrawals since 2009



A few people have asked, why Shanghai ? why not Beijing as China's financial centre ?

It is because Shanghai historically used to be the gold trading centre of the world, trading ~60% of the gold in the world.

China's ambition appears to be for Shanghai to gradually reclaim its historical status, as the gold trading hub of the world.

Shanghai became the gold centre of the world in the Qing dynasty (1644 to 1912). There was apparently a lot of shorting, but settlements still had to be made using physical gold. In 1921 Shanghai established gold mines and gold bars throughout the world, with a standard gold quote of 97.8% or 0.978 and lending houses, spot and futures trading. In 1937 the war occurred and Shanghai's gold trading gradually temporarily became obsolete.

In 1958/59 China globalised its gold reserves to stabilise the markets and provided gold to stabilize nations. In 1960, Shanghai was the leading financial centre, especially in silver while gold had ~16,000 trades per year, and a highly regulated central bank. The SGE (Shanghai Gold Exchange) is currently the third largest gold exchange in the world after the US & UK, and the SHFE (Shanghai Futures Exchange) is the 3rd largest futures exchange in the world, after the US & UK.

The precious metals program for Shanghai's International Board was **contracts in gold, then silver, then platinum and then spot control**. It should be noted that the 1000t trading vault in Shanghai is to be additional to China's expected level of gold reserves.

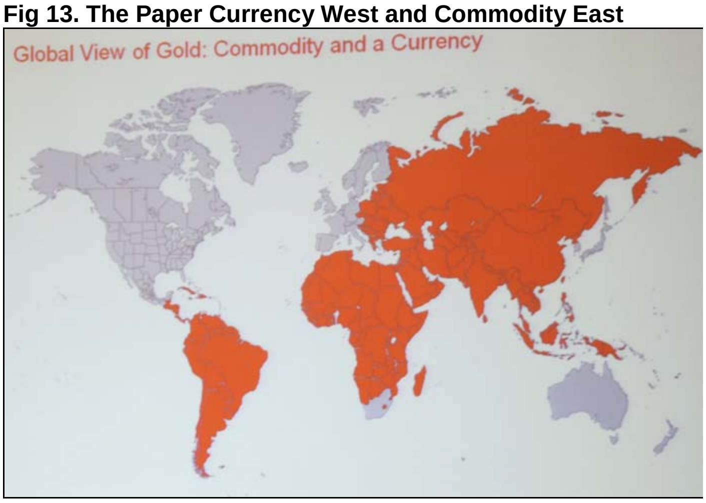
However, the CME and LBMA do not seem keen to relinquish their lucrative control just yet. The CME (/Thomson Reuters) stated that they had taken over the silver fix at the LBMA's request, and expected to take over the gold price fix too, as part of the gradual demise of London and expected significant retrenchments there over the next 2 years. CME's expected collapse of London within 2 years was due to manipulation, corruption and the Libor scandal, unlike the clean, transparent, regulated, efficient CME (although some [possibly "sour grapes"] have stated that it resembles the "pot calling the kettle black").

What happened in the replaced silver fix, was that the LBMA canvassed 444 (clearly the LBMA has no problem with the number 4, despite Chinese hotels avoiding it in the room number and floor level) of its participants, of which ~25% wanted to take part provided it was more transparent. In that second survey, the majority wanted the silver fix to be set by CME/Thomson Reuters (which has resulted in 3 participants).

Anyone can sign up for it provided they are LBMA approved (apparently a lengthy process that can take months, and gold bars are issued that comply with the tested and regulated LBMA approved size of 400oz (yet another 4 and specified in oz, although 400oz is apparently equivalent to the 12.5kg gold brick/bar, [if it is silver, then LBMA bars are 1000oz]) and comply with CME's and Thomson Reuters requirements. *So the world silver fix has been replaced and is now currently set by 3 western world participants on a digital CME trading screen / platform.*

The LBMA stated that they are now starting on the surveys to replace the London gold fix and expected to have a similar result (as in fixed by the CME in US$/oz). Chinese companies were going to be invited to become participants provided that they follow the approved LBMA programme and comply with CME requirements, and presumably produce 400oz gold bars fixed in US$/oz. (It seemed doubtful that China can participate in the survey, as it has already started for which the outcome seems to be already known/expected, ie CME). The SGE began accepting LBMA approved 12.5kg gold bars in July 2013.

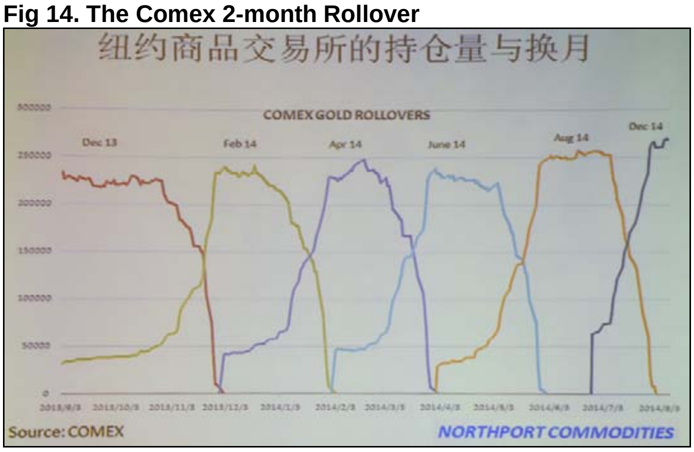
Fig 13. The Paper Currency West and Commodity East



Just why the CME/LBMA expect China to conform and instead settle in Hong Kong in US$/oz, and abandon China's stated intention to have its own RMB/g daily gold and other precious metals' benchmarks, is anyone's guess.

*Particularly as China's apparent **aim is to wrest control from** the developed western countries that treat gold and precious metals as other forms of **paper currency**, whereas the developing eastern countries regard them as valued commodities.*

Fig 14. The Comex 2-month Rollover

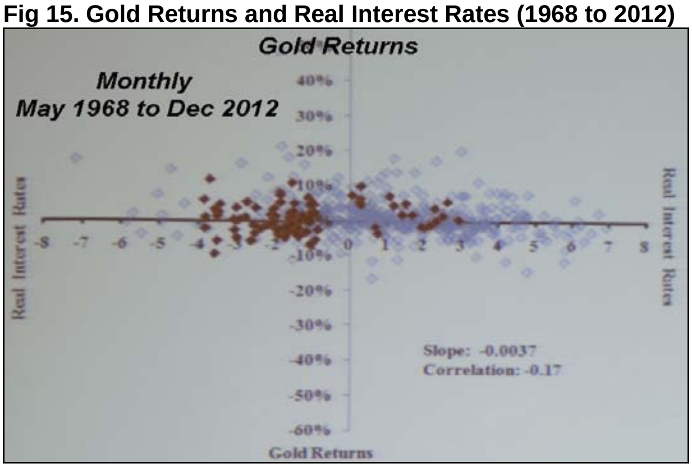


As a Comex trading rep stated in their presentation, the positions are simply rolled over mostly every two months...

...unlike Shanghai, where the contracts are 6 months and deliveries have to be capable of being settled in physical gold....

...on Comex settlements are rarely made in physical (the facility/capability to settle in physical gold doesn't really exist anyway).

Fig 15. Gold Returns and Real Interest Rates (1968 to 2012)

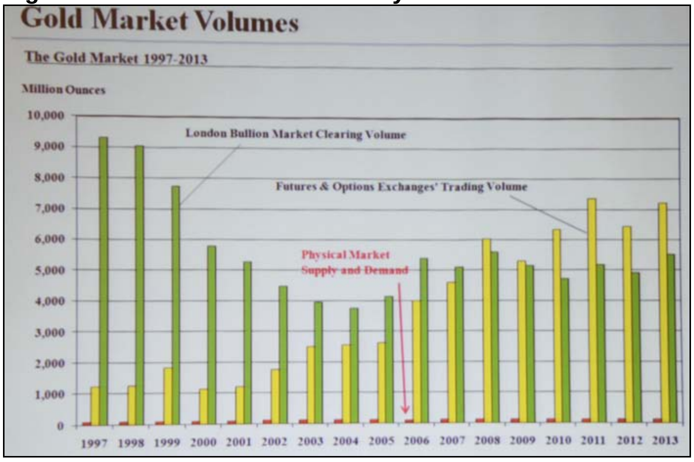


Another argument that has been made is that gold has to weaken due to potential **rising real interest rates** in the US (in 2015).

CPM in their presentation stated that this assumption is **incorrect.**

Because the impact on the gold price has only really occurred when real interest rates are ~5% to 6% (based on US 3 mth rates less CPI), or when interest rates are **~7% to 10%**, which appears unlikely to suddenly occur.

Fig 16. The Relative Size of the Physical Gold Market



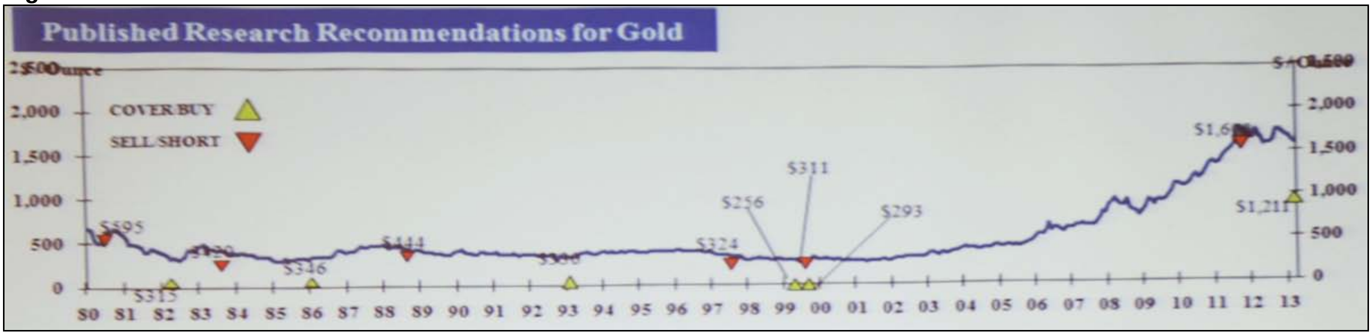
CPM stated that the current main problem with the gold price is :

That the derivatives (ie Comex) are dictating to the physical market what the price should be (as shown by the volumes in Figure 16),

Whereas by definition, as derivatives they should be derived from prices set in the physical market.

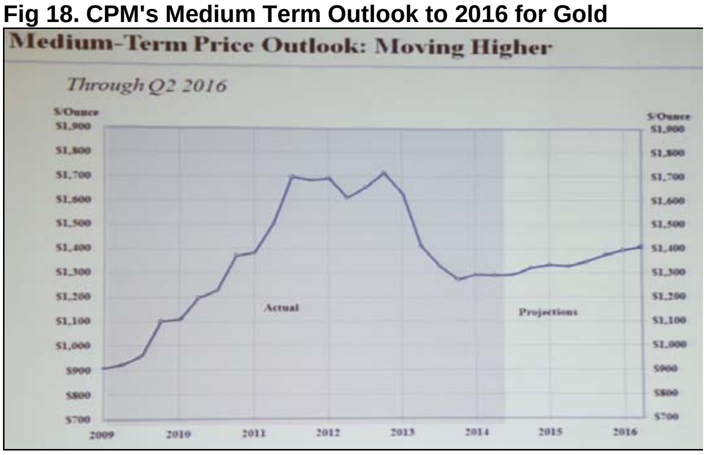
It's "like the tail wagging the dog, and not the dog wagging its tail".

Fig 17. CPM's Published Gold Price Forecasts since 1980



Jeffrey Christian's CPM group has had remarkable success in forecasting precious metals prices since 1980. I remember when I was in South Africa trying to forecast/predict the gold price for a mining house at that time, the mining houses were amazed at Jeffrey's forecasting accuracy in gold and platinum (it really was legendary), as shown in Figure 17.

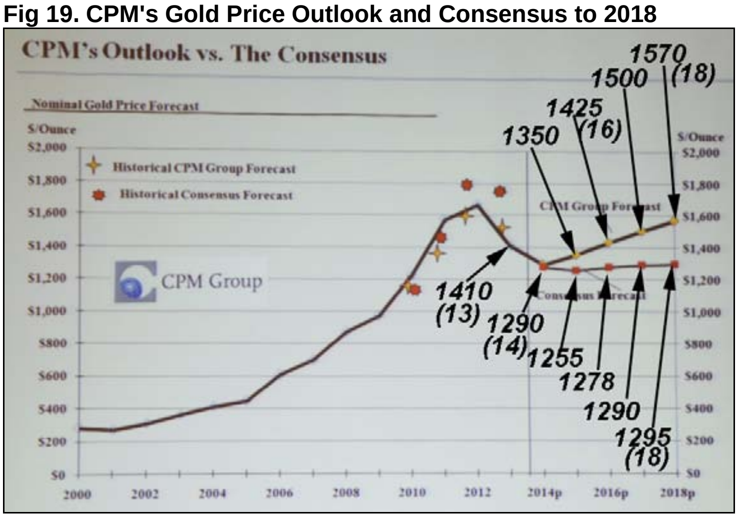
Fig 18. CPM's Medium Term Outlook to 2016 for Gold



CPM's current gold price forecast is shown in Figure 18, and they remarked in their presentation that they were surprised at the Congress as they did not expect gold to fall below US$1240/oz in 2014.

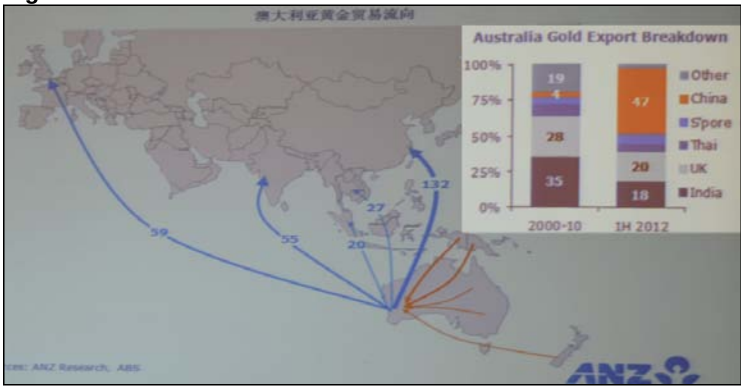
And instead expected it to recover to at least $1260/oz by y/e 2014 (after all CPM's forecast for 2014 is the same as the consensus shown in Figure 18 at $1290/oz, and the average price so far this year (to 30 Sept 2014) is ~ $1288/oz.

Fig 19. CPM's Gold Price Outlook and Consensus to 2018



CPM's expected steady appreciation in the gold price to 2018 is shown in Figure 19, along with the consensus figures.

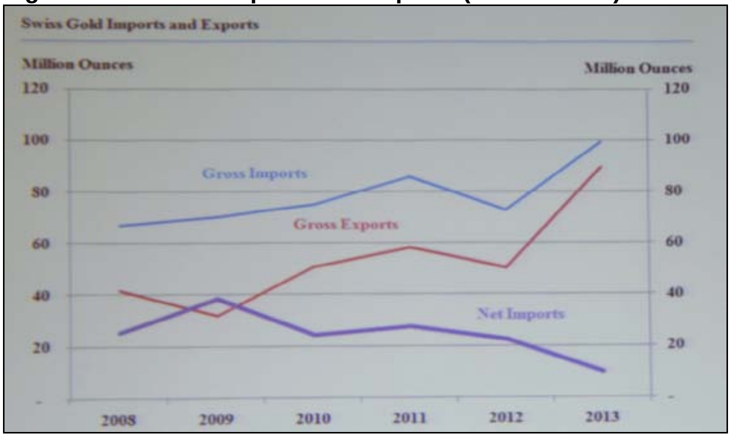
Fig 20. Where Australia's Gold Now Goes to



Most of Australia's gold now goes to China as shown by the ANZ presentation in Figure 20,

Being ~47% or 132t in early 2012

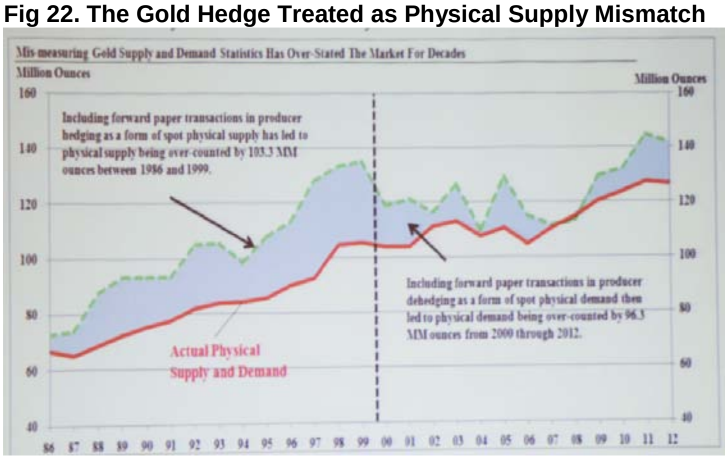
Fig 21. Swiss Gold Imports and Exports (2008 to 2013)



And although many thought that most of the gold passing through Switzerland went to China..

..Instead a "large quantity" stayed in Switzerland as Swiss-based investors have increased their holdings by ~143.3moz (~4,456t) from 2008 to 2013, while actually only a further ~43.5moz (~1350t) went directly to China in that same period.

Fig 22. The Gold Hedge Treated as Physical Supply Mismatch



On the subject of numbers, CPM thinks that the supply and demand compilers of gold stats made a major miscalculation treating some hedging as additional supply. As they were paper transactions.

A hedge is a piece of paper that can be replaced by physical when it is produced. Early close out is another paper transaction, *not* additional supply. CPM estimate the possible error at ~200moz or ~6,200t of gold supply.

However, as HSBC stated in their presentation, it should be noted that if gold behaves more like a commodity then its demand should depend on elasticity. Or in other words if prices are low, demand increases or accelerates - which is what we are seeing with demand transferred through Shanghai increasing to 50t for the week of 15 to 19 Sept, and scrap sales falling from the >1600tpa between 2009 and 2012, to ~1200tpa since then as shown in Figure 23a, and in HSBC's S & D Table of Figure 23b.

Fig 23a. Old Gold Scrap has fallen or has it ?

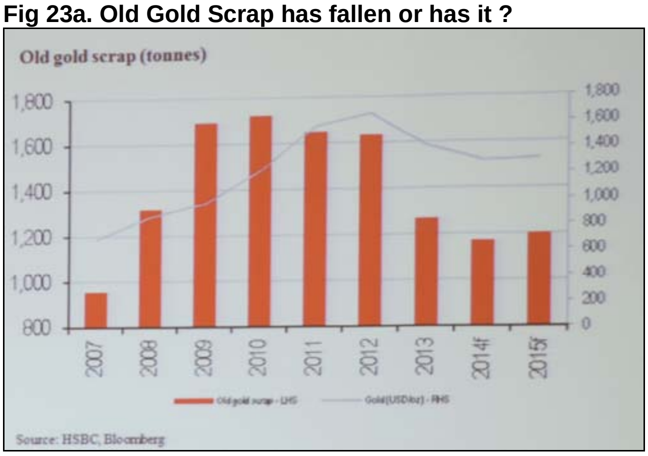


Fig 23b. HSBCs estimates for Gold Supply & Demand to 2015

Gold: Supply/demand balance (tonnes)	2013	2014f	2015f
Mine production	3,039	3,075	3,050
Official sector net sales	-344	-400	-425
Old gold scrap	1,267	1,170	1,200
Producer hedging	-45	-100	-100
Total supply	**3,917**	**3,745**	**3,725**
Jewelry	2,361	2,175	2,275
Electronics	280	287	297
Dentistry	36	37	39
Other industrial uses	93	96	99
Other fabrication	409	420	435
Total fabrications	2,770	2,595	2,710
Bar hoarding & other retail	1,379	914	1,171
Official coins	283	188	241
Medals	104	69	88
Exchange-traded funds	-880	20	50
Total investment demand	886	1,190	1,550
Total demand	**3,656**	**3,785**	**4,260**
Balance = net investment	261	-40	-535
Gold price (USD/oz)	1,411	1,292	1,310

Fig 24. Gold and Inflation

HSBC have a steady gold price of $1290 in 2014 rising to $1310/oz in 2015, but were negative on the short-term outlook for gold based on their perception of the strength of the US$, and its effect of distorting world economies.

Because gold tends to increase with inflationary expectations, which are drifting sideways in the US

America has shown that it is possible to inject money into or stimulate a system and not affect inflation, and then stop it & reduce inflation further.

Fig 25. Falling Inflationary expectations in other countries

1. Inflation forecasts confuse intentions with reality: they're mostly anchored at 2%

	US		UK		Spain		Sweden		Germany	
	First forecast	Outturn	First forecast	Outturn	First forecast	Outturn	First forecast	Outturn	First forecast	Outturn
2008	2.3	3.8	2.0	3.6	2.6	4.1	2.0	3.5	1.5	2.6
2009	2.1	-0.4	2.0	2.2	2.6	-0.3	2.3	-0.3	1.7	0.3
2010	2.0	1.6	1.9	3.3	2.2	1.8	1.1	1.3	1.5	1.1
2011	1.9	3.2	1.7	4.5	1.7	3.2	2.1	2.6	1.3	2.1
2012	1.8	2.1	2.0	2.8	1.6	2.5	2.3	0.9	1.7	2.0
2013	1.9	1.5	2.0	2.6	1.7	1.4	1.7	0.0	1.8	1.5
2014*	2.1	1.7	2.3	1.7	1.5	0.1	1.8	-0.3	2.0	1.2
Avg absolute forecast error		1.0		1.1		1.3		1.4		0.7

Note: * Outturn is the average of first five months of 2014
Source: Consensus Economics, HSBC

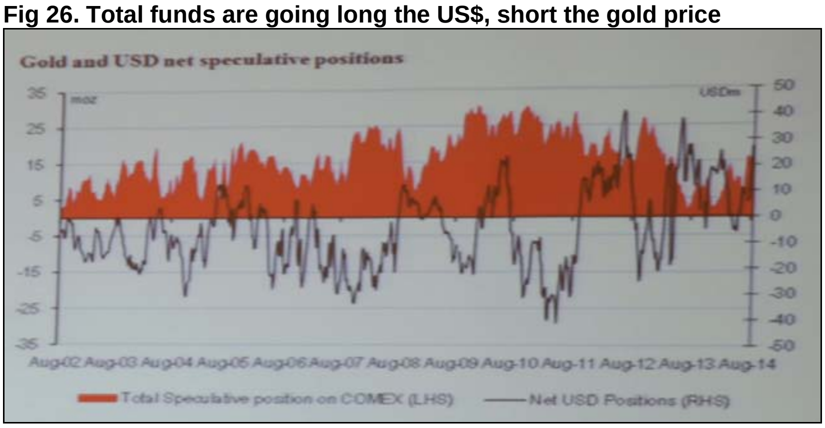
Note :The outturn is the actual average of the first 5 months

As expectations for inflation in other countries are for the figures to continue to falling.

...if anything inflation estimates are falling below expectations in other countries.

Which may partly be due to a stronger US$.

Fig 26. Total funds are going long the US$, short the gold price

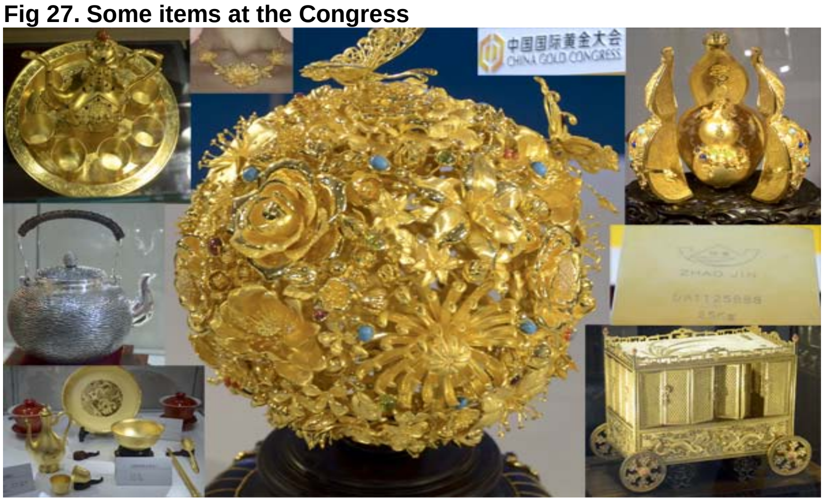


Without inflation, the US funds are increasing their long US$ positions...

...and shorting gold, causing further downward pressure on the gold price.

However, looking at the HSBC's S & D table in Figure 23b, jewellery demand is expected to have fallen from 2,361t in 2013, to 2,175t in 2014, with bar hoarding also down ~400t from 1379 to 914t, and official coins down from 283t to 188t, although investment demand is higher. You wonder what some of the numbers are based on, or what assumptions have been made:

Fig 27. Some items at the Congress



One surprise I had was the size of China's domestic jewellery market which had retail spending of US$76.6bn in 2013, having doubled from $37bn in 2011.

Some of the items that were on show at the Congress are shown in Figure 27 (the golden ball was about 15cm or 6in in diameter).

After the last Congress presentation there were about 135 awards in 15 different categories such as the top 10 provinces that produced the most gold, the top 5 counties, or the highest profits, or those that had exploration success, or top refineries, or the top 5 proprietary gold bar brands, or the top 10 jewellers based on their sales. At the Congress dinner there were about another 15 or 20 awards including 5 to the top 5 people that had made the Congress such a success.

Fig 28. Some of the ~150 awards at the Congress

All received massive plaques from the China Gold Association to a background "jingle of jaunty music".

Also at the dinner they had the lucky door prizes. Each of the top 5 jewellers presented 10 of their items on fashion models. So after the 5th ranked jeweller presented their jewellery, that jeweller gave away 20 or 30 items of their jewellery as lucky door prizes. After the 4th there were 10 gifts, 3rd: 5 gifts, 2nd: 3 gifts in special gift-boxes in a photo ceremony (bear in mind, these are just randomly drawn prizes), and lastly the top jeweller with his unique designs gave one jewellery gift as a lucky number door prize. Some of the jewellery is shown in Figure 29a.

Fig 29a. Some of the China Gold Congress 2014 Jewellery

Fig 29b. The Anglogold Jewellery at Diggers 2014

The jewellery was completely different (being more regular items), and not just gold, compared to the specialist mostly gold items of say Anglogold that have been seen at other conferences, which in some items appears to use as much gold as possible, as at Diggers 2014 in Figure 29b.

However, aside from the jewellery, China is manufacturing and selling gold and silver in more everyday forms such as cups, goblets, teapots, plates etc as shown in Figure 28, along with up to ~1m high solid gold statues etc. These items are being produced by the individual major gold companies, and by some of the banks, such as ICBC. The items are produced in both gold and silver, with the silver items shown in Figure 30a (& yes: large gold & silver bars are called bricks).

Fig 30a. Some of the Silver items for Sale by ICBC

Fig 30b. Some of the Silver items for Sale by ICBC

This more general jewellery can also be bought at China Gold's Beijing Airport shop as shown in Figure 30b. *I suppose the question is where do these items "fit" into the standard supply & demand categories as they are not jewellery, and they are not tradeable gold bars or coins.*

ICBC sells its items in catalogues and its 36 city branches in China, 170,000 agencies and 400 overseas branches. Chow Tai Fook opened its 2000th store, mostly in China in January 2014, compared to India which has ~30,000 gold selling retail outlets. China still has a long (retail market coverage) way to go. China's per capita **gold holding is only ~5g** compared to the world average of ~23g, there is still the untapped $800bn pension, insurance and annuity market that could diverse and invest some of their portfolio in gold assets too. And that's just China, there are many developing follower countries that also prefer to hold gold or silver more than paper US$.

The growing influence of China in the gold market is clearly shown in the WGC Figs 31a & 31b.

Fig 31a. China's Global Consumer & Investment Demand

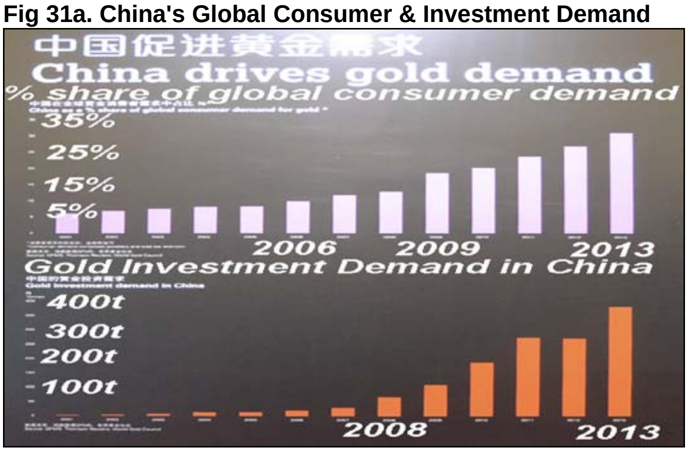
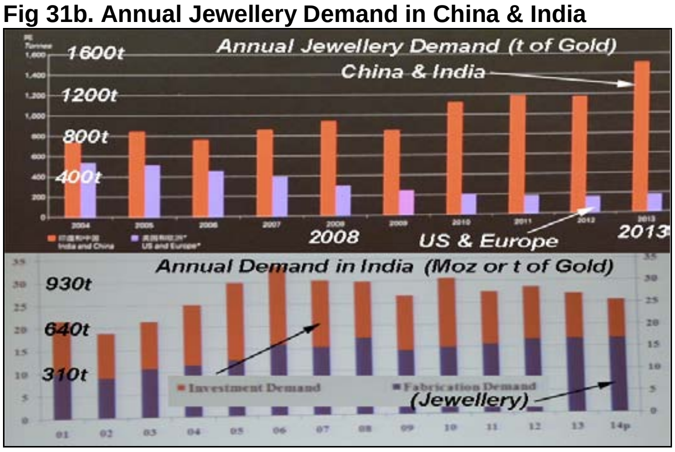


Fig 31b. Annual Jewellery Demand in China & India



Can China take control of the gold market ? Some say can't be done, can't replace Comex. But I can recall when Comex wanted to replace London and control the gold fix, and that is happening now. BHP, RIO and Vale etc used to control iron ore prices, China said at China Mining "how can the Big 3 or 4 control the iron ore price and we are the consumer?" ***Well, China took about 2 years to take control of the iron ore market and set lower prices regardless of their rising demand / consumption.***

The west has still yet to recognise that China operates its business according to **the "articles of war".** The "tiger" (CME/Comex) has already been "lured down the mountain" (Canada/US) to operate in China (Hong Kong, or according to CME's version stated in its presentation, the next obvious market expansion for Comex is Hong Kong). So where are the negotiations being done, and documents signed - in China, not in the US, as illustrated by the new JV between the Gold Associations signed between the CGA and WGC in front of everybody at the Congress in Beijing.

At China Mining Nov 2008, iron ore imports "were expected to flatten out" in 2009 and 2010, at the same level of 2008s (ie 435mt to 465mt), but in fact steadily rose to 550mt to 600mt, and "had peaked", as later remarked - "there would be no imports above 600mt". At China Mining Nov 2012, China was "slowing down and iron ore imports would peak at 700mt", whereas in 2013 they rose to 800mt.

At a recent September 2014 conference in Melbourne the CISA stated that "iron ore imports would peak" at 870mt (which is double that of 2008 and the "flattening out that was going to occur in 2009 & 2010), although 2014 would be an aberration at 900mt - that's why iron ore prices have weakened in 2014 to ~$80/t and are expected to remain weak in 2015, because "imports have peaked and China is slowing down" - sound familiar?.

China has been slowing down and importing more since 2008! China's manufacturers must be laughing all the way to the bank. Speak to any iron ore producer and they usually, "China is not turning the ships back, they take everything we produce". Even RIO stated there would probably be price pressure due to recycled scrap from earlier buildings, but that's not a new/additional concept.

However, it also to be recognised that China has undertaken numerous significant construction JVs with almost every country in the world that welcomed them with open arms in 2013. That construction is produced in China and shipped for use, but does not appear to form part of China's GDP.

China appears to have found that someone just has to say the words "slowing down" or report lower GDP or other numbers, and it results in weaker commodity prices. You can buy what you want for less, even if you buy more, you still pay less, as in higher demand can result in lower prices (provided the market thinks you are going to reduce demand and result in an oversupplied market, *or "make noise in the east, and attack in the west"* - "literally"*).*

At the Gold Congress, a delegate stated that they were surprised that no one questions China's GDP numbers that are produced ~2days after the end of a period such as a quarter - Japan is super efficient, but it still takes them close to 3 months or so to produce their initial GDP numbers. The delegate's understanding was that China's GDP etc numbers are a broad guideline, can be top-cut, have different compositions and are weighted by Province too. Similar comments have been made in other conferences that I have attended, and I wrote a *Paydirt* article on GDP numbers earlier this year (2014) and available on the Eagleres website : www.eagleres.com.au).

In 2011, China's GDP was reputedly ~US$7.32trn. According to Figure 9, it appears to have been US$9.18trn in 2013, ie 25.4% higher - surely that's more than 7.5%pa. I agree China is not in frantic growth/construction mode, however, steady construction is in progress, take the Beijing underground/metro for example which still costs Rmb2 per journey anywhere on the network, Line 14 is under construction and expected to be opened in the coming year, to add to the fully automated network of trains travelling ~ 2 - 3 mins apart, as in Figure 32a over the past ~9 yrs.

Fig 32a. The Beijing Metro in 2014 (2005 inset)

Fig 32b. Yantai (Shandong Prov 2014) Source: China Daily

I can't believe all that construction I saw in November 2013 has ground to a halt in Xian and Zhengzhou etc (available in a *Paydirt* report on the Eagleres website : *www.eagleres.com.au/paydirt/item/dec-2013-supercycle*). As I have said before, just because it is not visible to you, does not mean to say it has stopped or slowed down, where you are may have been built and completed. Guomau in Beijing continues to resemble Manhattan, with China World 3 in progress, Soho done and that other complex in construction.

Figure 32b shows a picture of **Yantai** (on the Jiaodong Peninsula of Shandong Province) from the 30 Sept 2014 issue of the China Daily. I first went there in about 2004, when it was so small (at ~2m to 3m people) that it was not on maps of China, and was little more than a fishing/tourist village/town with 5 cabs, 3 hotels and almost no one spoke English (the roadsweeper did). Now Yantai is a major fruit growing area that in 2013 yielded ~4.95mt of 120 varieties of apples (mostly red Fuji), for $2.1bn (RMB 12.7bn), which was about 6% of the total food industry revenue at Yantai, ie RMB170bn**(~$28bn)** from over 528 enterprises. The target expectation for 2017 is RMB300 (US$50bn).

Yes, car consumption is reducing and seen as another sign of slowing down - but in Beijing that's partly because there is a limit on the number of licences to buy cars, to reduce potential pollution - as someone remarked on a trip I went on, how come there are no old cars - they're all new - and yes, they are. Some people have been waiting over 2 years in Beijing to get a licence to buy a car.

While Australia reduces its commitment to science innovations/inventions, Beijing formed the Zhongguancun Science Park (near the University of Peking {near the Summer Palace}). The total revenue of Zhongguancun in 2013 was ~US$500bn (RMB3trn), with exports of US$33.6bn, contributing 21.7% to Beijing's GDP, and ~2,155 (another article had >21,000) new patents were applied for in 2013 (up 44.7% on 2012). There are >450,000 technical staff amongst the ~1.7m employees (~10,000 expats including 2,654 foreign "experts") in the >6,800 companies/organisations (including 98 Fortune 500 firms) there, and some company's staff wages average ~**US$260,000 per year.** Such staff are just one part of China's growing wealthy middle class, that are expected to increase by 200m to total ~500m people by 2020**. *And some if not most of them are going to buy some gold.***

ICBC (and China) appears to **firmly believe that in the long term, gold has to rise**, simply from its direct correlation with the combined world **central bank's balance sheets** as shown in an ICBC presentation, with the current movements in the gold price described as "short-term fluctuation in a long-term rising chart". It has to be recognised that China does not think of gold from a < 1-year viewpoint, it takes more of a **5, 10, 20 or even 50-year outlook and beyond.**

Yes gold and other precious metals may weaken, and the US$ may strengthen for the next 2 years and have "a bit longer in the sun", but ultimately for those that are patient, **China expects gold to recover and steadily increase against a falling US$**, with Shanghai becoming the centre of world gold trading yet again...**in RMB/g**.