

Focus: China's commercial banks

In the past 10 years China has become the world's largest gold producer and consumer. It has also developed a vibrant gold banking sector. China's commercial banks are a vital hub in the country's gold industry. And they have developed a range of gold-related businesses, significantly pushing up their gold holdings since 2009.

Commercial Banks propel physical investment

More than 60% of investment demand – sales of gold bars of a kilogram or smaller – is met through commercial banks' nationwide network of easily accessible branches. **(Chart 6)**

Large banks, such as the Industrial and Commercial Bank of China (ICBC) and China Construction Bank (CCB), dominate the retail market. They typically sell gold bars

bearing the bank's own brand (*proprietary brands*). A good example is ICBC's "Ruyi" gold. In addition, banks also sell brands other than their own (also known as *agent brands*). For example, banks sell Panda Gold Coins issued by the People's Bank of China (PBoC).

In recent years, smaller banks have entered the market, attracting customers by offering a broader range of gold investment products. These are usually lighter in weight and have higher profit margins. For example, Ping An Bank launched a gold bar for the Year of Monkey in late 2015 which incorporated state-of-the-art craftwork. These bars have the pattern of the Monkey stamp issued back in 1992 and the production process was overseen by the designer of that stamp.

Chart 6: Commercial banks' sales of physical gold on the rise¹¹

- Sales of physical gold to retail investors have remained strong.
- Commercial banks took a growing share in all investment demand.



Source: PBoC; Shanghai Gold Exchange; Metals Focus; GFMS, Thomson Reuters; World Gold Council

¹¹ The remaining market share will be accounted for largely by sales from retailers such as China Gold and Chow Tai Fook.

Gold accumulation plans used as trading vehicles

Products such as Gold Accumulation Plans (GAP) have also witnessed robust activity, providing an efficient and flexible channel for investors to get exposure to gold.

The first GAP in China was launched by the World Gold Council and ICBC in 2010. Since then a range of similar products have been created, including automatic monthly gold investment plans. These products provide investors with direct exposure to the gold price backed by physical gold. Although many other banks have launched similar products, ICBC remains the market leader.

Annual GAP trading volume¹² exceeded 500t in both 2014 and 2015, as investors used the product to gain short- and medium-term, speculative exposure to gold. This trading mentality contrasts with retail bar and coin investors who typically invest for a longer period.

While GAPs have high trading volume, their impact on Chinese gold demand is modest. Net inflows into GAPs, including automatic monthly gold investment plans, was around 25t to 30t in 2014 and 2015. 2013 was an exception, with investments in GAPs nearing 100t according to data from the PBoC.

Gold leasing: a new market

Over recent years we have observed a rising number of commercial banks participating in the gold leasing market. Gold leasing has allowed companies, such as jewellery manufacturers, to reduce production costs, hedge against price fluctuations, and raise finance.

There are two gold leasing data sources available: i) the Shanghai Gold Exchange (SGE), and ii) the PBoC, which helpfully provides additional granularity by distinguishing between leasing between banks (interbank leasing) and leasing to corporate clients.

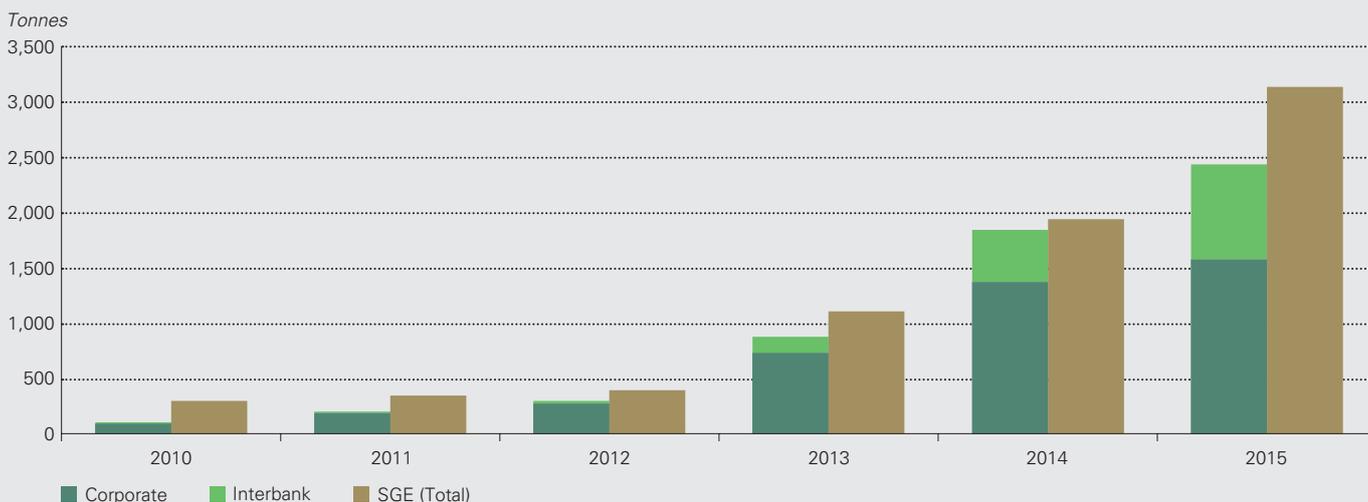
In 2015, SGE reported a 62% increase in gold leasing to 3,136t,¹³ while the PBoC reported that leasing by commercial banks stood at 2,432t, up 32% from 2014. The PBoC further said leasing to corporate clients stood at 1,583t (+16%) and interbank leasing rose by 79% to 849t.

SGE's leasing estimate is usually larger than the PBoC's as it has a larger sample size. The PBoC's data just captures leasing by commercial banks' headquarters, while the SGE's also includes leasing by bank branches.

It's estimated that around 10% of the leased gold leaves the SGE's vaults. The majority is for financing purposes and is sold at the SGE for cash settlement.

Chart 7: China gold leasing momentum remained strong

- Official sources of gold leasing data report strong growth in leasing volumes in last three years.
- This partly reflects an increase in the number of commercial banks participating in the gold leasing market.



Note: Leasing to corporates and interbank leasing (light and dark green bars) are sourced from PBoC, and the figure of SGE (total) is sourced from Shanghai Gold Exchange.

Source: PBoC; Shanghai Gold Exchange; World Gold Council

¹² The volume includes both investments into and redemptions of GAP.

¹³ This captures the total amount of gold leased in the reporting period, for example, if Commercial Bank A lends 1t to Jeweller B for three months and the Jeweller B returns it back for the Commercial Bank A to lend again to Bank C, a total of 2t of leasing volume will be recorded for the period.

Ambitious overseas activity

As well as developing their domestic market, China's banks have been active on the international stage.

After topping the notional 10,000t mark in 2014, overseas gold derivatives' trading volume by China's commercial banks continued to increase. According to PBoC data, China's commercial banks traded 13,930t (+34% YoY) of gold on overseas exchanges and OTC markets in 2015.

Some of the large banks' direct participation as LBMA market-makers has further enhanced China's role in the global gold market.¹⁴ And ICBC Standard Bank's recent purchase of a precious metals vault in London is illustrative of China's banks' growing presence in the world's largest over-the-counter gold market.

Commercial banks' gold holdings have increased

To support these gold related businesses, commercial banks have increased their gold holdings.

Hard data on banks' tonnage holdings are hard to come by. But we have looked at a large sample of banks' annual reports which include the RMB value of their precious metals holdings. This sheds light on the growth of their gold businesses.

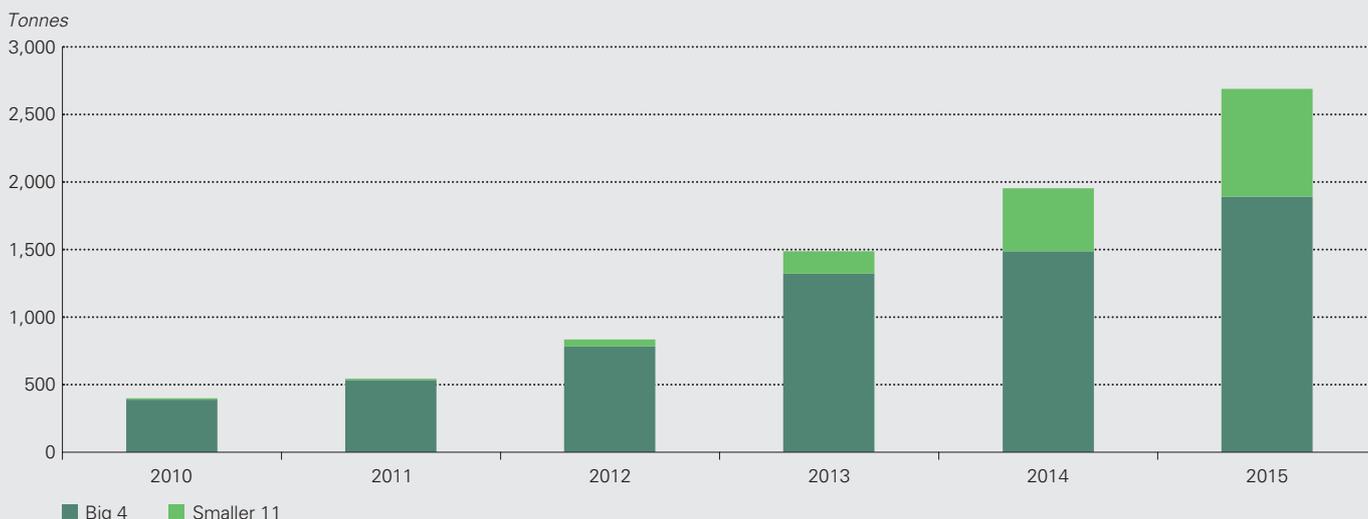
Assuming 100% of the precious metals assets held by commercial banks were gold, total holdings by the 15 commercial banks we track increased by 38% in 2015 to approximately 2,700t.¹⁵ Holdings by the "Big Four" banks¹⁶ (ICBC, ABC, BOC and CCB) were close to 1,900t (+27%).

A large portion of this growth is a result of the growth in the gold leasing market. And in recent years, smaller banks have been most active in this market. Holdings by the smaller 11 banks increased by 74% to around 800t in 2015.¹⁷ Shanghai Pudong Development Bank, for example, attributed its 145% increase in its annual precious metal assets to the increase in leasing physical gold. In addition, a couple of banks were granted gold import licenses in 2015 and have pledged to further promote gold leasing and precious metals proprietary trading.

It is that clear commercial banks play a key role in China's gold market, and have developed exciting gold business both within China and, more recently, overseas. Given the radical pace of change within the industry, any observer of China's gold market should also follow developments in China's commercial banks' businesses.

Chart 8: Commercial banks have increased their holdings

- Volume of gold held on the balance sheet of commercial banks has multiplied in recent years.
- This helps support the growth in China's gold leasing market.



Source: Respective commercial banks; Bloomberg; World Gold Council

14 Bank of China (BoC), China Construction Bank (CCB), Industrial and Commercial Bank of China (ICBC) and Bank of Communications (BoCom) have all joined LBMA as market makers.

15 This is a big assumption; it is unlikely to be all gold. It will include platinum, silver and palladium too. But most of it is likely to be gold and the assumption allows us to easily analyse the data and understand the trends.

16 The Big Four banks are Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China and China Construction Bank.

17 These 11 banks are China Everbright Bank, China Minsheng Bank, Shanghai Pudong Development Bank, Ping An Bank, China Merchants Bank, Industrial Bank, Bank of Ningbo, Guangdong Development Bank, Evergrowing Bank, China Citic Bank and Bank of Beijing.