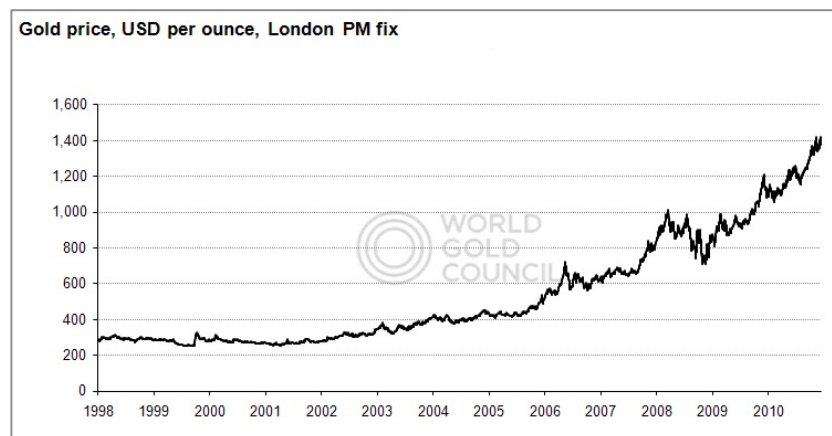


## China and India: Powering Gold Demand Forward

By Chris Gan, Dec, 2010

In a recent report, the World Gold Council (WGC) reported that the global demand for gold in 2010 will exceed that of 2009. The key drivers of this recovery are a strong demand for jewelry in Asian markets, in particular in China and India; a revival in the use of gold by the industrial sector and a robust investment demand as a result of concern over continued loose monetary policy in U.S, currency conflicts and fear of runaway inflation.

The jewelry demand for FY2010 is expected to surpass that of 2009, with the most significant improvements coming from India and China. This is despite the pressure on demand as a result of higher gold prices experienced this year. Gold in U.S dollar terms has increased by around 24% year-to-date, hitting a high of \$1,424.60/oz on 9 November 2010. WGC expects that demand for jewelry in 4Q of this year to remain strong due to seasonal support. Traditionally, during this time of year, gold purchases tend to spike, driven by Diwali, the Indian festival in October, Aidil Adha in the Middle East in November, and Christmas and New Year in the West (December / January).



Source : IHB Global Insight

In this article, we explore how the strong demand from China and India markets will provide clear and considerable future demand for gold globally, and how it will likely have a positive impact on gold prices going forward.

### India: the world's largest gold consumer market recovers

East Asia (which includes India and China), together with the Middle East accounted for 70% of gold demand in 2009.

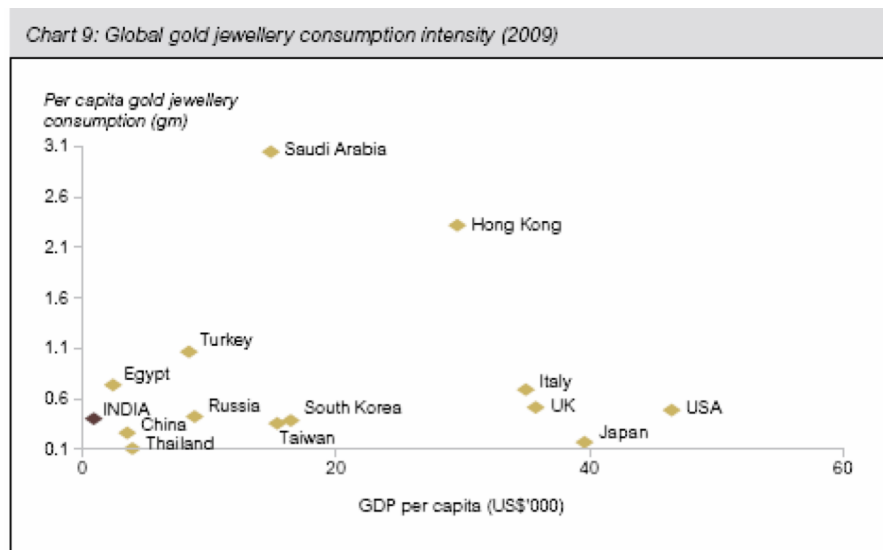
India is the incumbent with a 27% share of gold demand in 2009, but its position as the world's largest consumer market is being challenged by China. In India, gold has immense cultural and religious significance, and is not linked directly to global economics trend. For Indians, the demand for gold especially jewelry is a function of affordability and desirability. Demand tends to rise when prices are stable or rising gradually. Consumers dislike it when prices are volatile, as they believe that they could possibly buy it cheaper tomorrow. Hence, demand tends to fall when prices move up and down too much. Further, a steadily rising price (like we are experiencing currently) supports the contention that gold has inherent value (i.e. an appreciating asset) and this tends to encourage Indians to buy more.

**India’s gold demand**

In 2009, India imported 600 tonnes of gold, worth \$19bn, and accounted for 15% of the global demand. It has 18,000 tonnes of above ground stock (c. 11% of global total). In the last 10 yrs, gold demand in this fast growing country averaged around 13% p.a. according to WGC, outpacing GDP growth which averaged around 8% p.a. Indians tend to regard gold, both as jewelry and a form of investment, as well as, a store of value. Every home in India aspires to have at least a small piece of gold to signify its wealth. It is also well regarded as a form of money and as a tradable, liquid asset in that country. The price expectations was strengthened by the Reserve Bank of India’s purchase of 200 tonnes of gold in 2009 from the International Monetary Fund (IMF) to increase its reserve holdings; this was positive for domestic gold prices, and further reinforced the value of gold as a reserve asset.

India has one of the highest saving rates in the world, at around 30%; interestingly enough, 10% of which is held in gold! India certainly has a high affinity to gold. However, the intensity of gold consumption which measures the consumption of gold per capita for India is still quite low. At around 0.4g per capita, it lags that of developed countries like U.S (1.1g per capita) and Taiwan (1.4g per capita). This reflects the countries large population and low incomes. Nonetheless, as its income rises, and propensity to save improves, this intensity value is likely to shift higher towards that of developed countries – as a result, demand and gold prices are likely to move up further.

**India’s intensity consumption of gold lags developed countries**



Source: WGC estimates, GFMS, Bloomberg, IMF

**Jewelry demand**

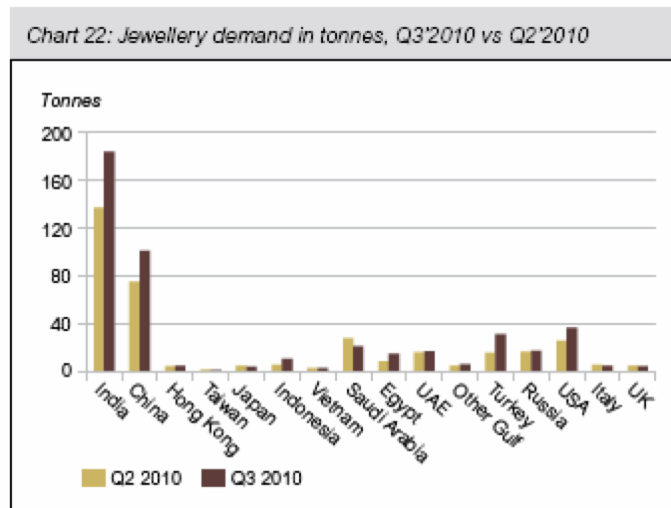
Globally, 2/3 of gold demand is made up of jewelry. Over the last 5 yrs, the average demand for this sector was roughly 2,150 tonnes, and this was worth c. \$55bn in 2009. India is the largest consumer market for gold with 27% share of this, followed closely by China.

While the rest of the world especially Western countries like the U.S and Italy saw a significant decline in demand for gold jewelry (as overall consumption declined during 2008/09 financial crisis), India held its own.

In 2010, India’s jewelry demand will likely recover to near pre-crisis levels, following a fall in 2009. In 1H2010, it was reported (WGC) that demand was up 67% y-o-y, as domestic prices surged. However, despite the higher prices, the outlook still remains positive due to the strengthening Rupee vs. USD. Incidentally, demand for gold investments (which accounts for 25% of demand) was up 264% in 1H2010, from 25 tonnes in 1H2009 to 93 tonnes; this further strengthened the contention of a strong recovery in gold demand for India.

India’s jewelry demand in 3Q of 2010 (latest) are also encouraging. From the charts below, we can observe that jewelry demand continues to be strong and increased 35% quarter-on-quarter, from 125 tonnes in 3Q 2009 to 180 tonnes in 3Q this year.

**3Q 2010: India’s jewellery demand continue to be strong**



Source: GFMS

All the latest data points to a strong recovery in demand for gold in India and provide a clear indication of its dominance in supporting global gold demand going forward.

**China's gold demand**

Although the Chinese government has somewhat liberalized the gold sector since 2001, its gold trade figures are not regularly published. The central bank (People's Bank of China) also seldom discloses or discusses its gold reserve data publicly.

However, WGC expects China's gold demand to double in the next 10 years, from the current 429 tonnes to around 800 - 900 tonnes. In 2009, China was the world's second largest consumer market for gold behind India. But it is expected to overtake India in the next 10 years, as the country's rising incomes, surplus of investable income and improving standards of living provide strong impetus for higher gold consumption. China's GDP growth is expected to remain in the double digits for the next 5 years, according to the IMF projections.

Already China is the largest producer of gold in the world, with annual production of 280.5 tonnes (vs. South Africa's 260 tonnes in 2009); almost all of the gold produced is consumed domestically.

China's intensity of gold consumption (which compares consumption per capita vs. GDP) like India's is still relatively low (0.3g per capita) compared to that of more developed nations like the U.S. As such, as its intensity of gold consumption improves on the back of increased economic prosperity, this will have a significant, positive impact on the country's gold demand and on prices globally.

Gold investments demand in China have also shown a marked improvement. Although the government has not officially encouraged private investments in gold, the central bank has been approving gold imports, according to the World Gold Council. Industry observers noted a big jump in delivered gold import through the exchange, and the increase in volume of the gold traded. Gold demand in China gained in the 1H2010 as the government set measures to cool down the overheating property market and falling equity prices, spurring the move into gold. About 70 - 80% of the gold imported in first 10 months of the year was made into mini gold bars or wafers, which are favored by Chinese investors. China's inflation showed a sharp hike (Oct 2010, its CPI jumped 4.4%), the fastest pace in two years and above the government's target of 3%. As a result, Chinese are buying more gold to hedge against inflation as the country tightening monetary policy drives money from properties and stocks into gold. China imported 209 tonnes of gold in first 10 months compared to 45 tonnes for all of 2009 (an increase of five folds).

**Willingness to increase its reserves positive for demand**

China's gold reserves currently stands at around 1.6% of its foreign exchange reserves. Most central banks around the world hold approximately 10% of its foreign reserves in gold; but in advanced countries the percentage tends to be higher (around 33%) due to the legacy of having been on the gold standard, while for Asian countries, it is less than 5%. China now holds in reserves at around 1,054 tonnes of gold, up from only 600 tonnes in 2004; but this figure is still very low (in terms of value) when compared to the size of its foreign reserves (excluding gold) at \$2.45 trillion which are held mainly in US dollars. To put it in perspective: the U.S has 8,133 tonnes of gold in its reserves held at Fort Knox, while Germany holds 3,408 tonnes (roughly 8 times, and 3.4 times China's gold reserves, respectively).

Given the size of its reserves, however, a small increase in percentage of holdings could have a significant impact on gold demand and also prices. For example, if China were to double its reserves from 1,000 to 2,000 tonnes, the increase (of 1000 tonnes) would be equivalent to almost 40% of the total global mine production in 2009. Although China is now the largest producer of gold in the world, its production of close to 300 tonnes per year would not be sufficient to meet this increase.

**Summary and conclusion**

Asia’s demand for gold especially from India and China, the two powerhouse of Asia’s economic growth, will be a key growth driver for decades to come. Currently, India and China accounts for approximately 25% of annual gold demand and this will likely grow further. The latest data on gold demand in India especially from jewelry, bodes well for future demand for gold and is positive for gold prices; it appears that the Indian demand for gold has recovered this year to its pre-crisis levels. In China, the import of gold numbers for the first 10 months of the year has surged to 209 tonnes from 45 tonnes recorded in 2009. WGC expects gold demand from China to double in the next 10 years from 429 tonnes currently to 800 - 900 tonnes.

All these significant market developments in India and China suggest considerable support for the future demand for gold, and a basis for gold prices to move higher from current levels.



*“Gold does not rust on the ground, and rocks don’t get soaked in the rain.” Turkish proverb*

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