



Shanghai Gold Benchmark Price

White Paper

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About Shanghai Gold Benchmark Price

1. Definition

What is Shanghai Gold

The term Shanghai Gold refers to pricing product launched by the Shanghai Gold Exchange (“SGE”). The underlying is gold ingots with a standard weight of 1 kg and a fineness of no lower than 999.9, delivered in Shanghai, and traded via SGE price trading platform.

What is Shanghai Gold Benchmark Price

The term Shanghai Gold Benchmark Price refers to RMB-denominated benchmark price follows the principle of “tendering volume based on price”, with all orders executed on the SGE price trading platform. During the auction period of Shanghai Gold trading which is done through SGE price trading system, when the price and volume reach the balance, the final benchmark price is determined.

2. Purpose of launching Shanghai Gold Benchmark Price

To provide a tradable and reliable RMB-denominated Gold Benchmark Price for the gold market

China is the largest producer and consumer of gold in the world. SGE, the exchange where major gold producers, consumers, financial institutions and investment companies gather, has ranked as the world's largest physical gold exchange for nine consecutive years. Therefore, Shanghai Gold Benchmark Price launched by SGE will be useful as it adequately reflects the gold supply and demand in China and represents the price trend of China's gold market. It will provide a tradable and reliable RMB-denominated gold price for the gold market.

To improve the development of China's financial market

At present, China's gold derivatives market is lacking in an authoritative and equitable gold benchmark price which is denominated in RMB. The launch of Shanghai Gold Benchmark Price will facilitate the development of China's gold derivatives market which will also have a big impact on the price of gold related financial products, wealth management products and derivatives.

3. Comparison between Shanghai Gold and Loco London Gold

Shanghai Gold is quoted in RMB per gram, with the underlying of 1 kg standard gold ingot with a fineness of no lower than 999.9 and physically settled in SGE

certified vaults. The Loco London Gold is quoted in USD per troy ounce, with the underlying of 400 ounce gold ingots with a minimum fineness of 995 and physically settled in London. Due to the difference between quotation units, underlying assets, delivery points and time zones, the relationship between Shanghai Gold and Loco London Gold is non-competitive while the two complement and facilitate each other and share mutual benefits.

Shanghai Gold and Loco London Gold will reflect the different supply and demand situation of two markets in two locations respectively which provide investors that have different needs for reference and usage. At the same time, the non-exclusive and non-fungible relationship between Shanghai Gold and Loco London Gold can make the two complement each other and promote mutual development in the global gold market.

Comparison between Shanghai Gold and Loco London Gold are as follows:

Graph 1. Comparison between Loco London Gold and Shanghai Gold

	Loco London Gold	Shanghai Gold
Trading Market	Intercontinental Exchange (ICE)	Shanghai Gold Exchange (SGE)
Trading Code	LBMA GOLD PRICE	SHAU
Quotation Unit	USD per troy ounce	RMB per gram



Trading Method	Centralized pricing trading	Centralized pricing trading
Trading Platform	WebICE platform	SGE trading platform
Participants	Direct participants and their clients	All qualified SGE's members and clients
Trading unit	1 troy ounce per lot	1 kg per lot
Chairperson	Yes	No
Minimum Price Fluctuation	USD 0.01 per troy ounce	RMB 0.01 per gram
Daily Price Limit	No Limit	No Limit
Minimum Quotation Size	1 lot	1 lot
Maximum Quotation Size	100000 lots	30000 lots
Matching method	By volume	By volume



Trading Threshold	10000 troy ounces (approximately 311 kg)	400 kg
Imbalance Allocation	12 direct participants	12 pricing members
Auction Start Times	AM auction 10:30 PM auction 15:00 (London Time)	AM auction 10:15 PM auction 14:15 (Beijing Time)
Reference Price Submission Window	None	AM Session: 10:09-10:14; PM Session: 14:09-14:14
Initial Price	Set by the chairperson	1. Calculate the arithmetic average after removing the highest price and lowest price from the qualified reference prices. 2. If reference prices are not qualified, then calculate the arithmetic average price of Au9999 transactions done during



		<p>the reference price offering period.</p> <p>3. If there is no transaction of Au9999 during the period, then the price will be same with the benchmark price of last session.</p>
Round Durations	30 seconds	<p>First round: 60 seconds of market tendering session plus 10 seconds of supplementary tendering session</p> <p>Starting from second round: 30 seconds of market tendering session plus 10 seconds of supplementary tendering session</p>
Submission method	Direct submission by direct participants	<p>Two countdown periods: Market tendering session and supplementary tendering session by fixing members</p>
Clearing Method	OTC clearing by the direct participants	<p>Centralized clearing by Shanghai Gold Exchange</p>



Settlement Method	Physical Settlement	Physical Settlement
Settlement Day	T+2	T+2
Product for Delivery	Standard LBMA Good Delivery gold ingots of 400 ounces ,with a minimum fineness of 995 (unallocated)	Gold ingots with a standard weight of 1 kg and a fineness of no lower than 999.9
Client Participation Method	Indirect participation. Clients place order through direct participants	Direct participation. Clients obtain individual trading code through SGE brokers.

4. Comparison between SHAU and Au9999

SGE price matching products are traded under the principles of price priority and time priority, which one member or client place an order with the price and volume to buy or sell, another member or client sell or buy at the same price or the best price.

Shanghai Gold Benchmark Price Trading aims to discover the price of a certain point of time when the net volume between buy and sell is relatively balanced, all orders are executed at that price. It is the balance between supply and demand of the whole market that determines the transactions.

The comparison between SHAU and Au9999 are as follows. More details can be seen in Annex 1, *Product Specifications of SHAU*.

Graph 2. Comparison between SHAU and Au9999

	SHAU	Au9999
Connection	Price interaction and mutually complement.	
Trading Mode	Periodic trading with point price	Continuous trading with consistent price Price Matching Transactions
Trading Principle	All orders executed at the price at a certain time when tendering volume between buy and sell is relatively balanced. The supply and demand balance of the market	Price priority and time priority Each declaration prices play a decisive role in the transaction.



	plays a decisive role in the transaction.	
Trading Method	Centralized pricing trading	Price matching
Trading unit	1 kg per lot	10 gram per lot
Daily Price Limit	No Limit	30% above or below the closing price of the previous trading day
Settlement Day	T+2	T+0
Trading Hours	AM session: 10:15 PM session: 14:15 When the net volume of all participants is balanced, the Shanghai Benchmark Gold Price is set and the auction is complete.	Morning session: 9:00 to 11:30; Afternoon session: 13:30 to 15:30; Night session: 20:00 to 02:30 of the next day
Participants	SGE members and clients shall apply and obtain approval from SGE to	All SGE members and clients.

	participate in the Shanghai Gold Benchmark Price trading.	
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5. Trading

Characteristics

Under the principle of fairness, justice, transparency and integrity, SGE provides a centralized marketplace of gold trading, clearing and physical delivery.

Shanghai Gold Benchmark Price trading is regulated by the People's Bank of China.

SGE follows the Rules of the Shanghai Gold Exchange on the Shanghai Gold Benchmark Price Trading, which ensure the normative of trading and protect legitimate rights of trading participants.

The initial price of Shanghai Gold Benchmark Price is set by third party, which makes it much fairer and easier to be accepted by global regulatory authorities, legal and compliance department of banks and investment institutions.

Participants

All qualified SGE members and clients can apply to participate in the Shanghai Gold Benchmark Price trading. The Shanghai Gold Benchmark Price trading is

based on Fixing Member and Reference Price Member.

Fixing Member refers to the institution that shall submit the market reference price during centralized auction period and make supplementary offering against the imbalance. Currently 12 domestic and foreign commercial banks are fixing members.

Reference Price Member shall submit market reference prices during the first round of centralized referencing price offering period. Currently 1 commercial bank and 5 domestic and foreign gold producers and consumers are reference price members.

SGE examines and accredits qualification of the Fixing Members and the Reference Price Members.

An eligible applicant for Fixing Member should:

- be a financial institution;
- be with registered capital or net assets of RMB 100 million or equivalent;
- have a good business reputation and operating history with no record of violation of the law in the latest two years;
- possess a sound organizational system of, financial management, internal control and risk management;
- be an active trader with SGE or in the international gold market;
- abide by the rules of the Exchange;
- satisfy other conditions prescribed by the Exchange.



An eligible applicant for Reference Price Member should:

- be a leading producer or consumer in the gold industry;
- be with a registered capital or net assets of RMB 50 million or equivalent;
- have a good business reputation and operating history with no record of violation of the law in the latest two years;
- have been an active trader with SGE or in the international gold market;
- be involved in the production, processing, trading, or investment of physical gold;
- abide by the rules of the Exchange; and
- satisfy other conditions prescribed by the Exchange.

After approval by SGE, Fixing Member and Reference Price Member shall meet the obligations required by SGE and have rights granted by SGE.

Pricing process and operating flow

The key point for Shanghai Gold Benchmark Price trading mechanism is to find a point of time when supply and demand reach a balance. The price at this point of time is regarded as the benchmark price.

Each session of Shanghai Gold Benchmark Price consists 3 main steps as following:

1. The Shanghai Gold Benchmark Price trading system calculates and publishes the Initial Price based on the reference price provided by Fixing Members and Reference Price Members.

*** The Calculation and Formation of Initial Price:**

Before the start of AM session or PM session, each Fixing Member and Reference Price Member will provide a market reference price. The Initial Price is determined by the following rule in three scenarios:

- All Fixing Members and Reference Price Members will first offer reference prices within the designated time period. If 50% or more of them have offered the prices, the Exchange will discard the highest and lowest, and use the arithmetic mean of the remaining reference prices as the Initial Price for the first round of the current centralized pricing trading session;
- If less than 50% of Fixing Members and Reference Price Members have offered reference prices, the Exchange will consider the reference prices invalid for the current session and will instead compute the arithmetic mean of all the executed prices for the Au9999 spot gold product traded on the Exchange within the time frame for the submission of reference prices and set that average price as the Initial Price; and lastly
- In the event that, within the time frame for the submission of reference prices, Au9999 has no valid execution price, the Shanghai Gold Reference Price from the previous trading session shall be set as the Initial Price for the current session.

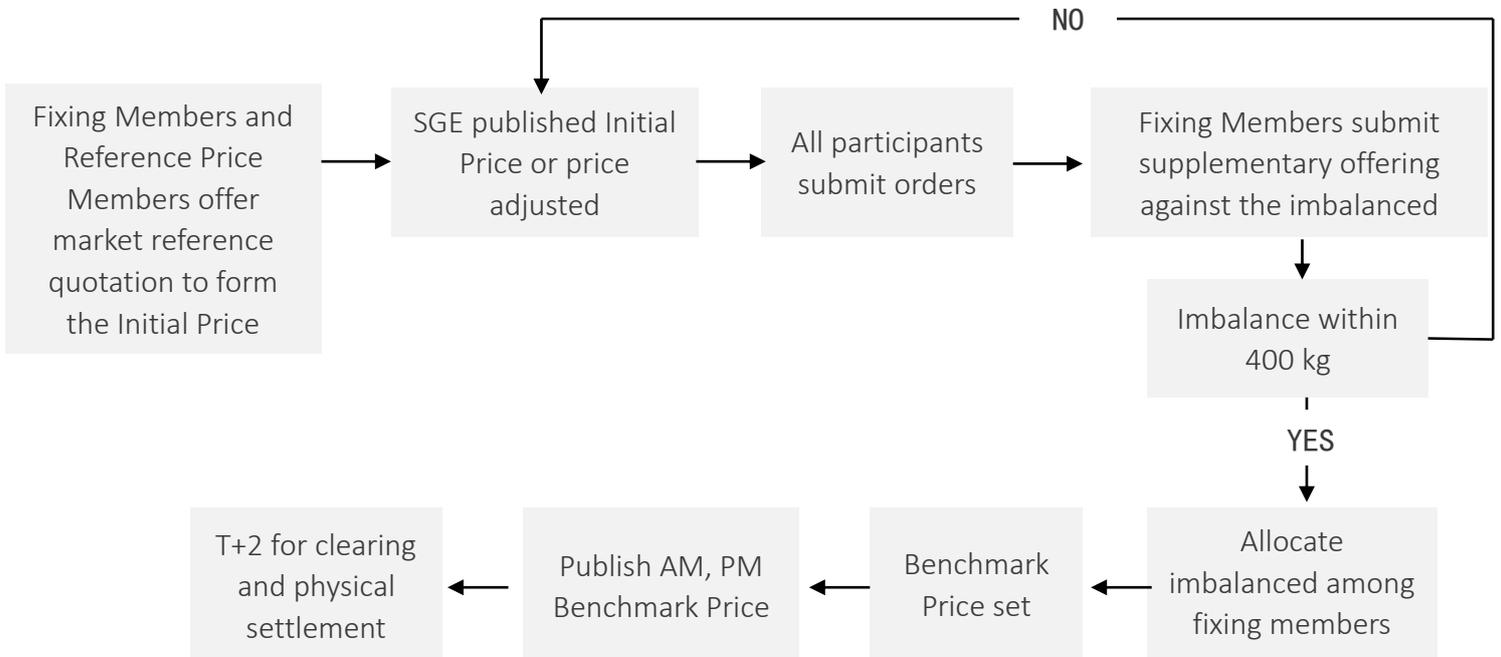
*The Shanghai Gold Benchmark Price, introducing both Fixing Members and Reference Price Members to provide quotations during the first round of centralized pricing auction makes the trading much fairer and will reduce the risk of manipulation.

2. All SGE members and clients submit their buying quantity and selling quantity based on the Initial Price or the offered price. If the net volume in the market

is imbalanced and the total buying volume is larger than selling, SGE will adjust the price upward following the trading rules round by round, until the buying volume is reduced while selling volume is increased so that the market reaches equilibrium. If the net volume is imbalanced and the selling volume is larger than buying volume, SGE will adjust the price downward following the trading rules round by round, until the selling volume is reduced while buying volume is increased so that the market reaches equilibrium.

- Once Shanghai Gold Benchmark Price is determined, all valid orders are executed at this price.

The operating flow is as follows:





***Note:**

- Imbalanced Volume: weight difference between tendered buying volume and tendered selling volume.
- Shanghai Gold Benchmark Price is traded on margin. Once the tender is successful, margin will be frozen immediately.
- Any tendering volume in a particular session shall be valid for that session only.
- Only the fixing members can participate in the supplementary tendering session. The supplementary session is aiming to improve the trading efficiency in the market and speed up the formation of a balanced price. Meanwhile, it will also reduce the imbalanced volume that allocated to fixing members through supplementary tendering session. This is the privilege for the Fixing Members along with their obligation to take the Imbalanced Volume.
- More details can be found in the *Shanghai Gold Benchmark Price Trading Rules of the Shanghai Gold Exchange*.

Product Specifications

Category	Specifications
Trading Code	SHAU
Quotation Unit	RMB per gram
Trading unit	1 kg per lot
Minimum Price Fluctuation	RMB 0.01 per gram
Daily Price Limit	No Limit



Minimum Quotation Size	1 lot
Maximum Quotation Size	30000 lots
Matching method	By volume
Trading Threshold	400 kg
Trading Hours	AM session: begins at 10:15 a.m. PM session: begins at 14:15 p.m.
Round Durations	First round: 60 seconds of market tendering session plus 10 seconds of supplementary tendering session; Starting from second round: 30 seconds of market tendering session plus 10 seconds of supplementary tendering session.
Clearing Method	Delivery-versus-payment
Settlement Method	Physical Settlement
Settlement Day	T+2
Quality Standard	Physical gold produced in compliance with SGE gold ingot quality standard SGEB1-2002 by SGE Standard

	Gold Ingots and Bars Delivery refiners, or standard physical bullions produced by LBMA accredited Good Delivery refiners.
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*Note: Please see Annex 1. *Product Specifications of the Shanghai Gold Exchange-SHAU* for further details.

6. Clearing and Delivery

Shanghai Gold (SHAU) is the new trading product launched by SGE and traded at a fixed time period. SGE acts as the Central Counterparty for all participants of the trading, conducts centralized clearing and delivery, and collects margins from all trading participants. SGE members and clients shall not worry about counterparties' credit risk, financial risk or physical risk when participating the Shanghai Gold Benchmark Price trading.

Clearing and delivery time

Net positions on T+0 are cleared on T+2 at settlement price on T+0.

Delivery Vault

The delivery vaults for SHAU includes all SGE certified vaults.

Quality Specifications for deliverable ingots

The physical bullions for delivery of SHAU shall be standard bullions produced by SGE certified gold producers and meet SGEB1-2002 quality standards, or produced by qualified producers certified by London Bullion Market Association (LBMA).

*Note: Other rules of clearing and delivery shall refer to *the Detailed Clearing Rules of the Shanghai Gold Exchange* and *the Detailed Rules for Physical Delivery of the Shanghai Gold Exchange*.

7. Default and Enforcement Measures

Before the end-of-day clearing on T+2, there should be sufficient funds in the buyers' account and sufficient physical bullion on the sellers' account, otherwise it will be regarded as default. SGE shall impose a penalty on the defaulting member (details for such penalty amount will be published on the SGE website). In the meantime, the transaction of the defaulting party will be terminated, while the transaction remain valid for non-defaulting member.

8. Supervision and Regulation

During the Shanghai Gold Benchmark Price Trading process, SGE members' risk

control department and person in charge must monitor the transactions and conduct on-site supervision and inspection from time to time. Any violation shall be reported to SGE in a timely manner. All the communications and contacts with the Fixing Members and the Reference Price Members including to the exterior must be recorded during the trading process and to be reserved by specialized person to be subject to occasional inspections.

SGE strictly prohibit any trading behaviours including price manipulation, matched orders, malicious traded back and forth in the same sessions, individually or jointly disrupt the market, misleading or fraudulent transactions. SGE reserves the right to take actions including oral warning or written warning, notice of criticism, trading permit cancelation or other punishment measures to the market participants who disturb the market order or are in violation of the relevant provisions of the transaction management, according to the relevant rules and regulations of the SGE.

The Shanghai Gold Benchmark Price Trading Oversight Committee (the “Committee”) is responsible for regular inspections on members and clients’ implementation of trading, clearing and delivery rules, regularly checks on whether the conflict of interests exist in the SGE’s members and clients trading behaviour. The committee shall study and evaluate the behaviour and trend which may not be in accordance with the certain trading rules; report serious violations in a timely manner and submit proposals to the SGE. The

committee shall suggest any amendment to the trading rules, according to international and domestic laws and regulations. The committee should engage in continuous research on the usage and compliance of the Shanghai Gold Benchmark Price in the domestic and global gold market, and study the benchmark price trading and the application of such benchmark prices in exchange traded market and OTC derivatives trading market.

* The Committee is consist of SGE delegates, delegates from domestic and foreign financial institutions, professionals from gold industry associations and so on. They conduct supervision and management of compliance for the Shanghai Gold Benchmark Price Trading.



Annex 1

Product Specifications of the Shanghai Gold Exchange

SHAU

Product	Gold
Trading Code	SHAU
Quotation Unit	RMB per gram
Trading Method	Centralized pricing trading
Trading unit	1 kg/lot
Minimum Price Fluctuation	RMB 0.01 per gram
Daily Price Limit	No Limit
Minimum Quotation Size	1 lot
Maximum Quotation Size	30000 lots
Matching method	By volume
Trading Threshold	400 kg
Minimum Trading Margin Rate	6%



Transaction Fee	*may be altered pursuant to SGE's announcements
Trading Hours	AM session: begins at 10:15 a.m. PM session: begins at 14:15 p.m.
Round Durations	First round: 60 seconds of market tendering session plus 10 seconds of supplementary tendering session; Starting from second round: 30 seconds of market tendering session plus 10 seconds of supplementary tendering session.
Clearing Method	Delivery-versus-payment
Settlement Method	Physical Settlement
Settlement Day	T+2
Product for Delivery	Gold ingots with a standard weight of 1 kg and a fineness of no lower than 999.9
Quality Standard	Physical gold produced in compliance with SGE gold ingot quality standard SGEB1-2002 by SGE Standard Gold Ingots and Bars Delivery refiners, or standard physical bullions produced by LBMA accredited Good Delivery refiners.



Delivery Vault	SGE certified vaults
Delivery Fee	0
Default Penalty	Equal to the Trading Margin Rates
Listing date	April 19 th , 2016

Annex 2

The Strategic Value of the Shanghai Gold Benchmark Price

The dollar-based gold price in today's market is not able to affect the need of price discovery process in different markets. It has remarkable strategic value for China to introduce its new Renminbi-denominated 'Shanghai Gold Benchmark Price', to influence the power of the Renminbi currency in the global gold market.

The launch of 'Shanghai Gold Benchmark Price' will provide experience and reference to Renminbi-denominated trading of both commodity and financial products. It will further promote the structural change to these two market.

The strategic value of 'Shanghai Gold Benchmark Price' including the following aspects:

1. Based on the concept of the 'Shanghai Gold Benchmark Price', it will help the participants to discover the price advantage of the domestic gold market. Enhance the voice power of China in the global gold market for its No.1 ranking of the production, consumption, import volume, and refiner process in the world. Build the 'Shanghai Gold Benchmark Price' to a major product in

the global market, increase the voice power of China in the global gold pricing market, improve the internationalization of the Yuan currency.

2. The 'Shanghai Gold Benchmark Price' will promote the diversification of the gold products, increase its hedge function for the domestic gold enterprises. Besides its risk control function, the Benchmark Price will also create opportunities for Shanghai Gold Exchange and its market participants to develop relevant gold derivative products. Furthermore, it will improve the market function and provide better risk management tools for upstream and downstream enterprises.
3. The 'Shanghai Gold Benchmark Price' will act as a price foundation for domestic gold enterprises in both national and international business. It will provide advantages to domestic gold enterprises from the aspects of raw materials, gold semi-manufactured products, various kind of gold product transactions, the import and export activities, and the negotiation and contract signing of gold investment projects.
4. The 'Shanghai Gold Benchmark Price' will play an important role in prospering and developing the gold investment and transaction in China's gold market. The Benchmark Price will continuously enrich the development of gold derivative products, attracting more direct and indirect market participants such as gold companies, commercial banks, institutional and individual investors.

Annex 3

The Significance of the Shanghai Gold Benchmark Price

With the development of the global gold market, the Shanghai Gold Benchmark Price, introduced by the Shanghai Gold Exchange after the launch of its international board, is a sign of the internationalization of China's gold market. The pricing mechanism of Shanghai Gold Benchmark Price will provide a transparent and tradable RMB- denominated gold benchmark price to market participants including gold manufacturers, consumers and financial institutions, to increase the effect of the Benchmark Price, the trading and delivery activities in the international gold market.

Shanghai Gold Exchange is the largest physical gold exchange in the world. With the characteristic of its ample liquidity and diversified physical bullion products stored in its certified vaults in Asia Pacific, it is an important trading platform for investors to participate the new RMB-denominated gold trading, it is also a significant step in the internationalization of the RMB currency.

With the continuous open-up of China's gold market, the Asia Pacific is becoming an important area for gold manufacture and consumption in the global gold industry. The domestic gold market has been improving its effect in physical gold trading word widely, and the demand for gold derivative product and the price

risk management based on the Shanghai Gold Benchmark Price has been increased. After the global financial crisis in 2008, institutional and individual investors are more concerned the function of gold as asset allocation. The launch of Shanghai Gold Benchmark Price is expected to active the willingness of investors in gold investment. The commercial banks can take advantage in wide participation, transparent mechanism and delivery versus payment settlement of Shanghai Gold Benchmark Price trading, together with the investor demand of trading to develop relevant financial derivative products, gold wealth management and investment products to provide comprehensive services for institutional and individual investors.



Annex 4

SGE Contract and Its Role in Price Discovery

By David Marsh

The new renminbi-denominated gold benchmark offered by the Shanghai Gold Exchange is a necessary addition to the international gold market and should make the pricing of physical gold more open to the play of market forces. The SGE is the world's largest spot gold exchange, with all trades denominated in renminbi and backed by physical gold held in SGE accounts. However prices are still derived from dollar-based benchmarks set by trading venues in London, New York and other locations far from China. The majority of trading on these venues is made up of 'paper' contracts, in contrast to China, where consumption is comprised mainly of demand for gold bars, coins, jewellery and manufacturing inputs, as well as central bank purchases.

This demand, is expected to expand in coming years, boosted by rising average incomes (especially in China's interior provinces and 'third-' and 'fourth-tier' cities) and the rebalancing of China's economy towards greater private consumption. The relatively small portion of gold holdings in Chinese households' large overall savings – and the uncertain outlook for investments in property or the stock market – create opportunities for gold product development, boosting demand for physically-backed gold products.

Chinese banks have increased the range of financial products and services for their retail and corporate customers. Gold accumulation plans, structured



investment products such as Ruyi gold bars – as well as banks allowing their customers to directly trade gold by providing access to the SGE trading platform – have increased the quantity and variety of gold investment options. Moreover, gold’s importance in the overall Chinese financial system has been increased by Chinese banks’ gold custody, collateral and leasing services.

Gold exchange traded funds, too, are making headway in China as a portfolio diversification tool, accompanying the growing offering of gold-backed products to bullion-sensitive Chinese investors.

There is a strong rationale for an international effort to shift price discovery to China, since this country will be responsible for a large share of future growth in world gold consumption. The market’s size and growth potential, and the expanding range of available gold products, will support market liquidity and ensure relative ease in finding ready buyers and sellers – both necessary factors for efficient pricing.

Apart from liquidity, efficient price discovery requires low transaction costs. The SGE will provide central clearing of all bids and offers by its members, with strict rules covering participating members, product quality and trading conditions. This increases transparency, reduces information and search costs and helps lower counterparty risk, increasing transaction efficiency.

The interaction between Shanghai and London will take time to settle down. One of the factors adding to price volatility would be undue fluctuations in the renminbi-dollar exchange rate if there is further nervousness about the scope of US monetary tightening or about a slowdown in the Chinese economy. By



making pricing of physical gold more receptive to the genuine play of market forces, the longer-term effect of the new renminbi benchmark may produce further long-term structural effects that could have an impact in sectors well beyond bullion trading. If the SGE contract proves successful in its early stages of operation, this could open up further possibilities for renminbi pricing of commodities heavily traded and used by China in the Chinese currency, as part of the currency's gradual move to full international status.



Annex 5

Shanghai Benchmark and the Rise of the Renminbi

By Meghnad Desai

Shanghai's renminbi-denominated gold benchmark comes at a propitious but also a precarious time for the world economy. For the first time in many years, and as a result of varied influences on the international economic and financial system, gold stands prepared to move once more towards the centre stage of world money.

This transition in gold's role is accompanied and has been influenced by a significant increase in the international use of the renminbi, as the Chinese currency moves toward full status both as a reserve asset and as a unit widely used in international financial transactions. A landmark move is the inclusion of the renminbi in the International Monetary Fund's special drawing right, giving it reserve currency status alongside the dollar, euro, yen and sterling, decided last November and due to take effect in October 2016.

Gold's official position in the global financial system disappeared after the collapse of the gold exchange standard and the Bretton Woods system in 1971-73. But now change seems to be underway – and the epicentre of this activity is in Asia. A renminbi-denominated, physical gold-based trading standard seems ideally placed to assist a growing number of Asian central banks keen to diversify away from US and European assets in their foreign exchange reserves – a factor



that has helped put a floor under the gold price during the downturn of the past few years and has contributed to a sharp recovery in 2016.

All these issues are linked. The lesson of history is that, at a time of flux in the world monetary system, as seen for example in the 1960s, gold goes through a resurgence. As a result of oil price fluctuations and uncertainty over US, European and Japanese monetary policies, financial markets have witnessed great febrility since the start of 2016. The global economy is likely to see further volatility as it transitions towards a multicurrency reserve system.

The world is witnessing pervasive growth pessimism. The 'new normal ' is low growth rate of GDP in real terms, lower than in the era of the Great Stability 1990-2007. Productivity growth, which is at the heart of real income growth, has collapsed when compared to the longer run trend of the post war years 1945-2005.

After 75 years since 1939 of positive and sometimes dangerously high inflation, the rate of price increases has fallen to levels not seen since the Great Depression of 1873-96. Europe and Japan have moved to negative interest rates, even though there is no certainty that the policy will produce the desired rise in inflation, and every chance that it will be counterproductive by dampening bank profitability. There is no general governmental willingness to take advantage of the low rates for financing infrastructure investment badly needed in G7 economies. Although the IMF has been warning about the poor world economic prospects, the Fund and leading G7 countries have not changed their negative attitude on using fiscal policy to revive growth.



Directly linked to worries about the world economy, doubts about the dollar, and negative returns on other major reserve currencies, central banks have been progressively larger net buyers of gold since 2010, with the main activity centred on the emerging market economies. Central banks from the developed world, which unloaded large portions of their gold stocks in the last 1990s and early 2000s, have stopped selling. The result is that annual reported net central bank gold purchases are now around the highest for 50 years.

While total currency reserves fell in the final quarter of 2015, central banks made net purchases of 167 tonnes of gold in that period, a 25% increase on the year before. Amid a fall in Chinese foreign exchange reserves, partly because Chinese companies are using the People's Bank's dollars to repay foreign debt, China is investing more of its trade surplus into gold rather than dollars.

The activities follow a certain pattern. In a report on 'Gold, the renminbi and the multicurrency reserve system' published in January 2013 and updated in April 2014, OMFIF drew attention to the probable increase in gold's role: 'The role of gold in the international monetary system will be further enhanced in the coming 10 years as a result of basic uncertainties over the dollar and the euro, and over whether the renminbi can emerge as a robust international currency without encountering fundamental setbacks.'

After the price recovery, the crucial test for gold is whether it can be as good a hedge against disinflation as it was believed to be against inflation. In a world of negative or very low rates of inflation, gold can be seen as a safe bet with a



positive rate of return. The fear of another financial crisis has not gone away. The failure of recovery to take hold, despite persistent heavy money creation, has added to the fears of a crisis coming sooner rather than later.

Foreign banks will need to participate in the SGE in order for it to become a truly global benchmark. Simultaneously China is recalibrating its growth strategy away from exports and infrastructure to one based on domestic demand. The strategy that succeeded for two decades in taking China to its second place in the global economy was capital-intensive and has led to excess output. China has to redistribute income away from (public as well as private) corporate profits towards wages and salaries. It has to reduce its very high rate of savings and allow households to consume more.

Thus the renminbi's success will depend on the smooth completion of multiple Chinese economic policy transitions. In my foreword for the January 2013 OMFIF report, I wrote, 'If the spectre of collapse continues to haunt the main reserve assets, and on the expectation that the renminbi will take time to get into its stride, the world will rush to safe havens. Gold may be the only one with the requisite size, clout and – dare I say it – history to help ward off the strains that will beset the world monetary system.' These remarks hold true today and provide an adequate backdrop for the launch of the Shanghai gold renminbi benchmark.

