

IS CHINA GOING ON TO THE GOLD STANDARD?



By Ian Williams, lead manager of the *HC Charteris Gold & Precious Metals Fund*

Is China getting ready to adopt the gold standard as a first step to make the yuan into a reserve currency with the ultimate aim of the Yuan replacing to the US Dollar?

At present the Chinese economy is the world's number 2 economy on standard comparison but is already number 1 on purchasing power parity. Whichever way one calculates this equation, with China growing at 6% a year & the USA growing at 3%, it is only a matter of time (circa 2025) before China becomes the undisputed Number 1 economy.

However, the Yuan becoming a reserve currency is a non-starter right now as China has capital controls in place and the Yuan is not fully convertible. The easiest way for China to speed up the process of making the yuan attractive as a reserve currency is for the yuan to be gold-backed - in contrast to the US dollar which used to be gold-backed but is now backed by absolutely nothing.

If one examines the recent chart (see below) of gold priced in yuan it is virtually horizontal with little movement, which implies some sort of market intervention by the Chinese central bank as this stability is simply impossible given the normal (high) volatility in commodity markets without some sort of official intervention.

CNY to XAU Chart

GOLD PRICE IN CHINESE YUAN

16 Jul 2008 00:00 UTC - 13 Jul 2018 13:21 UTC CNY/XAU close:0.00012 low:0.00008 high:0.00021



(Source: XE.com)

A chart of gold priced in SDR's (special drawing rights - Yuan recently admitted as a member) is equally static. This is starting to look like a 1st stage (similar to the UK joining the ERM in 1990 as a prelude to joining the Euro) to the next step which is likely to be the abolition/relaxation of exchange controls coupled with pressure applied to Silk Road beneficiaries to abandon the US Dollar in favour of the Yuan. Pakistan which is expected to get \$70 billion of new trains, roads, ports etc has been told that henceforth all bilateral trade between Pakistan & China must take place in Yuan.

This also has the added attraction of making Pakistan more resistant to US sanctions - something that will appeal to other Silk Road beneficiaries such as Iran, Syria etc. Also part of this long term plan is the recent launch of the Shanghai oil futures market priced in Yuan but convertible (if required) into physical Gold. China has acquired a huge stockpile of Gold in recent years through imports via Hong Kong as well as from its own mining activity as China is currently the world's largest Gold miner (400 Tonnes per annum - no exports).

This Gold has been stockpiled for a reason: China's long-term plan is that the yuan will ultimately replace the US dollar especially in Eurasia, which accounts for 60% of the world population. Backing the yuan with gold helps to fast-track this process by 10-20 years as it makes the yuan much more attractive as a potential world reserve currency and an alternative the US dollar.

A further added attraction for the Chinese is that if they can establish the Yuan as a reserve currency it opens up the possibility of foreign central banks & other foreign investors buying Chinese government bonds. This would be a highly convenient method of dealing with the excessive debts that the Chinese state-owned enterprises owe to the Chinese state-owned banks as the debts could effectively be parcelled up as government bonds and sold off to foreigners with the assurance that they are backed by gold assets. For the foreign investors they would be getting a higher yield than available on US T-bonds (& gilts, bunds, Japanese bonds) with the currency tied to the price of Gold.

Quite what implications this has for Gold is unclear, as in the short term as it eliminates any price volatility when the price is measured in Chinese yuan. Long term it is potentially very bullish as there

is not enough Gold around to back China's external trade with the Eurasian countries never mind everyone else and at some stage gold would have to be sharply revalued in all currencies.

Ian Williams, Chartered Fellow of CISI, is the manager of the HC Charteris Gold & Precious Metals Fund, the top-performing of approximately 4,000 funds from all sectors in 2016.

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