

THE CHINESE PLATINUM JEWELLERY MARKET

Strong consumer demand, healthy manufacturing output and stock-building of raw materials and finished pieces all contributed to a record performance by the Chinese platinum jewellery market in 2009.

INTRODUCTION

2009 was an exceptional year for platinum jewellery in China with gross demand rising from 1.06 million ounces to a record 2.08 million ounces. In the most general terms, this was due to the twin stimuli of a lower platinum price and a booming domestic economy. The real picture is rather more complex, with the motivations of consumers, manufacturers, retailers and wholesalers all playing their part.

DEFINING GROSS DEMAND IN THE JEWELLERY SECTOR

In previous years, Johnson Matthey has only reported net demand for platinum group metals in the jewellery sector. While recycling remained at low levels, this made sense and the numbers reported reflected the state of the market well. In recent years, though, in markets such as China and Japan, recycling has increased in volume and obscured the underlying trends in consumer and manufacturer purchases.

We have now therefore chosen to report demand as a gross figure, representing the total weight of metal bought by manufacturers from any sources and made into jewellery, plus any increases in stocks of unfabricated metal throughout the industry. Recycling figures – the amount of metal recovered from second-hand jewellery and from any wholesale and retail stock returned for reprocessing – are now reported separately.

To explain the underlying health of the market thus requires a focus on understanding manufacturing output and examining why stock changes take place in this industry.

CONSUMER PULL – PRICE

Consumer purchasing of platinum jewellery strengthened considerably during 2009. Growth in the Chinese economy maintained the positive mindset amongst domestic consumers. The Shanghai Stock Exchange

performed particularly well during the first two-thirds of 2009, augmenting people's perceptions of their own personal wealth. Rising real estate prices also enhanced this "feel-good factor", encouraging higher discretionary spending.

Platinum demand increased by more than this effect alone would suggest, though. Plain platinum jewellery (i.e. pieces which do not contain precious or semi-precious stones) is typically priced by weight in Yuan per gram in China. In a normal year, this retail price – which is prominently displayed in most jewellery stores – would typically move in line with changes in the bullion price. In the first half of 2008, for example, the rising platinum price pushed the retail price of platinum jewellery to ever-higher levels, hurting consumer demand as it became less affordable.

Many retailers were slow to reduce prices in the early part of 2009 as they averaged down metal costs on existing stock. Thus, although the bullion price had fallen, consumer prices were relatively slow to follow. In some cities, retail prices were therefore still falling even as the platinum price rose in the second half of 2009. These lower retail prices improved the affordability of platinum compared to the previous year, releasing a surge of pent-up demand and sending consumer purchasing sharply higher. Imports of fine, lightweight platinum chain from Japan also benefited, helping to increase Japanese platinum jewellery manufacturing demand.

CONSUMER PULL – PLATINUM AND GOLD

The narrowing price differential between gold and platinum also aided platinum demand last year. With the gold price stronger than in 2008 and the platinum price weaker, the differential in price between the two metals shrank. Although the gold jewellery market remains very much larger than the platinum market, this made platinum relatively more attractive to some consumers, with demand

for platinum improving accordingly.

This could readily be seen in the range of gem-set jewellery on display in retail stores. During 2007 and 2008, an increasing amount of white gold could be seen as retailers tried to maintain sales in the face of rising prices for platinum and for diamonds. However, white gold has a lower brand acceptance than does platinum within China. Thus, when the platinum price fell, retailers gladly returned to stocking more platinum at the expense of white gold. Consumers happily bought platinum at these more affordable prices instead of being forced to trade down to the cheaper white gold.

CONSUMER PULL – RISING AND FALLING PRICES

While lower platinum prices have clearly benefited affordability and platinum demand, the longer term impact of price changes and price volatility on consumer perception of platinum is more complex.

Precious metal jewellery in China is both an adornment and an investment. Although a rising price hurts affordability, it may make a material more attractive as an investment. To some extent, a rising metal price reinforces perceptions of the "store-of-value" status of precious metal jewellery as well as actually increasing its value.

For some consumers, the rising price of platinum in 2009 was therefore a positive factor, encouraging purchasing. For others, the precipitous fall in the price of platinum of late 2008 may have damaged confidence in its future value. The balance between these two opposing trends is hard to ascertain but this tension does demonstrate the complexity of consumer thinking in this market.

CONSUMER PULL – CALENDAR EFFECTS

The effects of the Chinese calendar also drove consumer purchasing in 2009. The year of the ox started in January and contained

two Springs (this number can vary due to discrepancies between when the Chinese New Year starts and when Spring begins) and was an auspicious year for marriages. (It is worth noting, however, that some of these marriages took place in the Chinese year of the ox but in calendar year 2010 and therefore will contribute to demand in 2010 rather than in 2009). The 9th of September 2009 also saw large numbers of weddings as the number nine is generally viewed as lucky: 09/09/09 was therefore an especially good day to marry.

Allied to this, the influence of dates in the Western calendar is increasing in China. Valentine's Day has become an increasingly important occasion and now forms one of the key buying seasons in China along with Chinese New Year, Christmas and the May and October National Day holidays. In 2009, Valentine's Day fell on a Saturday and retailers reported hugely positive sales, adding extra strength to an already good retail performance for the year.

MANUFACTURER PUSH

With consumer demand at very healthy levels and retailers and wholesalers increasing stock levels too, manufacturing demand strengthened considerably in 2009.

At various points during the year, latent demand – the amount of jewellery that manufacturers could have sold – was higher than their production capacity. Some companies refocused their production, manufacturing platinum jewellery instead of white gold and palladium. Almost every manufacturer increased capacity, recruiting more staff and investing in larger premises in several cases.

Weakness in manufacturing in the South of China of other goods for export – due to the global recession – contrasted with the rising profits available from platinum jewellery, both in total but also in margin per piece. This stimulated more investment into this sector and brought new companies into jewellery manufacturing. The increasing competition led to improvements in the design and

quality of some of their pieces while many manufacturers started to produce quantities of Pt999 (99.9 per cent purity alloy) jewellery in an attempt to further boost their profits.

CHANGES IN STOCK LEVELS OF FINISHED JEWELLERY

Manufacturing demand in 2009 was further augmented by significant increases in retail and wholesale stocks of finished platinum jewellery in China, driving gross demand upwards at a faster rate than the rise in consumer purchasing.

The consumer preference for platinum over white gold stimulated an increase in the amount of counter space devoted to gem-set platinum jewellery at retailers at the expense of white gold, leading to some of the stock-build which occurred at the retail level. Increases in plain platinum jewellery stock were also seen throughout the industry. Wholesalers expanded their stocks of finished jewellery in order to capture strong interest from the retailers.

In department stores, which account for a large proportion of jewellery sales in China, the store charges a percentage of turnover as commission from the individual concession-holders. A high gold price and good levels of sales of jewellery in general convinced these larger stores to devote more floor space to jewellery. It is questionable how much impact this had on sales of platinum but it did contribute to the increased levels of stock being held throughout the industry.

The ready availability of credit to businesses also encouraged independent retailers to add new outlets alongside their current operations in the larger cities or to expand into smaller, less affluent cities. Even a small store could require 50 oz or more of platinum in the form of initial stock with larger shops needing much more metal to stock their display cases.

Although the Chinese market is not yet saturated in terms of the number of jewellery stores per head of population, expansion of the number of retail outlets has slowed since late 2009. We also see little evidence of increasing

stock-build due to platinum replacing other precious metals in retailer display cases and there have instead been some indications of stock reductions in response to recent rises in the platinum price.

CHANGES IN STOCK LEVELS OF UNPROCESSED METAL

Just as retailers and wholesalers had done, manufacturers had reacted to the rising platinum price of recent years by minimising the amount of metal they owned in raw or finished form or in their in-process inventories. By the time metal prices had reached their peak in the middle of 2008, these stocks had probably fallen close to a practical minimum. As the price fell, therefore, manufacturers bought heavily to rebuild stock levels in late 2008 and early 2009.

In order to increase their output of finished pieces, more metal was required in the form of working stocks at manufacturers. Many manufacturers try to keep their stocks at a flat value in Yuan terms and it can therefore be seen that the fifty per cent fall in the platinum price had a major impact on the amount of physical inventory held. The new manufacturers starting operations in China last year also each required a significant quantity of platinum to begin production.

The stock-build at the retailer, wholesaler and manufacturer levels added several hundred thousand ounces to platinum demand during 2009.

THE OUTLOOK FOR DEMAND IN 2010

Although the underlying health of the Chinese platinum jewellery sector remains fairly good, it is unrealistic to expect another year of such strong demand in 2010. The factors leading to the heavy stock-building of 2009 are unlikely to be repeated. Recent higher bullion prices have started to impact upon the affordability of platinum jewellery and there have been some early signs of inventory reductions in the first part of 2010, suggesting that while demand may be strong by historical standards, it is unlikely to reach the heights of 2009 this year.