

The influence of the Sharia gold standard introduction on the gold market

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Abstract

The launch of the so-called Sharia gold standard was announced by the Organization for Accounting and Audit for Islamic Financial Institutions (AAOFIFI) at the end of 2016. The standard has consolidated the types and forms of gold, the parameters of gold trading, as well as solutions for financial products based on gold and rules for the activities of Islamic institutions working with gold. The purpose of this work is to systematize the available information on this innovation and assess the impact of the introduction of the Standard on the gold market. The introduction of the Standard allowed investors to expand the range of investment instruments. In addition, against the backdrop of the introduction of the Standard, the interest of Russian banks in the Islamic finance market has increased. After only six months from the beginning of the Standard, detailed data on its impact on the gold market, have not yet appeared, which increases the relevance of this work. Based on the results of the study, the conclusions about the current and planned impact of the introduction of the Standard are drawn.

The Introduction

At the end of 2016, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOFIFI) announced the launch of the so-called Sharia gold standard (hereinafter referred to as the Standard), which was confirmed by the World Gold Council [7]. The standard was designed to solve the difficulties with growth which Islamic finance traditionally face with. Gold has deep and historical ties with Islamic civilization. At the same time, gold in the Islamic tradition was limited as an investment asset. Gold is one of the six elements of ribavi, along with silver, wheat, dates, barley and salt. The ribavi elements are defined as a food product, everyday goods. In this sense, strict rules of transactions are applied in the Islamic world to prevent injustice or inequality between their participants. A historical dispute about whether gold is a currency or commodity has not been solved fully in the Islamic tradition.

A certain dogmatization of the statements about gold led to fragmented and fragmentary decisions. The lack of uniformity was the main obstacle to the development of financial products based on gold in the field of Islamic finance. The development of a coherent and Sharia-compliant theory of gold became a prerequisite for the inclusion of this metal in the portfolios of recognized Islamic investors.

In general, the Standard has consolidated the types and forms of gold, the parameters of gold trade, as well as solutions for financial products based on gold and rules for the activities of Islamic institutions working with gold. At the same time, according to the introductory provisions to the Standard, the term "institutions" is used as a short form for the whole set of Islamic financial institutions that include Islamic banks.

The introduction of the Standard makes it possible to acquire gold and financial products associated with it in accordance with Sharia law, which is expected to stimulate demand for gold in the Muslim world, as well as globally [10].

Part 1. Prerequisites for the introduction of the Standard

The Secretary-General of AAOIFI, H. H. Merah, pointed out that one of the reasons for the adoption of the Standard was to ensure that the relevant products became available to provide investment solutions to clients and manage liquidity for Islamic financial institutions within the framework of Sharia-compliant options. At the same time, H.H. Merah, highly appreciating the doctrinal provisions of the Standard, as skillfully thought out and professional, noted that "proof of the taste of pudding lies in its eating." In this connection, the task "to strive together to make this work in the real world" directly arises [10].

In the years preceding the adoption of the Standard, Islamic banking assets grew modestly. So, the volume of sukuk (Islamic bonds), as an element of Islamic finance - decreased by 1.4% in 2015. More than 50% decrease in the part of the new issue occurred after the suspension of the Short-term program for the issuance of sukuk in the central bank of Malaysia. Although there are many reasons for slowing Islamic finance, the conclusion of AAOIFI is unambiguous, they need to go beyond their existing portfolio of products. And the Standard can help to fulfil this task.

Figure 1. Islamic finance in 2012-2015 (in billions of US dollars)

Part 2. Practice of the implementation of the Standard.

At the time of the introduction of the Standard in December 2016 there was a consolidation in the gold market against the backdrop of ambiguous US statistics. It looked as if gold was consolidating after the suffered loss, initiated by the presidential election in November 2016 in the United States. In December, gold reached its low of \$ 1 137 per ounce, after the Federal Reserve made a statement on December 14 to increase the rate by 25 basis points. Gold finished December at \$ 1 152.3 an ounce. Despite a net outflow of 7.2 million ounces after Trump's victory, the cumulative net inflow for 2016 is still impressive amounting to 11.8 million ounces.

Figure 2. Dynamics of the price of gold from May 20, 2016 to May 19, 2017.¹

¹ Source: made by the author with using <http://www.finanz.ru>

By mid-May 2017, gold rose again to \$ 1 250 an ounce. And this is due to political instability, as well as weak US economic data, which lowered expectations of an aggressive rate hike in 2017, pushing down the yield of US bonds [6].

At the same time, American experts (opinions are collected by Reuters), analyzing the factors influencing the dynamics of gold prices refer to a general drop in the yield of shares, a weakening of the dollar, which provided "support" for gold. And at the "top of all this" the political uncertainty, which weakens the dollar is also indicated. In addition to it, the reason for this uncertainty is for some reason the President of the United States Donald Trump, who in the main opinion of journalists is "under pressure" and can not explain whether he tried to interfere with the Federal investigation conducted by former FBI director James Komi concerning the already former National Security Adviser Michael Flynn. Moreover, among the factors that affect the dollar, and hence the price of gold, is "disclosure of confidential information by Trump to the Russian Foreign Minister." All this caused investors to question whether Trump could push through tax cuts, deregulation and stimulating demand for safe haven assets, including gold. Indeed, against the backdrop of Trump's election, the dollar, like shares, and the ten-year yield of US bonds fell to the lowest level. Thus, at least, American analysts are focused exclusively on domestic factors, believing that the price of gold depends solely on domestic, and at the moment, political factors.

After six months from the introduction of the Standard, many analysts do not take into account its impact on the dynamics of the price of gold. We believe that these views are justified in relation to the document of soft regulation, and even more likely to a doctrinal and confessional plan, in contrast to, for example, more specific CBGA cartel agreements. The standard is unlikely to have a significant impact on the dynamics of gold prices in the short term.

In addition, WGC enthusiastically accepted the introduction of the Standard, evaluating it as an innovative initiative for Islamic investors, as well as for the global gold mining industry. WGC predicts that the introduction of the Standard will allow 1.6 billion Muslims in the world or a quarter of the world's population to have "significantly greater access to the gold market" than it was before. At the same time, GoldCore analysts cautiously point to the diffusion of "Western values and ideals" into the Islamic world [3].

Indeed, the Standard will allow Islamic investors to invest in shares of gold mining companies, as well as gold in exchange-traded funds, in gold certificates, respectively, observing the now strictly formalized and to some extent codified the norms of Sharia (on this issue).

In the current year, GoldCore has already prepared a fully compatible investment proposal with the Standard. Thus, the Standard has already introduced a variety of investment products, focusing on operations with physical gold. At the same time, GoldCore experts predict an increase in the influence of the Islamic financial world on gold prices. However, what the impact will be and how it is associated with the current CBGA-IV regime, is not yet clear due to the short-term nature of the action of real gold instruments for the application of the Standard. In the long term, a new agreement of the CBGA format may be needed when it becomes clear whether there is a threat in general to an effectively operating mechanism for the formation of gold prices.

It is noteworthy that WGC, while welcoming any certainty and formalization of intentions in the gold sphere, actively cooperated with AAOIFI in the development of the Standard, considering that AAOIFI is a unique example of confessional soft regulation in the field of Islamic finance, it is customary for the Association to listen to decisions in the Islamic world. Participation of WGC has brought not only "Western views and values", but also allowed to integrate into the Standard the mechanism of interface with the current order and institutions in the global gold sphere. As a result, the Standard introducing unambiguous recommendations to financial decisions in gold in accordance with the Sharia law does not seem to be something exotic. Rather, on the contrary, it opened up new investment opportunities, allowing Islamic banks and financial institutions to expand substantially, in terms of a range of savings, hedging and product diversification.

Part 3. First results of the implementation of the Standard

First, the introduction of the Standard allowed investors to expand the range of instruments. In February 2017, the world's largest exchange-traded index fund (ETF) linked to gold was recognized as compliant with Sharia, which became a landmark event for investors. Previously, the use of gold in Islamic finance was limited to spot transactions, now a wider range of investment products based on gold has become available. In particular, the SPDR Gold Trust (assets - 836.7 tons of physical gold worth \$ 33 billion), traded on the stock exchange, also fell under the AAOIFI criteria and was certified for compliance with the Sharia by the Malaysian consulting company Amanie Advisors [8].

Secondly, the introduction of the Standard can become a catalyst for activating interest in Islamic finance. So Russian banks (Vnesheconombank, Sberbank) are already exploring opportunities to work in the Islamic finance market, in terms of attracting foreign investments². The incentive for this, among other things, was the existing sanctions that prompted participants of the Russian market to seek alternative ways to enter the capital market. Islamic Banking reformed by the adoption of the Standard, provides new opportunities for Russian banks both for funding investment activities, as well as for supporting Russian industrial exports. At the moment, Russian banks are working on the formation of a "product matrix" that meets the requirements of both Islamic investors and bank customers. Vnesheconombank took part in the development of a road map for the development of Islamic finance in Russia.

Thus, Russian banks are establishing interaction and cooperation with key players in the Islamic finance market, including AAOIFI, with which in May 2016 a Memorandum of Understanding was signed, as well as with sovereign funds and with the largest banks of the Arab countries [5]. At the same time, the promotion of the practice of Islamic banking, including investment and gold operations, encounters a number of problems, among which it should be noted that the Russian legislation is not adapted to the new conditions, where the specifics of Islamic financial products are not provided for, as well as the certain underdevelopment of the infrastructure.

The solution to these tasks is entrusted to the Working Group on Partner Banking under the Central Bank of Russia. At the same time, in our opinion, it would be optimal not to adopt new normative acts, which will take time and in which there is no need, but complement the existing ones so that the main tools of partner banking can be equalized in rights and opportunities with old, acting banking instruments, including taxation. This position supplemented by recommendations for particularly strict control over Islamic financial institutions prevails in the literature [9]. In general, it is also about the fact that any opportunities and prospects for the application of the Standard have been taken into account by Russian legislation.

Moreover, there are serious concerns about the fact that Islamic banking structures can not enter the Russian market on their own and, accordingly, will work with Russian financial institutions, as well as with the authorities. It is this that Russian experts see as the main problem connected with the fact that Islamic financial interests are oriented toward acquiring "powerful lobbyists of their own interests, far from pure business interests"[4]. In this regard, a legitimate question about the relationship between the benefits of admitting Islamic banking to the Russian economy and the inevitable risks arises³. The researchers directly point out that the main task of

² It should be noted that in the CIS countries the volume of Islamic financing at the beginning of 2017 was insignificant. Thus, in Kyrgyzstan in 2016 they amounted to approx. 13 million dollars (about 1% in the banking sector), respectively - in the non-banking sector - only 435 thousand dollars (0.24% of the sector of microfinance organizations) // Jyldyz Sulaimanbekova: Islamic banking is based on a real economy // RIA News". 2017. February 13 <https://ria.ru/interview/20170213/1487692419.html> (in Russian)

³ In accordance with the Shari'ah, Islamic financial institutions have a religious obligation to contribute zakat to fellow believers. This activity is regulated by the Shariah Committees, authorized to directly interfere with banking operations and dispose of the limited account of "mudaraba", where funds are

such institutions, especially those operating in European countries, is to promote the concept of "Islamic solidarity" and confessional geopolitical interests [1].

It should not be forgotten that a year and a half before the introduction of the Standard, the gold standard was introduced by IGIL, putting into circulation the basis of its "monetary system" - a gold dinar worth 91 pound sterling. This measure, at least in the opinion of the leaders of the group, fully corresponded to religious requirements and moreover, was able to "cleanse the land of corruption, which spoiled it"[2].

Conclusions

At the moment, only after six months from the beginning of the Standard, the detailed data on its impact on the gold market have not yet appeared. At the same time, there are quite a few other strong factors affecting the gold market today.

At the same time, the time that has elapsed since the adoption of the Standard has made it possible to draw some conclusions.

First, the Standard is adopted, works and is favorably received in the financial world.

Secondly, the adoption of the Standard did not entail the destabilization of the gold market. In any case, other, traditional factors, are felt more noticeably. Thus, American analysts mainly relate fluctuations in gold prices to the fluctuation of the dollar.

The issue of revision of the CBGA is not put, which means that the Standard is not regarded as a threat to the stability of gold prices. In a sense, we can talk about some undervaluation of the Standard due to the relatively recent introduction and underestimation of its potential.

Thirdly, "soft" regulators, such as CBGA and Standard, began to prevail in the "golden" sphere.

Fourth, it seems useful for the rest of the faiths (Catholics, Orthodox) to formulate their views on gold doctrinally.

Research limitations and direction for further research

Since the introduction of the Standard, not enough time has passed yet to speak of its steady and constant influence on the gold market. More detailed consideration of the effects of innovation will be advisable to take into account with the appearance of the data for 1-3 years of its operation.

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