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The Turkish appetite for gold: An Islamic explanation

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ABSTRACT

A significant constituent of household wealth in Turkey is gold. Families accumulate gold especially on a variety of cultural occasions such as female-only gold days, circumcision feasts, and engagement and wedding ceremonies. This paper attempts to explain the gold appetite of Turkish households with a rational approach, although still rooted in culture. Many people in Turkey view “earning interest on money” as a transgression of Islamic rules and avoid investing their savings in fixed-income investment instruments. We study the implications of this investor behavior on portfolio gold holdings. Using the Markowitz mean-variance model and monthly return data from 1997 until 2015, we calculate optimal investment portfolios. We find that while the share of portfolio gold holdings is less than a meager 4% if the portfolio includes interest-earning deposits (in addition to the stock index, USD, EURO, and gold), this ratio may go up to more than 50% if interest-earning deposits are not included. Our results show that the role gold plays in an investment portfolio is greatly amplified when interest-earning deposits are not viable. We believe the key factor driving our pronounced findings has been Turkey’s historically high rates of inflation. Avoiding fixed-income instruments, many Turkish investors may have turned to gold to shield their savings against inflation and manage portfolio risks caused by its high volatility. Our findings suggest that Turkish policymakers may find it useful to popularize *Sukuk* (Islam-compliant bonds) if they are to divert household savings away from gold into more productive uses.

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1. Introduction

All around the world people buy gold with a variety of motives: to store wealth, to shield savings against inflation, as a portfolio diversifier, for its ornamental value, or simply as a symbol of status and power. The demand for gold is not uniform across time and space. However, gold demand is high in some countries and low in others. In some places people buy gold mostly in the form of jewelry while in others as bullions or coins. Gold demand tends to fluctuate seasonally and across years. Drawing on this variation in gold demand past research studies performed various statistical analyses and tested a variety of economic models, so as to better understand why people buy gold and what implications may follow if certain gold-related policies are adopted. Our paper makes a contribution to the literature on gold research along these lines: We study a country—Turkey, where the investment demand for gold is exceptionally high, propose and test a theory as to why it is

so, and discuss certain policy implications of our findings.

Fig. 1 below shows Turkey’s nominal GDP and its consumer demand for gold in various categories as a percentage of the global figures in years 2000 through 2014. During this period of time, Turkey accounted for 5.6% of the global consumer demand for gold, amounting to 171 tons (metric) per year. This stands in sharp contrast with the country’s relatively much smaller nominal GDP figure, corresponding to about 1% of the global figure.¹ According to a report by World Gold Council (2013), as of 2013, Turkish households accumulated an estimated stock of 3500 tons of gold tucked “under-the-pillow,” a term used in Turkey to refer to physical gold stored by the general population. This corresponds to about 200 g of gold per household, the worth of which roughly corresponds to the annual salary of many public employees.

The constituents of consumer demand for gold are jewelry consumption and investment demand. It turns out that the Turkish consumers’ attachment for gold is not restricted to an affection of the material as a decorative item for adornment. In years 2000

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¹ According to World Bank WDI data, in the relevant period the population of Turkey also stood at approximately 1% of the global figure.

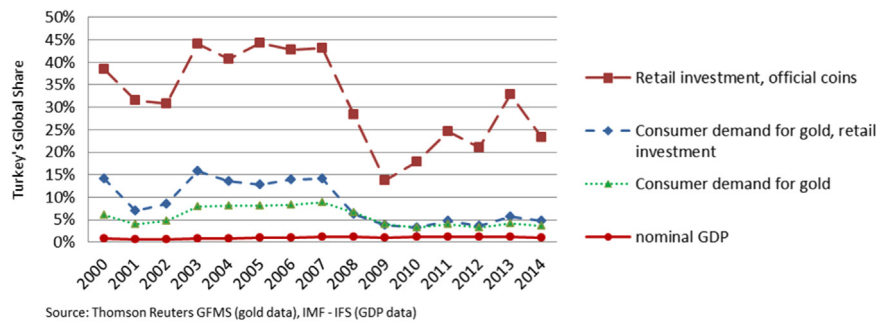


Fig. 1. Turkey's global share of gold demand in various categories and nominal GDP.

through 2014, while the average annual demand for gold for jewelry consumption in Turkey was 98.5 tons, the annual demand for retail investment also stood at a robust 51 tons. Indeed, Fig. 1 above shows that in relative terms the Turkish consumers' demand for gold has been even more pronounced when it comes to retail investment. In years 2000 through 2014, while Turkey accounted for about 5.6% of the global consumer demand for gold, its share of global consumer demand for gold in the form of retail investment stood at 6.6%.

An even more striking indication of the lure of gold as an investment instrument for Turkish households is the popularity of gold coins in the country. Retail investment in gold consists of investment made in the form of gold bars and gold coins. Since gold bars are sizeable,² gold coins are arguably a more viable investment instrument for small investors—the majority of households. As it turns out, Turkey is the country where the demand for gold coins is by far the highest in the world. In years 2000 through 2014, out of 51 tons of average annual gold demand for retail investment in Turkey, official coins accounted for 46.3 tons. During this period of time, as can be seen above in Fig. 1, about one third of official gold coins globally have been purchased by Turkish households.

Our paper aims to provide an explanation as to why gold is such a coveted item as an investment instrument for Turkish households. There is also an important policy dimension to our analyses: Turkey is historically a country with low savings rates and chronic current account deficits. Therefore, the country relies heavily upon foreign capital to finance its growth-stimulating capital investments. The fact that Turkish households invest a significant portion of their savings in gold does not help. Much of the gold accumulated by households is held at home, outside of the financial system. This type of investment has a productivity of zero and does not add value to social welfare. Past attempts by Turkish authorities to bring household gold savings into the financial system had transitory and limited success. Therefore, to design effective policies to divert household savings away from gold and into more productive investment instruments, it is imperative to understand the root causes of the lure of gold as an investment instrument for Turkish households.

Common arguments as to why gold is such a coveted item for Turkish people are rooted in history and culture. Turkey is located in Mesopotamia and Anatolia where gold has a long history. The history of gold production in this region goes back to 3000 B.C. The Lycian Kingdom, which established the first gold money in around 630 B.C., ruled in modern-day Western Turkey. In the Ottoman Empire, the predecessor of modern Turkey, gold signified the power of the imperial house as well as families. The Grand Bazaar was established in Istanbul in the 15th century, which serves ever

since as one of the biggest markets in the world for gold trade. In Turkish culture gold holds a distinct place. It is a tradition, for instance, for Turkish women to participate in so-called “gold days.” In these female-only social events, women come together periodically at one another's homes, and in each gathering each guest in the circle presents the host with a predetermined type of gold, often an official gold coin. Turkish people also present gold gifts to hosts in a variety of festivities such as circumcision feasts and engagement and wedding ceremonies. Indeed, it is a tradition that each wedding ceremony ends with what is called an “ornament pinning ceremony,” where guests literally pin their ornament gifts to cloth pieces, specially designed for this occasion and worn by the bride and the groom. Presenting the new couple with high-value golden ornaments—such as official coins, bracelets, and chains—is a display of wealth and prestige and also signifies the strength of attachment felt for the young couple and their families.

The significant role gold plays in Turkish history and culture is undeniable. Nevertheless, there are reasons to believe that the gold affection of Turkish households extends beyond historical and cultural reasons. First, as explained above, Turkish households accumulate gold not only in the traditional form of gold jewelry but also in the form of investment instruments, in particular, official gold coins. Second, an explanation for Turkish gold appetite rooted only in history and culture would suggest that the country's gold production capacity should parallel its gold demand. Nonetheless, Turkey's demand for gold dwarfs its gold production capacity. In years 2000 through 2014, the average annual mine production of gold in Turkey was 13.52 tons, corresponding to a meager 0.5% of the average annual mine production globally (2685.6 tons).

In the face of the above facts, our paper asserts a rational explanation for the gold appetite of Turkish households as an investment instrument. Our explanation is nonetheless still rooted in culture, more precisely, in religion. In Turkey the vast majority of people are Muslims. There is virtually universal acceptance among Muslims that Islam prohibits *riba*, which in Arabic literally means “usury,” or “unjust, exploitative gains made in trade or business.” *Riba* has been mentioned and condemned in several different verses in the Qur'an (2:275–280, 3:130, 4:161, and 30:39), which is the central religious text in Islam. Although some scholars raised certain objections, in practice *riba* is most often viewed as an Islamic term for interest charged on loans.³ In accordance with this interpretation, many Muslims in Turkey and elsewhere in the world refuse to invest their savings in fixed-income investment instruments such as bonds or interest-earning deposits. In contrast, assets such as stocks, gold or currency are not viewed un-Islamic *per se*, because these assets do not promise their investors a fixed return. Buying the stocks of a company, for

² The standard gold bar held and traded internationally by central banks and bullion dealers is the *Good Delivery bar* with a 400 oz (troy-ounce) (12.4 kg or 438.9 ounces) nominal weight.

³ For a detailed discussion on *riba* and the place of interest in Islamic law, see Nabil (1986).

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