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Changing Scenario of Gold Imports in India

Kavita Rani — Ph.D Scholar, Department of Commerce, Maharshi Dayanand University, Rohtak – 124001

Dr. Sanjiv Kumar — Professor, Department of Commerce, Maharshi Dayanand University, Rohtak – 124001

ABSTRACT

India has the world's third-largest current account deficit, which is approaching nearly $90 billion, driven in a large part by appetite for gold imports in the world's biggest consumer of the metal that has played a major role in driving the rupee to a record low. India imported approximately 860 tonnes of gold in 2012. Gold and silver imports in April-October, 2013 declined by 12.86 per cent to USD 24 billion compared to USD 28 billion in the same period last year due to the restrictions imposed by the Reserve Bank of India to curb the gold imports. The RBI and Central government believe those measures would help bring down current account deficit. However, the merchants association thinks it would be counterproductive. The RBI restriction would lead to shortage of gold in market and artificial price rise in domestic market. The decline in gold price in international market would not be reflected in local market price because of the RBI order. There is a distinct possibility of gold price rising in domestic market also. These trends in turn would lead to smuggling, black marketing and hoarding of gold which is fatal to the Indian economy. If India can resolve those gold imports related problems, it could solve the country's economic problems, decline the current account deficit, appreciate the rupee and boost growth.

KEYWORDS : Current Account Deficit, Gold, Gold Imports, India

Introduction

The economy of India is the tenth-largest in the world by nominal GDP and the third-largest by purchasing power parity. The country is one of the G-20 major economies and a member of BRICS. On a per-capita-income basis, India ranked 141st by nominal GDP and 130th by GDP (PPP) in 2012, according to the International Monetary Fund. India is also the worlds largest consumer of gold from the period of liberlisation.

Gold plays a very important role in the social, religious and cultural life of Indians. India's love for gold is almost a religion. Beyond being a symbol of wealth and status, gold is part of worship and culture - a tradition that goes back thousands of years. And with its growing prosperity, the one event that drives most of that demand is an Indian wedding. There may be no wedding like an Indian wedding. The events can last for days with music and dancing and traditions that go back centuries. Everywhere you look, there's a collection of colors, flowers and food. And then there's the gold: breathtaking. Here it's a symbol of purity that also shows off the couple's wealth and wellbeing. From birth to death, for men and women, among rich and poor - acquiring gold is a goal for the people of India. India Gold Market looks poised to achieve greater heights given the fascination for gold in the country.

Economics of Gold in India

The economics of gold is enmeshed in several socio-economic problems in India. For instance, the smuggling of gold, drug trafficking, foreign exchange leakage, black market in foreign currencies, under and over-invoicing in exports and imports trade, unaccounted incomes and wealth, black or parallel economy and tax evasion are issues in one way or other linked to the purchase, sale and holding of gold and gold jewellery in India. Since gold forms part of the reserves of the Reserve Bank of India, it has implications for money supply and price levels. The prohibition on the import of gold existed in India ever since 1947. The Gold Control Order 1963 and the Gold Control Act 1968 contained tight controls on the gold-related activities. However, the Gold Control Act failed in curbing the domestic demand for gold jewellery. The insatiable demand for the yellow metal has continued to grow. The Gold Control Act also failed to control the smuggling of gold. The Act placed hurdles in the export production of gold jewellery in India, when countries such as Italy were riding ahead in world gold jewellery exports. The Gold Control Act placed severe restrictions on goldsmiths, gold dealers and gold jewellery exporters. The quantitative restrictions did not permit large quantity production for satisfying overseas orders, which are usually large. The Act did not allow a certified goldsmith to receive more than 100 gms of standard gold for manufacturing jewellery. A Certified Gold Smith was not allowed to possess a stock of more than 300 gms of primary gold at any time. The quantity of primary gold in the possession of a licensed dealer was limited to between 400 gms and 2 kg., depending on the number of artisans employed. There existed a legal ban on transactions between one dealer and another. The Act also required gold dealers to operate from licensed premises only. This restriction was a hurdle to exports as foreign buyers could not visit widely scattered places of manufacture for inspection and buying.

The Gold Control Act was abolished in 1990, the year in which the Government of India had to transfer 40 tonnes of gold to London and swap for foreign exchange to tide over the country's balance of payment crisis. India had hibernated during the gold control era and missed the opportunities for gold jewellery exports while even smaller Asian countries like Thailand and Malaysia could record quantum jumps in gold jewellery exports. The prospects for gold jewellery exports from India have now brightened. After the abolition of the Gold Control Act, the Government introduced further reforms. Import of gold was allowed on payment of customs duty. Subsequently, the import of gold was brought under open general licence (OGL) by designated agencies. The designated agencies for the purpose are Minerals and Metals Trading Corporation of India (MMTC), State Bank of India (SBI), State Trading Corporation (STC), Handicrafts and Handlooms Exports Corporation (HHEC), Bank of India (BOI), Indian Overseas Bank (IOB), Canara Bank, Allahabad Bank, Bank of Nova Scotia and Standard Chartered Bank.

From the period of liberalization India is the world's largest gold market in volume terms that has expanded considerably, but according to World Gold Council Report presented on 15 August 2013, China may overtake India as the world's biggest gold consumer in 2013 as the dragon country has more favorable policy on the precious metal as compared to the economy in India. The data presented by this report showed that Gold consumption in China rose to 570 tonnes in the first half of the current calendar year, slightly higher than 566.5 tonnes in India. Gold consumption stood at 864 tonnes in India, while it was 832 tonnes in China during 2012.

Consumption of Gold in Q2, 2012 and Q2, 2013 (tonnes) World wide

	Q2'2012			Q2'2013*			Q2'2013vsQ2'12,% change		
	Jew1	TBCI2	Total	Jew1	TBCI2	Total	Jew1	TBCI2	Total
India	124.6	56.5	181.1	188.0	122.0	310.0	51	116	71
Greater China	108.8	50.1	158.9	167.3	127.3	294.6	54	154	85

China	99.5	47.9	147.4	152.8	122.9	275.7	54	157	87
Hong Kong	7.3	0.5	7.8	12.1	1.0	13.1	66	83	67
Taiwan	2.0	1.7	3.6	2.4	3.5	5.8	21	107	61
Japan	4.5	2.1	6.6	4.5	4.5	9.0	0	114	36
Indonesia	5.8	4.8	10.6	7.8	8.6	16.4	35	79	55
South Korea	2.0	0.8	2.8	2.1	1.1	3.2	7	40	17
Thailand	0.7	16.1	16.8	1.0	25.6	26.6	46	59	58
Vietnam	2.6	16.2	18.8	3.2	20.0	23.2	25	23	24
Middle East	42.0	7.0	49.1	55.7	11.6	67.4	33	66	37
Saudi Arabia	15.3	3.9	19.2	18.8	4.9	23.7	23	26	23
Egypt	8.4	0.5	8.8	12.5	0.9	13.4	50	84	52
UAE	14.2	2.1	16.3	18.8	4.0	22.8	32	90	40
Other Gulf	4.2	0.5	4.7	5.6	1.8	7.5	35	247	58
Turkey	19.1	18.0	37.1	26.4	37.9	64.3	38	111	73
Russia	15.8	-	15.8	16.5	-	16.5	4	-	4
USA	19.8	12.4	32.3	20.3	24.3	44.5	2	95	38
Europe ex CIS	8.3	75.6	83.9	7.1	85.8	92.9	-14	14	11
Italy	4.6	-	4.6	4.2	-	4.2	-9	-	-9
UK	3.8	-	3.8	3.0	-	3.0	-21	-	-21
France	-	0.6	0.6	-	0.3	0.3	-	-50	-50
Germany	-	33.5	33.5	-	40.6	40.6	-	21	21
Switzerland	-	17.3	17.3	-	20.4	20.4	-	18	18
Other Europe	-	24.2	24.2	-	24.5	24.5	-	1	1
Total Above	353.9	259.7	613.6	499.8	468.8	968.7	41	81	58
Other	66.9	26.2	93.1	75.7	38.8	114.5	13	48	23
World Total	420.8	285.9	706.7	575.5	507.6	1083.2	37	78	53

Source: World Gold Council Report, 2013

1: Jewellery
2: Total Bar and Coin Investment

Table 1 is depicting the data produced by World Gold Council's quarterly report, which shows that gold demand in India rose 71 per cent to 310 tonnes in the second quarter of calendar 2013 which is highest in the last 10 years, despite government curbs to restrict imports to rein in burgeoning current account deficit. Of the total, Jewellery demand rose 51 per cent in volume terms to 188 tonnes while investment demand (investment in bars and coins) was up 116 per cent at 122 tonnes. In value terms, demand rose 55 per cent to Rs. 78,681 crore with jewellery demand up 37 per cent at Rs. 47,716.2 crore and investment demand rising 96 per cent to Rs. 30,964.8 crore.

In a statement, Marcus Grubb, Managing Director, Investment, at the World Gold Council, said "The second quarter continued the trend that we saw in the first, of a rebalancing in the market, as gold coming onto the market from ETF sales met with a wave of demand for bars and coins, as well as jewellery. This surge in bar and coin investment was a common theme in key markets around the world, and has been particularly prominent in the world's biggest gold markets, India and China."

With domestic production falling to insignificant level, the consumption is met entirely through imports. The large gold imports have led to major concerns in the macroeconomic management. Table 2 is presenting the gold imports trends in India.

Table 2. Trends in Gold Imports

Year	Import of Gold in Rs. Crore	Growth Rate (%)
1999-00	17991	-
2000-01	18829	4.7
2001-02	19889	5.6
2002-03	18608	-6.4
2003-04	29946	60.9
2004-05	47348	58.1
2005-06	47951	1.3
2006-07	65440	36.5
2007-08	67330	2.9
2008-09	95324	41.6
2009-10	135878	42.5
2010-11	184742	36.0
2011-12	269563	45.9

Source: RBI Reports

As shown in table no 2 gold imports have risen exponentially in the last decade. Based on the data from DGCI & S which is represented in RBI report, India's gold imports are growing tremendously as in 2000-01 the growth rate was 4.7% and in 2011-12 it becomes 45.9%. Gold imports constitute more than 10 per cent of total imports and about a third of India's trade deficit today. Indian consumer generally views gold as a hedge against inflation because the inflation rate in India is very high. Consumers measure the value of gold according to traditions where gold is considered a symbol of wealth and prosperity. Consumers also invest in gold as a part of household savings and a long-term investment to protect wealth. The India-gold love affair is now facing a close scrutiny from the government. The budget has doubled import duty on bullion and non-standard gold to 4% and 10%, respectively, and slapped a 1% cess on unbranded jewellery. Rising gold imports is bad news for the government, which has launched a slew of measures to contain the trend. The measures include raising import tax from 2 to 6 per cent, banning traders from importing gold on margins and the rupee plunged to a record low of Rs 58.16 against the US dollar in the June first week, 2013, making imports even more expensive. The depreciation of the rupee has been on account of an increasing current account deficit, which is expected to be around 5% in 2012-13 and over 4% in the first quarter of 2013-14. Finance Minister of India on 14 June, 2013 has been given a statement that "investing in gold turns your money into an illiquid asset". Consequently, this money cannot be used by banks or the government to invest in job-creating projects. To import gold from the international market, India has to make payment in US dollars. And if the country makes higher imports of gold means more foreign currency goes out of the country, which hits the economy. According to World Gold Council India Managing Director, hike in import duty on gold will make the precious metal expensive, while cautioning that curbing supply will not be effective in the long run as this is likely to lead to demand being met through unauthorized channels. Almost all of India's gold demand is met through imports and this hike will increase the cost of gold for retail customers.

Indians are irresistibly attracted to gold - either to be bought as ornaments or investments. Their fascination with gold jewelry has roots in the culture, tradition and also the economic realities at the rural and grassroot levels of the society. The increasing demand for gold in India is putting a burden on India's current account balance. Domestic gold production is negligible and the resultant gold imports directly contribute to the widening of the current account deficit. Not with the standing increasing prices of gold, the volumes of gold purchases are induced by the prospects of getting good appreciation. The gold imports appear to be price inelastic in India. In a country with over one billion population, with social customs warranting purchase of gold for specific occasions, irrespective of the price, there will be a core component of demand for gold imports. Emergence of a new class of investors who has appetite for investment in gold for real returns also adds to the demand and thereby to imports. In short, the current trend in quantum of gold imports appears to be making India's external sector vulnerable in terms of rising trade and current account deficits which, in the absence of adequate foreign capital flows, can have implications for maintaining adequate foreign exchange reserves buffer.

Gold Imports and Current Account Deficit

India imported an estimated 835 tonnes of gold in 2012-13, which is the one of the major reasons for the record current account deficit of $88.2 billion or 4.8 per cent of Gross Domestic Product. The CAD - the excess of foreign exchange outflows over inflows - is among the fac-

tors that put pressure on the rupee, which dropped to a lifetime low of 68.85 against the dollar in August, 2013. Current account deficit in India narrowed sharply to $5.2 billion, or 1.2 per cent of Gross Domestic Product, in the July-September quarter of 2013-14 on the back of turnaround in exports and decline in gold imports. As part of the steps to curb gold demand, the government raised import duty on the metal to 10 per cent and the Reserve Bank of India imposed several conditions on imports. The local currency has since recovered and closed at 63.11 against the dollar on November 14, 2013.

Measures taken by Central Bank and Government of India in 2013

Jan 22 - The government doubles the duty on raw gold to 5 percent.

Jan 30 - Finance Minister P. Chidambaram says no plans for additional taxes or curbs on gold imports.

Feb 1 - The RBI plans to introduce three to four gold-linked products in the next few months.

Feb 6 - The RBI says it would consider imposing value and quantity restrictions on gold imports by banks.

Feb 14 - The central bank relaxes rules on gold deposit schemes offered by banks by allowing lenders to offer the products with shorter maturities.

Feb 20 - Trade ministry recommends suspending cheaper gold jewellery imports from Thailand.

Feb 28 - India keeps its gold import duty unchanged in its annual national budget, defying industry expectations.

Feb 28 - India proposes a transaction tax of 0.01 percent on non-agricultural futures contracts including precious metals.

March 1 - Finance minister appeals to people not to buy so much gold.

March 18 - The Reserve Bank of India says it is examining banks that sell gold coins and wealth management products to identify "systemic issues", with a view to closing any legal loopholes.

April 2 - Finance Minister suggests unlikely to raise the import tax on gold further to avoid smuggling and would instead introduce inflation-indexed instruments.

May 3 - The RBI restricts the import of gold on a consignment basis by banks.

June 3 - Finance minister says India cannot afford high levels of gold imports and may review its import policy.

June 5 - India hikes gold import duty by a third to 8 percent.

June 21 - Reliance Capital (RLCP.NS) halts gold sales and investments in its gold-backed funds.

June 24 - India's biggest jewellers' association asks members to stop selling gold bars and coins, about 35 percent of their business.

July 10 - India's jewellers could continue a voluntary ban on sales of gold coins and bars for six months.

July 22 - The RBI moves to tighten gold imports again, making them dependent on export volumes, but offers relief to domestic sellers by lifting restrictions on credit deals.

July 31 - India hopes to contain gold imports well below 845 tonnes that were shipped last year, Finance Minister says.

Aug 13 - India hikes import duty on gold for a third time in 2013 to 10 percent. Duties for silver and platinum also increased to 10 percent. Customs duty on gold dore bars, ore or concentrate increased to 8 percent from 6 percent.

Aug 14 - India turns the screws on gold buying again; banning imports of coins and medallions and making domestic buyers pay cash.

Gold and silver imports in April-October, 2013 declined by 12.86 per cent to USD 24 billion compared to USD 28 billion in the same period last year (April-October, 2012) due to the restrictions imposed by the Reserve Bank of India to curb the gold imports, which required importers to re-export at least 20% of all the purchases from overseas, and jewellers started using stocks that had piled up in April and May following record imports of 304.5 tonne. The restrictions imposed by Reserve Bank of India are applicable on nominated banks, agencies, premier, star trading houses, units in special economic zones (SEZs) and export-oriented units, which are permitted to import gold for use in the domestic sector. If any of those importers of gold fails to export 20% of the gold from the arrived consignment, he would be barred from importing any more gold. This could reduce imports, as only a very small portion of gold is exported now. Indian gold imports may fall 70 percent in the final quarter of the year 2013 from 255 tonnes in the year-ago period and are expected to be half usual levels at 500-550 tonnes next year if new import rules are maintained.

Although the RBI rule was aimed at curbing the flow of gold into the country and not to stop it, the importing agencies took time to get a grasp on the many operational procedures involved, including the undertaking that needs to be submitted to the customs department once the goods are delivered to an exporter for the next lot of imports. The Kerala Gold and Silver Merchants Association has warned the restrictions on gold imports introduced recently by the Reserve Bank of India would not yield the intended results but instead encourage gold smuggling and hawala trading in the yellow metal. In view of the RBI order, when a bank imports 100 kg of gold, it can release only 80 kg into market for sale. The remaining 5 per cent should be kept in customs bonded warehouses and 15 kg exported as gold ornaments if it wants to place fresh order for gold import. The RBI and Central government believe those measures would help bring down current account deficit. However, the merchants association thinks it would be counterproductive. The RBI restriction would lead to shortage of gold in market and artificial price rise in domestic market. The decline in gold price in international market would not be reflected in local market price because of the RBI order. There was a distinct possibility of gold price rising in domestic market also. These trends in turn would lead to smuggling and black marketing and hoarding of gold.

Suggestions and Recommendations

1. RBI and the Finance Minister of India P. Chidambaram have taken measures to reduce gold imports but the consumers of India need to realize that investment in gold is a dead asset. The Reserve Bank of India has also told regional banks they can no longer provide loans against gold jewellery — the latest move to discourage gold buying as the government seeks to reduce a gaping current account deficit. There's logic to this as gold is India's second-biggest import cost after crude oil. Experts, however, say addressing India's inflation and low real interest rates would have more of an impact on the current account deficit than curbs and duty hikes on gold. To discourage people from investing heavily in gold, the Reserve Bank has also placed restrictions on overseas purchases on a consignment basis and limited imports for local consumption against cash only. It has also asked banks to not give advances against gold exchange traded funds (ETFs) and units of gold mutual funds.
2. In an effort to curb gold imports, Reliance Capital suspended gold sales, subscriptions in gold savings fund and financing against gold as security.
3. The World Gold Council suggested that India needs to adopt a long-term policy on gold, and said measures such as import duty hike to 10 per cent and linking all forms of gold imports to mandatory exports are unlikely to bring down the burgeoning Current Account Deficit.
4. Economic Affairs Secretary Arvind Mayaram said that all imports of gold in India will now need a licence from the foreign trade office and will have to be brought into a customs bonded warehouse. He also added that unrefined gold would be added to existing rules stipulating that 20 percent of all imports must be used for export, which is usually in the form of jewellery.
5. People should rather invest in financial instruments such as mutual funds and government bonds to safeguard their investments against inflation. At a time when stock markets and mutual funds have failed to fetch good returns on investments, gold is seen as a

lucrative investment by many.

6. India may need to examine its monetary policy rather than taxing the only store of value available to the Indian consumer.

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