Research Paper Economics

Significance of The Indian Gold Loan Market

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ABSTRACT *Possession of gold has been a symbol of prosperity in India and is considered a safest form of investment that provides hedge against inflation. Gold has always been a highly coveted product not only in the form of jewellery, gold bars or bullion, but also has the ready acceptability as collateral for the lenders because of its high liquidity character. According to an estimate of World Gold Council, about 10 per cent of world's gold is in India's possession. Accumulated Gold stock in India is around 18,000 to 19,000 tonnes as per independent estimates. During 2002-2012, annual gold demand has remained relatively stable at around between 700 to 900 tonnes despite the rise in prices from Rs. 13,333 to Rs. 86,958 per troy ounce (as on May 25, 2012). In India, the demand for gold has not been adversely impacted by rising prices.*

KEYWORDS : Gold Loan, India, Demand, Trends, Consumption

INTRODUCTION

In India, it is believed that most of the gold is held by people in rural areas and in many cases this is the only asset they have in their possession though in small quantity. All the while, rural Indians know that if his crop fails or his family is sick, he can raise cash in a moment from the goldsmith or may be pawnbrokers and moneylenders, because the rural India lags in availing banking facilities. Therefore, even the pattern of saving in India differs for various income groups. While richer sections diversify their portfolio according to risk-return equation, the poor rely more on commodities like gold as well as silver. The jewellery bought in times of prosperity has been pawned or sold for cash in periods of distress or need. Over the years, some portion of this is being used as collateral for borrowing in the informal market, though estimates is not available. It is a common practice in India that gold is pawned, bought back and re-pawned to manage day-to-day needs of the poor and middle class. The pledging of gold ornaments and other gold assets to local pawnbrokers and money lenders to avail loans has been prevalent in the Indian society over ages. Due to the increased holding of gold as an asset among large section of people as also the borrowing practices against gold in the informal sector have encouraged some loan companies to provide loans against the collateral of used gold jewelleries for years and over a period to emerge as 'specialized gold loan companies'.

Some independent estimates indicate that rural India accounts for about 65 per cent of total gold stock in the country. At times of emergency, gold ensures a loan almost instantaneously for the poor and without any documentation process. Most of the loans are for meeting unforeseen contingencies and may be categorized as personal. Further, growth in middle income classes and increase in the earning capacity of women, a core customer group for gold is expected to further boost the demand of gold. The demand for gold has a regional bias with southern Indian states accounting for around 40 per cent of the annual demand, followed by the west (25 per cent), north (20-25 per cent) and east (10-15 per cent). Accordingly, even the gold loan market has also developed on the same lines where a large portion of market is concentrated in southern India. India continues to be one of the largest gold markets in the world. The attraction towards gold in India stems from varied historical and cultural factors and its perceived safety in times of economic stress.

Objectives

1. To examine the structure of Indian gold Loan market
2. To study the trends in the gold loan market
3. To analyze the basic features of the Indian loan market

Structure of the Gold Loan Market

Borrowing against gold is one of the popular instruments based on physical pledge of gold and it has been working well with Indian rural household's mindset, which typically views gold as an important saving instrument that is liquid and can be converted into cash instantly to meet any urgent needs. The market is very well established in the Southern states of India, which accounts for the highest accumulated gold stock. Further, traditionally gold holders in Southern India are more open to accept and exercise the option of pledging gold as compared to other regions in the country which are reluctant to pledge jewellery or ornaments for borrowing money.

The major players in the organised gold loans market in India are

- commercial banks,
- cooperative banks and
- Gold loan NBFCs known as non deposit taking.

In addition to a growing organized gold loans market, there is a large long-operated, un-organized gold loans market which is believed to be several times the size of organized gold loans market. There are no official estimates available on the size of this market, which is marked with the presence of numerous pawnbrokers, moneylenders and land lords operating at a local level. These players are quite active in rural areas of India and provide loans against jewellery to families in need at interest rates in excess of 30 percent. These operators have a strong understanding of the local customer base and offer an advantage of immediate liquidity to customers in need, with extreme flexible hours of accessibility, without requirements of any elaborate formalities and documentation. However, these players are completely un-regulated leaving the customers vulnerable to exploitation at the hands of these moneylenders and pawn-brokers.

Seizing the vast untapped potential available for lending against gold, the organized players such as NBFCs became more aggressive in the gold loans market and a significant part of the gold loans likely to have shifted from the un-organized lenders to the organized lenders, thus fuelling a strong growth in the organized market. Further, the growth would be even higher if the customer attitude towards gold pledging becomes more positive aided by positive government regulations and aggressive promotion by banks, finance companies and other formal financial institutions. South India continues to account for 80-85 per cent of the gold loans market in India. Despite attempts by banks to expand in certain pockets of Northern and Western India, historically, the market has remained concentrated in Southern India. However this trend is changing gradually, as witnessed in the strong expansion of branches of the leading gold loans providing NBFCs in Northern and Western India.

Trends in Gold Loans

Gold as an asset is liquid and can be readily exchanged for cash even in the informal market. With the gold market getting more organized within a formal setup, in recent years there has been rapid growth in the gold loans market particularly in gold loans disbursed by Banks and NBFCs. Both demand and supply side factors have played important roles in bringing about this growth. From the demand side, holders of gold were able to get cash in lieu of their gold in a formal setup and at higher loan to value ratios at relatively less rate of interest with better terms when compared with the informal segment. From the supply side, banks and NBFCs were able to disburse loans against

Volume-5, Issue-3, March - 2016 • ISSN No 2277 - 8160

collateral whose value was stable even in times of financial turmoil.

Table 5:1
Annual Growth Rate of Gold Loans Outstanding

Year	Bank Gold Loans	NBFC Gold Loans	Total Gold Loans
2008-09	54.2	41.4	52.5
2009-10	47.7	169.3	62.6
2010-11	52.1	126.7	67.2
2011-12	77.6	80.0	78.3

Source: working group calculations based on data from Commercial banks and five major gold loans NBFC

An analysis of the annual growth rates of the total gold loans disbursed reveals that the growth rate of gold loans disbursed by banks has witnessed an increasing trend during March 2008 and March 2012. Growth in gold loans by NBFCs has fallen over the years but it remains higher than the growth of gold loans disbursed by banks. With the small base effect waning over the years, the growth of gold loans disbursed by NBFCs has fallen in more recent years. However, consumer interest in gold loans by NBFCs still remains high and can be gauged from the fact that currently it is still growing at a rapid pace of about 80 per cent. Gold loans disbursed by banks and NBFCs have moved in tandem and are highly correlated. Total gold loans outstanding have progressively grown.

In the recent years gold loans given by NBFCs and banks have grown sharply. Concurrently, the gold prices and gold imports were also on increase. The Working Group examined whether the recent surge in gold imports by India was in any way influenced by the steady growth in gold loans by the Commercial Banks and NBFCs.

Basic features of gold loan industry

1 Dominance of banks in gold loan provision

Gold loans are provided by the banks (commercial and cooperative) and specialised NBFCs. The Working Group collected the loans outstanding data from all the public sector banks, State Bank of India and Associates, prominent private sector banks and Apex Cooperative Banks. The Group collected the relevant data from the leading gold loan NBFCs as well. Of the total gold loans outstanding at end-March 2012, 72 per cent were provided by banks while the remaining 28 per cent were given by gold loan NBFCs. Banks thus have been the most important supplier of gold loans.

2 Growing importance of NBFCs in providing gold loans

While the importance of banks has continued unabated, a striking increase in the share of NBFCs in total gold loans is also discernible in the recent years. The share of NBFCs doubled from 13 per cent at end-April 2008 to 27 per cent at end-March 2012. In other words, on average, the share of gold loan NBFCs increased by about 3 percentage points on an annual basis.

3 Growing demand for gold loans from NBFCs

In general, there has been a growing demand for gold loans in the recent years. On a year-on-year basis (taking three-year moving average), gold loans in India have grown at strikingly high rates of 60 to 70 per cent per annum in the last four years. The growth of gold loans from NBFCs has been particularly high albeit marked by fluctuations. After smoothening, the annual growth of gold loans from NBFCs shot up to significantly high levels of over 140 per cent per annum in 2009-10 and showed fluctuations around a declining trend thereafter. The year 2011-12 saw a steady fall in loans from NBFCs and yet, the rate of growth remained much higher than banks. The year-on-year average growth in gold loans from banks has been on a steady rise in recent years. Since August 2009, when the rate had dipped to 35.0 per cent per annum, it rose steadily to 76.0 per cent by February 2012.

4 Banks as a major source of funds for gold loan NBFCs

Given that NBFCs-ND-SI (non-deposit taking systemically important) are barred from accepting public deposits, borrowing in general and bank borrowings in particular has been an important source of funds for these NBFCs. At end-March 2012, bank borrowing constituted 20 per cent of total liabilities of NBFCs. Within the NBFCs-ND SI sector, gold loans NBFCs have been particularly more reliant on bank borrowings. Bank borrowing formed nearly half (48 per cent) of total liabilities of these institutions. Thus, any analysis of stability concerns related to gold loan NBFCs has to take into account not just their own financial soundness but also their interlinkages with the banking sector.

Conclusion

The demand for gold loans is influenced by many factors. As the gold loans are granted against the gold ornaments deposited by the borrower, the size of the stock of gold jewellery, available with the borrowers is a crucial parameter. The needs of the borrower coinciding with various purposes like cropping season, academic year, festivals, Medical purposes etc, are also critical in determining the demand for gold loans. While banks would typically give around 75 per cent of the gold value as loan, NBFCs give loans up to 60 per cent of the value of the pledged gold, in case of high purity gold jewellery, under the extant norms. Hence, the prevailing loan-to-value ratio is a factor that can affect the demand for gold loans. Finally, alternative sources of borrowing and the interest rate charged, which depends on the tenure and amount of loan is a crucial factor in affecting the demand and supply of gold loans.