



India and Gold ETF- An Historical Report

KEYWORDS

India, Gold, ETF

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ABSTRACT *India has for long been obsessed with gold. Year after year Indians buy tons and tons of gold. Comparing with the official reserves of gold held by Reserve Bank of India, private holding is large. This paper aims to identify the reasons for India's obsession affair with gold and the way it is currently precipitating the Current Account Deficit (CAD) crisis. All measures of the government till date has not been able to whet the appetite of the average investor to cut his or her gold consumption. Probably it is here that financial products like Gold ETFs can offer a win-win solution to both the investor and the government. This paper tries to locate on a macro level as to the factors that can ensure the success of gold ETFs in India*

INTRODUCTION

India's passion for gold continues unabated. The national rush to buy gold has presently led to a situation wherein the government has started to act to restrain foreign exchange being spent on this class of asset. The main contention being that gold is simply held without any further productive gains for the economy. This seems to be hindering economic growth. Despite many measures to curtail consumer spending on gold, the government has not been successful in its efforts.

Certain new age financial products like the Gold Exchange Traded Funds have entered the market and now offer the investor with a chance to hold gold in electronic format just like holding dematerialized shares. Experience and data points that Indians cannot be dissuaded from buying gold, even when the prices rise perhaps only the quantity bought gets reduced but the appetite for consumption remains intact. Economists view this practice as harmful given the fact that the gold held by people normally sits within the safety of bank locker or safe boxes without contributing anything to the growth of the economy. In this scenario, the Gold ETF products which closely resemble and offer the investors the satisfaction of holding gold albeit in electronic format offer a glint of hope to the government to do something about this perceived money drain. This particular product may have the power to shift physical gold holding from unproductive private holding to productive institutional/organisation holding.

Reasons for India's passion for Gold:

India's unabated love for the yellow metal, gold is a well-known historical fact. It would be erroneous to assume that India's love for gold is of recent origin. It is a passion that is as old as the Indian civilization itself. Over the period of time cited thousands of tonnes of gold has flown into the country and in the opposite direction only little tonnage may have actually got away. It is again a well-documented fact that India was a magnet for invaders thanks to glitter of gold treasures that the nation held and still holds.

While Indians loved gold and bought it in large volumes in exchange for local merchandise exported, the other world

powers who saw their gold reserves declining adopted very often to devious means to capture what was lost to India, say through invasion and plunder. India has a history of foreigners invading and plundering the country for gold and other precious materials.

In times of chaos that followed foreign invasion and looting, Indians found that gold was a perfect way to safeguard their wealth as gold was: 1) Nonperishable, could be stored safely underground 2) Held to its value at any given time, 3) was accepted by everyone as a medium of exchange, 4) its price kept moving with current prices

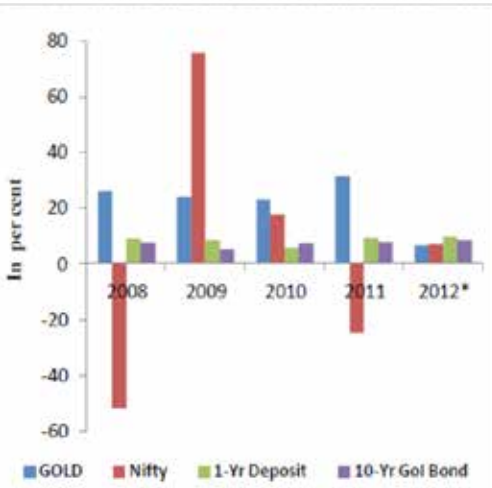
Given these inherent advantages offered by gold, the Indian DNA was thoroughly coded with its desire for gold and that gene is pretty much intact to date. For years economists have wanted to use this unproductive asset and the cash flows used to purchase the same for productive purposes. The major part of this exercise involved in dissuading people not to buy gold but then that did not succeed is a well-documented fact of history.

So probably the demand for gold is driven by the Indian psyche which sees the following advantages in a gold investment:

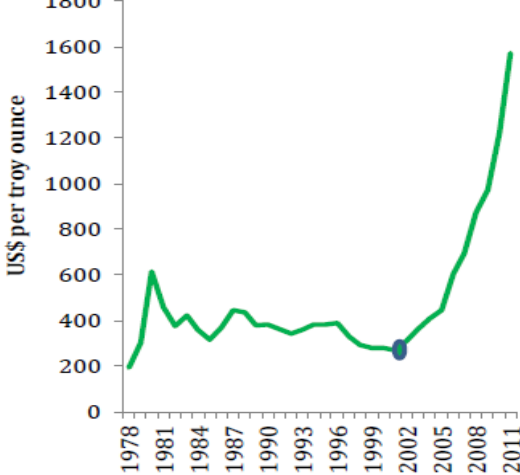
- Gold is a preserver of wealth; it was valuable millennia back and it is going to remain valuable in future as well.
- Almost all international currencies either formally or informally are linked to gold, so gold offers a perfect hedge against any valuation risks.
- Inflation does not impact gold value.
- Holding gold over a period of time will result in more gains in local currency when sold, as national currencies across the world tend to depreciate vis-à-vis dollar.
- Demand for jewellery is increasing by the day which means that gold prices are always in the upward trajectory.
- The amount of gold in the world is limited; it cannot be made or printed like currencies, so gold will always retain the 'valuable investment' tag.

Comparison of Return on Various Investment Instruments with Gold and Trend of movement of International Gold Prices

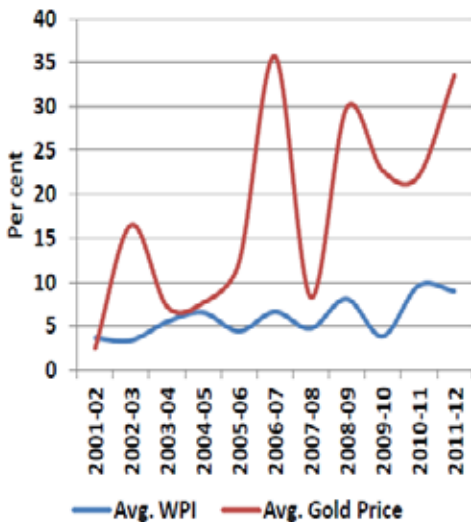
Annual Return on various Investment Instruments



International Gold Prices



Movement of International Gold Prices and comparison of WPI with Gold Price



Annualized Monthly Average Growth rate in Gold Price and WPI

Period	Avg. WPI Growth	Avg. Gold Price Growth
2001-02	3.64	2.44
2002-03	3.38	16.51
2003-04	5.48	7.24
2004-05	6.51	7.63
2005-06	4.44	12.17
<i>Average of 2001-02 to 2005-06</i>	<i>4.69</i>	<i>9.20</i>
2006-07	6.59	35.68
2007-08	4.74	8.30
2008-09	8.09	29.83
2009-10	3.86	22.69
2010-11	9.57	22.08
<i>Average of 2006-07 to 2010-11</i>	<i>6.57</i>	<i>23.72</i>
2011-12	8.96	33.54

Source: Director General of Commercial Intelligence and Statistics (DGCI&S) and the World Gold Council

GOLD CONSUMPTION - HISTORICAL TRENDS IN INDIA

Gold that has entered India over the centuries is estimated by the World Gold Council to be over 20,000 tonnes, worth US\$1.1 trillion or half of India's GDP. In any given year after the start of the new millennium about 15% to 25% of world demand for gold happens from India. The trend in Gold consumption in India is as follows:

Global Gold Supply and India's Demand

Year	Global Gold Supply \$ (Tonnes)	Gold Demand from India @ (Tonnes)	Growth of Global Gold Supply (%)	Growth of Gold Demand from India (%)
1999	4206	486
2000	3704	462	-11.9	-4.9
2001	3764	471	1.6	2.0
2002	3667	467	-2.6	-0.9
2003	3953	367	7.8	-21.3
2004	3426	537	-13.3	46.1
2005	4034	792	17.7	47.5
2006	3559	707	-11.8	-10.7
2007	3554	716	-0.1	1.3
2008	3657	679	2.9	-5.1
2009	4146	743	13.4	9.4
2010	4274	871	3.1	17.2
2011	4030	975	-5.7	11.9
2012	4130*	1079*	2.5	10.7

Source: World Gold Council and Estimations from DGCI&S Data; Calendar Year; @ Financial year

India's Gold Import expenditure

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: DGCI&S

During the calendar year 2013, to curtail an ever increasing demand for gold, the government has increased taxes paid on import of gold and has introduced certain market restrictions like ban on sale of gold coins. These restrictions seem to have the desired effect. Total gold consumption in India fell significantly to 148 tons in the quarter ended September 2013, compared to 310 tons in Q2 of 2013. This was revealed in the latest World Gold Council Gold Demand Trends report, which covers the July-September 2013 period.

CONCLUSION

It is not within the scope of this paper to further analyse as to what will motivate people to invest in Gold ETFs, however this paper aims to highlight the important role that Gold ETF can play in channelising India's insatiable demand for gold from private holding to a more organised financial sector. Through this paper aims to extrapolate that the Indian investor will give a thumbs up to the Gold ETF only when the product improves in his or her perception. Given the potential of this product to transform the way India saves, it is all more important for the government to further popularise the gold ETFs by offering incentives like relaxation from capital gains or even Income Tax benefits in case of a longer lock in period. While this measure may attract the urban investor, the rural investor has to be wooed only by changing their perception about this product. This can be done only if the rural investor reposes confidence in the product as safe and secure, accessible, simple and durable.

The task ahead is uphill. First legislation guaranteeing the safety and returns of this product needs to be ensure, secondly a massive awareness campaign is needed to make people be aware of the benefits of this product, in that the necessary infrastructure to reach people and make them be aware of the merits of this product might take a longer period of time, parallel to this, infrastructure required to both roll out the product and enable people to register for one has to be ensured. Only these measures can ensure the success of Gold ETFs across the length and breadth of our country.