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IMPORTANCE OF GOLD IN INDIAN ECONOMY

In the Indian society, life's earnings are spent in big fat weddings and 35-50 per cent of the expenditure spent for a wedding goes into the purchase of gold and other jewellery. As a custom, the gold jewellery gifted to the bride is also displayed in the wedding which symbolises the status of the family. Like genes and the genetic traits, gold is passed down from generations to generations. It is considered as an investment and savings which may come to rescue during a huge financial crisis of the family.

Gold is a precious metal with which mankind has had a long and very intimate relation. Gold is considered as a symbol of purity and good fortune. Most of the gold that the entire world holds lies in India.

There are many investment areas such as stock markets, mutual funds, fixed deposits and government bonds amongst others, but people still prefer to invest in gold.

The 1980 crash in gold was not felt in India because of the appreciation of the dollar against the rupee buoyed the domestic prices. The situation right now is similar, with the rupee having fallen against major global currencies. While this may not be good for the economy as a whole, a weaker rupee will prevent domestic gold prices from crashing.

Despite being a poor country, India has expensive taste. In order to provide a more global picture of the size of gold imports and whether as to India's obsession with gold is justifiable, the study looks at the gold demand alongside some other key economic variables.

Market trends in gold prices

The gold rate in the market depends on the demand and availability of the metal. The gold price has become unpredictable but those in commodities market seem to have a better grip on this. Due to its appeal, gold has been historically priced above other commodities most of the time.

Table I shows the gold price history of the last 50 years.

The price of 10 gm of gold in the year 1964 was ₹ 63.25 whereas in the year 2012 was ₹ 31,050. The gold price of 10 gm in December 2013 was ₹ 29,600. Initially the increase in gold price was less from year to year but there is a drastic increase in the recent years.

In the past decade, the increase in gold prices has been notable. However, a sudden jump in the price from ₹ 18,500 in 2010 to ₹ 26,400 in 2011 is an astonishing increase.

Factors influencing gold prices

Gold has always been an object of desire. Individuals seek it out for personal wealth and security. The value of money appeals above all other appeals in our world.

The following are the factors which are influencing gold prices:

Demand of gold. Indians treat gold as a token of good luck, prosperity and good fortune. No wedding, no festival is complete without gold and jewellery in India. Though there is a high price, still the demand has not come down. India accounts for nearly one-third of the total world demand for gold. Indian consumers' demand for gold is 37.6 per cent more than that of China.

Inflation. The most popular reason to own gold is as a hedge against inflation. The foremost reason given for the rising price of gold is inflation that runs rampant amongst the world's currencies. While gold is not the cause of inflation, gold as a commodity responds to market fluctuations and interest rate changes.

Gold as an investment

Due to its consistently increasing value, gold is considered as a safe and secure investment. The rural population sees gold as the most liquid saving instrument that can be converted into cash in the shortest possible time.

Table I

Gold Price History for the Last 50 Years for 10 gm (24k)

Year	Price (₹)	Year	Price (₹)
1964	63.25	1989	3140
1965	71.75	1990	3200
1966	83.75	1991	3466
1967	102.50	1992	4334
1968	162.00	1993	4140
1969	176.00	1994	4598
1970	184.50	1995	4680
1971	193.00	1996	5160
1972	202.00	1997	4725
1973	278.50	1998	4045
1974	506	1999	4234
1975	540	2000	4400
1976	432	2001	4300
1977	486	2002	4990
1978	685	2003	5600
1979	937	2004	5850
1980	1330	2005	7000
1981	1800	2006	8400
1982	1645	2007	10,800
1983	1800	2008	12,500
1984	1970	2009	14,500
1985	2130	2010	18,500
1986	2140	2011	26,400
1987	2570	2012	31,050
1988	3130	2013	29,600

Source: www.goldprice.in

Import duty

The fluctuations in rupee along with the increase in import duty and curbs on import of gold have made consumers postpone gold purchases. Gold prices tumbled from ₹ 32,500 per 10 gm in November 2012 to ₹ 29,600 in December. One of the ways in which the Indian government is fighting against rising imports of gold is through increase in its import duty. It has been done five times in the recent past—from one per cent in January 2012 to ten per cent in 2013. It also increased the import duty on gold jewellery to fiteeen per cent from ten per cent in September 2013.

Behavioural reasons

Gold has been perceived as a safe haven, especially during periods of financial and economic stress. Stating that, a safe haven can broadly be defined as an asset that protects investors' wealth against financial turmoil and holder can resell it without loss at any time.

There are also two behavioural reasons why you should consider buying gold.

One, gold has been the traditional form of savings amongst Indian households for many years. So, people need not be as nervous about fluctuations in gold prices when stock or bond prices move. Buying gold gives a feeling of comfort! Psychologists call this the 'exposure effect.'

And two, gold is a real asset. And real assets possess an important characteristic—we can touch and feel them. The touch-and-feel factor is one reason why many prefer to buy physical gold than financial gold.

Value of US dollars

Historically, gold has traded in opposition to the dollar. A stronger dollar makes dollar-backed commodities such as gold more expensive to buy in other currencies, which weakens demand. Since the dollar has become the global trading currency, the gold rate has always been in relation with the dollar.

Any fall in the value of a dollar will lead to the increase in gold prices. When the dollar is seen to be on the rise, investors move away from gold and invest in currency. This causes the price of gold to drop drastically. Hence the value of the US dollar in turn affects the fluctuating gold price in India.

Interest rates offered by banks

The banks often invest in gold to hedge against inflation. Their other policies on interest offered on savings will also affect the gold price. The higher interest rates offered on savings by banks will drive the customers to invest more in currency. If the interest rates on savings are low, customers invest in gold and the gold purchase increases.

Impact of fluctuating gold prices on Indian economy

Early signs are coming in that India could slip from its position as the world's largest consumer of gold. The fluctuations in the economy affect the gold prices in India. The price of gold was seen to reflect the monetary inflation. Rising inflation often coincides with a booming economy. A rise in gold prices can at times be attributed to the booming economy.

The following facts related with gold affect the growth of Indian economy:

Gold is not a productive asset. Gold as a commodity on its own does not add much to the productive capacity of the economy. When one buys gold, it either is stored in lockers or gets converted into jewellery. In both the cases, money spent on purchasing gold gets blocked since gold is not a productive asset.

India's gold imports are starting to weigh down the economy. India's insatiable appetite for imported gold is at the heart of the problem. Demand for gold grew from 679 tonnes in 2008 to 975 tonnes in 2011. Gold imports during the end of 2013 were around 650 tonnes, down just 33 per cent from the previous year. Indians may be the biggest buyers of gold in the world with the country also holding the prime position as the largest importer of the precious metal.

Table II

Relationship between Gold Price Growth and Inflation

Year	Price (₹)	Average gold price growth (per cent)	Average inflation rate	Average inflation growth rate (per cent)
2001	4300	–2.33	3.77	9.13
2002	4990	16.05	4.31	14.32
2003	5600	12.22	3.81	–11.60
2004	5850	4.47	3.77	–1.05
2005	7000	16.43	4.25	12.73
2006	8400	16.67	5.79	36.24
2007	10,800	28.57	6.39	10.36
2008	12,500	15.74	8.32	30.20
2009	14,500	16.00	10.83	30.16
2010	18,500	27.59	12.11	11.81
2011	26,400	42.70	8.87	–26.75
2012	31,050	17.61	9.30	4.85
2013	29,600	–4.67	11.05	18.82

Source: www.inflation.eu

When India purchased 200 tonnes of gold under the International Monetary Fund Limited gold sales programme, it was interpreted by experts that it may further inflate the gold price when the price was already ruling high. Table III explains the share of India's gold import against total import.

Current account deficit (CAD)

The nation's CAD, which reached a record 6.7 per cent of GDP in three months ended in December 2013, is widely considered the biggest concern for Asia's second largest economy. CAD represents the difference between India's imports of goods and services and its exports plus remittances by Indians living abroad.

One way of looking at it is that India does not earn enough in foreign exchange to pay for imports such as oil and fertilisers. The excess of imports over exports, or the CAD, is usually covered by foreign investors bringing money into India or by dipping into the country's forex reserves.

According to the Reserve Bank of India, with domestic production of gold falling to an insignificant level, current gold consumption is met entirely through imports. Though it is generally considered that a CAD of between 2.5 per cent and 3 per cent is sustainable for India, it has been very high since 2011, and external resilience has weakened on account of gold.

Gold locked in temples

The potentially large but dormant source is the gold locked up with the temples across India. Larger holdings of gold are estimated to be with Tirupati temple in Andhra Pradesh, Sree Padmanabhaswamy temple, Guruvayur temple and Sabarimala temples in Kerala, as well as scores of religious places in southern states, with substantial gold holdings.

The Sree Padmanabhaswamy temple is estimated to have gold holdings valued at more than ₹ 1000 billion.

According to Jamal Mecklai, chief executive, Mecklai Financial, the

Tirupati temple could have gold holdings of almost 1700 tonnes. Even if the government borrows 500 tonnes from Tirupati and pays it two per cent interest, the temple authority could earn ₹ 30 billion a year in interest. Tirupati's holdings could be about five per cent of an estimated 30,000-35,000 tonnes of gold held in India.

Action taken by the Central government

The government has tried to tackle the problem, raising import taxes and considering changing regulations so that less gold comes into India via the banking system. But the recent drop in gold prices could have provided the most effective fix.

In August 2013, the finance ministry had banned banks from selling gold coins in order to contain the country's burgeoning CAD.

Gold imports have fallen sharply to $650 million in August 2013 on account of a slew of steps taken by government to curb inbound shipments of the precious metal.

Gold imports are estimated to have declined by 41 per cent to 500 tonnes in 2012-13 financial year on account of curbs imposed by the government.

Action taken by the RBI

The Reserve Bank of India (RBI) thinks that a CAD of 2.5 per cent of the gross domestic product (GDP) is sustainable. Against this, India's CAD in 2011-12 was 4.2 per cent of GDP and in the last quarter for which data is available, October-December 2012 was 6.7 per cent of GDP. The greater the gap between the sustainable CAD level and the actual figure, the more vulnerable the economy is to adverse global developments which could suck out foreign investment.

On the quantitative front, RBI introduced the 80:20 formula under which 80 per cent of imports would be for domestic demand while 20 per cent of total imports would have to be re-exported through value additions in the form of jewellery.

Table III

India's Gold Imports Against Total Imports

(US$ million)

Year	Gold import	Total import	Percentage share
2001-02	4170.4	51,413.3	8.1
2002-03	3844.9	61,412.1	6.3
2003-04	6514.9	78,149.1	8.3
2004-05	10,537.7	111,517.4	9.4
2005-06	10,830.5	149,166	7.3
2006-07	14,461.9	185,735.2	7.8
2007-08	16,723.6	251,439.2	6.7
2008-09	20,725.6	298,833.9	6.9
2009-10	28,640.1	288,372.9	9.9
2010-11	33,875.8	352,574.9	9.6
2011-12	55,962.3	489,319.5	11.44
2012-13	61,409.9	491,487.2	12.50

Source: www.tradingeconomic.com

Conclusion

The financial crisis rocked global markets at the end of 2008. A trend started to develop enticing regular investors allocating a certain amount of their portfolios into gold. Gold is a hedge against all kinds of uncertainties. Gold comes to recue even in the prevailing global and financial uncertainty. However, the government needs to take strict measures to control the increasing prices of gold and help investors overcome the losses due to uncertainties in other markets.

India's passion for gold is not new. However, what has happened over the last few years is that rising gold imports have coincided with a rise in its prices and a weakening of the rupee against the dollar. The combined impact has served to widen the CAD.

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