

IIGC conference opening address

Opening remarks

- It gives me immense pleasure to be able to share a common platform with the dignitaries on the dais, friends and colleagues from the bullion industry and other participants of the 12th IIGC. I would like to begin by thanking you all for providing me with this opportunity to address such distinguished audience.
- Famous American capitalist and philanthropist Bernard Baruch once said, *'Gold has worked down from Alexander's time ... When something holds good for two thousand years I do not believe it can be so because of prejudice or mistaken theory.'*
- While the current environment seems really challenging times for the yellow metal (global demand for gold has dropped by 12% to a six year low in the June quarter), the long term prospects have always been intact

Macro & Environment

- Traditional geographies of consumer demand for gold i.e. India and China accounted for a majority of fall in the global demand for the metal. With the continued recovery in the US economy, the associated strengthening dollar, and an expected rise in US interest rates, gold prices have more or less remained directionless in the medium term. Devaluation in the Yuan may further contribute to weaken the consumer demand for gold in China while weakness in the metal's prices has kept investors away in other geographies. Extreme weather has dented sentiment among rural Indian consumers.
- Domestic demand for gold jewellery was further weakened by the fact that The Hindu calendar this year has no auspicious days for marriages between 11 June and 1 November, compared with 2014 which saw the auspicious period run through to early July. India's gold imports in FY2015 stood at 900 tonnes and it is expected to remain flat in FY2016.
- PBoC's claim of holding far lesser amount of gold in its vaults than estimated further contributed to the weakening of gold price. The only bright spot seems to be Europe where investors have increased their exposure to gold in light of uncertain economic conditions in Greece. However, the optimism was localised as most global investors don't foresee the crisis posing a systemic risk across global markets. In addition, political tensions have eased, as illustrated by the tentative resolution of a Greek bailout. All in all, while the current environment appears challenging for the prospect of gold as an investment alternative, I am here to tell you otherwise.

Positives

- We know that India had just witnessed a historic and decisive electoral mandate which led to a renewed level of optimism about India's prospects as an investment destination. Since then, the Indian stock indices Sensex and Nifty have returned 8% and 10% respectively, whereas gold prices have corrected more than 9%.
- The trade deficit has since retreated into comfortable territory during FY2015 and the Government repealed the he 20:80 scheme and restrictions placed on import of gold in October 2014.
- CPI inflation that had remained stubborn for a couple years has eased since to sub 5% levels primarily aided by lower crude oil prices. Interest rates have softened and given the inflation trends, they are expected to reduce further. This has resulted in more capital flow away from gold into the equity markets.
- That being said, corporate earnings are yet to mirror the optimism of the equity markets and business environment has remained challenging. Weakening of the Yuan has also put pressure on the Rupee that has gone back to more than Rs. 65 per USD for the first time since the general election results.
- In July 2015, PBoC announced that it has increased its gold reserves by 604 tons. It also encouraged Chinese consumers to increase their ownership of the metal. As mentioned earlier, gold prices too have corrected sharply.
- In price sensitive consumer markets such as Asia and Middle-east, such correction in prices is often construed as a sign to buy the metal. The onset of the festival and wedding season in India in Q4 suggests healthy prospects for jewellery demand for the remainder of the year, with the caveat that this assumes normal monsoon rainfall.
- Gold is a unique commodity i.e. drivers of demand respond differently to different economic conditions. While increased systemic risks boosts demand for gold for its role being that of an insurance asset, economic growth boosts demand for gold jewellery especially in markets like India.
- The demand for gold is not correlated to that of other commodities primarily due to its non-industrial uses. Therefore, predicting the demand for gold is far more complex than that for other commodities that find use in industry.
- That being said, all these factors combined put weight behind the argument of gold being a good alternative investment option at current price levels.

Gold monetization scheme

- All of us know that India is having the largest private hoard of gold (25,000 – 35,000 tonnes) in the world while stressing on unlocking this capital and using it for productive purposes through monetization schemes and through issuance of gold bonds to curtail pressure on the trade deficit owing to our significant imports of gold.
- Since then, the Government has made efforts in this regard and introduced a Gold Monetisation Scheme to replace the existing but less effective Gold Deposit and Gold Metal Loan Schemes.
- Hon'ble Finance Minister, Shri Arun Jaitley, in his budget speech, also announced the development of an alternate financial asset, a Sovereign Gold Bond, as an alternative to purchasing metal gold. Such asset would allow investors to earn returns equivalent to those provide by holding physical gold without actually having to hold it and thus save on other allied expenses and taxes. It would help lower the demand for physical gold.
- The monetization scheme will allow depositors to earn interest in the form of cash or gold on their deposits of physical gold that were otherwise hoarded in lockers and safe deposits rendering it an unproductive asset. This gold can then further be lent to jewellers reducing their reliance on imports and currency fluctuations.
- However, the scheme primarily caters to institutions with large holdings of gold while presenting certain challenges to banks and retail depositors. The Government needs to address these concerns to make the scheme effective in reducing the strain of gold imports on the trade deficit and mobilizing physical gold holdings by institutions and households alike.
- If the government wants gold monetisation scheme to work, it has to provide other incentives to banks if it does not want them to use gold deposits as part of CRR and SLR. Although that was part of the initial proposal, it was later dropped by the finance ministry. There are some very interesting suggestions provided by WGC in this regard which the Government can look into:
 - For every tonne of gold the bank gets deposited, it should be allowed to import equal quantity of gold without duties. With import duties being as high as 10 per cent, this could be an incentive for the bank to provide 3 to 3.5 per cent interest on the gold deposited.
 - If government wants the scheme to work, it can also look at interest rate subvention, bearing the cost incurred by banks

- The first step is to set up critical infrastructure for running the scheme like warehouses, refineries, purity verification centers and transportation. The Government must incentivize the private sector to set up such infrastructure. We, at Edelweiss believe in the business potential this initiative entails and have already set up gold and silver scrap refining facility at Naroda, Ahmedabad in the state of Gujarat.
- The next steps would be to incentivize banks and provide tax exemptions on interest from gold deposits to allow the scheme to take off. The Government can also look at providing a one-time tax amnesty for disclosure of undisclosed holdings in physical gold.
- Setting up a Gold Exchange and Bullion Corporation to undertake a wide range of functions related to gold imports, exports, financing, refinancing and domestic usage of gold. It should also aim to develop gold markets through innovative gold products and create a large pool of domestic recyclable gold. It would provide liquidity for gold trading and operations.
- These steps will help mobilize the vast holdings of gold in Indian religious institutions and households to create large enough domestic supply of gold to allow the Indian market to influence global gold prices.