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## INDUSTRY OUTLOOK

### GOLD INDUSTRY OF INDIA: GROWTH AND PROSPECTS

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“When we have gold, we are in fear; when we have none, we are in danger”-English proverb.

#### Introduction

Gold has been an integral part of Indian society and a foundation of wealth and savings in the country. But changing consumer preferences and re-setting globalization require a re-look at the entire set of issues.

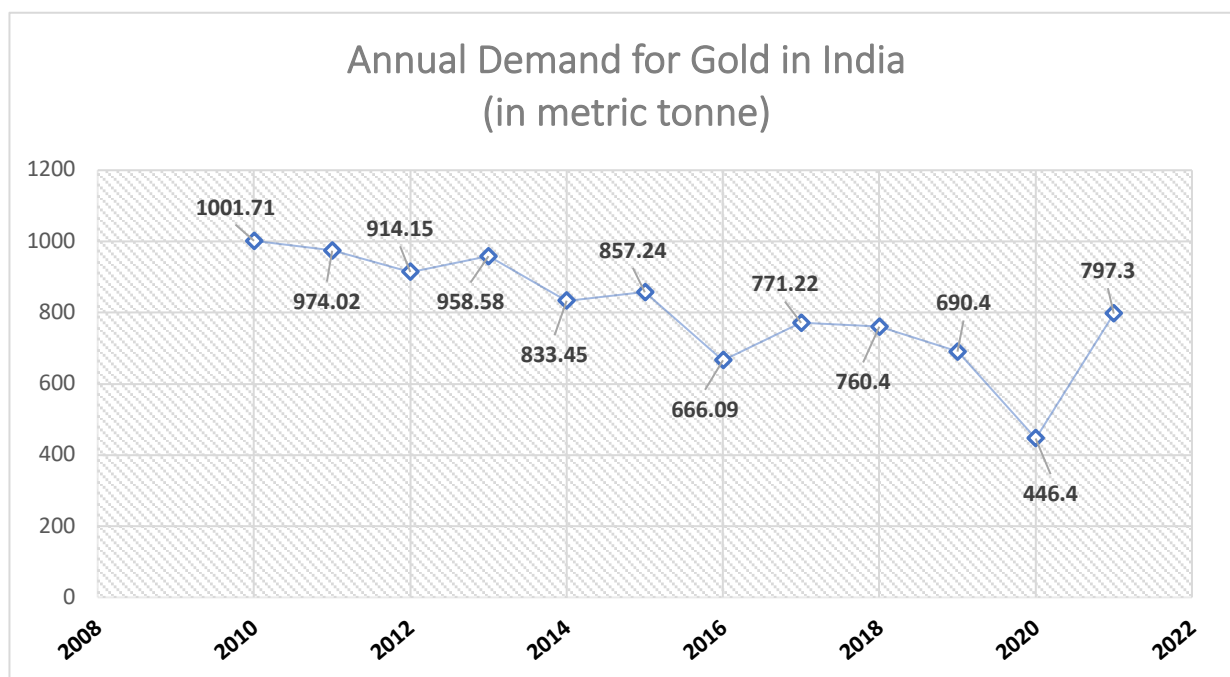
In May 1991, the Government had leased 19.99 tonnes of gold, out of its stock of confiscated gold to the State Bank of India (SBI), which, in turn, sold 18.36 tonnes in the international market with a repurchase option. SBI repurchased gold in November-December 1991. Subsequently, the 18.36 tonnes of gold were sold by the Government to the RBI. The balance of 1.63 tonnes of gold had been returned by the SBI to the Government. The gold involved in both the transactions, adding up to 65.27 tonnes, was kept abroad.

India is the one of the largest markets of gold in the world and the rising affluence is driving an increase in the demand for gold. The global demand for gold in Q2 of FY 23 rose 4 per cent year-on-year (y-o-y) to 453 tonnes, helped by a recovery in India's demand, which soared by 49 per cent compared to Q2 FY 22.



The gold industry of India contributes 1.3 per cent to the national GDP and the sector is dominated by small and medium enterprises<sup>1</sup>. The domestic market of gold in India is mostly supported by culture, wedding, and festive demand. The strong performance in India occurred against the backdrop of a significant decline of 28 per cent in China, where the market was dampened by COVID-19 lockdowns that stalled economic activity and constrained consumer spending. In 2017, the demand for gold in India was 771.22 metric tonne which decreased to 446.4 metric tonne. After the successive decline in four years, now the demand for gold in India is on the path of recovery and reached the pre-pandemic level (See Figure 1).

Figure 1: Annual Demand for Gold in India from 2010 to 2021



Source: Statista

Due to the fall in the price of gold, gold demand increased by 14 per cent in the September 2022 quarter to the pre-pandemic level of 192 tonnes compared to 168 tonnes reported in the corresponding period last year. In 2021, the demand for gold reached 797.3 metric tonnes with an uptick of 78.6 per cent as compared to the previous year, and the first growth after four years of continual annual decline. In 2022, the overall demand for gold increased by 19 per cent in terms of value to US\$10.6 billion from US\$9.7 billion reported last year. According to the World Gold Council’s Demand Trend report, jewellery demand increased by 17 per cent to 146 tonnes as customers bought more ornaments even though gold prices dropped less than they did on international markets because of the depreciation of the rupee against the dollar.

In India, the rising demand for gold is largely met by imports and is thus a major contributor to India’s trade deficit and current account deficit.

<sup>1</sup> [https://www.business-standard.com/article/news-cm/domestic-gold-industry-contributes-1-3-to-indian-gdp-122092900621\\_1.html](https://www.business-standard.com/article/news-cm/domestic-gold-industry-contributes-1-3-to-indian-gdp-122092900621_1.html)

## Economic Case for holding Gold as part of Reserve by the Central Banks

The economic case for holding gold stems from safety and liquidity considerations, the fact that gold is a good diversifier, use of gold as a hedging instrument against inflation and the movement in gold price versus US Dollar. Hence gold has an important role in macroeconomic management.

### Rising demand for gold-why?

- Economic growth drives gold demand.
- Urbanisation will change the shape of consumer demand.
- India has a young population with a strong affinity with gold.
- India's gold industry is becoming more organised.
- The central banks across countries increased interest rates. Gold prices are likely to be subdued given the aggressive interest rate tightening by central banks to check inflation. However, gold may find some support owing to safe-haven demand amid concerns over slowing global growth. Considered in a proper historical and comparative perspective, there is a strong economic case to hold sizable reserves of gold especially during 'heightened uncertainty'.
- The Russia-Ukraine war is also a catalyst for higher inflation, thereby greatly increasing not only the safe-haven appeal but also the inflation hedge premium for gold. This will support gold prices.
- Gold is an important asset class in rural India, which accounts for 60 per cent of India's total annual gold consumption. Rural demand for gold is expected to be impacted by inflationary pressures and an erratic monsoon reducing farmers' income.

### Production and Consumption

Gold is an important asset class of the rural India and according to the media reports, it accounts for 60 per cent of the country's total annual gold consumption. There is a huge gap in the consumption and production of gold in India. Despite the rise in the demand for gold in India in 2022, the consumption of gold is low in the current year due to higher inflation and consistent monetary tightening by the central bank, which severely eroded disposable income of the consumers. The inflationary pressure largely affected the consumption pattern of consumers in rural India. The inflation in India has been sticky and remained above the Reserve Bank of India's tolerance band for more than nine months.

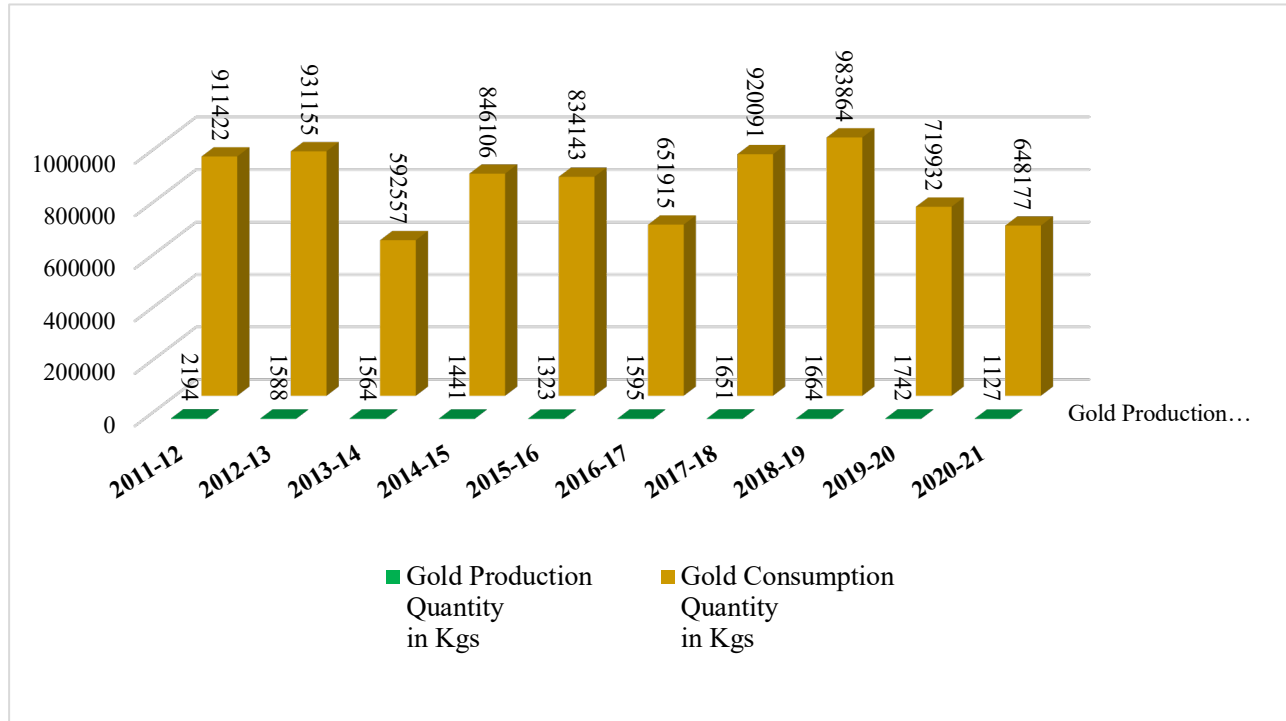
As per the estimates by the World Gold Council, the gold consumption in India in 2022 would be at 800-850 tonnes, but the likely slowdown in demand in the second half prompted it to scale down this estimate to the lower end of that range at around 800 tonnes<sup>2</sup>.

As per the CMIE's database, both the production and consumption of gold consistently decreased for the two consecutive years, i.e., 2019-20 to 2020-21 (See Figure 2).

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<sup>2</sup> <https://www.reuters.com/markets/commodities/inflation-price-rise-could-dent-indias-gold-demand-july-dec-wgc-2022-07-28/#:~:text=In%20the%20first%20half%20of%202022%2C%20gold%20consumption%20rose%2043,range%20at%20around%20800%20tonnes.>

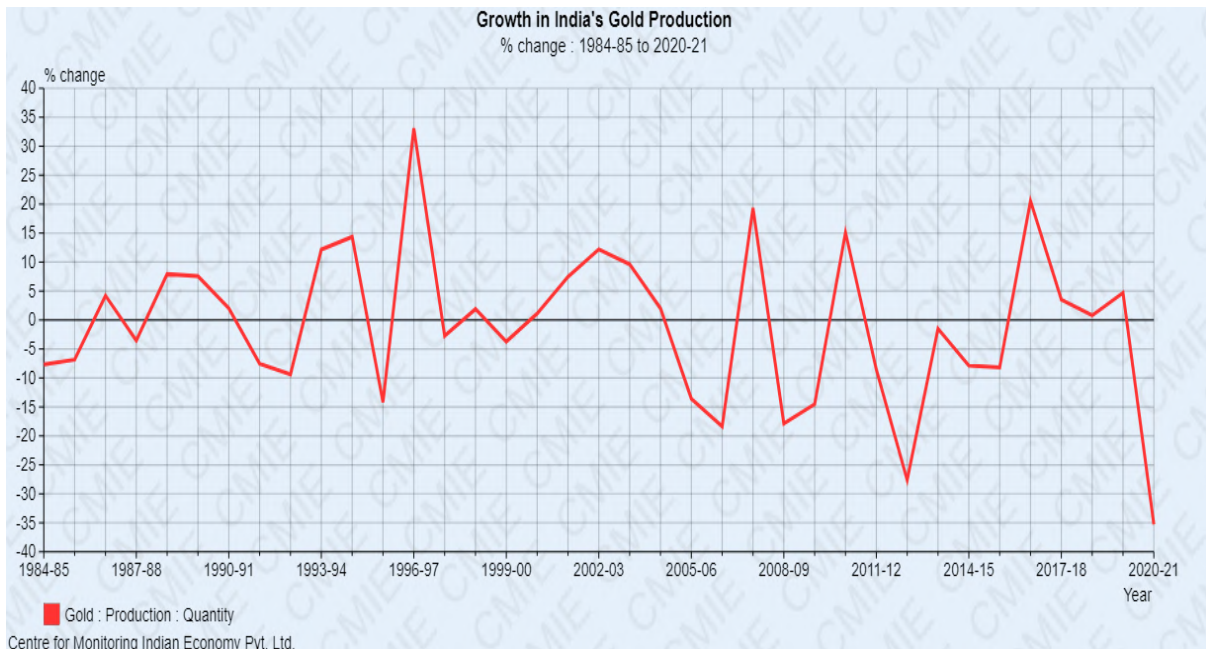
Figure 2: Gold production and consumption quantity (in Kgs)



Source: CMIE

The production of gold in India touched a new low in the last decade with 1127 kgs of gold produced in 2020-21. The growth in gold production is seen in Figure 3:

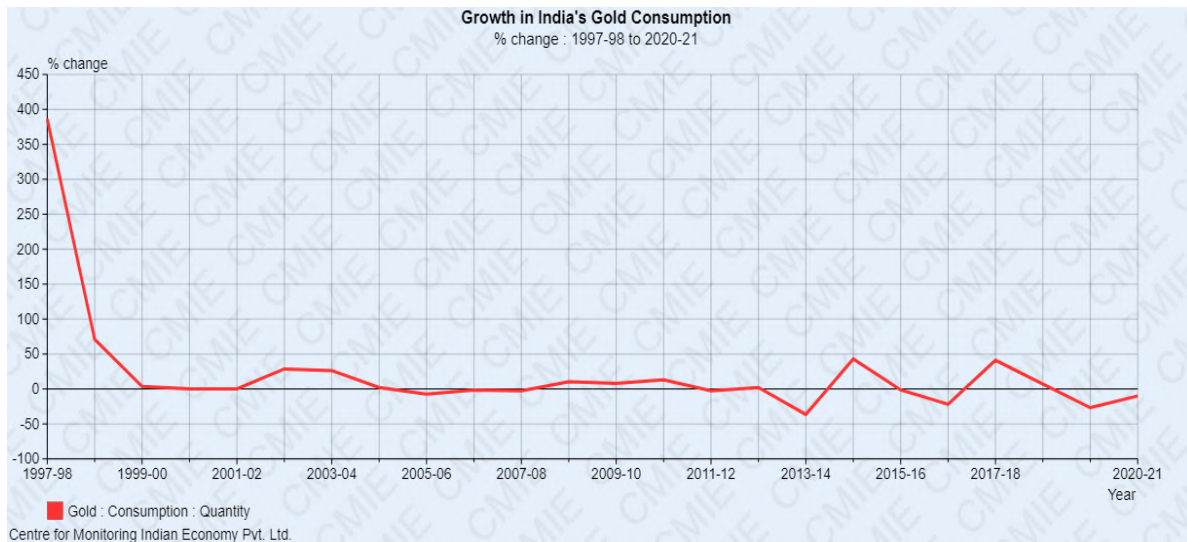
Figure 3: Growth in India's Gold Production from 1984-85 to 2020-21 (% change)



Source: CMIE

In 2020-21, the consumption of gold decreased to 648177 kgs from 983864 kgs in 2018-19. The growth in gold consumption can be viewed as reflected in Figure 4:

**Figure 4: Growth in India's Gold Consumption from 1984-85 to 2020-21 (% change)**

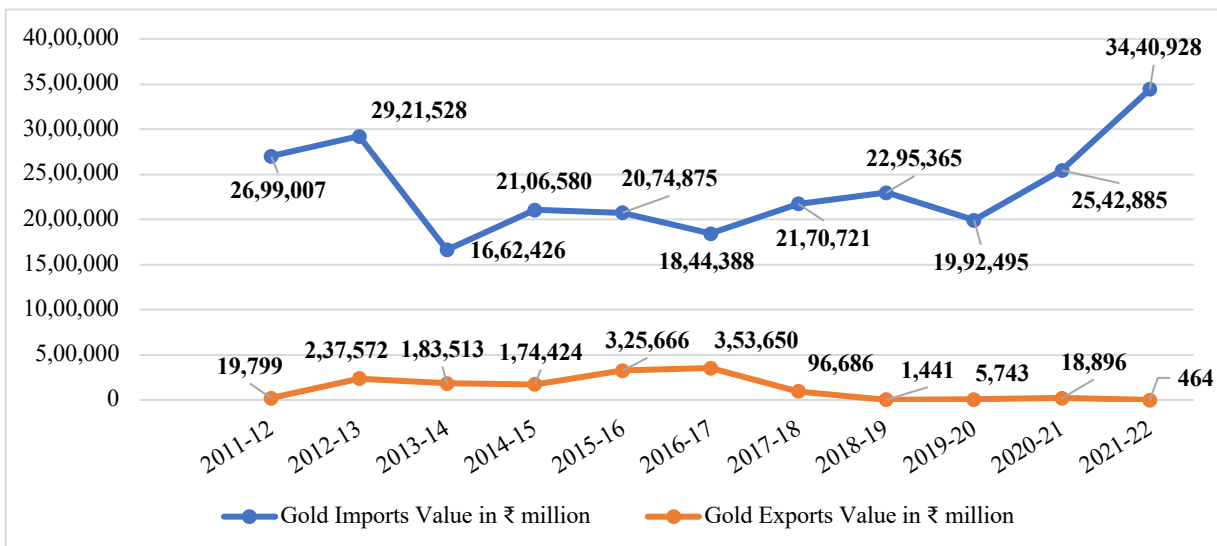


Source: CMIE

## Trade Status of India's Gold Industry

With economic activity recovering in the FY 22, there was a boost to gold demand in India. The increase in demand and low prices of gold led to higher gold imports by 34.9 per cent during the FY 22. In an attempt to improve the deteriorating trade balance and depreciating Indian Rupee, the Government of India on July 1, 2022, raised the basic custom duty on gold imports by 4.25 per cent to 18.45 per cent tax from the earlier 14.07 per cent for refined gold. It made gold expensive for the domestic consumers. The gold imports started declining from July onwards. During the FY 2021-22, India imported gold of the value ₹3,440,928 million while it was of the value ₹3,440,928 million in FY 2020-21 (See Figure 5).

**Figure 5: Gold Exports and Imports from 2011-12 to 2020-21 (values in ₹ million)**

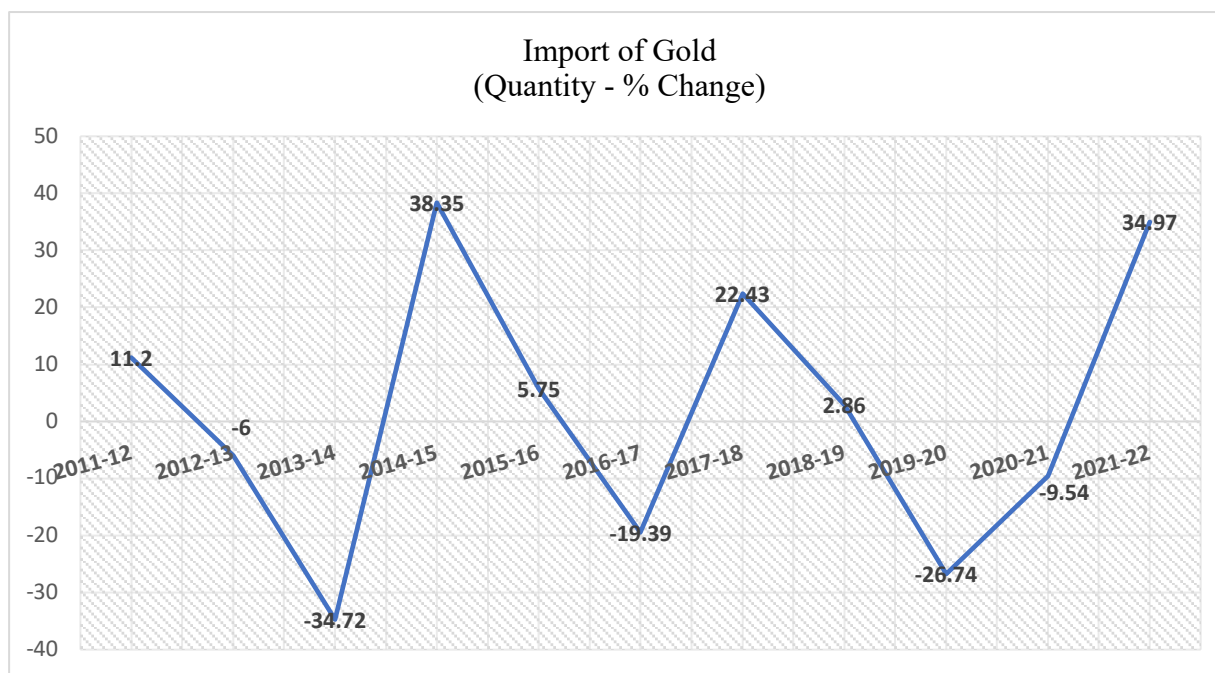


Source: CMIE

After a strong recovery from the pandemic, it is now expected that the gold imports could be flat in the current financial year (2022-23) due to hike in the custom duty on gold import and low rural demand amid rise in the prices of gold.

Import of gold during the FY 2019-20 was quite low (-26.74 per cent) in terms of percentage change. Disruptions in economic activity due to the pandemic were major causes of low demand for gold. As the economy started reviving, the gold import increased by 34.97 per cent in FY 2021-22 from the previous FY 2020-21 (See Figure 6).

Figure 6: Import of Gold (Quantity - % Change)



Source: CMIE

## Prices of Gold

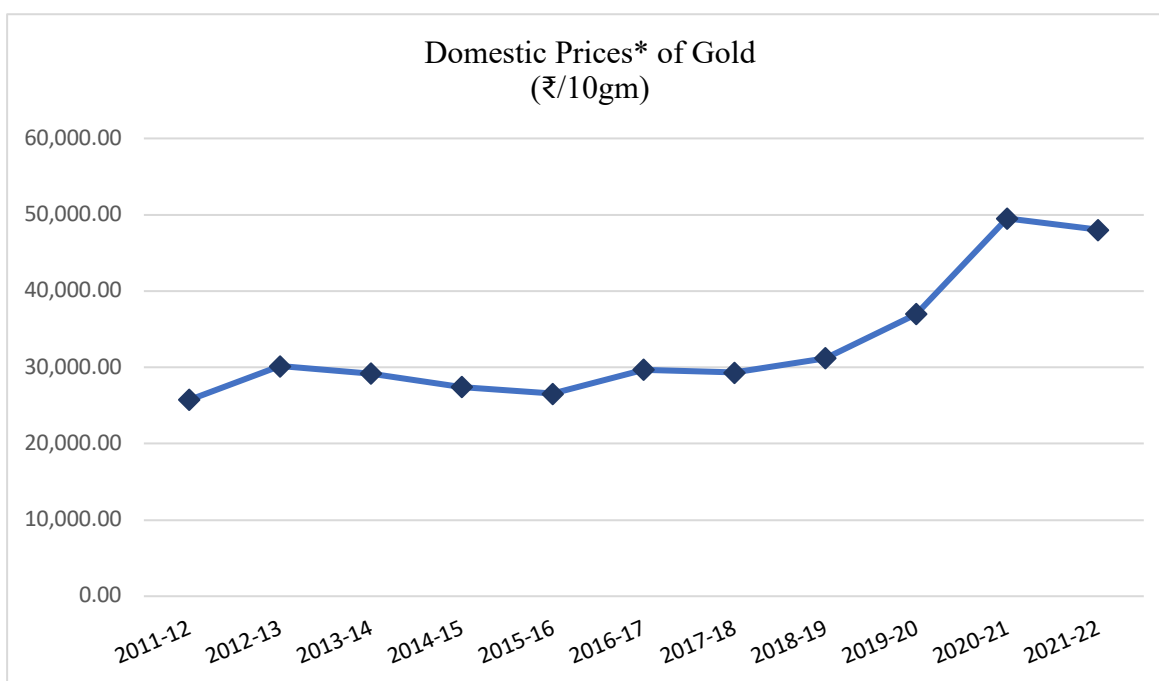
In the first six months of fiscal year 2022, the gold domestic prices increased by almost ₹3,000 from the price of around ₹48,243 in January 2022 to ₹51,243 in June 2022.

The gold price is volatile after hitting a 9-month high in the first week of December 2022 before settling almost on a flat note. The gold future contract for February 2023 on multi commodity exchange (MCX) closed at ₹54,325 per 10 gm levels on December 16, 2022, logging minor weekly gain of ₹30 per 10 gm whereas spot gold price ended at \$1,792 per ounce levels, around \$5 per ounce lower from its last Friday (December 9, 2022) close<sup>3</sup>.

Gold prices reached record high of ₹52,916 per 10 grams in August 2020. Subsequently, gold prices began to cool off. Gold prices came below the ₹50,000 per 10 grams mark from December 2020 and fell to ₹44,776.1 per 10 grams in March 2021. The drop in the price favoured retail buyers to purchase gold. Pent-up demand for gold from weddings that were delayed in 2020 also led to an increase in gold demand in 2021-22. Imports of gold increased from 651,240 kg in 2020-21 to 879,010 kg in 2021-22 (See Figure 7).

<sup>3</sup> <https://www.livemint.com/market/commodities/gold-rates-trade-around-9-month-high-buy-sell-or-hold-11671238529611.html>

See Figure 7: Domestic Prices of Gold (₹/10gm) in the last 10 years



\*Standard, 0.995 (Mumbai)

Source: CMIE

The gold prices are likely to be subdued given the aggressive interest rate tightening by central banks of various countries across the globe to tame inflation. Recently, the Monetary Policy Committee (MPC) of Reserve Bank of India increased repo rate to 6.25 per cent, by 35 bps from 5.90 per cent. The MPC has decided to remain focused on “withdrawal of accommodation” to ensure that inflation remains within the target going forward, while supporting growth<sup>4</sup>. However, gold may find some support owing to safe-haven demand amid concerns over slowing global growth. In addition to the geopolitical uncertainty, the Russia-Ukraine war is also a catalyst for higher inflation, thereby greatly increasing not only the safe-haven appeal but also the inflation hedge premium for gold. This will support gold prices.

## Institutional Initiatives

In 2021, the Government of India amended the MEMC (Minerals (Evidence of Mineral Contents)) Rules to allow auction of composite licence at G4 level for deep seated minerals including gold. This will bring more participation from private players with better technological support in the field of exploration & mining of deep-seated minerals, which is expected to reduce cost of extraction of gold<sup>5</sup>.

On the policy front, the Government of India has taken up several reforms to revive the gold industry of the country. Gem and Jewellery Export Promotion Council (GJEPC) and other stakeholders in industry voice the concern of the industry and the government has tried to resolve and address those issues from time to time. The

<sup>4</sup> <https://www.infomerics.com/admin/uploads/RBI-MonetaryPolicy-Dec22.pdf>

<sup>5</sup> <https://pib.gov.in/PressReleaseframePage.aspx?PRID=1739166>

government has also revamped the Gold Monetisation Scheme, reduction in import duty of gold, hallmarking, etc., which would help the industry to grow to the next level<sup>6</sup>.

Recently, the Government of India reduced the import duty on cut & polished diamonds from 7 per cent to 5 per cent and implemented the mandatory hallmarking of the gold.

Apart from the gold monetization scheme, there are various other schemes under which about 90 per cent assistance is provided the Government of India for establishing the common production/processing centres, design centres, testing facilities including plug & play facilities. The Government also provides financial assistance up to 80 per cent of the project cost to different marketing hubs and exhibition centres by associations. In Indian gold industry, more than 90 per cent units are in the MSME category and the government has allowed extension of emergency credit line guarantee scheme (ECLGS) for MSMEs up to March 2023.

As per the government official sources, the government has plan to invite bids to extract gold from 50 million tonnes of processed ore in a cluster of colonial-era mines in Karnataka. The Kolar mines, which were closed more than 20 years ago, held gold deposits worth approximately \$2.1 billion.

On 15 December 2022, a senior government official stated that the government intends to invite bids to extract gold from 50 million tonnes of processed ore in a cluster of colonial-era mines in Karnataka. The Kolar gold fields, about 65 kilometres from Bengaluru, are among India's oldest gold mines. The Kolar mines, which were closed more than 20 years ago, held gold deposits worth approximately \$2.1 billion, and India is now eager to take advantage of new technology that can extract gold from even the leftovers of ore that was processed in the past.

## Price-Taker to a Price-Setter

In the ultimate analysis, the gold industry has to move from being price-taker to a price-setter. Towards this end, there has to be a sharper focus on various factors. Such factors include:

- Policy predictability;
- Transparent physical market;
- Robust quality assurance system;
- Appropriate infrastructure (both solid and soft);
- Integral part of global value chain;
- Consistently high trading volumes on exchanges;
- Currency convertibility; and
- Strong regulatory oversight

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<sup>6</sup> <https://pib.gov.in/PressReleaselframePage.aspx?PRID=1754993>



## Risks and Challenges

Rural demand for gold is expected to be impacted by inflationary pressures and an erratic monsoon may impact farmers' income, which may reduce their ability to purchase gold. Skewed distribution in the crucial July-August 2022 period left large rain deficits in the Gangetic plains, leading to around 1 per cent decline in the overall acreage of kharif (summer sown) crops as compared to the last year. The lower sowing would result in higher food prices and lower farmer income, which will impact their ability to purchase gold (CMIE, 2022)<sup>7</sup>.

Gold imports, which increased year-on-year (y-o-y) in May 2022 and June 2022, started to decline after the government raised the import duty on gold. The import duty on gold was raised from 10.75 percent to 15 per cent, effective 1 July 2022. Gold imports declined by 41.3 per cent in July 2022. The hike in the import duty will make gold even more expensive for domestic consumers. High gold prices will impact the gold demand in the country, and as a result, gold imports are likely to be impacted.

A significant rise in the smuggled gold in the Indian market has been one of the major concerns for the gold industry. As per the recently released report titled – “*Smuggling in India 2021-22*” by the Ministry of Finance, Government of India, the Directorate of Revenue Intelligence (DRI) has seized 833.07 kg of smuggled gold worth Rs 405.35 crore in 2021-22. The rising demand for gold, including high import duty, is the key reason for gold smuggling in India. Out of the total smuggled gold caught, 73 per cent was brought in through Myanmar and Bangladesh<sup>8</sup>.

## Successful Gold Spot Platform

How does India develop a successful gold spot platform? This is a tall order and necessitates, *inter-alia*, the following set of measures:

- A strong and autonomous regulatory body, clear regulatory architecture, well-established quality standards and good delivery norms,
- Other policy enablers-well-distributed vault network: India's gold economy is made up of diverse participants—retail consumers, banks, large trading houses and AMCs, to lakhs of jewellers and goldsmiths.
- Geographical dispersal would facilitate easy delivery of the metal & also aid in efficient price discovery in far-fetched physical markets. Electronic record keeping will connect the stakeholders with the formal markets for finance.
- Instituting a benchmark price: with supportive policy regime that promotes mainstreaming of gold investment, a widely-acceptable and referenceable India Gold Price can emerge.
- Diversity in trade participation
- Broadening the scope of exchange deferred trading, swaps, gold leasing, etc.
- Building on existing trade processes and infrastructure created by the gold derivatives market and enabling fungibility between spot and derivatives platforms.

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<sup>7</sup> CMIE, <https://industryoutlook.cmie.com/kommon/bin/sr.php?kall=wshreport&nvdt=20221102090932260&nvpc=055000000000&nvtype=TIDI NGS&icode=0101012520000000>

<sup>8</sup> [https://www.business-standard.com/article/economy-policy/india-seized-833-kg-gold-worth-rs-405-cr-in-fy22-highest-from-myanmar-122120500724\\_1.html](https://www.business-standard.com/article/economy-policy/india-seized-833-kg-gold-worth-rs-405-cr-in-fy22-highest-from-myanmar-122120500724_1.html)

## The Way Forward

A marked shift of India's retail jewellery market from highly fragmented to organised jewellery has been driven by transforming consumer behaviour and government regulations. These factors encourage the industry to become more organised. The way the culture of chain stores evolved in the last one and half decade is quite phenomenal, and its market share significantly increased from 5 per cent in 2016 to 35 per cent in 2021. This brought in greater technological innovation to the gold and precious metal industry.

One of the key challenges in the gold industry is the small size of most of the units and their independent nature. These units mainly rely on the monthly gold scheme for funding or operating as money lenders. Securing bank finance is challenging for such units. The regulatory measures and newly introduced transparency measure have crowding out effect on the small firms in gold industry and caused them to exit this business.

The first half of the fiscal year 2022 was volatile for the gold industry. In the second half also, there are persisting uncertainties. The stakeholders are still trying to assess the implication of higher interest rates, and disruptive Russia-Ukraine war with uncertain end. There is also the possibility of the emergence of another pandemic wave because of the Chinese situation.

Gold market reforms and the attempts to create a vibrant bullion industry require synchronized measures with a sense of urgency. Such measures include:

- Gold purity certification centers should be established across India for bringing out old into market which may reduce gold price India.
- Gold certificates need to be sold in post offices.
- To avoid gold smuggling domestic price, need to be aligned international price
- Popularizing electronic gold receipts (EGR) as “securities”.