Gold Prices in India: Study of Trends and Patterns

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Abstract

The present paper aims to explore the trends in gold prices and its demand, volatility in gold prices, and causes of the mounting prices of gold in the Indian economy. Moreover, it analyses the comparative trends and patterns between India and China.

Key Words: ETFs, Production Costs, and GDP.

Introduction

September, 14, 2012 was a golden day, for the gold as it broke all previous records to touch Rs. 32,900 for 10 grams in the spot market while April 2013 futures hit a new high. Festive and wedding season demand besides global cues and investor expectations lead to touch new highs in gold prices.

As per World Gold Council, India is a major importer of gold and global trends in pricing directly impact domestic prices. The India's gold demand in April-June 2012-13 was 181.3 tones. It is expecting a stimulus package by the US government to boost the economy which could lead to devalue the dollar and push up gold prices further. Due to economic slowdown and poorer returns of other asset classes, investors are turning to gold. The increased demand for gold in India is predicted due to festive season. A lot of consumers buy gold as the wedding season approaches. But, demand in India fell in April June. The holdings of gold exchanges traded funds gained to their highest level in India since mid-March. On other hand, demand from Asia remains steady.

In addition buying physical gold, Indian investors also take exposure to the precious metal through gold ETFs (Exchanges Traded Funds) that tracks the metal's prices or through gold equity mutual funds that invest in the share of gold companies. While gold ETFs have gained up to 12.90% in the last 12 months, the gold equity funds have performed badly, with losses of 6-9 % in the past one year. With large-scale gold mining almost absent in india, gold equity MFs invest in firms listed abroad such as Gold crop, New Gold Inc, Randgold, Eldorado Gold and Osisko Mining. The investment philosophy of such funds is that profits and share prices of miners will ris with surging gold prices, but that scenario has not played out in the last 12 month. Gold equities, through closely correlated with bullion, are also impacted by the factors that affects equity markets. So, periods in which overall equity markets are going through a bear phase could see gold equities also under perform bullion.

Trends in Gold Price

Gold prices registered an upward trend in every year in India since 1971-72 to till now. The trend in Gold Price states that gold has started giving very sharp return sine 2006-07 which is more than 22 percent annualized except the year 2007-08. The worst period for Gold has been 1996 – 2005 and 1982-93 where the Gold prices remained near stagnant and having annual return less than 8 percent except 1991-92, 1986-87 and 2002-03 .

Table 1: Showing Gold Price Trends

Year	Avg. Gold Price	Year	Avg. Gold Price	Year	Avg. Gold Price	Year	Avg.Gold Price
1971-72	200	1982-83	1,723(00.23)	1993-94	45,32(10.42)	2004-05	6,145(07.45)
1972-73	243(21.5)	1983-84	1,858(07.84)	1994-95	4,667(02.97)	2005-06	6,901(12.30)
1973-74	***369(51.85)***	1984-85	1,984(06.78)	1995-96	4,958(06.24)	***2006-07***	***9,240(33.78)***
1974-75	***519(40.65)***	1985-86	2,125(07.11)	1996-97	5,071(02.28)	2007-08	9,996(08.18)
1975-76	545(04.77)	1986-87	2,323(09.32)	**1997-98**	**4374(-13.74)**	***2008-09***	***12,890(28.95)***
1976-77	550(00.92)	**1987-88**	**3,082(-32.67)**	**1998-99**	**4,268(-02.42)**	2009-10	15,756(22.23)
1977-78	638(16.00)	1988-89	3,175(03.02)	1999-00	4,394(02.95)	2010-11	19,227(22.03)
1978-79	**791(23.98)**	1989-90	3,229(01.70)	2000-01	4,474(01.82)	***2011-12***	***25,048(30.28)***
1979-80	***1,159(46.52)***	1990-91	3,452(06.90)	2001-02	4,559(01.90)	***2012-13 (Sept.14,2012)***	***32900(31.35)***
1980-81	***1,522(31.20)***	**1991-92**	**4,298(24.51)**	2002-03	5,332(16.96)		
1981-82	1,719(12.94)	**1992-93**	**4,104(-03.44)**	2003-04	5,719(07.25)		

Source: RBI

The table 1 reveals that: The average annual growth in the price of gold has been registered as 12.27 on the basis of prices of gold of 42 years. The highest return or growth in prices of gold was in 1973 while the lowest return -32.67 in the year 1987. The 30-50 percent return was given by gold in the years 1974,1979,1980,2006, 2011, 2012. The decline in the prices was observed only in the 4 years.

After the years 1981, return more than 30 percent was observed in the years 2006, 2011, and 2012.

Return (%)	Years	Number of years	Return (%)	Years	Number of years
30-50	1973,1974,1979,1980, 2006,2011,2012	7	5-8	1975,1983,1984,1985,1990 ,1995,2003,2004	8
24-30	1991	1	0-5	1976,1982,1988,1989,1994 ,1996,1999,2000,2001,	9
18-24	1972,1978,1991,2009, 2010,	5	-(0-3)	1992,1997	2
12-18	1977,1981,2002,	3	-(13.74)	1997	1
8-12	1986,1993,2005,2007,	4	-(32.67)	1998	1

Source: Calculated

The 0-8 percent return from gold was seen in the 17 years, 8-12 % in 4 years, 12-24 % in 8 while 24-50 % in the 8 years.

Some Key Reasons affecting prices of Gold in India

Gold will continue to remain a preferred investment option in present economic scenario due to the following reasons:

International Scenario

The present global economy is in sadness and Europe is still clouded with uncertainty, US is still not stabilizing, China is not as strong as it was a year ago and India is also reflecting the unrest. Therefore, the exits situation led to gold acting as a safe haven.

Fluctuations in Currency

As the gold is traded all over the world, consequently its price is maintained in USD. In present scenario, USD prices have been fluctuating as it has its bearing on gold price. The US has seen major disorder in its economy and this has affected the USD badly which is not expected to stabilize in the near future.

Gold Mining

The quantity of gold mined in a year will directly affect its price by the simple application of supply and demand mechanics. In the year 2008 and 2009 observed a decline in gold production and it again picked up in 2010. But the production is still less than the 2006 production. The production number in 2011 is not out; however, doesn't seem very hopeful. Grasberg mine, Indonesia facing two strikes this year, the second of which is still unresolved.

Unfavorable Financial Markets Performance

In present scenario, gold is being preferred due to weak financial markets. Gold is inversely related to stocks, bonds and real estate. The stock market has been showing volatile behavior and this has again reflected in gold prices. Gold is still preferred as the others are not as safe as investments as gold.

Interest rates and Inflation

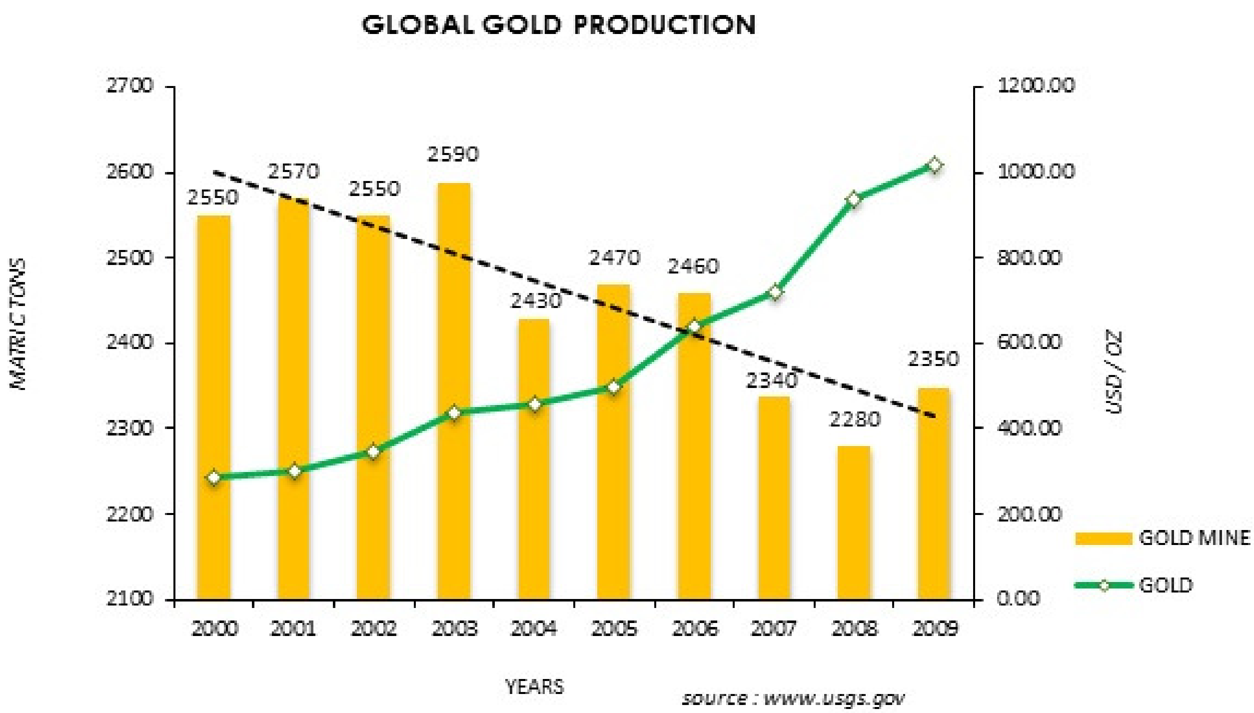
Due to rising inflation on the rise and RBI hiking interest rates regularly, gold prices have become unstable. Rising inflation has increased gold prices while rising interest rates lead to a fall in gold prices. The gold has still risen as the effect of inflation has been substantial as compared to interest rates.

Rising middle class

In India middle class is rising which led to an increase in demand of gold. This leads to increasing gold prices.

Global Production Costs

From many years the trend of gold is always high as various factors influence the level of demand. It is a natural mineral, the gold is not renewable. Therefore the amount of gold mined each year will decrease but the amount of demand for precious metals is increasing every year. The scarcity in the long term lead to gold prices will further rise.



This graph exhibits that the amount of gold mined has downward trend since 2000 while the production of gold has sharpen upward trend since2000. Rising production costs of gold is also a main factor of rising gold prices and mounting high fuel prices are increasing production costs that lads to increase the price of gold in present and same will do same in future.

Taxes

India imports almost all of its gold and the tax, currently is 2%, which will rise to 4 % and India's new tax will impact gold demand. It may lead to hike in gold prices.

European Demand on Euro zone Debt Crisis

European investors to increasing their purchases of bullion in the form of coins and bars due financial instability and eminent sovereign, monetary and systemic risk continue. The WGC reported that European demand rose by more than 25% year on year to 374.8 tonnes in 2011, with Switzerland and Germany being the main drivers in the region.

Diwali Effect

Diwali season is just one of the biggest excuses to buy Gold. The recent economic scenario has made it impossible for everybody to afford Gold unluckily. Diwali bring sharp increase in Gold price. Since time immemorial gold has been the choice of investment for Indians. The gold is much favorite among the Indian buyers as – First, Indian buyers are interesting at Gold due to a family heirloom rather than investment option. Second, Gold is a profitable investment option as the prices of gold over a period of time generally tend to move up.

Volatility in Gold Prices

As per world Gold Report confusion in the currency markets improved gold's volatility to approximately twice historical levels during the third quarter. The gold's recent roller-coaster ride is an irregularity.

During 10 years of data to capture all of the 10 percent (plus or minus) moves selected assets have had over a one-month period. The results show gold experiences plus/minus 10 percent moves 7 percent of the time; about the same as the S&P 500 Index. In comparison, crude oil sees moves of this magnitude 30 percent of the time.

Volatility of Various Assets

	Number of +10% Moves	Number of -10% Moves	Frequency of ± 10% Moves
NYSE Arca Gold BUGS Index (HUI)	563	284	33%
WTI Crude Oil	465	325	30%
MSCI Emerging Markets (MXEF)	137	170	12%
Gold Bullion	128	52	7%
S&P 500 Index (SPX)	41	93	6%

Calculated over rolling 20-trading day periods. Based on approximately 2,600 total occurrences over the past 10 years as of 9/30/2011.

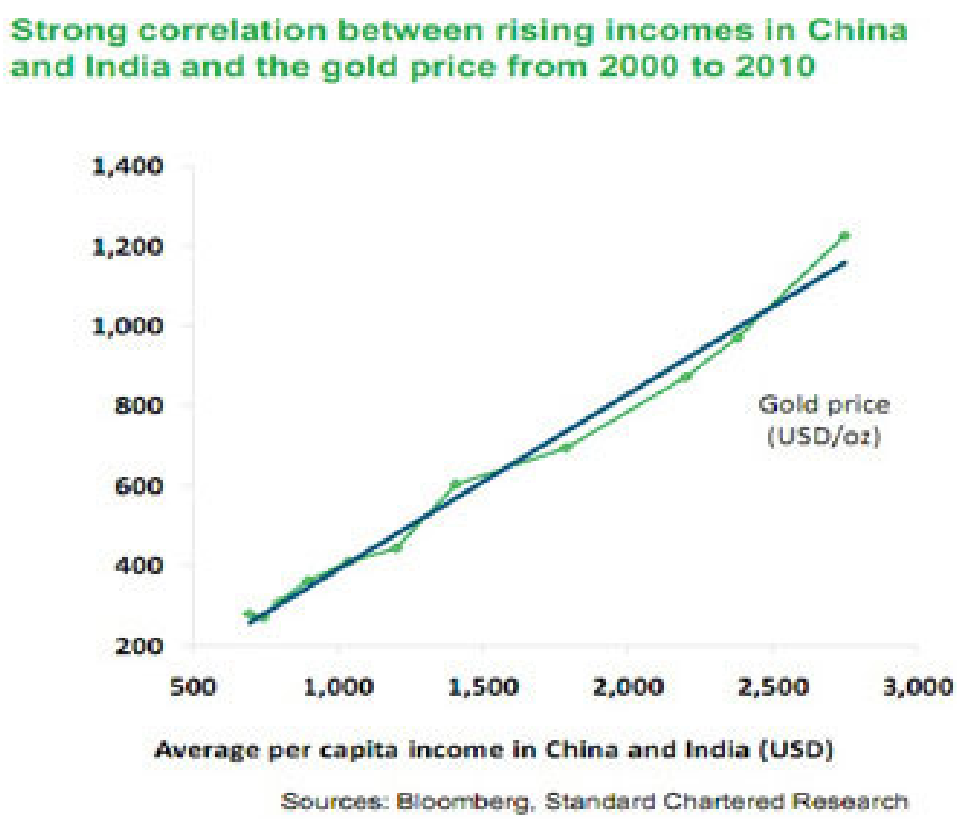
Source:Bloomberg

In a market with gold prices trending upward, this beta provides a potential boost for miners. However, this can also have a negative effect during volatile markets as investors overreact to downside swings.

China and India: A comparison

China and India account for more than 50 percent of global demand, and charting rising incomes and gold prices (*at left*), there is a strong relationship between the two. That is, gold prices have pretty much appreciated in line with rising incomes in China and India. More than the past 10 years, from 2000 onwards, the two lines are virtually marching in step.

Gold is a beneficiary of the rising nominal incomes of the private sector in India and China. If one believes that rising nominal incomes (and low/negative real rates) are here to stay in these countries, then gold can be a way to participate in this growth.



China should consider its leadership as the No. 1 gold market a short-term position, though. While China's presence in the bullion market is strong and growing for jewelry and investment,

India's ancient relationship with the yellow metal is such that "domestic drivers of demand are largely independent of outside forces. The WGC does not see India's role in the gold market diminishing over the long term.
During the Great Recession in 2008-09, both countries shrewdly used the global downturn as an opportunity to dramatically boost their gold reserves. China's gold reserve jumped 75.6 percent to 33.9 million ounces in 2009 from 19.3 million ounces in 2008. Over that same period, India's gold reserve rose 55.7 percent to 17.9 million ounces from 11.5 million ounces

After flirting with the top spot for some time, China emerged as the world's largest gold market for jewelry and investment during the fourth quarter of 2011 as demand in India weakened. This is the first time China's demand outpaced India's in 11 quarters. However, India did retain the gold demand crown for the entire year, purchasing 933 tons compared to China's demand of 770 tons.

Gold Demand Trend

The World Gold Council stated "The strength of demand in India and China, coupled with an overall drop in recycling activity this quarter, demonstrates that consumers have adjusted to the current price environment and expect the upward price trend to continue. In addition, ongoing macro economic uncertainty, the continued sovereign debt crisis and widespread inflationary pressures, will result in gold demand remaining strong." The Q2 2011 exhibits unprecedented demand of Gold reaching to 919.8 tones. A matter of fact, it is more than half of the Gold demand comes from only two countries i.e. India and China. These two emerging economies is purchasing Gold more than rest of the world. Gold Demand Trend report for Q2, 2011 indicates that Gold will continue to be in demand for next half year in 2011 due to the following vital reasons: (i) higher gold price has been remained unable to cut Gold demand in India and China. It grew by 38 % and 25 % respectively during Q2, 2011 on year on year basis. There is no sign of slowing down demand from India and China. (ii) With European debt crisis, US Debt downgrade and higher inflation, Gold is turning out be a favorite investment in coming year. (iii) With net purchase over 69 tone in Q2 2011, Central banks will remain one of the top purchasers of Gold to keep their reserves diversified. (iv) The highlighted dip in case of Gold has come from Gold Supply. It has declined by 4 % in 2010 and stood at 1058.7 tonne in Q2, 2011. The main reason for dip is net purchasing by Central banks. (v) Sustained momentum in Chinese and Indian jewellery demand will underpin growth in the jewellery sector throughout 2012. Strong demand in India during the recent Akshaya Tritiya festival and the beginning of the wedding season, alongside extensive purchasing on dips in the gold price, underlines the strength of the Indian market.
Net purchasing by the official sector is expected to continue in 2012 as central banks turn to gold as a means of diversifying their reserves into an asset with no credit or counterparty risk. Resource nationalism is now considered increasingly as a threat to the mining industry, with news more frequently pertaining to more and more violent opposition to major mining projects around the world. Even while in so-called "safe" environments, resource nationalism is seen as a potential cash cow for profligate governments. Resource nationalism is threatening mining infrastructure investment, and in some areas, seems to be turning dangerous in terms of "affirmative action" by locals and sometimes by governments themselves. Globally, there are many examples where government attitudes to foreign mining investment turn contentious and domestic disputes and violence result. Philippines, Colombia, and Peru have especially suffered with demonstrations and opposition. According to the 2012 budget delivered to parliament on Wednesday, Africa's second-largest gold miner, Ghana, is proposing an increase to its corporate mining tax from 25 percent to 35 percent. This would bring Ghana's corporate tax rates up to roughly the same level of many of its peers. The IMF has been aggressively urging Ghana to look into possibilities of increasing tax revenues from the mining sector which is one of the largest contributors to their GDP. Investment demand will continue to be driven by "uncertainty over the U.S. economy and the

dollar, ongoing European sovereign debt concerns, global inflationary pressures and continued tensions in the Middle East and North Africa. Central bank purchases jumped to 129 tons in the quarter, exceeding the combined total of net purchases during the first three quarters of 2010.

Conclusions

In view of above discussions, it may be concluded that the average annual growth is 12.27percent which indicates that investment in gold is an effective investment avenue in the hand of investors. The recent trends of the gold price have lead to gold's "safe-haven" investment option. Investor deleveraging and capital flight from the Euro has forced the US dollar higher, dampening gold's sensitivity to systemic risk and hampering its performance since September 2011. Even if, with operation twist coming to an end in the next few months, US employment data indicating a stagnating US labor market and Europe's politicians still far from a comprehensive solution to the region's problems, the likelihood of another round of US quantitative easing is increasing. However, high impact risk of a full-blown Euro crisis could also be a catalyst for the gold price to break higher. The resilience of gold during recent volatility in the commodities market exemplifies the strength of the global gold market and its unique demand drivers. Consumer confidence in India has been knocked by the persistence of high domestic inflation rates. Inflation of almost 9.5 percent, as measured by the Wholesale Price Index (WPI), adversely affected jewelry demand, through its impact on both disposable income levels and general consumer sentiment.

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