

1. Demand, Supply and the Economic Contribution of Gold

Demand for gold in India is interwoven with culture, tradition, the desire for beauty and the desire for financial protection. In this chapter, we analyse the drivers of gold supply and demand in India and assess the genuine economic contribution that gold makes to the Indian economy.

Over the past five years, annual demand has averaged 895 tonnes, equivalent to 26 per cent of total physical demand worldwide. For many years the most avid purchaser of gold in the world, India remains one of the leading markets for gold globally today.

However, as India has little domestic supply of gold, demand is primarily satisfied by imports. The cost of these imports is partially responsible for today's current account deficit (CAD).

Assuming that curbing gold imports would be the most efficient way to reduce the CAD, the previous government introduced a range of policies designed to reduce gold demand. Most of these remain in place under the new administration. Recently, the present government has rolled back the 80-20 rule that had been introduced in 2013. Our survey suggests, however, that demand cannot so easily be curtailed.

In Brief:

- 77 per cent of respondents bought gold at least once during 2013 while some bought it more than once. Highlighting consumers' reluctance to change buying habits whatever the fiscal circumstances, more than half bought more gold in 2013 than the previous year.
- 2013 was an exceptional year – the price drop

would have brought many customers out plus the price drop happened in the first half of the year, while the restrictions were put in place from July. From January to September 2014 Indian demand was 620 tonnes. The average demand in first nine months over the past 10 years has been 616 tonnes.

- Indian consumers buy gold as an investment and for adornment. More than 75 per cent of respondents perceived gold as a safe investment and 53 per cent consider it primarily an adornment; and the overwhelming majority believe that gold is both.
- Consumers view gold as a protection against uncertainty. While 12 per cent of respondents would buy gold if the stock market was booming and 12 per cent would buy if it was falling, 22 per cent said they would buy gold in volatile market conditions.
- Gold is part of an Indian households' regular expenditure. The purchase of jewellery and coins comprises 8 per cent of daily consumption, only marginally behind medical expenses and education.
- Gold demand is not dependent on price fluctuations. Among respondents, 34 per cent said their behaviour would not change if the gold price increased and 20 per cent said they would buy more under such circumstances.
- While almost half our respondents said they would buy gold if the economy was growing and 22 per cent said they would sell if the economy was in recession.

Looking more closely at supply, the current picture shows that India has minimal domestic production, with mined gold volumes of just two tonnes in 2013. In many countries where mined production is low, recycled gold makes a meaningful contribution to supply. In India this has rarely been the case. However, recent data indicates that recycling can play a part in the Indian gold market.

Domestic recycled gold increased 29 per cent to 116 tonnes in 2009, following a sharp spike in gold prices. Recycled supplies rose from 59 tonnes in 2011 to 113 tonnes in 2012 and 101 tonnes in 2013, following government restrictions and a depreciation in the rupee. Moreover, our survey reveals that Indian consumers are willing to recycle their gold, armed with appropriate incentives.

The solution to India's enduring appetite for gold would therefore seem to lie not in restricting the import of gold, but in making better use of the gold that is already in the country.

Such a plan could also boost the already valuable

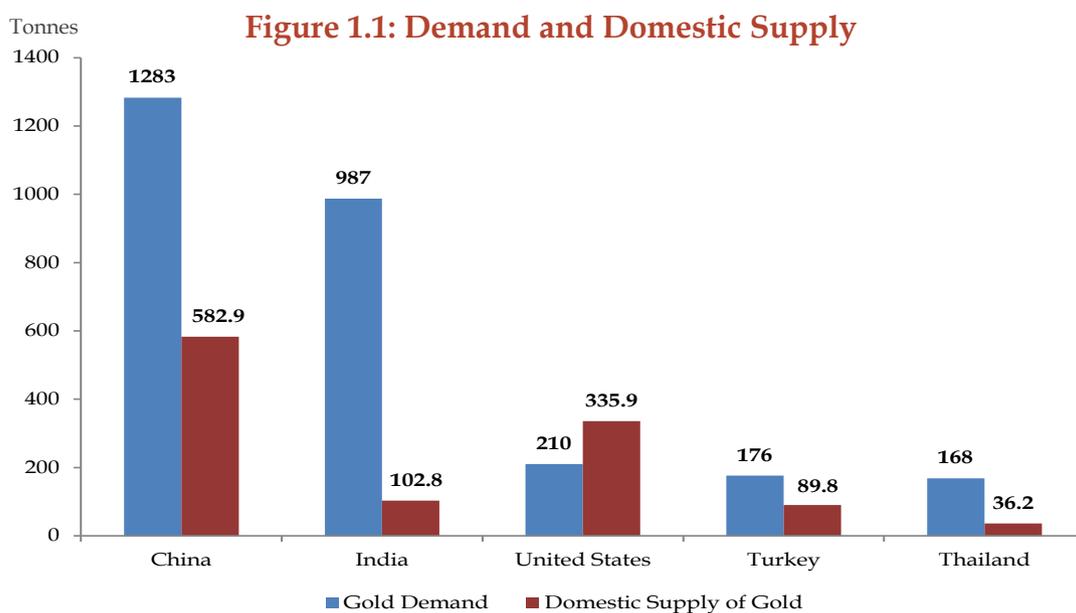
contribution that gold makes to the Indian economy.

- The Indian gold industry employs 2.5 million people and contributes more than \$30 billion to the domestic economy.
- Gold plays a central role in the Indian gems and jewellery export market, which is one of the fastest growing industries in the country and a leading foreign exchange earner. In fiscal 2013, gems and jewellery constituted 15 per cent of India's total exports and the value of gold items alone was more than \$18 billion.
- Bringing more recycled gold into circulation would foster the domestic jewellery industry, bolster the financial services industry, drive employment and boost economic growth.

We provide more detail on these points below.

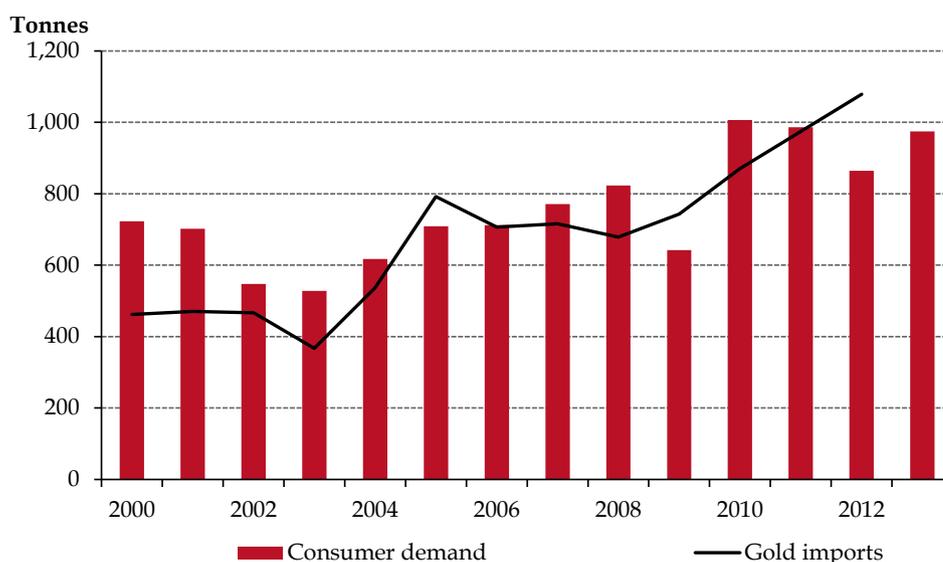
Supply and Demand Dynamics

A quick glance at the demand for gold in India, the supply of gold in India and amount of gold imported to India paints a stark picture.



Source: GFMS Gold Survey 2014

Figure 1.2: India's Dependence on Gold Imports



Source: GFMS, Thomson Reuters, Reserve Bank of India, World Gold Council

Looking at the top five countries (Figure 1.1), India is the only country whose prime sources of gold supply (mine and old scrap) would meet barely 10 per cent of physical demand.

Figure 1.2 indicates the link between consumer demand for gold and gold imports in India.

Gold Demand Drivers in India

Our survey revealed that Indian households buy gold for a variety of reasons. Importantly however, gold is viewed as a core expense, during good times and bad.

1. Combining Security and Beauty

A key finding from our survey was this: Indian consumers view gold as both an investment and an adornment (Table 1.1).

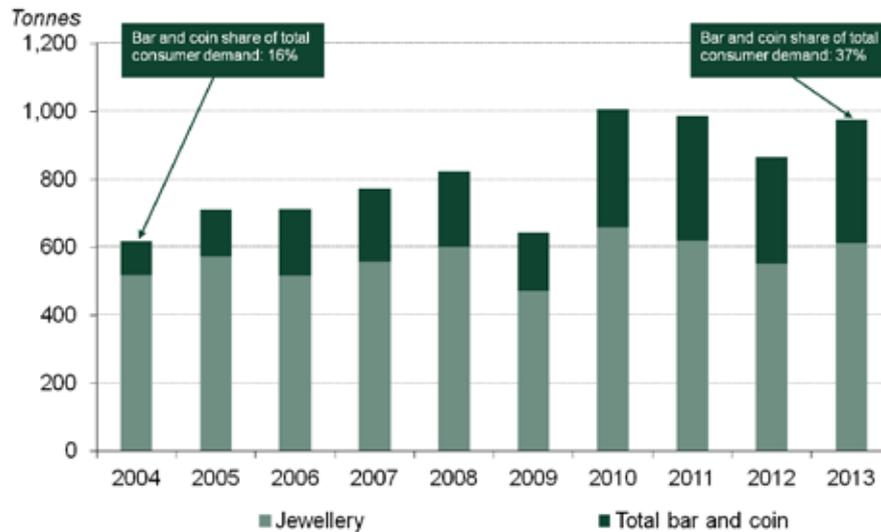
When asked why they bought gold, almost 77 per cent of respondents cited safe investment as a factor, while just over half cited adornment as a rationale behind their purchase of gold.

Table 1.1: Rationale Behind Gold Purchases

Why do you buy gold?	Percentage out of 4846
Safe Investment	76.62%
For Adornment	52.54%
Festivals	42.24%
For Dependent's Marriage	34.54%
Own Marriage/Engagement	32.85%
Special Occasions	30.99%
Collateral	29.92%
Gifts	25.30%
Convert into Jewellery in Future	23.05%
Towards Specific Objective	12.17%
Others	2.21%

Source: FICCI Gold Survey

Figure 1.3: Indian Consumer Demand by Category in Tonnes



* Consumer demand comprises jewellery and total bar and coin

Source: GFMS Gold Survey 2014, World Gold Council

Data from the World Gold Council shows that consumers increasingly buy gold explicitly as an investment asset. In 2004, jewellery accounted for 84 per cent of demand with 16 per cent acquired for investment. Last year, investment accounted for 37 per cent of demand, while jewellery accounted for 63 per cent (Figure 1.3).

2. Protection Against Volatility

In India, as elsewhere, people want to hold gold to protect themselves from volatility and uncertainty.

Looking at the influence of stock market conditions on gold, our survey shows that the largest driver for buying gold is volatility. Among respondents, 12 per cent said they would buy gold if the stock market was booming and 12 per cent said they would buy gold if the stock market was going down. However 22 per cent said they would buy gold if the stock market is volatile.

More than 40 per cent of respondents said they

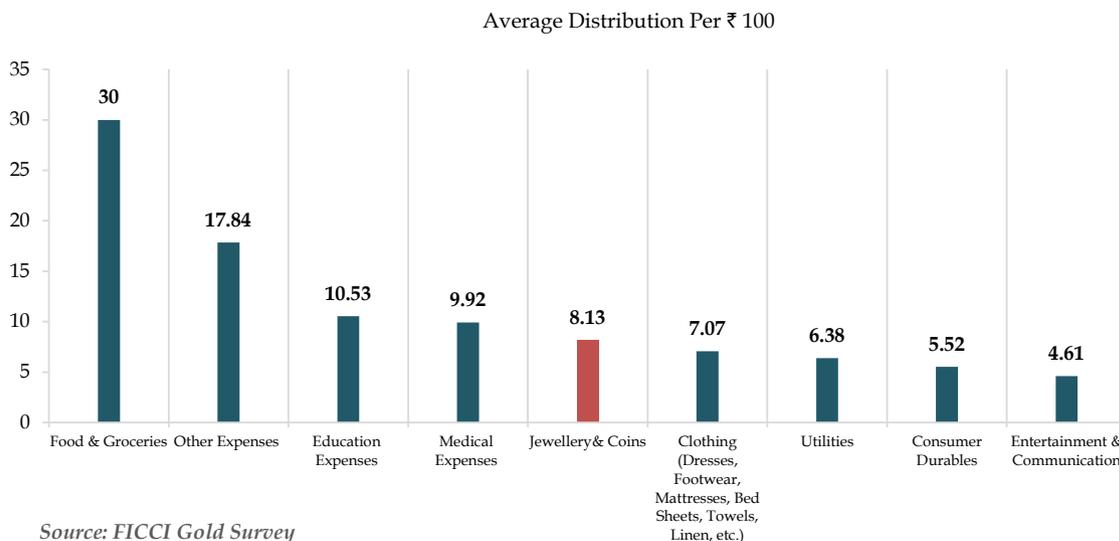
would buy gold if property prices were decreasing and 29 per cent said they would sell gold if property values were rising. This highlights Indian consumers' preference for physical assets. It also indicates that Indian households view gold as a safe haven, an asset to buy when other assets are losing value.

Underlining gold's attraction as an asset for good times and bad, most respondents said they would buy gold whether the domestic economy was growing or in recession. Just under half, 48 per cent said they would buy gold if the economy is growing, while only 22 per cent said they would sell during a recession.

3. Part of the Family Budget

Viewed as a fundamental investment, gold is an integral part of the Indian budget. When surveyed about annual consumption patterns, purchase of jewellery and coins constituted 8 per cent of the amount spent, a significant proportion of total expenditure (Figure 1.4).

Figure 1.4: Average Distribution of Household Expenditure

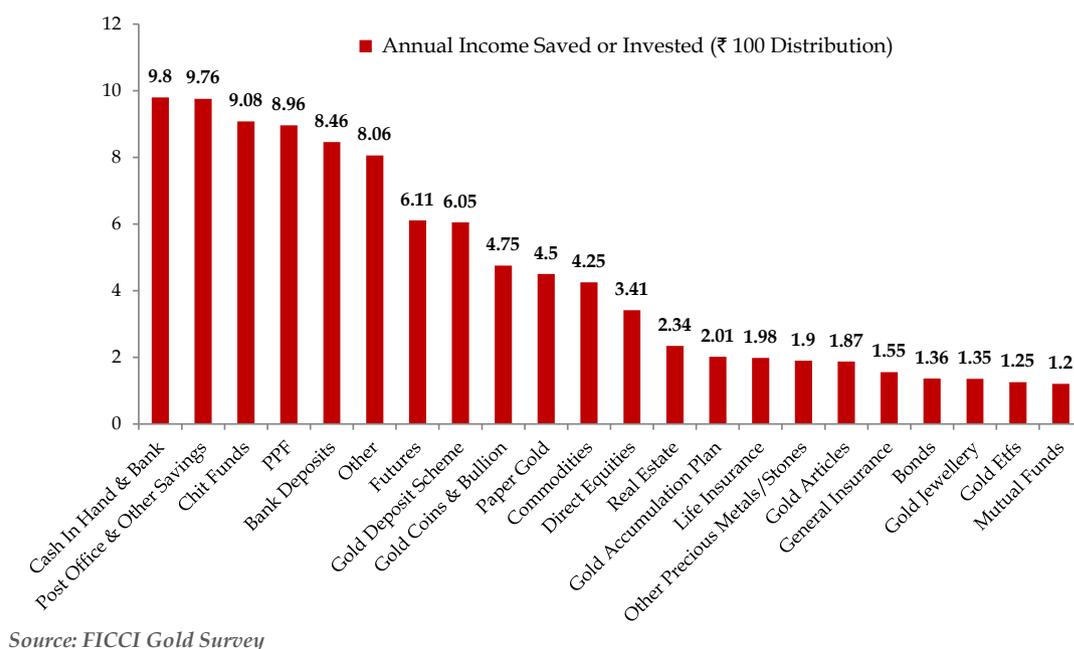


4. A Trusted Asset

Analysis of consumers' savings habits highlights gold's position as a trusted asset. Among respondents' savings and investments, gold products lie just behind cash, bank deposits and other mainstream savings accounts.

Looking closely at gold-related products, just over 17 per cent of respondents invested in gold deposit schemes, gold coins and bullion, paper gold and gold accumulation plans. Among our respondents, these products are significantly more attractive than bonds, mutual funds and even general insurance (Figure 1.5).

Figure 1.5: Distribution of Savings and Investments of Average Respondent



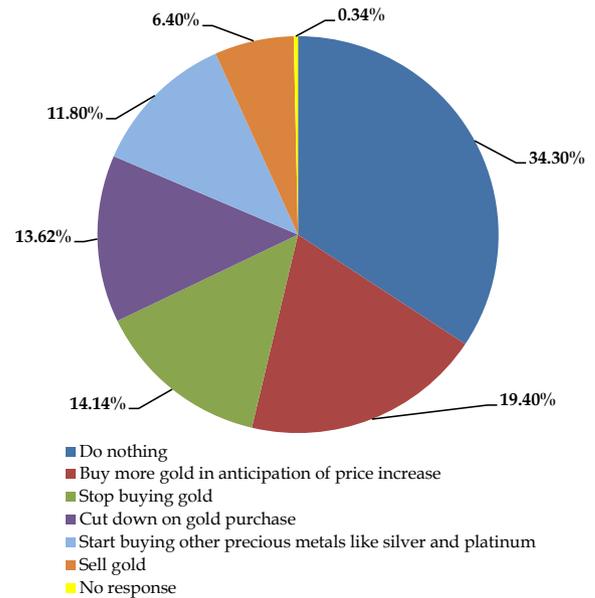
5. Easy to Understand

The survey reveals that Indian households understand gold and gold products better than any other asset class. Looking at the length of time over which respondents stay invest in common market products, various gold investments were clearly the most popular particularly in the short and medium term. This reflects a certain level of comfort around gold and gold-based products (Table 1.2).

Elasticity of Demand

Having identified the key drivers of gold demand in India, our survey also tried to establish the nature of this demand. We found that appetite is little affected by rising prices. Among respondents, nearly 20 per cent said they would buy more gold if prices rose and 34 per cent said they would do nothing. Only 14 per cent said they would stop buying gold if prices increased, while just 6 per cent said they would sell (Figure 1.6).

Figure 1.6: Actions Taken When Price of Gold Increases



Source: FICCI Gold Survey

Table 1.2: Average Holding Period of Investments

Distribution of Holding Period of Investment						
	Less than a year	1 to 3 years	3 to 5 years	5 to 10 years	More than 10 years	Frequency
Insurance	1.7%	1.6%	5.4%	19.5%	71.8%	3988
Mutual Funds	17.1%	22.7%	19.0%	13.9%	27.3%	291
Direct Equities	42.2%	15.5%	7.5%	11.8%	23.0%	241
Real Estate	27.5%	33.0%	13.4%	12.4%	13.7%	1077
Gold Bullion	29.8%	31.5%	14.5%	19.4%	4.8%	183
Gold Accumulation Plan	43.6%	28.7%	8.9%	7.9%	10.9%	240
Gold Deposit Scheme	0.0%	50.0%	33.3%	16.7%	0.0%	1676
Paper Gold	23.5%	29.4%	17.6%	29.5%	0.0%	20
Gold as Commodity	45.7%	14.5%	30.1%	7.2%	2.5%	1246
Gold ETFs	61.5%	15.4%	0.0%	7.7%	15.4%	77
Highest Frequency	2nd Highest Frequency		3rd Highest Frequency			

Source: FICCI Gold Survey

Gold’s Contribution to the Indian Economy

India’s gold market is driven primarily by the consumption and fabrication of gold. Both have a significant impact in terms of economic value add, employment, contribution to foreign exchange earnings and the trade balance. A recent report commissioned by the World Gold Council from PricewaterhouseCoopers estimated that gold made a direct contribution of more than \$30 billion to the Indian economy in 2012.

The Indian gold industry also employs 2.5 million

people and makes a substantial contribution to the Indian export market. According to the 2013 ONICRA report (a leading Credit and Performance Rating agency in India), exports of gold gems and jewellery amounted to \$18.28 billion in fiscal year 2013, ahead of diamonds at \$17.4 billion and coloured gems at \$0.65 billion.

The report also states that the gems and jewellery sector is the leading foreign exchange earner in India and one of the fastest growing industries in the country, comprising 15 per cent of total exports in fiscal 2013.

Table 1.3: Gold’s Economic Contribution

Components of demand	Direct Gross Value Add (in \$ billions)
Consumption of gold bars and coins	17.6
Gold jewellery fabrication and consumption	12.8
Technology fabrication demand	0.1
Recycling	1.6 – 1.9

Source: *The Direct Economic Impact of Gold, PricewaterhouseCoopers, 2013*

Key Points

- Gold demand is strong and enduring.
- Gold is perceived as an investment and an adornment.
- Gold is viewed as a trusted safe haven asset.
- Gold demand persists in good times and in bad.
- Gold supplies in India are constrained by the limited use of recycled gold.
- Gold makes a strong economic contribution to the Indian economy.
- Gold could make a stronger economic contribution and imports could be reduced if gold was more effectively monetised.