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Getting the best out of gold

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SUMMARY

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India's latest balance of trade figures have once again thrown the spotlight on gold. Trade deficit widened sharply in September, increasing to $14.25 billion from $10.84 billion in August. The October figure holds little cheer either, at $13.4 billion. A surge in the import of gold is being blamed. September saw gold imports of $3.8 billion, up from $2 billion in August. The October total is $4.18 billion, nearly three times more than a year ago. Recall that when India's current account deficit (CAD) had touched a high of $80 billion in FY13, gold imports alone accounted for $60 billion.

India produces little gold and imports aggravate an already shaky trade balance. Bad news on CAD has become a cue for finger-pointing at gold.

At the first hint of trouble, we are reflexively ready to squeeze its import, no matter the wider consequences. Our fascination for gold having endured over centuries, a flourishing ecosystem has evolved around it with a skilled artisan class at its centre. There's little purpose in risking it all by throwing the baby out with the bathwater.

It is well known that India has the world's largest stock of private gold, about 22,000 tonnes. Gold kept idle in lockers and vaults is a drag on the economy because billions of dollars in savings are kept out of the financial system. Our gold has undeniably become our weakness. Can we somehow convert it into a strength? Yes, provided we draw on it to satisfy domestic demand for gold and cut down on imports. But the devil, as always, is in the details. How do we go about it?

Discussions about monetisation of India's gold have revolved around getting people to use it as collateral for borrowings from banks and NBFCs. The real game-changer, however, would be to entice private gold into the financial system as deposits. In other words, a scenario where people who need money use their gold to borrow, and those who don't need money place their gold as deposits with banks. This gold can be melted and sold in the domestic market. It will substitute for import of gold and help fund national priorities like infrastructure.

A sensible suggestion made in this context is to tap into retail gold with a gold bond scheme that would offer higher interest rates linked to dollar-denominated FCNR (B) deposits by according gold the status of "quasi-dollar." In cricket, a run saved is equal to a run scored. Every tonne of gold mobilised in this fashion would shave off nearly $40 million from the import bill. In September 2013, RBI had responded to the sharp depreciation of the rupee with a dollar-rupee swap window that attracted $34 billion in FCNR (B) deposits. But with swap charges kept low, the implicit cost for RBI was high. (One credible estimate was $1.2 billion per year.) Surely, there is no logic in paying 4-5% interest on dollar deposits while offering only a measly 1-2% on gold bonds!

The retail focus would throw up challenges of cost and logistics. Nonetheless, it is needed because ownership of gold is scattered and rural India holds the larger share. The drawback here is that rollout of the collection infrastructure would take time. Moreover, melting the jewellery imposes a cost on depositors which would restrict its attraction to periods when interest rates rule higher.

The other option is to tap into the gold lying with our temples. That India's temples have accumulated a lot of gold over the years is no secret. Tirupati temple, for instance, is estimated to hold jewellery worth up to R70,000 crore. The treasure trove at Sri Padmanabhaswamy temple in Thiruvananthapuram may be worth over R1 lakh crore. While some of this gold has found its way to banks, the bulk lies untapped. Unlike family gold, temple managements have no particular emotional attachment to the gold and therefore won't mind its melting (unless it has antique value), and won't turn away when interest rates head down. Further, collection in bulk quantities would save costs otherwise incurred on a dispersed collection infrastructure.

However, popular opinion is unwelcoming of officialdom casting covetous eyes on temple treasures. It did not help that the way the idea was presented, it seemed to be all about helping the economy with little clarity about benefits flowing back. Once interest is linked to dollar-denominated FCNR (B) deposits, temples would earn substantially more from the transaction. That would certainly help but may not be enough. Because the question remains, what do the temples do with all the extra income in hand?

A gold bond scheme that hopes to attract temple gold must move in tandem with reforms in temple administration to ensure that the new income is not appropriated by the state governments controlling them. Instead, the temple administrations must be revamped and given the authority to use the proceeds to improve amenities for pilgrims and step up welfare and charity work, say, setting up schools, colleges, hospitals, etc. Once the idea is perceived as win-win for all—including the devotees who begin to see visible differences at the ground level—it would likely gain traction of its own.

A final thought in this context. Gold is deeply ingrained in the Indian psyche. There is no wishing it away. That being the reality, the next best thing is to get the best out of it. Gold bonds and gold loans are but ways to make the best of our stockpile of gold. India's gold can, and should, become its strength.

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