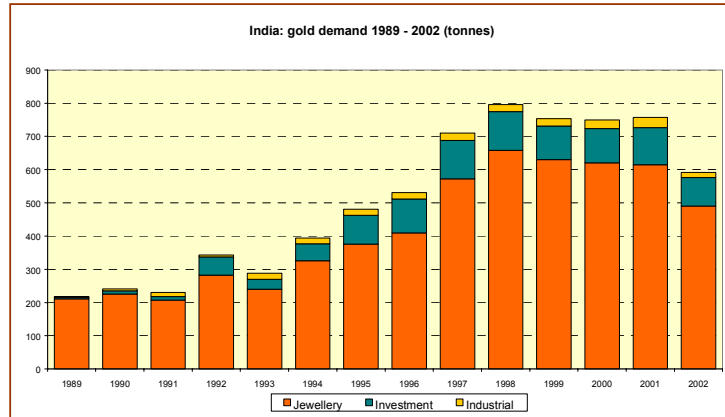


India: exciting advances in the local gold market

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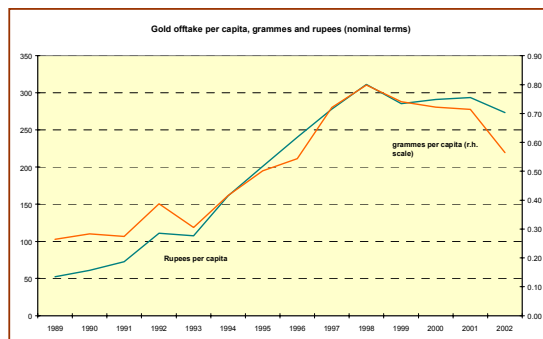
The evolution of local demand

Gold has played a pivotal role in the Indian social fabric for as far back as man’s memory will stretch. In India, gold has a religious significance. Gold was acquired in India in Roman times as part of the silk and spice trade, and the first gold ducats struck by the Venice Mint in 1285 went into the Levant (i.e. the countries bordering the eastern Mediterranean) and on into India. In the seventeenth century the Dutch and English



East India companies paid for goods with gold and silver and during the American Civil war India received gold from the US in return for the cotton that it supplied to make up for the lost crops in America. Estimates vary, but it is believed that at least 13,000t of gold rest in India - or approximately nine per cent of the world’s cumulative mine production. The hoarding tendency is well ingrained in Indian society, not least because inheritance laws in the middle of the twentieth century lent a great desirability to anonymity. Indian people are renowned for saving for the future and the financial savings ratio is strong, with a ratio of financial assets-to-GDP of 93% (source: World Bank)

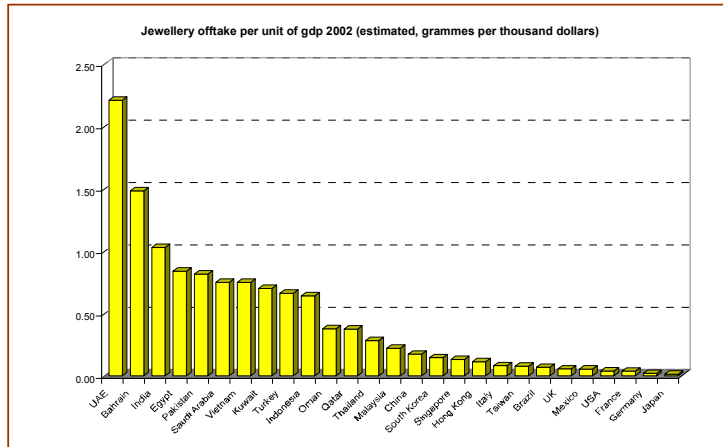
Gold is valued in India as a savings and investment vehicle and is the second preferred investment behind bank deposits. India is the world’s largest consumer of gold in jewellery (much of which is purchased as investment). Gold’s circulates within the system and roughly 30% of gold jewellery fabrication is from recycled pieces. India is typically also the largest purchaser of coins and bars for investment (>80tpa), although last year it had to concede first place to Japan in the wake of the heavy buying in the first quarter due to fears for the stability of the Japanese banking system.



In 1998-2001 inclusive, annual Indian demand for gold in jewellery exceeded 600 tonnes; in 2002, however, due to rising and volatile prices and a poor monsoon season, this dropped back to 490 tonnes, and coin and bar demand dropped to 67 tonnes. Indian jewellery offtake is sensitive to price increases and even more so to volatility, although this decline in tonnage since 1998 is also due in part to increasing competition from white and brown goods and alternative investment vehicles, but is also a reflection of the increase in price. The Indian bride’s “Streedhan”, the wealth she takes with her when she marries and which remains hers, is still gold, however (thus giving gold an important role in the “empowerment” of women in India). Local expenditure, in terms of the value of the gold content purchased, peaked at Rp 302 billion (Rp 311 per capita) in 1998, when total Indian demand was almost 775 tonnes, and since then

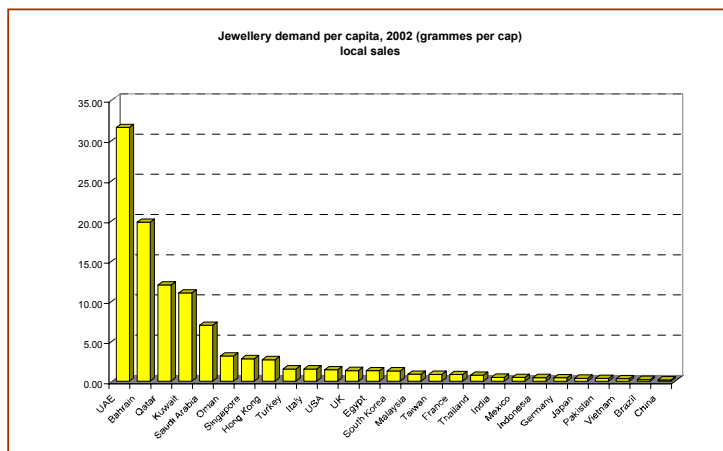
has dropped to Rp279Bn in 2002 (Rp284 per capita), a decline of almost 9%. This peak in 1998 came in the wake of the main liberalisation step, which was the freeing of imports in November 1997.

Typically, India accounts for 20% of global gold offtake in any one year. Its GDP (as measured by the World Bank) in 2001 was 1.5% of the world's total, ranking twelfth - although if this is measured on Purchasing Power Parity, then India ranks fourth with 6.4% of the world total. While changes in total demand per capita, in terms both of tonnage and expenditure, are shown in the chart above, these charts show how Indian jewellery demand in 2002



compared with the rest of the world in terms of offtake per capita and against GDP. Offtake per capita is still very low, reflecting the widespread distribution of the rural population and the social infrastructure of the country (the rural population accounts for approximately 70% of national gold demand), but offtake in terms of GDP is high. At just over one gramme of demand per thousand dollars of GDP, India stands third in the world, behind only the UAE (just over two grammes) and Bahrain (almost 1.5g) - although these two are both enhanced by tourist purchases.

It was not always thus. As recently as 1991, Indian gold demand was a little over 230 tonnes, or only 8% of world offtake. The deregulation of the market during the 1990s brought about a dramatic change. Jewellery demand increased from 208t in 1991 to peak at 658t in 1998, while demand for investment bars grew from ten tonnes in 1991 to 116t in 1998, and registered 85t in 2002. These figures reflect average growth rates of 16% and 30% per annum



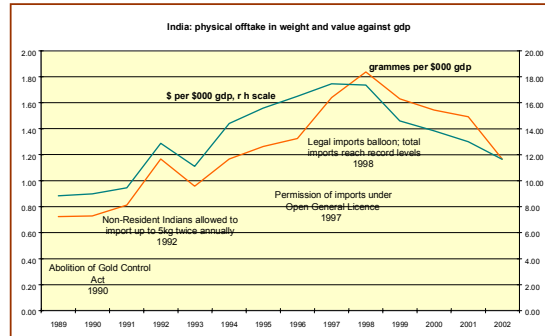
respectively between 1991 and 1998. While both have eased since 1998, there is still a fascination in India for gold and there is significant scope for the development of further demand in the country. The World Gold Council, which was involved in the deregulation of the market in the 1990s, continues to work closely with Indian gold market stakeholders to foster increased demand, partly through the development of new gold instruments that can be bought through banks, as an additional set of distribution channels, although the rural community does still tend to prefer to use jewellers

The regulatory steps in the 1990s

The chart below, showing offtake per thousand dollars of Indian GDP, also shows the major steps taken by the Indian government over the course of the 1990s. The Gold (Control) Act, implemented in 1968 and abolished in 1990, had forbidden the holding of gold in bar form. The

repeal of the Act was part of the economic reform process that took place in the wake of the balance of payments crisis of 1990 and 1991. In 1993 the Foreign Exchange Regulation Act was repealed, which had little tangible impact (the Act had treated gold and silver as foreign exchange for foreign exchange control purposes, and allowed the government to restrict dealings therein prior to, or at the point of, import), but reflected a more pragmatic attitude towards gold and silver.

Also in 1993 the government permitted non-resident Indians to bring 5kg of gold into the country twice yearly on the payment of import tax of Rp 250 per 10 grammes (at current rates this equates to US\$14.56/ounce or 4.2%). The allowance was raised to 10kg per trip in January 1997.



Meanwhile in 1997 the Committee on Capital Account Convertibility recommended that the market should be liberalised, but also that a well-regulated and transparent market should be developed. The first step in this process was to allow import and export of gold under Open General Licence and the banks involved had to fulfil certain specific criteria. There are currently approximately twenty such banks operating in the market, both executing international trade in gold and selling and leasing the metal for domestic Indian use. These include local banks ICICI Bank and HDFC bank, both of which are enthusiastic about the developments in the market and are looking to drive developments forward, see below.

In the 2003 budget the Finance Minister reduced the customs duty on “serially numbered bars, or.... gold coins” from Rp 250 per 10 grammes to Rp 100 per 10g. At today’s rates (gold at \$345/ounce), this is the equivalent of a cut from US\$16.5/ounce or 4.6%, to \$6.6/ounce or 1.9%. The move, which was accompanied by a reduction in customs duties on diamonds, notably on some rough and half-cut stones, is designed to enhance India’s already important role in the world’s jewellery industry. It does not include ten tola bars, which have for years been the favoured bar for hoarding in India (this is partly historical because their design made them particularly suitable for carriage by smugglers). To qualify for the lower tax, the bars should have their weights expressed in metric form. Although ten tola, or “TT” bars are popular elsewhere, including Saudi Arabia, many have now been melted down in favour of metric bars.

The current position

Banks’ activities

The second phase, the development of gold-related financial instruments, is rapidly coming to life. The one blot is perhaps the poor performance of the Gold Deposit scheme, which was launched in October 1999. Under the scheme the State Bank of India takes local gold deposits and issues interest-bearing gold term deposits in return (and allow local banks to lease the metal to jewellers). This has however gathered little momentum as members of the public continue to show a preference for holding their gold in physical form rather than a paper representation. Roughly eight tonnes have so far been mobilised; the bank had been looking for 100t in the first twelve months of the scheme. Gold in any physical form can be tendered and is subject initially to a non-invasive assay (no effect on the piece in question). At that stage, if the tenderer does not agree with the assay results or wishes to withdraw for any reason then he may do so. If the deposit is made, then the metal is melted and subjected to full assay, which would reduce the metal to scrap form.

The lock in period has also deterred would be investors. The terms available offer interest rates over a range of lock-in periods from three to seven years, although there was also an initial lock-in period of one year, after which premature encashment would be permitted.

The slow uptake of the scheme has meant that leasing to jewellers remains comparatively limited. The State Bank of India (SBI) cut the rates payable on these deposits in April, from 3-4% to 1.5% because of the low interest rates prevailing in the international gold market, which further suggests that uptake is likely to remain sluggish.

Futures trading is on its way

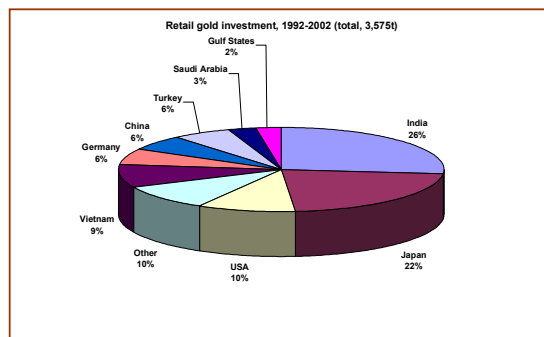
At present, banks may trade forward in gold locally or internationally, for the purposes of managing price-risk, but as yet they are not permitted to trade forward with other non-bank counter-parties. In February 2003, however, the Cabinet Committee on Economic affairs approved futures trading in 54 commodities, of which gold is one and this could presage a major increase in gold-market activity. The National Commodities and Derivatives Exchange in India (NCDEX), led by a joint venture including the ICICI Bank, the Life Insurance Company of India, the National Bank for Agriculture and Rural Development and the National Stock Exchange expects to start introduce cash and futures trading in bullion (for up to three months forward) by autumn 2003. Options trading is expected to be introduced towards the end of 2004. NCDEX also plans also to introduce a gold index and trading in the index at a later stage. Meanwhile the Indian press is reporting that the Multi Commodity Exchange (MCX) is planning to commence business by September, offering a range of contracts including gold. HDFC Bank will act as the clearing bank for the Exchange. Meanwhile ScotiaMocatta has recently trebled the size of its team in India, while HSBC is also expanding its bullion activities there.

Other products are coming

ICICI Bank is launching a range of gold bullion products, including ICICI Bank gold accumulation plans, gold accounts for private investors and lending facilities for local manufacturers. The bank expects to have 200 branches with gold retail facilities by the end of this year. The bank is already selling ICICI gold coins, at 140 branches all over India, which were launched last December and are the first retail gold investment products to be sold by a local Indian bank.

The terms of the accumulation plan, which is expected to launch this year, are that an investor may deposit Rs1,000 (\$21 at prevailing rates in early June), for which the bank will deposit 1.5g of gold to the account. Once the amount deposited is equivalent to 10g of gold (at a pre-determined gold price), then the customer may take delivery of a 10g gold coin. Mr. Amitabh Chaturvedi, head of the bank's retail channels and liabilities group, described the programme as working "like a forward contract where gold will be priced at a pre-determined rate, that is, the day he starts depositing money on that account." He also told the press that "For the next year, our target is three tonnes, and we are confident of being able to make it".

Other banks, both nationalised and private, are planning to launch gold coin retailing and gold savings accounts soon. From 1992 to 2002 inclusive, India accounted for 26% or almost 960t of the 3,575t identified as gold bars bought for private investment. Along with Japan at 777t, these two account for almost half of the world's physical gold investment bar purchases. World Gold Council research has shown that consumer interest in coins and bars is often regarded as a precursor to an eventual jewellery purchase; it also shows, however, that the potential to make gold coins and bars the preferred choice for savings (apart from bank savings accounts) is extremely high.



At the start of this year, Indian private savings in bank deposits totalled Rp 938,286 crore (one crore is 10 million, which implies a dollar saving level of just under US\$200 billion). Banks that are prepared to develop a full range of bullion products have the potential to tap a vast store of wealth. The gold market in India may be an old one, but it has considerable scope for growth.

The recent changes in the regulatory environment should be a major help in stimulating fresh products and new demand; indeed some of the top mutual funds, along with the World Gold Council offices in India, are working closely with the regulators to introduce a gold fund into the Indian markets.