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Redefining Gold ... The shift from Savings to Luxury

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An MKS PAMP GROUP Company

1.

Savings or Luxury

The traditional belief about Indian gold demand

- ⇒ Demand is rural
- ⇒ Rural income is primarily agricultural
- ⇒ Consequently monsoons dramatically impact gold demand

- We have always been aware of how much gold India consumes
- And we have always known the form in which gold is consumed

But do we really know which sections of India consume gold

And do we really know why Indians consume gold?

Widely different views on who consumes gold in India today

Economic survey of India 2015-16¹

- **The 'rich' consume most of the Gold** - top 20 per cent of population account for roughly 80 per cent of total consumption

NSS 68th survey of consumption patterns in India

- Gold is more than 1% of monthly consumption **only for the 10% richest rural consumers**, while it is consistently a larger share of the urban consumers spend

GFMS Gold survey 2016

- Indian households dependent on agricultural activities **contribute to 35% of annual gold demand**, and are highly sensitive to monsoons

NSE- IFMR survey 2016

Gold is the second largest asset for rural households, **comprising 45% of total savings for rural households**

With increasing urbanization, has the definition of “Rural” changed?

In addition to consumption, the traditional role of gold as a savings vehicle is clear

CONSUMPTION

INVESTMENT

SAVINGS

Illustrative of FICCI survey²

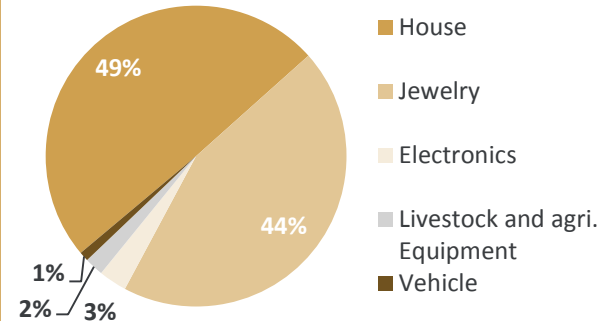
Safe asset
76.62%

For
adornment
52.54%

Save for
future
23.05%

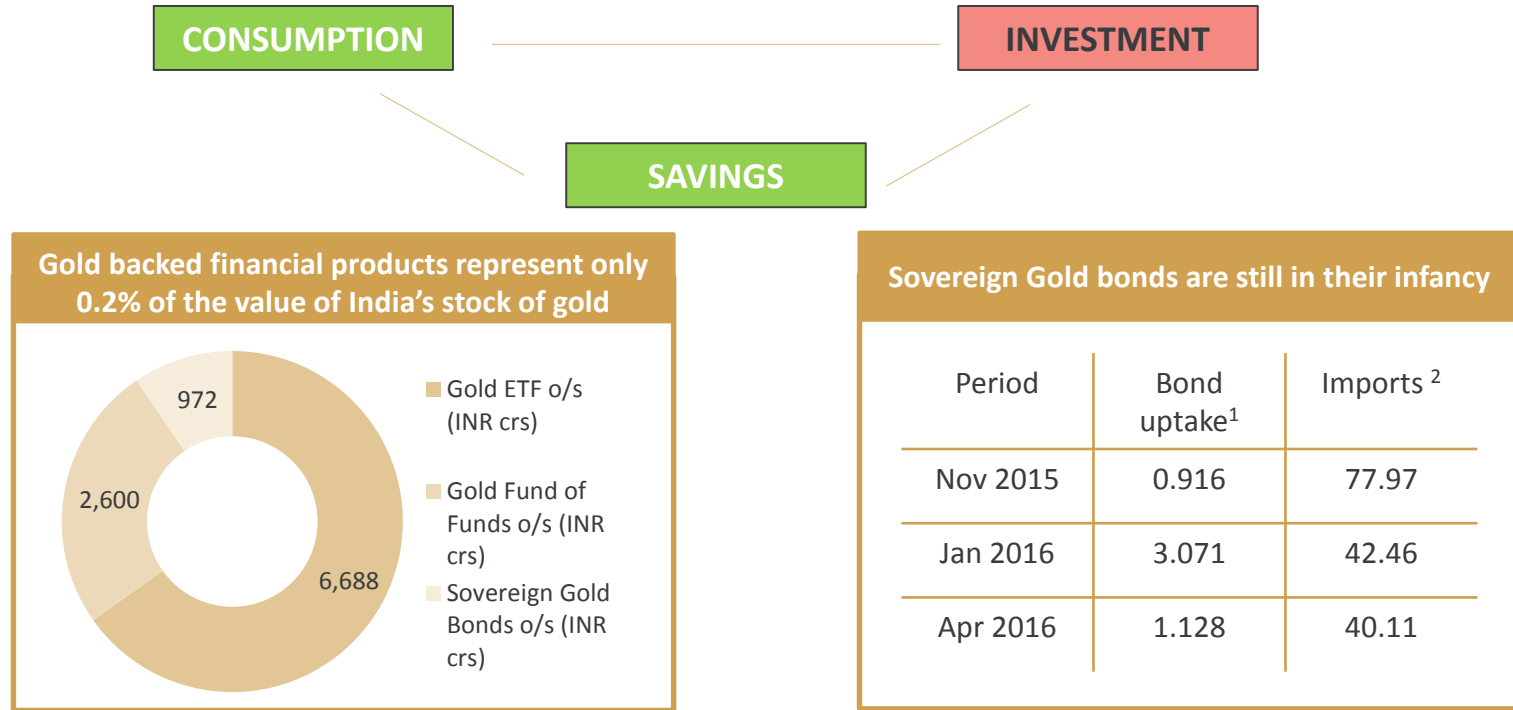
Consumer surveys vary from gold's role as luxury or saving but not investment

IFMR research in rural India



Financial instruments do not feature as a significant tool for investment in rural India

Whereas there may be an investment benefit, the driver for Gold is not 'conventional' investment



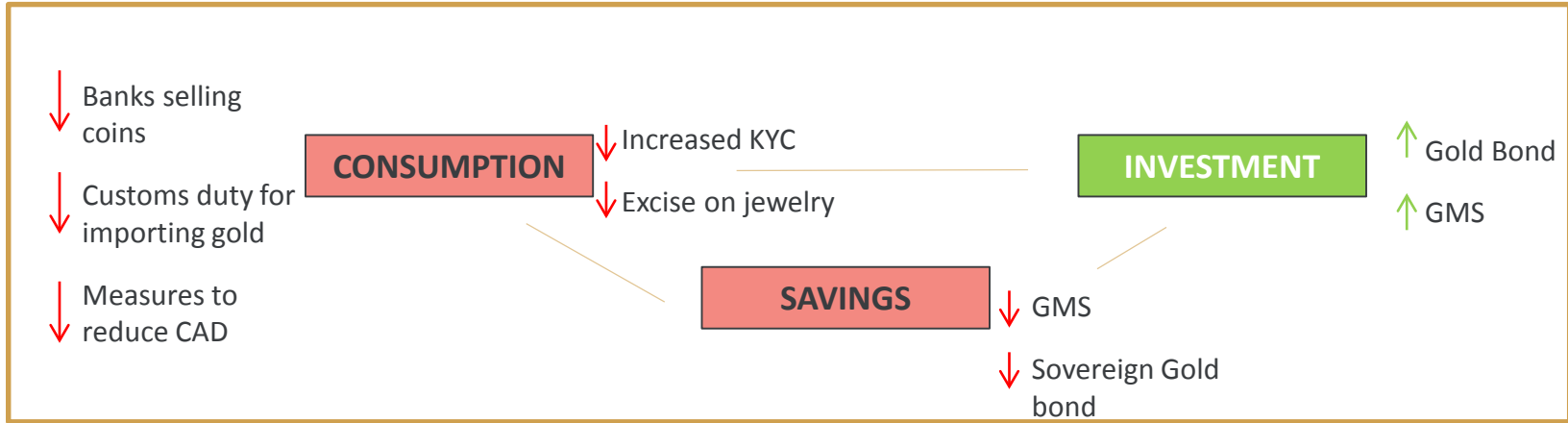
1 <http://economictimes.indiatimes.com/wealth/invest/how-much-sovereign-gold-bond-issues-have-collected-till-now/articleshow/52584514.cms>

2 <https://www.gold.org/statistics#group2>

Independent of what the policy focus has been, gold has been steadily viewed from a policy perspective as an unproductive asset class

Economic survey 2012: “There is scope to discourage **unproductive imports**, like gold and consumer goods, to restore balance”

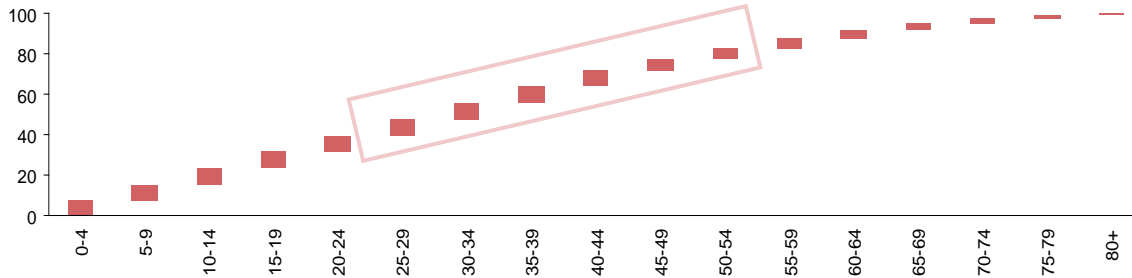
Economic survey 2016: “Gold is a **demerit good**..there is a huge subsidy of 25%..about 98% of the subsidy accrues to the better off...”



Changing Demographics

88% of India's population to be less than 60 years old by 2025E

India's age profile in 2025E (% of population)



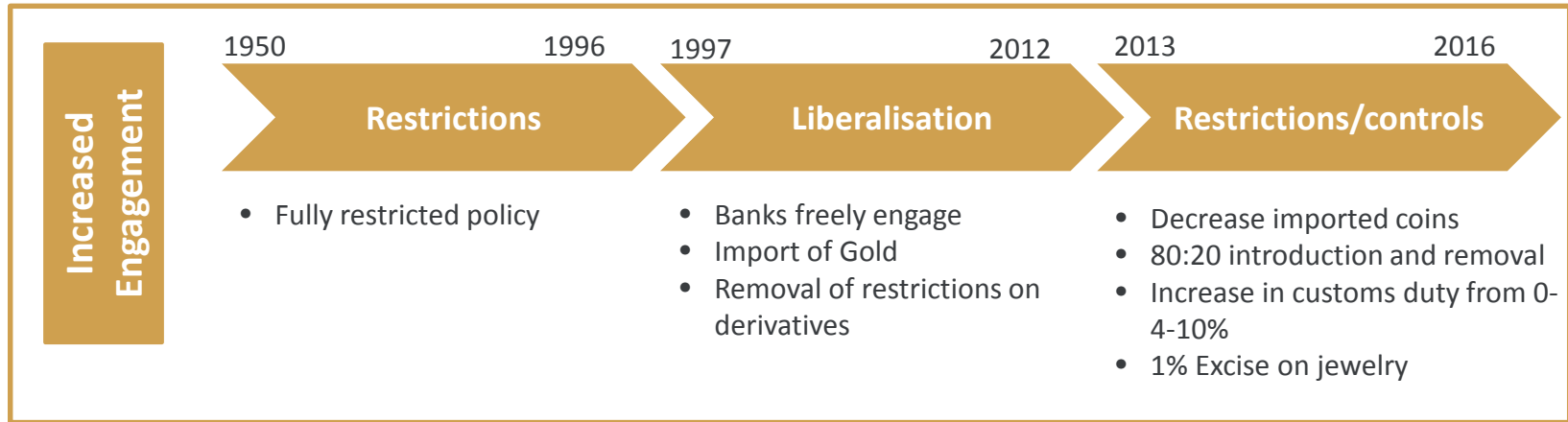
Source: Kotak Institutional Equities estimates

- **Improved demographics will imply stronger India's consumer demand**
- **Consumption basket will evolve with time as incomes grow**
- **Across a wide-variety of industries, from food to hotels, from housing to transport, from real estate to gold the nature of the industry can alter dramatically**

2. | Policy and implications

Policy is increasing controls on gold

- *Gold continues to be a strain on current account deficit.*
- *Managing gold imports is a challenge due to the difficult tradeoff between controls and smuggling of gold & associated revenue loss*



The participants in the gold value chain

Import Value chain	Key activities	Nature of business model
<p>1 Refinery</p>	<ul style="list-style-type: none"> • Import mine Dore against actual user import license, refine into gold bullion • Domestic value added activity 	<ul style="list-style-type: none"> • Low refining margin leaves limited room to operate if domestic prices trade at discount to global prices • Refining margin is derived from customs and excise tariff structure
<p>2 Bullion merchants</p>	<ul style="list-style-type: none"> • Focused on efficiently buying wholesale, and selling retail • Trading activity 	<ul style="list-style-type: none"> • Bullion merchants are price takers, hence unable to operate when market is in a significant discount • Only buy gold from banks and nominated agencies
<p>3 Jewelers</p>	<ul style="list-style-type: none"> • Purchase bullion, add value by making jewelry, sell to end customer 	<ul style="list-style-type: none"> • Ability to buy gold and sell jewelry off the books • Impacted by taxes (Excise, GST), limits (for applicability of excise) and other regulation (PAN)
<p>4 End customer</p>	<ul style="list-style-type: none"> • Customers do not buy gold • Purchase jewelry and coins 	<ul style="list-style-type: none"> • Typically pay for taxes which are all passed on to the end consumer • Can transact in cash

During the year, participants have responded to policy in different ways

Stakeholders	Participant response to policy
1 Refinery	<ul style="list-style-type: none">Refiners faced reduced margin due to budget changes in excise and custom differentialHowever simultaneously hit with sharp disparity in local prices vis-à-vis global pricesConsequently have shut down manufacturing operations waiting for market to normalise
2 Bullion merchants	<ul style="list-style-type: none">Deep disparity in pricing between international gold price, and official gold pricesBullion merchants have reduced trading operations significantlySome merchants are compelled to resort to purchase from unorganized sectorMushroom growth of paper invoicing entities to legitimize cash transactions
3 Jewellers	<ul style="list-style-type: none">In order to avoid threshold of Rs.15cr, jewelers conducting business through multiple companies with lower transaction volumesIncrease in cash transactions (and consequently reliance on unofficial importing)

Policy impacted value added manufacturing, increased tax evasion and created an underground business

Looking ahead, what questions do we need to contemplate?

Stakeholders	Expected policy announcements	Questions we need to ask
1 GST committee	<ul style="list-style-type: none">• Sets GST rate on gold and jewelry, excise duty gets subsumed• Expected November	<ul style="list-style-type: none">• Does it matter if gold is a savings or a luxury?• If government intends manage gold, what GST should we expect?
2 Finance ministry	<ul style="list-style-type: none">• Sets customs duty on gold imports• Expected January 2017 Budget	<ul style="list-style-type: none">• How will Dore be tackled?• Will focus on Responsible Gold increase?• Will two way trade in gold override round tripping?
3 Total impact	<ul style="list-style-type: none">• GST on jewelry plus customs duty on gold add up and affect the end consumer	<ul style="list-style-type: none">• If we believe the total tax rate impacts smuggling, what should the total tax rate be?• If the government can seriously tackle black money, then does the tax on gold even matter?

The debate

Our expectations of the future

- 1 GST will be medium to high
- 2 Low duty on Dore
- 3 Increased emphasis on Responsible Gold
- 4 Increased two-way trade
- 5 Black money tackled via stringent KYC.
No reduction in customs duty

What does this mean for stakeholders

- Physical gold discouraged, investment in dematerialized form
 - Encouraging local circulations, **greater role for financial institutions**
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- Increased share of Dore in imports, promoting Make in India
 - **Greater role for refiners**
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- Enhanced reputation and reduction in unofficial transactions
 - **Greater role for good delivery players on the value chain**
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- Enabling exports and creating a productive use of India's gold stock
 - **Greater role for financial institutions**
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- Transparency across the value chain
 - **Quality becomes the differentiator**
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THANK YOU

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