Investing in Gold Bonds

GS-PAPER-3 Economics-Investment (PT-MAINS)

Fourth tranche of sovereign gold bonds 2020-21 are opened for subscription.

Gold bonds:

The government introduced the *gold bonds scheme in 2015*. The scheme was introduced to wean away investors from the physical gold market. These bonds have a *maturity period of eight years*. But, the investors have the *option to exit after the fifth year*. Funds raised through such issuances form part of the government’s overall borrowings in a year.

What are the benefits of buying gold bonds?

- Gold bonds offer investors *twin benefits of price appreciation along with a fixed 2.5% coupon per year*. Interest earned on these gold bonds is added to the holders’ income. Interest earned on *these bonds is taxed according to their slab rate*.
- *Any capital gains on these bonds at maturity are tax free*.
- This makes them far more attractive than owning physical gold. To offer greater liquidity, *the bonds are listed on stock exchanges within a fortnight of issuance, and can be traded*. Gold bonds appear attractive when gold prices spike. This leads to greater investor interest in this asset class.

Why price rise??

Much before Covid-19’s impact led to a *crash in global stock markets*, gold prices had started their upward glide. The global *spread of Covid-19* has raised concerns on global growth over the last three or four months.

*Negative growth rates* and *fears of a global recession* have pushed central banks and big investors to take shelter in gold. There is nearly 40% crash in benchmark equity indices in the US between February and March 2020. This has forced the *US Federal Reserve to announce a record liquidity injection and bond-buying programme of more than $3 trillion*.

In India why it has been rising!!!

- Since *India mostly imports gold*, the depreciation of rupee with regard to dollar makes gold costlier in India.
- *Domestic factors* such as concerns over the country’s fiscal health and a
higher demand for gold also pushes up prices.

- In India, the **RBI has cut policy rates by 115 basis points over the last three months, and brought down the repo rate to 4%**. [Repo rate - The rate at which the RBI lends to commercial banks]
- The RBI has also announced liquidity injection in the economy. Any expansion in the paper currency tends to push up gold prices.

**Will gold prices continue to rise??**

**Gold is an efficient tool to hedge against inflation and economic uncertainties.** It is also **more liquid** when compared with real estate and many debt instruments. Generally, after any major economic crash and recession, gold prices continue their upward run. Market analysts feel that gold could overtake its previous peak of around **$1,900 per ounce in the global market**.

**Can one invest now?**

In India, **there is a sharp decline in interest rates over the last year alongside high volatility in the equity markets**. This has brought investors’ focus towards gold.

A cut in interest rates by the RBI has led to a decline in interest rates on small savings and term deposit rates of banks. **SBI is currently offering an interest of 2.7% on savings bank deposits, and 5.4% on 5-10 year term deposits.**

Experts say that it makes good sense for investors to invest in gold.

**Can the price of gold crash?**

- Given the economic uncertainty, gold would touch a new all-time high.
- In India, prices will be supported by any further weakness in rupee.
- **Key events that could stall the rise of gold are,**
  1. Sudden sale of gold holdings by central banks to tide over the economic crisis,
  2. Crisis in other risk assets prompting investors to compensate their losses through sale of gold ETFs (Exchange Traded funds).

**Gold Monetisation Scheme**

In a move to revive the flagging Gold Monetisation Scheme, the **Reserve Bank of India (RBI)** has made it easier for depositors to hand over their holdings of Gold.

- **RBI has liberalised the GMS, 2015,** allowing depositors to directly deposit their bullion with either banks, refiners or Collection and Purity Testing Centres (CPTCs). Earlier, the Banks, CPTCs and Refineries had to sign a tripartite agreement for this.
Temples, High Networth Individuals (HNIs) and entities like fund houses, trusts and even government entities would now find it easier to deal directly with banks instead of CPTCs.

Gold Monetisation Scheme

- The scheme was launched in November 2015 along with sovereign gold bonds and India gold coins.
- It facilitates the depositors of gold to earn interest on their metal accounts. Once the gold is deposited in metal account, it starts earning interest on the same.
- Under the scheme, a depositor gets **2.25% interest annually** for a short-term deposit of one year to three years. Medium- and long-term deposits get 2.5% interest rate.
- **Objective:** To mobilize the gold held by households and institutions in the country to put this gold into productive use and in the long run to reduce the current account deficit by reducing the country’s reliance on imports of gold to meet the domestic demand.
- Along with GMS, a Sovereign Gold Bond Scheme (an alternative to purchasing metal gold) and development of Indian Gold Coin, were also announced.

- Banks may accept the deposit of gold at designated branches, especially from larger depositors.
- The RBI also further relaxed norms under the scheme by which banks, at their discretion, can, allow the depositors to deposit their gold directly with the refiners.
  - This suits the temples also, as it is estimated that they may be holding around 4,000 tonnes of gold and are capable of depositing gold in tonnes under the scheme.
- Several depositors had earlier complained that banks are not taking an interest in accepting deposits under the GMS in many cities even from large depositors. Banks had hardly publicised that they run the GMS.
  - The RBI has stated that banks have to identify branches in all states and union territories where they can accept deposits.
  - All designated banks have now been mandated by the RBI to give adequate publicity to the scheme through their branches, websites and other channels.

Background

- The GMS scheme had been able to garner only 16 tonnes of gold as deposits in the last four years. This was largely because of banks’ apathy towards it and also due to practical difficulties of banks in dealing with
The current scheme mandates that customers have to first approach the CPTCs which are approved by the Bureau of Indian Standards. These centres had issued depositors purity certificate on gold deposited, and based on the centres’ certificate, a bank was supposed to open a deposit account and credit gold. CPTCs sent the gold to a refinery which gave the final purity certificate and converted the yellow metal into bars.