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The glitter of gold

The rupee value of gold touched its record high of Rs 59,233/10gm on 20 Mar 2023 while crossing the Rs 60,000 mark in its intra-day trading. However, some correction was noticed subsequently (eyeing UBS decision to buy Credit Suisse and also Fed policy). In this context, it is interesting to evaluate the factors that have driven gold prices historically. Movement of dollar holds the key. In general, an appreciating dollar puts downward pressure on gold ceteris paribus. In the current context, with dried up liquidity and ongoing banking crisis, DXY is unlikely to trade with an appreciating bias. The Fed has kept its statement cautious indicating that decisions will be data driven. This indeed would push up gold demand with the safe haven factor coming into play. We expect an upside to gold price to persist and touching the US$ 2,000/troy ounce might be likely. All in all, as an asset class, inclination may continue to be towards the 'good old gold'. The shimmer of gold might further pinch the core inflation number going forward.

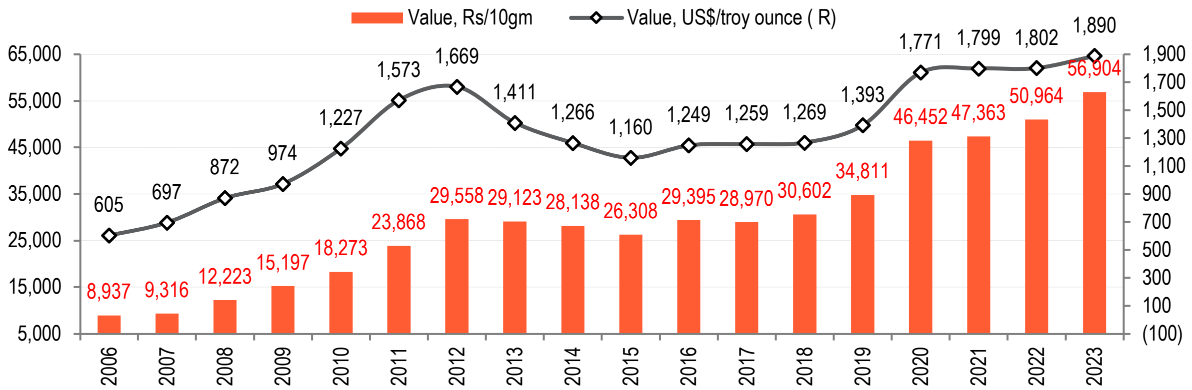
How Gold prices fared historically:

- We have tracked gold prices since 2006 to see the trend in prices both in Re and US$ terms. It is interesting to note that barring three period especially CY13, CY14 and CY15, gold prices have generally been on an uptrend. Ultra-low US Fed rate (0-0.25%) coupled with stable domestic growth during period in the region of 6.4-7.4% drove investors 'risk on' sentiment.

- Notably, years of geopolitical tension and economic crisis had a direct impact on gold prices. For example, post the global financial crisis of CY08, gold prices in Re terms shot up by 31%, whereas in US$ terms it increased by 25%. Also in CY12, post the political turmoil in Egypt, Libya, Yemen, and Bahrain, gold price in Re terms rose by 31% whereas in US$ terms, it increased by 28%. Further post Covid-19 situation, gold prices skyrocketed. In Re terms, the price increased by 33.4% and in US$ terms, the increase was 27%.

- In CYTD23 (till 21 Mar'20), again the uptrend is clearly visible. From an average of Rs 50,964/10gm in CY22, the price increased to Rs 56,904/10gm. In dollar terms similar increase is visible as this is the base number that gets converted in rupee terms. Uncertainty with regard to global growth conditions, ongoing banking crisis and its contagion effect, increased the safe haven demand for gold, which is explained in detail in the next section.

Fig: 1: Gold prices both in dollar and rupee terms are inching up



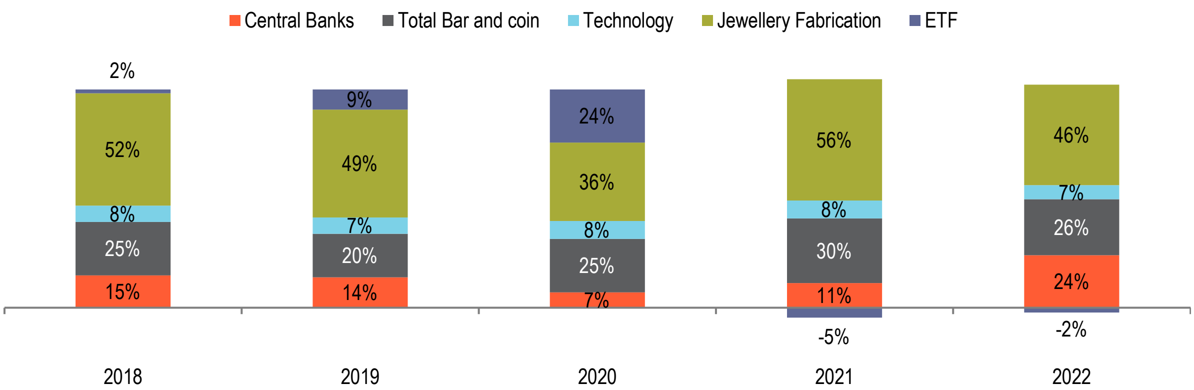
Source: Bloomberg, Bank of Baroda Research, Note: Prices are averaged, 2023: For Re terms price data till 21 Mar 2023 and for US$ terms price data till 22 Mar 2023

The rupee value is based on the dollar price multiplied by prevailing exchange rate plus other miscellaneous charges.

Factors driving gold price:

Demand dynamics: Gold demand firmed up especially the holdings of global central banks increased. Its share in total gold demand rose from 11% in CY21 to 24% in CY22. As per World Gold Council report, major buying was from Turkey and China. Notably, in CY22, PBOC (central bank of China) reported its first ever increase in gold reserves, a phenomenon last seen in Sep'19. Hedging against inflationary risk and geopolitical uncertainty may be cited as primary reasons towards increased holdings.

Fig: 2: Share in total gold demand

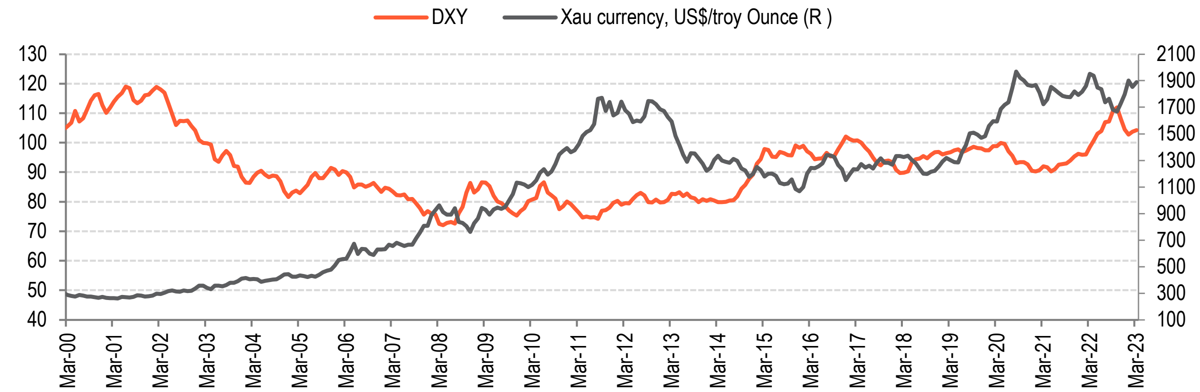


Source: World Gold Council, Bank of Baroda Research, Note: negative share in ETF due to outflow in this segment.

Uncertainty with regard to macro fundamentals globally: CY22 and CYTD23 have been a phases of volatility in growth prospects. Rising inflation dilemma grappled central banks globally. Synchronized slowdown was observed for major economies such as US (real GDP, YoY moderated to 2.1 in CY22% from 5.9% in CY21), Eurozone (real GDP, YoY moderated to 3.5% in CY22% from 5.3% in CY21), Japan (2.3% from 1.1%) and China (3% from 8.4%). Inflation through major part of CY22 remained above targeted levels for major advanced economies. Financial conditions remained tighter with Fed, ECB, BoE rolling back major stimulus undertaken during the Covid period and also hiking rates by 475, 350bps and 375bps respectively in the current cycle. This was translated into higher borrowing costs globally. These have increased safe haven demand for gold.

Dollar and Gold: As an asset class, gold prices exhibit a negative relationship with movement of DXY. Ceteris paribus, since gold is denominated in dollar, any increase in dollar theoretically makes gold less attractive as investment leading to a decline in demand. On most of the occasions, we have seen this negative relationship has hold true. In fact in the longer series, since 2000 onwards, the correlation coefficient between DXY and gold price was -0.28. For a short term series since 2022, the correlation coefficient was -0.76.

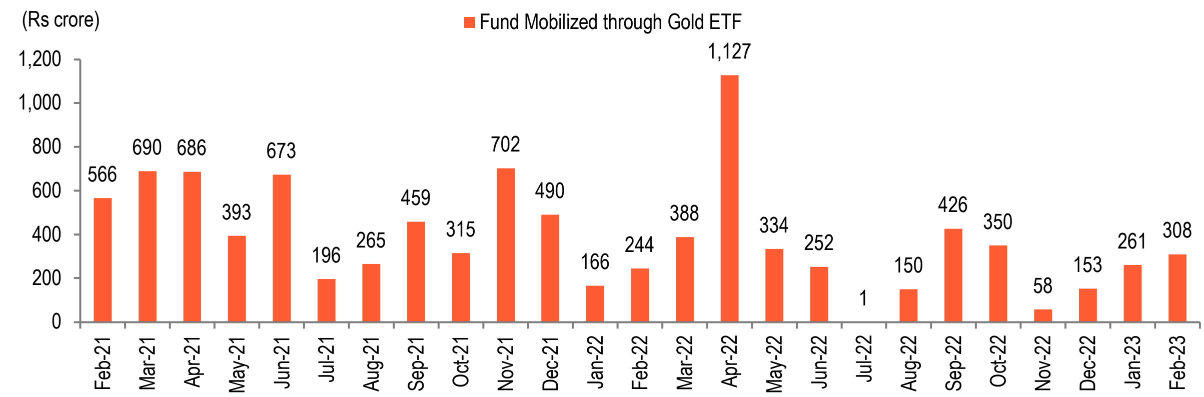
Fig: 3: DXY and Gold price exhibit negative relationship



Source: Bloomberg, Bank of Baroda Research, Note: Gold price and DXY have been averaged to arrive at monthly values

Exchange traded funds driving demand for Gold: As seen in Fig 2, the outflow on gold ETF has been reduced significantly in CY22. From outflow of 189 tonnes, it was reduced to 110tonnes. Even in India, the funds mobilized through gold ETFs are on an uptrend. Rise in gold price would further attract inflows in this segment going forward. In simple terms, gold ETFs are basically units denoting physical gold which may be in paper or dematerialized form. This is significant because in India there are several options of dealing in gold such as spot trading, gold bonds and futures market where one can derive benefits that flow from gold as an investment.

Fig: 3: Fund mobilized through ETF is increasing

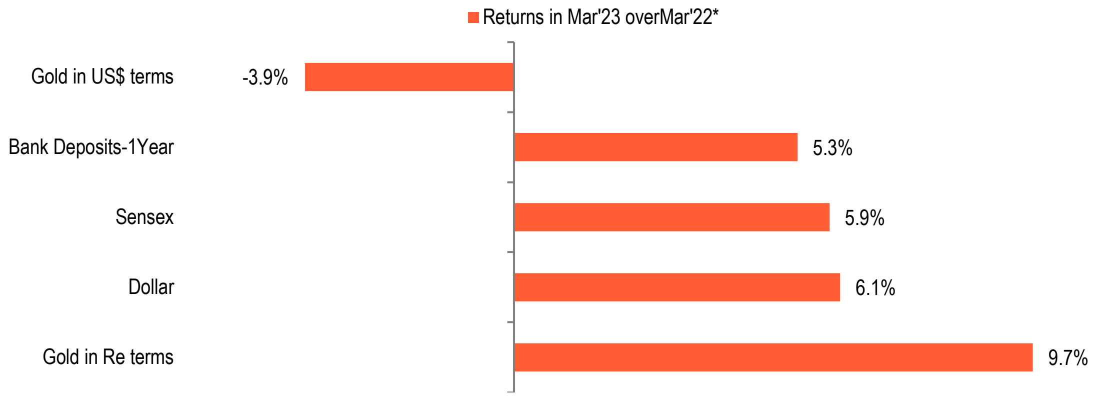


Source:CEIC, Bank of Baroda Research

How Gold has performed across major asset class (21 days of March 2023 over same period of 2022):

As seen in the figure below, much of the rally in gold was on account of an appreciated dollar. In US$ terms, return on gold has fallen by 3.9% whereas in Re terms it has increased by 9.7%. Much of this increase is explained by 6.1% increase in dollar (DXY).

Fig: 4: Gold in Re terms gave maximum return



Source: RBI Bloomberg, Bank of Baroda Research, Note: Return is calculated taking average of 1-21 of Mar'23 over Mar'22 and computing the YoY value in the same period of previous year. Only for Bank deposits the return is as on date. The US$/troy ounce and Re/10gm returns vary so markedly on account of dollar appreciation as well as conversion factor. Data till 21 Mar taken for computational purpose as Re value of gold is available till that date

Outlook on Gold:

The recent upsurge in gold is a risk-off sentiment and inclination towards safe haven demand. The crossing of Rs 60,000/10gm mark for gold was following the Credit Suisse debacle. The news of UBS buying Credit Suisse has heightened volatility in the market. In fact for the past week, the apprehension of banking failure post SVB, First Republic Bank crisis, has caused preference for gold. Both in rupee and dollar terms, gold have gained by above 6% itself in the past 1 week (since 13 Mar).

Dollar to hold cues: a lot will depend on how the dollar moves. A stronger dollar will work against gold. The Fed has raised the rates once again yesterday and it is still uncertain as to whether there would be a pause subsequently. This may help to retain attractiveness of gold as an investment option.

Physical Demand for gold to continue: Demand from India, China is likely to continue. In China, some economic indicators such as retail sales, fixed assets are holding up well. Also monetary stimulus will encourage demand. In case of India macros are relatively well placed compared to global counterparts. Apart from this, in the coming months, seasonal demand for gold would persist. Resilient agriculture sector would also push rural demand for gold higher. In other words, the good old gold would persist and favoured as a major asset class which in turn will put upside risk to its price.

Impact of rising Gold prices on India's macro:

CPI to be watched: Gold has 1.08% weight in the overall CPI basket, which is small when looked at. But within core, much of the movement in Personal Care and Effects inflation (3.9% weight in overall CPI), is attributed to the volatility in the gold prices in the past few months. So the shimmer of gold might bite further on the already sticky core inflation.

Pressure might be on imports: Gold has a share of around 5% in India's overall import basket. In FYTD23, gold imports in value terms has moderated to US$ 31.7bn. However, with rising gold prices trade deficit might (currently in FYTD23 at US$ 247.5bn compared to US$ 172.5 in FYTD22) widen especially, in a scenario where exports are already under pressure.

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