All that Glitters is GOLD

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IMF's deputy MD termed gold as a 'politically neutral safe asset, insulated from sanctions and seizure'. Amongst asset classes, gold remains one of the safe haven for the investors amidst the growing uncertainty, market volatility, a source of diversification and serves as a hedge against inflation during any financial or geopolitical risk.

This has been evident from the data, during the global financial crisis back in the year 2008 and 2009, the gold prices skyrocketed to 32% in FY08 and 22% in FY09. Notably, during the pandemic period (Covid-19), gold prices accelerated by 25% in FY21 reaching the US$ 1825/troy ounce mark. Post the crisis, the prices largely remained steady and edged up again on the back of Russia-Ukraine war. A similar phenomenon has been witnessed this year, the prices have soared by 25.4% in FYTD'25 compared with an increase of 8.9% last year. This is attributable to escalating geopolitical tensions due to the ongoing conflict in Middle East. Given the evolving conditions in the global environment, the prices currently stand at an all-time high mark at US$ 2749 (as of 22-Oct 2024). China is one of the biggest consumer of yellow metal, however, the demand for gold has weakened recently due to price sensitivity on account of slowdown in economic activity.

Gold Reserves: There has been a growing demand for gold and a major chunk is utilized in jewellery, towards investment purposes such as bars, coins and ETF and with Global Central Banks. It serves as significant component in the form of reserves for central banks. According to the World Gold Council report, central banks have purchased a record amount of gold totaling 1037 tonnes in CY23, the second highest since CY22 (at 1082 tonnes). The gold holding across the central banks have picked up in the span of the last 3-years. The US continues to hold the largest amount of gold reserves (in tonnes) across the globe. With the focus shifting towards more gold buying, these can turn out to be early signs of a possible de-dollarization trend, amidst the spur in global instability.

Dynamics of Gold and Dollar:
The dollar movement and gold prices are inversely proportional to each other. Since gold prices are denominated in US$, whenever there is a dollar appreciation, it translates to lower gold prices. In the last 5-years, the gold prices have scaled up by 10% while the dollar index is up by 2%. On the FYTD basis, the gold prices have registered double digit growth of 25.4% so far, while the dollar index for the same period is up by 0.5%. During the same period, there is a negative correlation of (-) 0.6 noted between these two variables.

The US Fed began the monetary easing cycle with the supersized 50bps rate cut in Sep '24 and is expected to reduce the rate again in the upcoming meeting scheduled in Nov'24. The lowering of rates tends to weaken the dollar, pushing away the investors and resulting in capital outflows. Gold as a non-yielding asset turns out to be more attractive during this period. Softness in the greenback pushed the gold prices higher. With more rate cuts anticipated, gold prices are expected to continue with the upward momentum.

India story
In India's context, there has been a steady increase in gold reserves, with a pick up noted in the last 5-years, resulting in an average increase of 18.3%. In FY24, the gold reserve registered an increase of 16.5% against an increase of only 6.2% in FY23. Moreover, this steady rise has also been captured if one notes a higher proportion of gold to total Forex reserves. Back in FY19, the proportion of gold to forex reserve stood at 5.6% and this has increased to 8.1% in FY24. RBI held a significant portion of gold reserves to the tune of 822.1metric tonnes in FY24 compared with 794.6metric tonnes in FY23.

Demand buoyancy:
In Jul '24, India slashed the import duty on gold from 15% to 6% (lowest since Jun'13) with the objective to deter smuggling and boosting the demand. The reduction resulted in a temporary blip in domestic prices which corrected as international gold prices remained in the upswing. Higher demand due to festive spending on account of traditional buying has overall resulted in a demand surge. Above normal monsoon along with higher acreage for kharif sowing is expected to boost rural income and support more purchases this year. Against this demand resurgence, in H1FY25, gold imports have accelerated to US$ 27.1bn compared with US$ 22.2bn in H1FY24, taking the double digit growth to 22.1%. In FY24, it rose by 30% to US$ 45.5 bn after declining by 24.2% in FY23.

Outlook:
Compared with other asset classes, on a FYTD basis, international gold prices are up by 25%, the dollar index is up by 0.5%, and Sensex and Dow Jones are up by 28% and 24% each. Equity indices this year have near about given return that is on par with gold return. The upcoming outcome of US Presidential election can also have some bearing on the gold prices. Trump's presidency could be inflationary given the imposition of tariff sanctions and lowering of taxes as part of policy measures.

The rally in gold prices is expected to continue in the near term in the wake of global economic turmoil, outcome of US Presidential elections, escalating geopolitical risks, monetary easing by global central banks and is expected to serve as crucial tailwinds for price movement.