

# The Curious Case of Gold Prices in India

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**Contact:**  
**Madan Sabnavis**  
Chief Economist  
Madan.sabnavis@careratings.com  
+91-22- 6754 3489

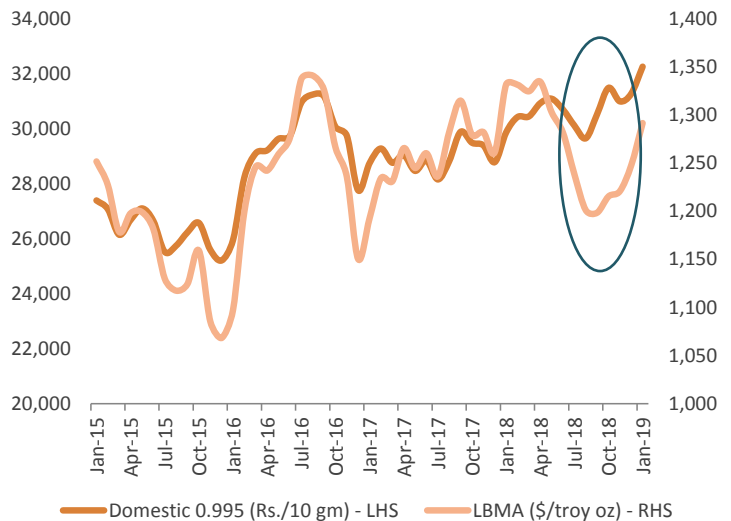
**Saurabh Bhalerao**  
Associate Director – Industry Research  
Saurabh.bhalerao@careratings.com  
+91-22-6754 3519

**Mradul Mishra (Media Contact)**  
mradul.mishra@careratings.com  
+91-22-6754 3515

## Overview

It has been commonly noted that domestic gold prices currently are at a significantly high level for a variety of reasons and that Indian consumers are extremely price sensitive and at higher prices, the market witnesses a certain level of demand compression. The following chart traces the average monthly gold prices, domestic as well as international, beginning January 2015.

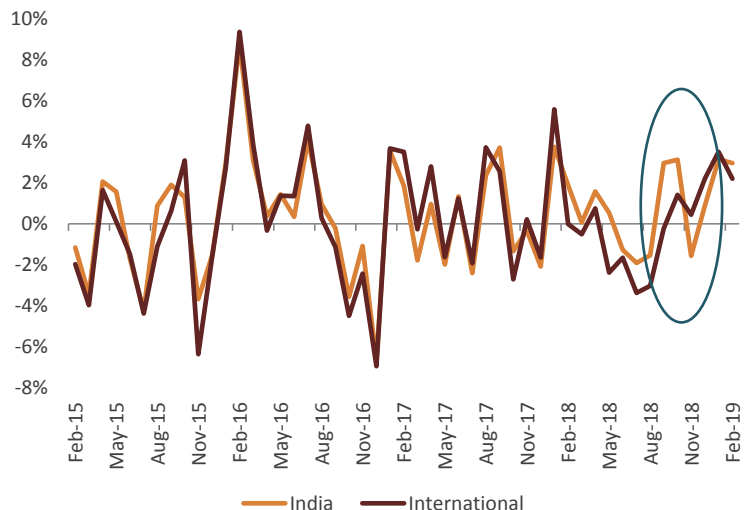
**Chart 1: Trend in Monthly Gold Prices**



Source: CMIE

The chart below captures the month on month price changes in the domestic as well as the international gold prices

**Chart 2: Relative Change in Monthly Gold Prices (in %)**



Source: CMIE, CARE Ratings

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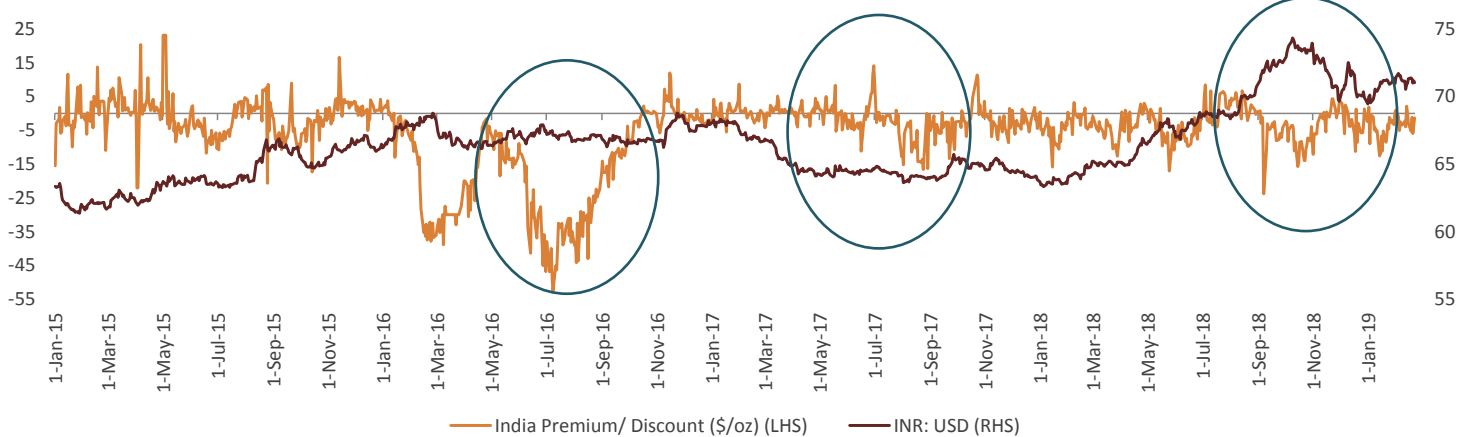
When both these prices and their month on month movements are juxtaposed against each other, the following points become readily apparent:

- Domestic prices generally follow international prices. This is also justified given the country’s near total reliance on imports for meeting its demand and as domestic gold mining is quite small, and,
- Even as the upward movement in the international prices is captured in the domestic price, the fall in international prices is not completely reflected in the domestic prices given that the Indian Rupee has depreciated against the US dollar and also due to import duties which distort the local prices as compared to international prices. As under normal circumstances, gold and dollar share an inverse relationship, any weakness in the dollar pushes up gold prices and vice versa.

The Indian as well as the Chinese consumers generally decide their gold purchases based on their requirements and on the local price of gold. These local prices are different from the international price of gold due to the prevailing local demand-supply dynamics, regulations, import restrictions, seasonal factors and purity requirements.

The following chart compares the difference in the domestic gold price in India and the international price of gold along with tracing this movement with the changes in the INR:USD exchange rate.

**Chart 3: Trend in Indian Domestic Gold Price Premium/Discount<sup>1</sup> to International Price (\$/oz) to INR-USD Movement**



Source: World Gold Council, Investing.com

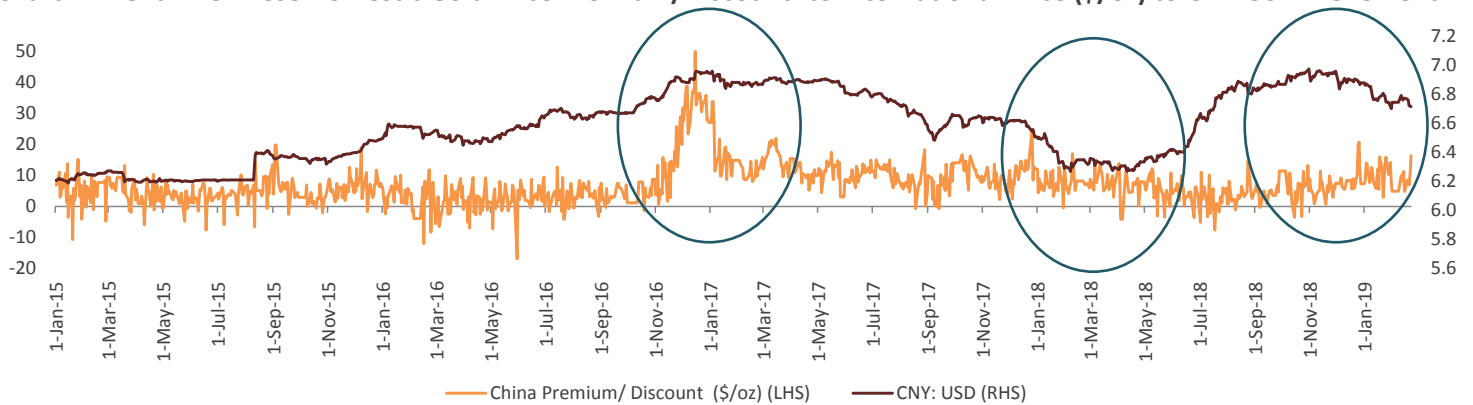
Interestingly, we see a surprising scenario emerge that if the domestic prices in India are converted into US dollar prices and further controlled for import duties, the local gold price was broadly at a discount to the international prices during the period in the chart i.e. 2015 onwards.

- The local rate was at a discount to the international price for more than twice the number of days the price had a premium to the international rate (745 days of discount compared to 301 days of premium).
- Additionally, it can be observed that the premium/ discount was at opposite end of the exchange rate i.e. when the rupee was weaker against the dollar, the local price was at a discount to the international price and vice versa.

Moving on to the larger Chinese consumer, the chart below compares the difference in the domestic gold price in China and the international price of gold along with tracing this movement with the changes in the CNY:USD exchange rate.

<sup>1</sup> Premium/Discount (US\$/oz) = MCX Spot Price (INR/10 gm) x FX rate published by RBI (USD/INR) x 0.32150oz/10gm – LBMA AM fix (US\$/oz) – Import tax (US\$/oz)  
(Source: World Gold Council)

**Chart 4: Trend in Chinese Domestic Gold Price Premium/Discount<sup>2</sup> to International Price (\$/oz) to CNY-USD Movement**



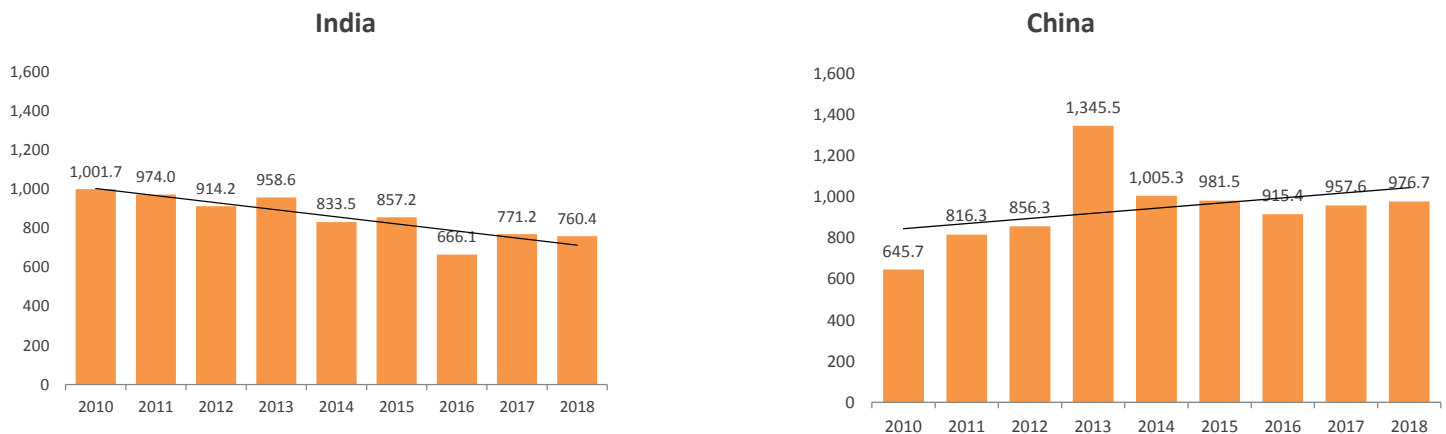
Source: World Gold Council, Investing.com

The above chart indicates that there seems to be minimal correlation between the exchange rate and the domestic gold premium/ discount. The local gold price was broadly at a premium to the international prices during the period in the chart i.e. 2015 onwards. The local rate was at a premium to the international price for more than 10 times the number of days the local price traded at a discount to the international rate (94 days of discount compared to 962 days of premium).

The following two points can be theorised from the above data:

- The higher prices in Indian market are more a function of the exchange rate rather the inherent price of the yellow metal internationally or demand

**Chart 5: Annual Consumer Demand (in tonnes)**



Source: World Gold Council

- Simplistically, lower prices seem to indicate lower demand for a commodity. Referring to the above charts, consumer demand for gold in India seems to be trending down justifying larger share of discount in local prices, while Chinese demand seems to be trending up, indicating the likely reason for the premium in local prices for the period under review.

Due to the weakness in the rupee, India has a higher effective rate for gold with record prices being quoted in the domestic market. Additionally, general elections are scheduled between April and May of 2019, and a new government would take over mid-year. Consequently, demand may seem to be subdued with all this change in the cards. Further, trade negotiations over tariffs between the US and China are underway and any movement therein will impact the currencies which in turn will have an effect on gold.

<sup>2</sup> Premium/Discount (US\$/oz) = Shanghai Gold Benchmark PM (US\$/kg) × 31.1035oz/kg - LBMA Gold Price AM (US\$/oz) (Source: World Gold Council)

**CARE Ratings Limited** (Formerly known as Credit Analysis & Research Ltd)

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway,

Sion (East), Mumbai - 400 022. CIN: L67190MH1993PLC071691

Tel: +91-22-6754 3456 | Fax: +91-22-6754 3457

E-mail: [care@careratings.com](mailto:care@careratings.com) | Website: [www.careratings.com](http://www.careratings.com)

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