Vol I Issue 3 September 2013

₹125/-

Steel360™

A Monthly Magazine on Steel Market

WHY IS STEMCOR SELLING ITS INDIAN ASSETS ?

Leverage Gold Stock in the Country to overcome Present Crisis

The article was written before 25th Aug

R. P. Gupta
CMD, Shiva Cement, Odisha
Author, Turn Around India

We should motivate public to deposit gold with RBI and issue trust receipt in the form of tradable Gold ETF. Thereafter treat all such gold stocks with RBI as a part of forex reserve.

Large current account deficit (CAD) is posing a serious threat to rupee valuation which has depreciated to Rs 65/- per USD in August '13 as against Rs 55/- in May '12 and Rs 44/- in July '11. India stands at the last notch of investment grade rating. If there is any downgrade from this level, there could be a sudden outflow of foreign capital, which can create extreme pressure on currency valuation. It will result in costlier import of energy thereby importing inflation and slowing down growth. Under the prevailing conditions, no foreign investors will come and help. Therefore, we must avert present crisis through some quick and innovative methods. Simultaneously, we must improve business environment for the existing and operating units through easing regulation that can provide a long term solution.

Currently, the total quantum of gold in the country is exceeding 22,000 tonnes which has an approximate value of USD 1,000 billion. And, this is rising owing to import of 1,000 tonnes of the metal every year which is worth about USD 50 billion. We must partially leverage this gold stock for gaining over the present crisis. Hypothetically, if such gold assets could have been in the shape of a USD; the same could have been routed to RBI through banks. Then the kitty of forex reserve in the country could have increased irrespective of ownership of foreign currency asset. It is also true that for all practical purposes, gold can be equated with any foreign currency. Hence, we must design ways and means to bring such gold stock to RBI in a gradual manner like any other currency with an investor friendly approach.

The current Gold ETF scheme is not popular owing to high maintenance and transaction cost. Lack of confidence on depository (includes NBFC) is another plausible reason. A revised gold ETF model has been suggested in my book 'Turn around India' by RP Gupta. One of the major changes suggested therein is to make the RBI a principal depository of gold and issuer of ETF like a 'Trust receipt'. Commercial banks and NBFCs can be its operating agencies. This will certainly improve confidence of investors and make the scheme more acceptable. KYC norms for depositing gold should be simplified and maintenance charges be exempted. Initially, the apex bank may pay 1% per annum as incentive to promote the scheme and slowly the incentive can fade out. An awareness campaign will promote this scheme and fulfil appetite of gold investors.

Such ETF can be en-cashed through commodity exchanges. Alternatively, it can be re-converted into gold by RBI through its operating agency. It means RBI will not carry any liability of repayment rather act as a custodian and depository only. Exchange trading norms should be simplified, charges be relaxed, and transaction cost be reduced. Once this scheme is popular, sizeable portion of gold stock shall come to RBI increasing forex reserves. Gold import will also reduce releasing the pressure on CAD.

Normally, RBI keeps about 10% of forex reserves in shape of gold and hence such gold deposit with RBI can also be treated as a part of the forex reserve. RBI shall return gold on surrendering of ETF. While returning, the reserve shall be reduced to that extent similar to foreign currency transaction. Considering these aspects, the gold stock can be treated in current account instead of capital account. Therefore, such receipts can be used for financing CAD. With such a system, forex reserve will jump by atleast USD 50 billion in the current FY itself. This is barely 5% of total gold reserve in the country and it will keep on rising every year. Gold import will also reduce by at least USD 10 billion, about 20% in a year. This will increase forex reserve, reduce CAD and improve sovereign rating. In turn, this will strengthen Rupee, attract foreign funds and avert crisis.

At the end of the day, structural reforms in our manufacturing, mining and energy sectors is a key necessity for long-term solutions. Such financial engineering solutions are meant for quick relief only.