

Market Update

Union Budget impact on Indian gold market

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The Indian government's sustained campaign for improving overall tax compliance through a carrot-and-stick policy was reflected again in the 2021–22 Union Budget, with a few material announcements that impact gold. Key highlights from the Union Budget announcement on 1 February are:

- a reduction in gold import duty
- the authorisation of the Securities and Exchange Board of India (SEBI) as regulator for domestic gold spot exchanges
- the establishment of welfare schemes for rural areas designed to boost incomes.

The lower import duty will likely enhance consumer demand and discourage unofficial imports. Oversight by SEBI may spur infrastructure development and likely lead to higher trading and more effective gold price discovery. And the rural welfare schemes may indirectly support gold demand through income growth.¹ We believe that this, combined with better gold policies, could bode well for India's gold industry in 2021 and beyond.

Key announcements

Finance Minister Ms. Nirmala Sitharaman outlined key announcements with relevance to the Indian gold market during her annual budget speech:²

- In the Union Budget of 2018–19 the government had indicated its intention to establish a system of regulated gold exchanges, and the current budget authorised SEBI as the regulator. It also expanded the responsibilities of the Warehousing Development and Regulatory Authority to include a commodity market eco-system, embracing vaulting, assaying and logistics, as well as warehousing.
- The current budget lowered custom duty on gold bars and gold doré in light of the significant increase in the gold price since the duty was last raised (from 10% to 12.5%).³ The various changes to the components of import duty and rates are as follows:
 - a) Basic Customs Duty (BCD) on gold bars and gold doré is reduced to 7.5% and 6.9% from the previous level of 12.5% and 11.85%, respectively
 - b) To improve agricultural infrastructure, an additional Agriculture and Infrastructure Cess (AIDC) is levied on several items, including gold bars and gold doré, at a rate of 2.5%.⁴
 - c) The Social Welfare Surcharge (SWS) is imposed on BCD at 10% for gold bars and gold doré but will not be applied to AIDC.
- The pre-trial for disposal of seized gold is to be revised. Expediting such disposals will likely increase the cost of gold seizures and discourage smuggling.

1 Our econometric analysis suggests that there is a positive link between income and gold demand. In particular, based on data between 1990 and 2015, a 1% increase in income (using Gross National Income per capita) has led to a 1% increase in consumer demand. See [India's gold market: evolution and innovation, January 2017, Appendix 2 on page 81](#)

2 [Budget Speech 2021-22](#).

3 Custom duty on gold bars was increased from 10% to 12.5% in the Union Budget 2019–20 and was effective from 6 July 2019. The domestic gold spot price, as measured by MCX Gold Spot has increased by 42% during the period from 5 July 2019 to 31 January 2021.

4 AIDC is a form of tax levied over and above the BCD.

Consumer impact

The new tax structure brings the total import duty on a gold bar (including BCD, AIDC, and SWS) to 10.75%, compared to 12.875% before the budget. With an additional 3% Goods and Sales Tax (GST) consumers will now be expected to pay 14.07% tax on gold bars compared to 16.26% previously – a net tax reduction of 2.19% post budget (**Table 1**). Similarly, the total post-budget import duty on gold doré (including BCD, AIDC and SWS) stands at 10.09% compared to the 12.21% pre-budget level.

Table 1: Tax calculation on gold bars for consumers post- and pre-budget

	Post-Budget	Pre-Budget
	Rs	Rs
Assessable value	100,000	100,000
Basic Customs Duty (BCD)	7,500 (7.5% of 100,000)	12,500 (12.5% of 100,000)
Agriculture and Infrastructure Cess (AIDC)	2,500 (2.5% of 100,000)	
Social Welfare Surcharge (SWS)	750 (10% of 7,500)	375 (3% of 12,500)
Total landed cost	110,750	112,875
Integrated GST (IGST)	3,323 (3% of 110,750)	3,386 (3% of 112,875)
Total cost for consumer	114,073 (110,750+3,323)	116,261 (112,875+3,386)
Total tax for consumer	14.07%	16.26%
Tax reduction for consumer post-budget	2.19%	

Source: Central Board of Indirect Taxes and Customs, World Gold Council

We believe that the lower tax rate on gold could, to an extent, support demand. Lowering tax rates is more about creating a level playing field for the compliant and organised sections of the trade by squeezing the grey market. Grey trading, an unfortunate consequence of high rates of duty, is the prime obstacle to extending gold's role in mainstream financial services and is a serious limitation to the global role India plays in manufacturing handcrafted jewellery and in trading. Tax cuts soften the price increase but are not necessarily a big driver of demand unless the cut is steep or is accompanied by a sharp drop in domestic prices due to other factors.

In this case, the cut of 2.19% juxtaposed with a 42% rise in gold prices since July 2019, when duty was last raised, may not, on its own, be a strong enough trigger for demand, although it is a step in the right direction. Econometric analysis we published in our report, [India's gold market: Innovation and evolution](#), indicated that – everything else remaining constant – a 1% decrease in gold import duty may increase consumer demand by 3 tonnes (t) per year in the long-term.⁵

This suggests that the impact of the approximate 2.2% net reduction in the import duty may result in an increase of slightly less than 7t per year in long-term consumer demand.

A more organised gold market

A lower customs duty may also increase the headwind for gold smuggling. Unofficial imports fell by a whopping 80% in 2020 – to 20–25t – due to logistical disruptions caused by COVID-19, and may be further impacted in 2021 with ongoing flight restrictions and lower customs duty.

With import costs falling, official inflows in 2021 could be spurred on. Lower customs duty and recovering demand may allow official imports to gain strength at the cost of unofficial imports, although the 14.07% duty continues to make the grey market attractive. In a year when unemployment and loss of livelihoods have been a reality, the support eco-system around tax avoidance is likely to be even stronger.

The revision in the pre-trial disposal of seized gold, which will expedite such disposals, may curb unofficial imports due to an increased cost for seizures.⁶ Lower customs duty could also aid the government's efforts to encourage cashless transactions and drive greater transparency, thus supporting the transition towards a more organised gold market.

5 We used a common approach to estimating long- and short-term effects called Error Correction Model (ECM) which we applied to determining the drivers of gold consumer demand using data from 1990 to 2015. See [India's gold market: evolution and innovation, January 2017, Appendix 2, p. 81](#).

6 Gold smugglers lose a part of the smuggled gold through seizures and such seizures are a cost to the smuggler. The cost due to seizures negatively impacts the smuggler's profit margin and discourages smuggling.

Boosting rural incomes

The government's focus on the rural economy is especially important for gold demand. Rural India accounts for around two-thirds of the nation's gold demand, and this is heavily linked to income levels. Indeed, our econometric analysis reveals that, as a rule of thumb, a 1% increase in income leads to a 1% increase in gold demand, all else being equal.⁷

The various rural welfare schemes announced in this year's budget look set to boost rural income:

- In order to enhance farmers' access to finance, agriculture credit is increased to Rs1.65tn (US\$22.6bn) from Rs1.5tn (US\$21bn)
- Allocation to the Rural Infrastructure Development Fund is increased to Rs400bn (US\$548m) from Rs300bn (US\$420m)
- 1,000 existing mandis will now be connected to a pan-India electronic trading platform, e-Nam.⁸

Bullion trading hub

The government announced its intention to establish a system of regulated gold exchanges back in the 2018-19 budget. At that time the Finance Ministry formed an expert committee on the integration of the commodity spot and derivatives markets. The committee suggested that regulation of the pan-India electronic spot exchanges – which involve clearing and settlement, and risk management – should be entrusted to a regulator such as SEBI. Acting on this recommendation, in the current budget the Finance Minister appointed SEBI as the regulator of domestic gold spot exchanges.

The Blueprint for the Gold Spot Exchange in India, prepared by an industry steering committee comprised of 27 major stakeholders of the bullion industry, was released in 2019. SEBI may consider the suggestions made in this blueprint when developing the architecture of the domestic gold spot exchange.

In the 2020-21 budget the government announced its intent to set up an International Bullion Exchange (IBE) in the Gujarat International Financial Services Centre (GIFT-IFSC), which would provide an additional trading exchange for global market participants.⁹

Accordingly, the following steps were taken by GIFT-IFSC:¹⁰

- The government declared that the bullion spot delivery contract and bullion depository receipt would be 'financial products' under the International Financial Services Centres Authority (IFSCA) Act 2019
- IFSCA entered into a Memorandum of Understanding with the India Gold Policy Centre (IGPC) in order to facilitate structured consultations with requisite stakeholders and provide technical and research support
- A working group was formed for focused discussion on the modalities, structure and framework of the exchange
- The International Financial Services Centres Authority (Bullion Exchange) Regulations 2020 were notified on 11 December 2020
- A steering committee was set up to examine the recommendations of the working group
- A working group (including Bombay Stock Exchange, National Stock Exchange, Multi Commodity Exchange, National Securities Depository Limited and Central Depository Services Limited) has been formed to enact the operational framework for the IBE.

The gold spot exchanges in both the domestic and GIFT-IFSC city will help to create an efficient price discovery mechanism. The exchanges may lead to the successful implementation of the gold monetisation scheme and the development of gold-backed products; they may also empower bullion banking and establish India as a major bullion trading hub.

Positive market reaction

The gold industry in India has reacted positively to the recent budget announcements. Rumours had previously been circulating that customs duty on gold might be increased rather than decreased. Consequently, the lower import duty is viewed as a boost to gold demand and a headwind for unofficial imports.

Following the budget, the listed jewellery retailers' share prices closed approximately 1%–9% higher than the previous day (**Chart 1**).

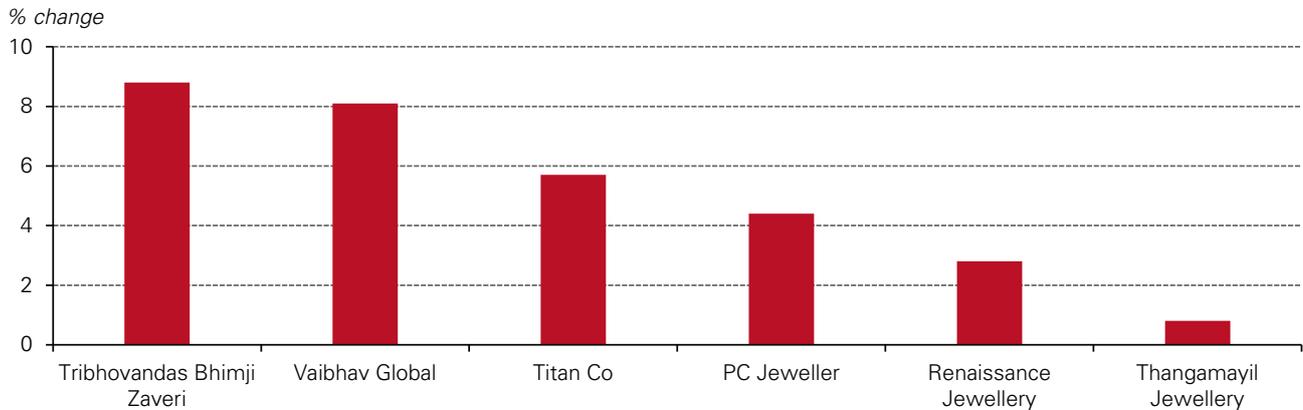
7 Ibid footnote 1.

8 Mandis are marketplaces where food and agricultural commodities are sold. E-Nam is a pan India electronic trading platform for agricultural commodities connecting mandis across India.

9 GIFT is India's only International Financial Services Centre for bringing offshore financial transactions to the Indian territory.

10 Implementation of Budget Announcements 2020-21.

Chart 1: Listed Indian jewellers' share price jumped after the budget*



*Percentage change in share price between closing price on 29 December and 1 February 2021.

Source: Bloomberg, World Gold Council

Outlook

We believe the policy announcements made in the 2021–22 Union Budget should be positive for India's gold industry. A lower import duty may boost consumer demand and curb unofficial imports.

Some policy areas could take longer to progress than others. The formation of the IBE at GIFT-IFSC city may happen more quickly as the relevant notifications and regulations are already published and the authority is working on the enactment of the operational framework of the exchange. The domestic gold exchange, however, may take longer, as SEBI chalks out future steps to work on the modalities of the exchange and the necessary regulatory framework.

The Department of Consumer Affairs has announced that hallmarking will be mandatory for 14, 18 and 22 carat jewellery. This will protect consumers from under-carating and is expected to come into effect from 1 June 2021.

The National Stock Exchange and the Bombay Stock Exchange have accepted 1kg bullion bars processed by Bureau of Indian Standards certified local refineries. This is an important step and will allow local banks and proposed spot gold exchanges to accept these locally processed bars to be accepted.

We believe India's gold market will not only benefit from these reforms but will also indirectly benefit from the various rural welfare schemes announced in the budget. With a revival in the economy and these positive budget announcements, Indian gold demand looks set to recover in 2021 from its 2020 lows.

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight, and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors. We provide insights into the international gold markets, helping people to understand the wealth- preservation qualities of gold and its role in meeting the social and environmental needs of society.

Based in the UK, with operations in India, the Far East and the US, the World Gold Council is an association whose members comprise the world's leading gold mining companies.

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