4 May 2024

Dipanwita Mazumdar

Prospects for gold loan business

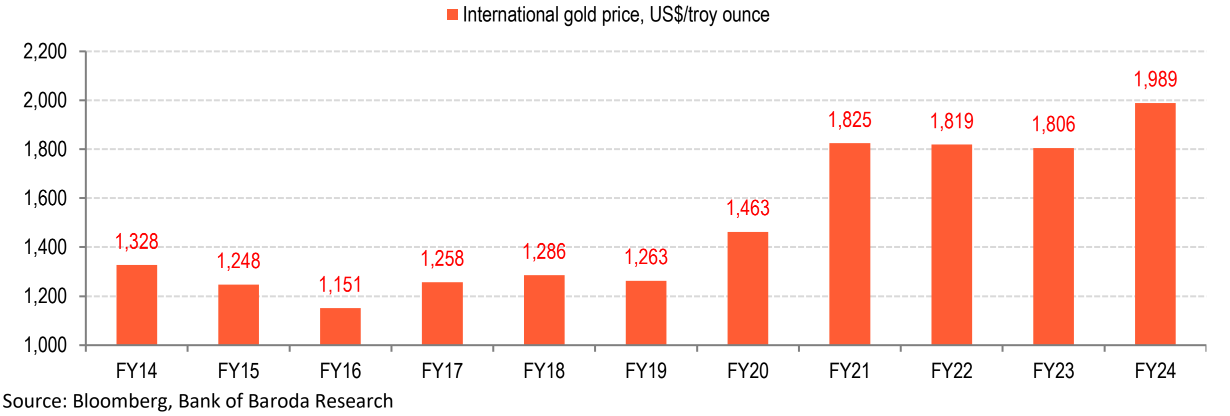
India is the second largest consumer of gold in the world. Since 2019 (pre-pandemic), gold consumption has increased by 10% (till CY23). The prospect for domestic gold demand is brighter on account of cultural affinity, long held traditions and as a safe-haven asset class and amidst growing geopolitical uncertainties. From the point of view of households there has also been a tendency to leverage their gold assets to borrow from institutions to finance consumption against gold as collateral. Thus, it opens more opportunities for both Banks and NBFCs for expanding the loan book of gold.

- *Our study shows that while NBFCs have a higher share of gold loans, when compared with banks, there has been a deceleration lately.*
- *Banks' funding against gold has increased effectively in the past two years.*
- *There has also been an increase in the ratio of incremental gold loans to imports (though it needs to be said upfront that loans sought against gold would not necessarily be from the current purchases but from the existing stock of the metal based jewelry).*

How have international gold prices moved?

The sharp upswing in international gold price was only visible since FY20 which accelerated due to Covid induced shock. Prior to this phase, favourable global interest rates, stable global growth and a rather stable dollar had muted gold demand, thus keeping international gold price range bound. The Covid episode alone led gold price to shoot up to US$ 1,825/troy ounce in FY21 from US$ 1,263/troy ounce visible in FY19, an increase of 44.5%. Post covid there not much downward correction in gold price. A part of the reason was the Russia Ukraine war with other factors being surge in global inflation resulting in restrictive monetary policy regimes. Hence gold as an asset class became a preferred choice of investors as an effective hedge.

Fig 1: Movement of International Gold price



Source: Bloomberg, Bank of Baroda Research

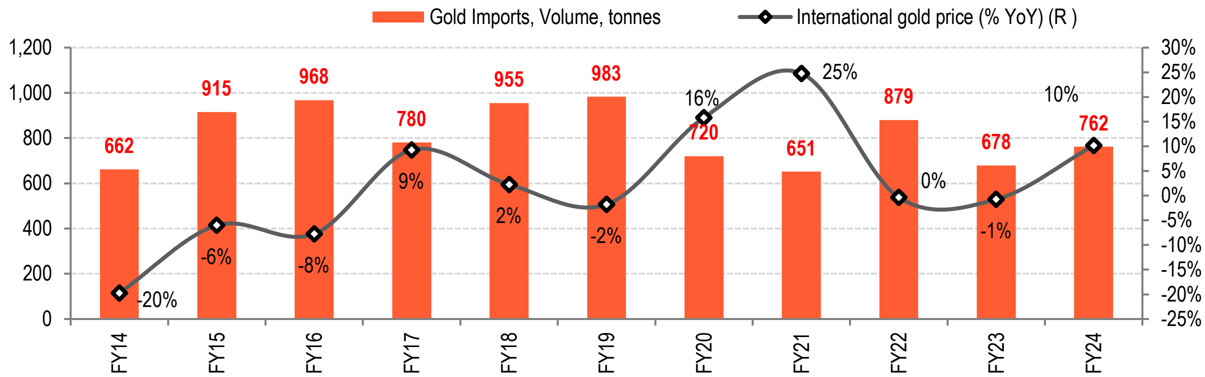
Domestic gold demand

Figure 2 shows that gold imports in volume terms have picked up considerably (exception has been FY17) during the period FY14 to FY19, increasing from 662 tonnes to 983 tonnes. This was supported by firm private consumption demand recording average growth rate of 7% during the same period. Gold imports in FY17 showed moderation partly due to a higher import duty that was imposed to contain the current account deficit (CAD).

However, the Covid led shock has resulted in considerable moderation in gold imports. From 983 tonnes in FY19, gold imports moderated to 651 tonnes in FY21. This is in sharp contrast to the prices data in Figure 1 which showed a considerable uptick, thus giving some signal that domestic demand must also have been buoyant during the same period. However, this is not reflected in the data. A likely explanation could be the slowdown in private consumption demand (PFCE fell by -0.4% between FY19-21).

Post FY21, gold imports were volatile. FY22 witnessed some upward correction with resumption in economic activity. FY23 showed moderation due to an increase in gold import duty by 4.25%. However, some turnaround was visible lately, albeit the level is still lower than the high of FY19.

Fig 2: India's gold imports vis a vis movement of prices



Source: Bloomberg, Bank of Baroda Research

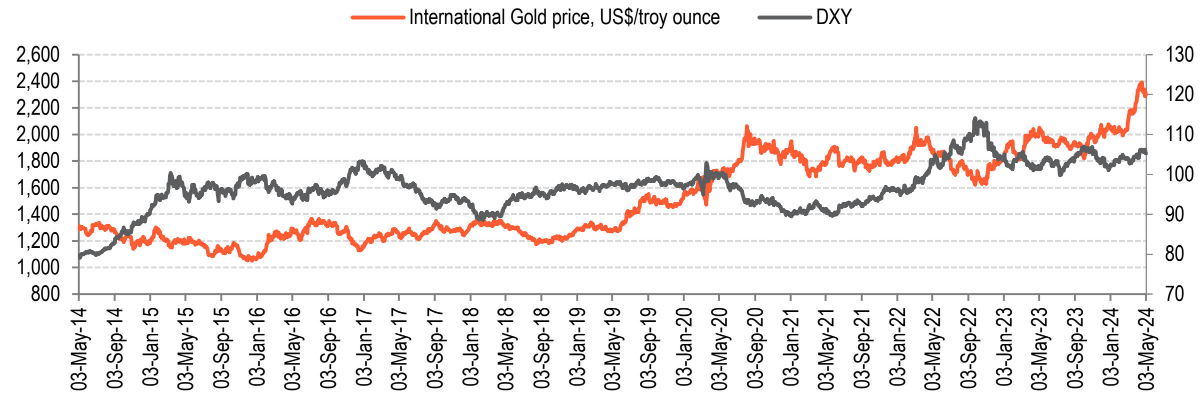
Thus, there is no clear one-to-one relation between import demand in India and international price of gold as several regulatory factors come into play while gauging the demand side.

Upward pressure in gold prices to remain:

1. Volatile dollar: Generally international gold price and Dollar movement should be a mirror image of each other as seen in Figure 3. As an asset class, gold prices exhibit a negative relationship with the movement of DXY. Ceteris paribus, since gold is denominated in dollars, any increase in the dollar theoretically makes gold less attractive as investment, leading to a decline in demand. The long run correlation (Since 2000) between Gold price and DXY translates to -0.17. Going forward, one rate cut by Fed is priced in as reflected in the CME Fed

watch tool data, possibly in Sep'24. Thus, DXY may have a softening bias, hence theoretically gold demand should pick up and prices should notice an uptrend in the near term.

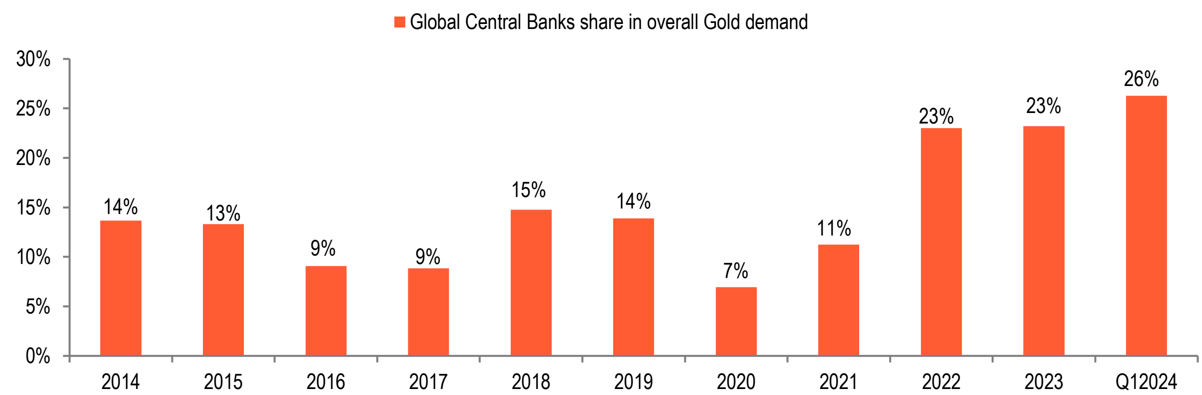
Fig 3: DXY and Gold



Source: Bloomberg, Bank of Baroda Research

2. Geopolitical conflict: Gold demand is likely to persist in the near term from a possible continuation of Israel-Hamas conflict. Apart from this, the likely impact in terms of spike in energy prices as crude prices bears the initial brunt in such cases; might also pose upside risks to inflation. Thus, gold may prove to be the desired choice amongst major asset class. Apart from this, it is an election year for major economies, thus safe-haven demand for gold remains.
3. Central banks are increasing their gold reserves: Over the years, central banks' holding has picked up. From a low of 7% seen in CY20, the share has improved significantly to 26% at present. As per World Gold Council report, Central Bank of Turkey was the largest buyer, followed by People's Bank of China and Reserve Bank of India. This may be on account of attaching greater weight to gold's value in crisis response, diversification of portfolio and credibility on account of store-of-value. This pace is likely to continue in CY24 as well.

Fig 4: Increasing share of central banks in overall gold demand

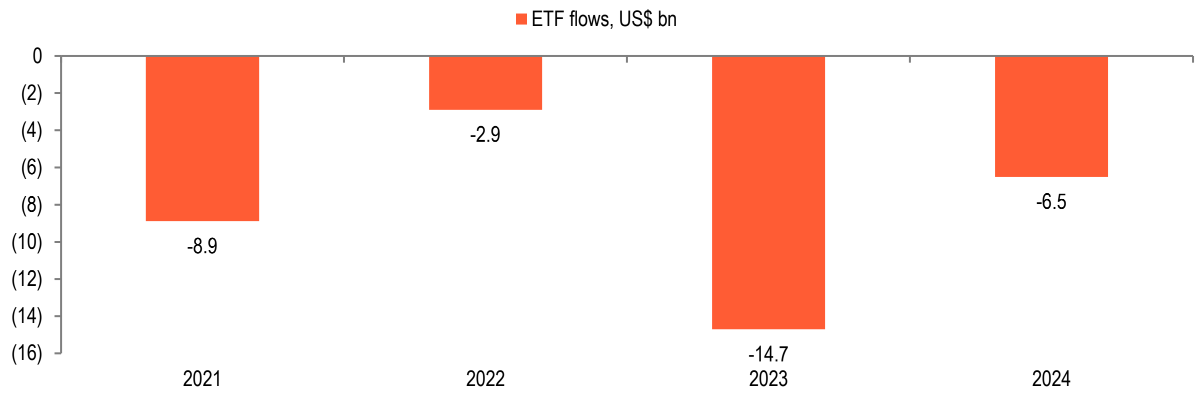


Source: World Gold Council, Bank of Baroda Research

4. Demand from ETFs: There have been consistent outflows in the ETF segment. 2023 level was quite significant. The outflow may be attributable to cashing out of gold back into positive

yielding bonds as highlighted in 'Gold Demand trends' report of World Gold Council. However, some momentum was visible in Q12024, where the pace of outflow slowed. For India, ETFs saw positive Q1 inflows, and two new funds were launched during the quarter.

Fig 5: Global ETF flows



Source: World Gold Council, Bank of Baroda Research

5. Retail appetite changing: Post Covid with resumption of economic activity and usual seasonal phenomenon such as marriage, holding gold as prestige especially as a mark of wealth and prosperity, the retail demand has picked pace. In overall gold demand, the share of jewellery fabrication has significantly increased to 48.6% in Q1CY24 from 36% seen in CY20, Notably, it is getting back to pre-pandemic level of 49.4%.

The financialization of gold

- Simultaneously it has been observed that households have been leveraging their gold assets to secure funds from the financial system. In FY21, there has been considerable jump in loan against gold jewellery by 72.9%. There was moderation in FY22 witnessed more due to the elevated base. Post FY22, the growth rate has been in double-digits, albeit some softening in FY24, on account of increased diligence.

- Table 1 shows that for all the years (except FY22, strong unfavourable base for SCBs) growth rate of SCBs outpaced NBFCs, albeit the outstanding credit under loan against gold jewellery being far higher in actual terms for NBFCs than SCBs. Since FY20, CAGR for SCBs have also been far sharper than for NBFCs despite discounting the last 6months data for NBFCs due to unavailability of information.

Table 1. Growth rate of gold loan portfolio

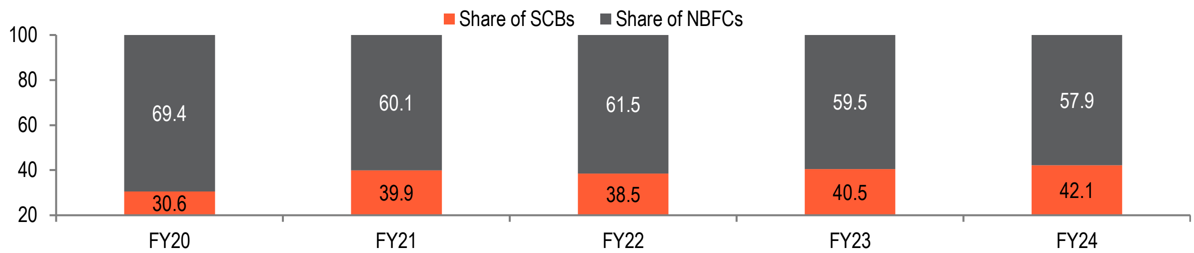
Loans against gold jewellery, Amount in Rs crore	FY19	FY20	FY21	FY22	FY23	FY24	CAGR since FY20
SCBs	24,671	33,257	75,049	74,665	89,382	1,02,658	-
(% YoY)		34.8	125.7	-0.5	19.7	14.9	**32.5**
NBFCs	-	75,451	1,12,898	1,19,311	1,31,165	1,40,901	**-**
(% YoY)		-	49.6	5.7	9.9	7.4	**19.5**
Total	-	1,08,708	1,87,947	1,93,976	2,20,547	2,43,559	**-**
(% YoY)			**72.9**	**3.2**	**13.7**	**10.4**	**22.3**

Source: RBI, Bank of Baroda Research, NBFCs data till Sep'23

How Gold loan portfolio has moved:

The two primary lenders, i.e. SCBs and NBFCs have witnessed an interesting change in shares of loans against gold jewellery. Data for NBFCs lending against gold before FY20 is not available for comparison. Figure 3 shows that SCBs share in gold loan has witnessed increase whereas NBFCs have shown some degree of loss of momentum of late. The same is reflected in the growth rates as well, as seen in the previous section.

Fig 6: How shares in loan against gold jewellery have emerged



Source: CEIC, Bank of Baroda Research, Note for FY24, SCBs data is till Feb'24 and NBFCs data is till Sep'23

Next, we tried to look at the incremental gold loans to imports. The data shows that it was high at 4.22 in FY20. It came down to 3.12 in FY21 and since then has been lower than 1. Given that the ratio was as high as 4.22 in FY20 it can be concluded that there is considerable potential to harness this route to grow the retail book. SCBs have reached its FY20 levels whereas NBFCs are lagging.

Table 2. Potential to grow the retail gold loan book

Ratio of incremental gold loan to gold imports	FY20	FY21	FY22	FY23	FY24
SCBs	0.43	1.64	-0.01	0.52	0.35
NBFCs	3.79	1.47	0.19	0.42	0.26
Total	**4.22**	**3.12**	**0.18**	**0.95**	**0.60**

Source: RBI, Bank of Baroda Research, NBFCs data till Sep'23

Way Forward:

As per major market consensus, gold price is likely to be in the range of US$ 2000-2300/troy ounce. World Bank projects international gold prices at US$ 2,100/troy ounce for CY24 and US$ 2,050/troy ounce in CY25. It further highlights that elevated geopolitical tensions and policy uncertainty would strengthen demand in CY24. Further, the report pointed out that the reserves management strategies of several EMDE central banks would also keep demand for gold higher. This in turn may prompt lenders to offer a higher loan amount against the same quantity of gold, thus resulting in a higher LTV ratio. This leaves more scope for further expansion of the gold loan portfolio and as visible in the data Banks should take it as an opportune moment to garner higher market share with the rapidly ongoing financialization of gold.

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
dipanwita.mazumdar@bankofbaroda.com