New gold bond scheme may draw more investors

Added sparkle: SGB prices should be exclusive of import duty and IGST, demand industry players. | Photo Credit: Getty Image/iStock Photos

The Government announced a few changes in its Sovereign Gold Bond (SGB) Scheme recently. The primary change was the increase in the limit to 4 kg (from 0.5kg) for individuals, HUF and 20 kg for Trusts. This was probably done to encourage high net-worth individuals, rich farmers as well as trusts to invest in these bonds. The basic premise is that most Indians believe in gold as a time-tested and safe asset class and prefer it over other forms of investment.

So far, SGB has been moderately successful with the launch of eight tranches of these bonds since November 2015, garnering approximately 5,000 crore or about 16 tonnes of gold. However, the potential to scale up is huge. Keeping this in mind, the Government also introduced flexibility in the scheme to design and introduce variants to cater to a cross-section of investors.

The sovereign gold bond initially introduced by the Government in 2015 has achieved only limited success, “mostly because of its unrealistic pricing pattern vis-a-vis the international price of bullion,” said James Jose, secretary, Association of Gold Refineries & Mints.

Bullion prices are highly sensitive to international geopolitical tensions, U.S. Federal rates and dollar upswings. They move in a price band of 5-10% year on year. Past SGB prices ranging from 3,150 per gm to 2,750 per gm was often not in parity with the market rate realities and this often led to the SGB consumers losing money, despite earning a 2.5% return on investments. The pricing of SGB ideally should be the average of the bullion price of the 60 day-period preceding the issue date of SGB.

Another factor diminishing the attractiveness of the SGB is its price being pegged to a 10% import duty, and any reduction in the import duty by the Government in the subsequent period would likely inflict severe loss of value to those who have already invested. To tide over this, “the Government should fix the pricing of SGB at bullion rates exclusive of import duty and IGST,” Mr. Jose said,

In case of physical delivery of bullion against SGB at a later date, import duty and IGST should be levied at the point of delivery, according to Mr. Jose. This will make the scheme much more attractive to the general public, thereby enabling substitution of expensive imports that impact the current account deficit (CAD).

While the Government introduced these bonds to help reduce India’s over dependence on gold imports, the move was also aimed at changing the habits of Indians from saving in physical form of gold to a paper form with Sovereign backing. Annual consumption of gold in India is in the range of 700-800 tonnes, almost all of which is imported. Of this, approximately 500-600 tonnes is bought by consumers as jewellery for cultural reasons (mainly for weddings). The balance is in the form of gold bars and coins for savings or investment purposes, which is what the Government hopes to convert to paper form so that both are served — investors are happy as long as they earn some returns and capital appreciation at the time of redemption, as well as it helps reduce an equivalent amount of physical gold imports.

To ensure further success, the Government should allow mass channels such as gold loan Non-Banking Finance Companies (NBFCs) to also market it, said Thomas George Muthoot, director, Muthoot Fincorp, part of the Muthoot Pappachan Group. “Gold loan companies have been a credible, customer-facing platform for millions of Indians who trust them and hence it can help the scheme reach many more consumers in urban, semi-urban and rural areas,” Mr. Muthoot added.

Further, offering gold loan against Sovereign Gold Bonds would help popularise the product from a consumer angle, according to him. For, it would then be perceived as being as liquid as physical gold. Over time, it would also help reduce various risk factors, such as spurious quality gold, and operational costs linked to manual assessment of gold for gold loan NBFCs.

“The increase in the annual investment limit is likely to attract more investment from HNIs and trusts,” said Jimeet Modi, CEO, SAMCO Securities. Added incentives are the interest which will be paid on the bonds, and zero capital gains tax on redemption. “Hopefully, now, the government should be able to garner more inflows than the previous schemes,” Mr. Modi added.

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