GOLD Consumption and its Impact on Indian Economy
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State Bank of India Monthly Review May 2012

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Shri Pratip Chaudhuri  
Chairman  
State Bank of India, Mumbai

Gold Consumption and its Impact on Indian Economy

Dr. Brinda Jagirdar  
General Manager & Head Economic Research Dept.  
State Bank of India Mumbai  
Shri Sumit Jain  
Dy. Manager (Economist), ERD, SBI, Mumbai

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Mr. Morten Dyrmose  
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Legal Decisions on Banking

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Views expressed in the State Bank of India Monthly Review are not necessarily those of the State Bank of India or its Associates.
Dear Shareholders,

It gives me great pleasure to place before you the highlights of your Bank's performance during the financial year 2011-12. Details of the achievements and initiatives taken by your Bank are provided in the Annual Report for the year.

Economic Overview

The global growth environment has remained challenging due to the Euro zone sovereign debt crisis, volatile oil prices and fragile growth in most countries. Though India's GDP growth in FY’12 was one of the best in the world, there are concerns about the state of the economy. Inflation has moderated but remains above tolerance levels and growth has slowed perceptibly. The high twin deficits namely current account deficit and fiscal deficit, combined with elevated inflation, particularly food inflation, pose risks to growth. In this milieu, India's GDP has slowed to 6.5% in FY’12 after growing at 8.4% in FY’11.
Bank's Financial Performance

Against the backdrop of a challenging environment, I am happy to announce that Net Profit of your Bank increased by 41.66% from ₹ 8,265 crores in FY'11 to ₹ 11,707 crores in FY'12, one of the highest net profits earned by any corporate in the country. Operating Profit for your Bank crossed ₹ 30,000 crores mark, rising by 24.62% to ₹ 31,574 crores in FY'12 from ₹ 25,336 crores in FY'11, indicating that core operations remain robust.

Your Bank consolidated gains on the income side by recording a robust increase in Net Interest Income. In particular, Interest Income on Advances rose by 35.18% from ₹ 59,976 crores in FY'11 to ₹ 81,078 crores in FY'12. Interest income of your Bank increased by 30.87% in FY'12 against a growth of 14.65% in FY'11 while growth in interest expenses stood at 29.39% in FY'12. Fee income also recorded a rise of 4.56% in FY'12. Consequently, Net Interest Income increased by 33.10% to ₹ 43,291 crores in FY'12. However, reflecting market conditions, non-interest income showed a decline of 9.31% due to the loss of ₹ 920 crores on account of sale of domestic equity and bonds.

On the other hand, with lower reliance on bulk deposits, interest paid on deposits showed a smaller increase of 28.70% from ₹ 43,235 crores in FY'11 to ₹ 55,644 crores in FY'12. More importantly, the quarterly movement in income parameters shows that the last year has witnessed a constant and consistent up trend, leading to enduring results.

Due to a prudent and market driven approach, your Bank is able to lend profitably and borrow at a reasonable cost which is clearly shown by the strong Net Interest Margin (NIM) of 3.85% in FY'12, up from 3.32% in FY'11. This performance is remarkable because your Bank has the lowest Base Rate in the industry, so, clearly we have the trust of the people as we strive to be 'The Banker to Every Indian'. I can proudly say that not only have we outperformed our guidance but also your Bank's domestic NIM at 4.17% is remarkable as it ranks at the very top among its peers.

You will be happy to see that revenue growth has significantly outstripped growth in expenses. Staff expenses, which have largely been contained after full provisions for current wages and superannuation expenses, rose by 11.59% from ₹ 15,213 crores in FY'11 to ₹ 16,974 crores in FY'12. Due to consolidated improvement all round, total provisions also increased by only 16.37% from ₹ 17,071 crores in FY'11 to ₹ 19,866 crores in FY'12.

Asset Quality

Along with robust growth, your Bank has ensured that asset quality is maintained. As of end-March'12, Gross NPAs of your Bank stood at 4.44%. Net NPAs, that had risen to 2.22% in December'11 also fell below the psychological threshold of 2% to
1.82%. What adds to our strength is that your Bank’s Provision Coverage Ratio improved to 68.10% in March’12 from 64.95% in March’11, reflecting our abundant prudence and caution.

Further, out of total Restructured Standard Assets of ₹37,168 crores outstanding on the books of your Bank as on 31st March 2012, only ₹6,010 crores are in the NPA category, so the risk is well contained.

Our improved performance in respect of NPAs has been possible due to our committed and focused efforts. You will be happy to see that we have reduced our NPAs but increased provisioning as a prudent measure. One reason for the low level NPAs is all-out efforts made by your Bank to step up recovery. This has also been helped by the fact that your Bank has revived the modular structure and posted DGMs at modules for closer supervision and monitoring. Going forward, our endeavour is to keep the NPA levels as low as possible.

**Capital structure**

I am happy to announce that the Capital Adequacy Ratio for your Bank increased from 11.98% in March’11 to 13.86% in March’12. Specifically, the Tier-1 Capital Adequacy Ratio, which is the bedrock of a bank’s strength, rose from 7.77% to 9.79% during this period.

This turnaround has been helped firstly, by improved internal generation and plough back of profits. A second reason is the ₹7,900 crores capital infusion by the Government at the end of March 2012. Finally, the huge effort made by your Bank in terms of optimising capital has paid off.

Let me point out here that while capital infusion happens only once in 3-4 years, as a good corporate citizen, your Bank discharges its duties diligently and is among the highest tax payers in the country every year. Including income tax and service tax, the total tax paid by your Bank rose from ₹7,329 crores in FY’10 to ₹7,647 crores in FY’12.

**Deposits and Advances**

You will be glad to see that deposits of your Bank rose from ₹9,33,933 crores in March’11 to ₹10,43,647 crores in March’12, a growth of 11.75%. I would like to draw your attention to the fact that not only have we grown our deposits, but the quality of your Bank’s deposit growth is very good. In time deposits, we have stopped taking bulk deposits and CDs and instead focused on increasing our stable term deposits portfolio. In a scenario where other banks offer higher interest on savings bank deposits, your Bank’s Savings Bank deposits increased by 11.27% from ₹3,23,394 crores in March 2011 to ₹3,59,847 crores in March 2012.
This was made possible through our efforts to deliver value to all our Savings Bank customers through multi-city cheques, doing away with minimum balance requirement, large number of ATMs and providing accident insurance for savings bank account holders.

Let me point out that overall CASA ratio declined from 48.52% in March’11 to 46.64% in March’12, a decrease of 188 bps, but this is still well above the CASA ratios other banks strive to achieve.

Gross Advances of your Bank recorded a yoy growth of 15.78% from ₹ 7,71,802 crores in March’11 to ₹ 8,93,613 crores in March'12. Credit deposit ratio (domestic) at 78.5% as at the end of March’12 was 220 bps higher than 76.3% at the end of March’11.

Your Bank's advances remain well distributed across all verticals. Large Corporate advances have grown from ₹ 1, 08,741 crores in March’11 to ₹ 1,25,023 crores in March’12, registering a growth of 15%. Mid-Corporate Advances increased from ₹ 1, 57,566 crores to ₹ 1,67,639 crores, growing by 6.4%. In fact, I am happy to place on record that your Bank has crossed a milestone of ₹ 1 lakh crore in agricultural advances.

Retail advances grew 10.9% from ₹ 1,64,576 crores in March’11 to ₹ 1,82,427 crores in March’12. Your Bank continues to be the No. 1 Home Loan provider with a 26% market share. It also maintains its retail market leadership in car loan financing and enjoys a market share of 17.51% as on March 2012.

Your Bank is also conscious of its responsibility towards the MSME segment which provides employment to large numbers and contributes substantially to India's GDP and exports. Advances under the SME Business Unit grew 17.40% from ₹ 1,39,470 crores in March’11 to ₹ 1,63,745 crores in March’12.

**Dividend**

I am happy to announce that the Board of Directors of your Bank has declared a dividend of ₹ 35 per share (350%) for the year ended 31st March 2012.

**New Initiatives**

- The new product, 'Unfixed Deposits', introduced by your Bank for deposits of 7-180 days, with option to break the deposit any time without penalty, has been a great success. With interest rate of 8-9%, this product is uniquely positioned to attract short term funds and compete with liquid mutual funds, which offer returns ranging from 8.8% to 9.5%.

- To promote trade finance, in March’11 your Bank launched a web-based portal, e-Trade SBI, to provide access to trade finance services with speed and efficiency. Presently, the e-trade platform has been introduced in all 6 CAG...
Branches and 63 MCG Branches. As on 31st March'12, 393 corporates have registered under e-Trade SBI.

- Your Bank is the market leader (market share around 25.55% as on March'11) in SHG-Bank Credit Linkage programme having credit linked so far 20.65 lakh SHGs and disbursed loans to the extent of ₹17,600 crores (cumulative) up to March'12.

- To support the growing demand from the retail segment and tap the huge potential available in the market, your Bank moved aggressively to create a comprehensive electronic payment infrastructure to activate our 108 million debit cards and has entered into Merchant Acquiring Business (MAB). It has, so far, approved deployment of more than 28,000 POS terminals. The number of transactions from these terminals rose from 2.62 lakh in March'11 to 10.19 lakh in March'12.

**Associates and Subsidiaries**

Your Bank’s footprints cover every facet of financial services through its Associates and Subsidiaries, and I am happy to point out that all of your Bank’s Associates and Subsidiaries continued to show robust growth. During the year, gross premium of SBI Life crossed the ₹13,000-crore mark and the company recorded a profit of ₹556 crores in FY’12, clocking an impressive YoY growth of 52% with the market share of 19.9%. SBI Life received the NDTV Profit Business Leadership award for organisational excellence for the second consecutive year. SBI Capital Markets Ltd. ranked No. 1 Mandated Lead Arranger - Global Project Finance Loans by Dealogic and posted a PAT of ₹251 crores during FY’12. SBI cards and Payment Services reported after tax profit of ₹38 crores, up by a record 434%.

Your Bank has retained its leadership as Mandated Lead Arranger and Book Runner for syndicated loans in Asia Pacific (excluding Japan but including Australia) in FY’12 also. Remarkably, even in a competitive and challenging environment, your Bank successfully completed 14 high value transactions during the year for financing ECB requirements as well as acquisition related financing requirements of Indian corporates aggregating USD 4,758 million.

You will be glad to see that the Operating Profit of Associate Banks increased from ₹7,569 crores in FY’11 to ₹8,214 crores in FY’12. I am happy to announce that all of our subsidiaries are profitable and well capitalised.

**Accolades**

It is heartening that all our all efforts have received wide attention and appreciation. SBI has been awarded the "Best Trade Finance Bank in India" Award for 2012 by The Asian Banker.
The year 2011-12 saw the CSR activities of the Bank scaling new heights of achievement and glory with your Bank winning the prestigious Golden Peacock Award for Corporate Social Responsibility 2012, awarded in Dubai by the Institute of Directors, New Delhi.

**Looking Ahead**

The global economy remains fragile, but we hope the situation will improve. Though the Euro zone sovereign debt crisis continues to dominate the financial landscape, we are optimistic the global political leaders and regulators will be able to stem the downslide. However, we need to be alert as in today's integrated world, global shocks can get transmitted to the Indian economy. Twin deficits (current account deficit and fiscal deficit) along with low growth and high inflation are the major challenges for Indian economy in the year ahead.

The Indian banking scenario is encouraging and positive. Your Bank is expecting a loan growth of 16% and a deposit growth of 20%. In the coming years, your Bank's main thrust will be on retail, and, as shown by our achievements, we are well positioned to meet the competition. Overall, your Bank will remain vigilant to the new opportunities and challenges as the current economic environment warrants greater prudence.

As we go forward, the Indian and global economic environment could remain challenging for the next few years. Let me assure you that while remaining vigilant to the new opportunities in this milieu, your Bank will act with the necessary prudence as required.

**With warm regards,**

**Yours sincerely,**

(PRATIP CHAUDHURI)
Gold Consumption and its Impact on Indian Economy

Dr. Brinda Jagirdar
General Manager & Head Economic Research Dept.
State Bank of India Mumbai

Shri Sumit Jain ¹
Dy. Manager (Economist), ERD, SBI, Mumbai

Introduction
Indians have always had a yearning for gold and, according to the World Gold Council, India is the world’s largest consumer of gold. Importantly, India's gold production continues to be minimal and almost all of India's demand for gold is met by imports. Gold demand has not only remained high but has shown a sharp rise in the recent period especially since 2001 as reflected in the increase in the volume of imports. The demand has shown no signs of abating despite the incessant price rise. Given that fact that much of this held as idle asset, one can only quote Lord John Maynard Keynes who famously commented that India's gold consumption reflects the 'ruinous love of a barbaric relic'.

Investment in Gold: Gold as a Safe Haven
Investment in gold has been perceived as 'safe haven' especially during periods of financial and economic stress particularly inflation. A 'safe haven' can broadly be defined as an asset that protects investors' wealth against financial turmoil. Therefore, an asset with a stable real value or, at least a stable nominal value is an uncontroversial safe haven, as it allows its holder to resell it without loss at any time (Coudert & Raymond, 2010). Viewed from this aspect, gold possess almost all characteristics essential to be classified as a safe haven.

¹Dr. Brinda Jagirdar, GM & Head, and Shri Sumit Jain, Dy. Manager (Economist), Economic Research Department, State Bank of India, Corporate Centre, Mumbai.
During the last decade, volatility of gold prices has been higher than that of sovereign bond markets but lower than riskier assets like equities and other commodities (Mishra & Mohan, 2012). Over the years, the process of financialisation of commodities has led to a far greater interest in gold as an alternative asset. Investors take confidence from high liquidity through daily trading in gold, which exceeds that of any sovereign's bond market with the exception of US Treasuries. The rising share of bars and coins and gold ETFs (Exchange Traded Funds) in total demand for gold is a sign of the financialisation of the commodity.

Gold has emerged as the best performing asset over the last year strengthening the perception that in an inflationary environment where real interest rates tend to be negative, gold prices can only rise.

Source: Bloomberg, World Gold Council

In the recent inflationary times, when WPI inflation has been ruling at 9-10% since early 2010, gold is perceived as the best hedge instrument for savers. From the chart below it is clear that inflation and increase gold consumption have been moving in tandem. This trend is also support by the correlation between WPI inflation and gold consumption which is positively co-related and stood at 0.36.

### Table 1: Rise in Gold Prices

<table>
<thead>
<tr>
<th>Quarter End</th>
<th>Gold Prices*</th>
<th>YoY% Growth</th>
<th>Quarter End</th>
<th>Gold Prices*</th>
<th>YoY% Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-12</td>
<td>27854</td>
<td>33.69</td>
<td>Dec-10</td>
<td>20506</td>
<td>19.50</td>
</tr>
<tr>
<td>Dec-11</td>
<td>28063</td>
<td>36.85</td>
<td>Sep-10</td>
<td>19056</td>
<td>21.20</td>
</tr>
<tr>
<td>Sep-11</td>
<td>27487</td>
<td>44.25</td>
<td>Jun-10</td>
<td>18745</td>
<td>28.05</td>
</tr>
<tr>
<td>Jun-11</td>
<td>22214</td>
<td>18.51</td>
<td>Mar-10</td>
<td>16614</td>
<td>9.07</td>
</tr>
<tr>
<td>Mar-11</td>
<td>20835</td>
<td>25.41</td>
<td>Dec-09</td>
<td>17159</td>
<td>32.79</td>
</tr>
</tbody>
</table>

Source: RBI; * per 10 grams at Mumbai
Gold prices in India have seen a sharp spurt from ₹17,159 per 10 grams in December 2009 to ₹27,854 per 10 grams in March 2012. Incidentally, inflation, which stood at 7.15% in Dec09, started trending up persistently from here on towards 9-10% levels. The spectacular rise in gold prices in the recent period can be attributed to several factors (Mishra & Mohan 2012):

- During periods of geopolitical risks, commodities have a great appeal as safe haven. The unrest in Libya and Middle East provided the initial impetus for its rise in 2011.

- Measures like quantitative easing have weakened fiat money vis-a-vis commodities in general and gold in particular. With US recovery remaining fragile and European economies clearly slipping into a recession, there is speculation of a third round of quantitative easing and fears over further debasement of the US dollar, which further enhances the appeal of gold as a safe haven.

- Gold has come to represent a safe haven in times of fall in risk appetite when sovereign debt sustainability on both sides of the Atlantic is being questioned. The political disagreement over how to address the large and growing government debt particularly preventing the sovereign debt crisis in Europe from escalating and breaking up the Euro zone, the resultant downgrade of USA, Japan and several European countries by rating agencies has quickened the pace of appreciation of gold. Some analysts and investors feel that in the current muddled political and economic scenario, gold is the only "hard currency" left.
India: Gold as a Savings Instrument

Table 2: Composition of household savings in financial and physical assets

<table>
<thead>
<tr>
<th>Period</th>
<th>Financial Savings</th>
<th>Physical Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950s</td>
<td>24.7%</td>
<td>75.3%</td>
</tr>
<tr>
<td>1960s</td>
<td>33.4%</td>
<td>66.6%</td>
</tr>
<tr>
<td>1970s</td>
<td>37.6%</td>
<td>62.4%</td>
</tr>
<tr>
<td>1980s</td>
<td>49.9%</td>
<td>50.1%</td>
</tr>
<tr>
<td>1990s</td>
<td>54.9%</td>
<td>45.1%</td>
</tr>
<tr>
<td>2000s</td>
<td>47.2%</td>
<td>52.8%</td>
</tr>
<tr>
<td>2010-11</td>
<td>43.9%</td>
<td>56.1%</td>
</tr>
</tbody>
</table>

Source: RBI Handbook of Statistics on Indian Economy

As financial markets have developed, savings of the household sector in India have come to be held in various financial instruments issued by intermediaries like banks, financial institutions and the Government. However, besides savings in financial instruments, households continue to have significant savings in physical assets like gold, housing, real estate, etc.

With increasing financial intermediation and development of new institutions and new products, there has been a decline in the share of savings in physical assets in the total savings of the household sector from 75.3% in the 1950s to 52.3% in the 2000s. However, this increased to 56.1% by 2010-11 due to poor performance of financial assets in that year.

Gold consumption in India is around 20% of the physical savings in the country. In India, households have traditionally purchased gold for marriages, social customs, meeting unexpected exigencies, etc. In the national income accounting, such purchases of gold are not treated as part of savings but are treated as consumption. From the consumer's point of view, gold is seen as a highly liquid asset and even though it does not earn any return to the holder it protects the wealth of the saver as seen by the persistent and sharp upward movement in gold price. The drawback, however, is that such purchases of gold result in savings remaining idle and not available for productive investment.

Gold Consumption in India

According to the World Gold Council, India accounted for over a quarter of the global gold purchase in 2011, lower than under one third in 2010. In calendar year 2011, Indians bought a total of 933.4 tonnes of gold worth $ 46.4 bn against 1006.3
tonnes worth $ 39.9 bn in 2010 (Table 2). Hence, in value terms, Indians bought 16.3% more gold in 2011 despite of the fact that average price of gold in India was 30.7% higher in 2011 compared to 2010\(^2\).

**Table 3: Gold Consumption in India**

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>% Change</th>
<th>Q1 2011</th>
<th>Q1 2012</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jewellery (in Tonnes)</td>
<td>657.4</td>
<td>567.4</td>
<td>-13.7</td>
<td>187.6</td>
<td>152.0</td>
<td>-19.0</td>
</tr>
<tr>
<td>Bars/Coins (in Tonnes)</td>
<td>348.9</td>
<td>366.0</td>
<td>4.9</td>
<td>103</td>
<td>55.6</td>
<td>-46.0</td>
</tr>
<tr>
<td>Total (in Tonnes)</td>
<td>1006.3</td>
<td>933.4</td>
<td>-7.2</td>
<td>290.6</td>
<td>207.6</td>
<td>-28.6</td>
</tr>
<tr>
<td>Total Value (in $ bn)</td>
<td>39.9</td>
<td>46.4</td>
<td>16.3</td>
<td>12.9</td>
<td>11.3</td>
<td>-12.4</td>
</tr>
<tr>
<td>Share in Global Purchase</td>
<td>31.3%</td>
<td>26.7%</td>
<td>-</td>
<td>30.2%</td>
<td>24.2%</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: World Gold Council (Quarterly Reports)

**Table 4: Gold Imports and CAD (in $ mn)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Gold Import</th>
<th>Current Account Deficit</th>
<th>Gold Import as % of CAD</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>4170</td>
<td>3400</td>
<td>82%</td>
</tr>
<tr>
<td>2002-03</td>
<td>3845</td>
<td>6345</td>
<td>165%</td>
</tr>
<tr>
<td>2003-04</td>
<td>6517</td>
<td>14083</td>
<td>216%</td>
</tr>
<tr>
<td>2004-05</td>
<td>10538</td>
<td>2470</td>
<td>23%</td>
</tr>
<tr>
<td>2005-06</td>
<td>10831</td>
<td>1102</td>
<td>10%</td>
</tr>
<tr>
<td>2006-07</td>
<td>14462</td>
<td>9565</td>
<td>66%</td>
</tr>
<tr>
<td>2007-08</td>
<td>16724</td>
<td>15737</td>
<td>94%</td>
</tr>
<tr>
<td>2008-09</td>
<td>20726</td>
<td>27914</td>
<td>135%</td>
</tr>
<tr>
<td>2009-10</td>
<td>28640</td>
<td>38383</td>
<td>134%</td>
</tr>
<tr>
<td>2010-11</td>
<td>33876</td>
<td>44281</td>
<td>131%</td>
</tr>
<tr>
<td>2011-12*</td>
<td>45500</td>
<td>53716</td>
<td>84%</td>
</tr>
</tbody>
</table>

Source: RBI  
* till Q3 (Apr-Dec 2011)

\(^2\) As per RBI data (Handbook of Statistics on Indian Economy), average price of gold per 10 grams in Mumbai stood at ₹ 23,872 in 2011 compared to ₹ 18,268 in 2010, higher by 30.7%.
Rising gold imports to meet domestic demand saw a doubling in gold imports in four years between FY09 and FY12 (Table). Interestingly, the sharp spike in gold imports in FY11 and FY12 was against average inflation of 9.6% in FY11 and 8.8% in FY12, suggesting that gold was seen as a hedge against inflation. After oil, gold is the second largest item of imports. In fact, if gold imports are eliminated, the entire current account deficit can be wiped out.

India's current account deficit which stood at 2.7% in FY'11 is expected to widen to 3.5% in FY'12 and one of the reasons is the sharp increase in gold imports which is likely to be around $58 billion in FY'12 against $34 billion a year ago.

To curb the import of gold and contain the current account deficit, the Union Budget 2012-13 raised the basic customs duty on standard gold bars, gold coins and platinum from 2% to 4% and on non-standard gold from 5% to 10%. Excise duty on refined gold was also increased in from1.5% to 3%.

Following a national strike among jewellers, demand in both the jewellery and investment sectors was affected as consumers and traders protested against the implications of a change in the tax treatment of gold. Currency weakness and volatility in the imported price of gold in rupee terms added to consumers' reluctance to increase gold purchases, resulting in a significant decline in gold consumption in Q1 2012.

Going forward, the second quarter could see a normalisation of investment demand as consumers adjust to higher import taxes and bullion dealers rebuild their stocks. Overall, India will continue to generate a significant proportion of consumer demand given its strong cultural link with the metal but lower number of auspicious days in the 2012 Hindu calendar could temper gold demand to some degree.

**Impact of Gold Consumption on Household Savings and GDP**

As discussed earlier, purchase of gold is treated as consumption not savings. In this study we examine the impact of shifting gold out from physical savings and bringing this into financial savings of households and its impact on domestic savings and GDP. In this context, we have also examined the income elasticity of demand for gold in India.
The table shows that total gold consumption in India (jewellery plus investment in bars/coins) stood at 2.54% of GDP in 2010-11 and 2.40% of GDP in 2011-12. This is investment in an idle asset. Therefore, if this could instead be channelized into productive investment, we believe the positive impact on growth would be very beneficial for the economy.

**Scenario 1:** If 100% of gold consumption in India can be moved into financial savings, then gross domestic savings will increase to 34.8% of GDP (32.3% + 2.5%) for 2010-11 and 32.53% (30% + 2.53%) in 2011-12. But this scenario is very unrealistic since total consumption of gold comprises jewellery and investment in bars/coins and given the strong affinity for gold jewellery it is not possible to convert the entire consumption into investment.
Scenario 2: Therefore in the second scenario we assume that only the portion held in bars/coins is converted into financial savings. Out of total consumption in 2010-11, 35% was held in bars/coins and 65% in jewellery, hence if this 35% moves out of physical savings then India's household savings will increase to 33.17% of GDP (32.3% + 0.868%). In 2011-12, 40% of consumption was in bars/coins, which, if it had been channelized into financial savings, the country's gross domestic savings would instead be around 31% of GDP (30.0% + 1.01%).

Hence, in a very moderate scenario even if we assume channelization of 40% of gold consumption into financial savings, our GDP will increase by 1%.

Table 6: Increase in GDP Growth Rates for 2011-12

<table>
<thead>
<tr>
<th>% of Gold Consumption convert into Savings</th>
<th>Scenario 1</th>
<th>Scenario 2</th>
<th>Scenario 3</th>
<th>Scenario 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in GDP (in %)</td>
<td>2.53%</td>
<td>2.02%</td>
<td>1.52%</td>
<td>1.01%</td>
</tr>
</tbody>
</table>

Source: Authors' Calculations

Income Elasticity of Gold

Empirical observation shows that as incomes increase, there is a propensity to buy more gold. To see whether this is borne out by data, we have examined the income elasticity of demand for gold. Earlier, a study by Kannan and Dall (2003) analysed the various factors of demand for gold in India and concluded that demand of gold has inverse relationship with its price and is positively related with income. In our study we have calculated the income elasticity of gold since income is the biggest deciding factor affecting gold consumption.

To calculate the income elasticity we ran regression (Ordinary Least Square) by taking log values of quarterly gold consumption (GOLD) as dependent variable and log value of quarterly GDP (INCOME) as independent variable.

\[
\ln(GOLD) = \alpha + \beta \ln(INCOME) + \varepsilon
\]

Here the coefficient \( \beta \) is interpreted as the income elasticity and read as: \( \beta \)% change in gold consumption due to 1% change in income (GDP). To calculate this \( \beta \) we culled data on quantity of gold consumption in India (in tonnes) from the World Gold Council, gold price Mumbai (per 10 grams) was taken as a proxy for price of gold in the country, and data on quarterly GDP from RBI's Handbook of Statistics on Indian Economy from Q2 2002 to Q1 2012. The result of our regression analysis is as under
(figures in parentheses are t-statistics):

\[ \ln(\text{GOLD}) = -11.812 + 1.554\ln(\text{INCOME}) \]

\((-5.90)\) \((-10.80)\) \(R^2 = 0.75;\ N = 40\)

The regression shows that:

(I) Elasticity coefficient \((\beta)\) is positive and highly significant even at 1% level of significance; and

(ii) For every 1% increase in income, gold consumption increases by 1.554%, showing that gold consumption is highly income elastic.

Conclusion

Gold holds immense opportunities as a source for catalysing growth. On the internal side, it has potential to increase the domestic savings rate and consequently GDP growth rate, and on the external side it has the potential to curtail the current account deficit (CAD).

Since India is one of the fastest growing countries, in the future as the incomes rise, consumption of gold will also go up. However, if we are able to convert even 30-40% of gold held in physical assets into financial assets and deploy these for productive purposes, then GDP growth of 9-10% will become a reality.

Gold imports have been continuously increasing and in 2010-11 these imports exceeded the entire current account deficit, touching 131% of the CAD. Gold imports in the first three quarters of 2011-12 amounted to 84% of the current account deficit. So curbing gold imports will help to bring down the current account deficit. About a fifth of India’s gold imports are estimated to be re-exported as jewellery while the remainder is net new flow that goes into domestic holdings as a store of value. So while we need policies that discourage gold imports, at the same time, very high tariffs could encourage gold smuggling.

If we can unlock value and provide new financial products like Gold Exchange Traded Funds (ETFs), or alternatives like inflation-indexed bonds for surrendered gold, then we can monetise the hidden value lying idle and channel this for supporting production in the economy, while at the same time meeting the incremental domestic demand for gold. We believe there is a big role for the banking sector in this context to tap this huge saving reserve.
References


India, Russia and China have in recent years undergone a remarkable transformation through financial reforms and their increased emphasis on playing an active role on the global political stage. Moreover, together with Brazil, they of course constitute the much talked about BRIC group.

This comparative analysis is a product of my fieldwork in the above mentioned countries. My research, at the University of St Andrews, Scotland, centres on the globalisation of financial markets and took me from early August to mid-November 2011 to Russia (Moscow), India (Mumbai) and China (Shanghai) to meet experts and opinion formers who could help me to understand better the functioning and efficacy of financial markets in these countries.

I visited each country for two weeks and complemented my trips with further conversations with local observers before and after each journey. Between the three countries I had conversation with a total of 54 individuals who were kind enough to share their in-depth knowledge with me.

This article touches upon some of the key findings that arose from my visits. For comparison purposes, this brief overview will focus on Board Composition, Information Flows, the Judicial Systems, the Stock Exchanges and the local Financial Regulators.

The views expressed are personal
Board composition

All three countries are increasingly recognising the importance of appointing independent directors to boards.

In Russia the government is currently replacing state officials with independent directors on the boards of state controlled companies, in an endeavour to improve corporate governance. In many cases it may be questionable whether they are actually independent. The nominees are often informally tied to the government. However, it is a step in the right direction.

India’s Clause 49 (Sarbanes-Oxley Act inspired), which was introduced in 2001 by the Securities and Exchange Board of India (SEBI), significantly raised the corporate governance standards expected and required of Indian companies. It, for example, stipulates that at least 50 percent of the board of directors should consist of independent members, if the chairperson is a non-executive director. However, this figure drops to one-third if the chairperson is a non-executive director. Such clear requirements certainly represent a positive development and should help form future norms in the board rooms.

In China independent directors are becoming more common but of the three countries visited, it would seem China is currently the least proactive in this area.

Information flows

In India, information has been made almost completely freely available since the liberalisation of the media in the 1990s. China and Russia, to some extent, have also made significant progress in this regard, although on their own very specific terms.

Russian censorship of the press is evident in all their media; especially any medium that reaches the wider population. As a result, TV news programmes are seen by the public as listing the policy objectives of the Kremlin and not transmitting actual impartial news i.e. it is a modern propaganda tool. However, the two main business papers (Vedomosti and Kommersant) have a reputation for being quite independent and objective. There are also some minor intellectual news sources that have remained independent of governance influence. The Internet is also not censured and is used by mainly one activist (Alexei Navalny) to publically highlight shortcomings corporate governance practices. As noted by one interviewee, Russians have the tools to become well informed but they have been very passive.

In China all types of media are heavily controlled and censored by the state; to the extent that the Internet is policed and micro-managed by the state. However, the Internet is increasingly becoming a forum for discussing corruption and poor business ethics. Although key terms and phrases are bannedblocked on-line, locals have been inventive in working around these general rules. When scandals are
widely disseminated on the Internet, the state normally takes action against the alleged offenders. Although the Internet is subject to the "Great Firewall of China" (the State filters all information flow to outside countries) it is possible to circumvent this instrument by using software (fairly common among the younger generations). Foreign companies can also access blocked sites from their offices (using proxy servers) and mobile phones is instrument to access restricted material.

Despite the obvious restrictions on information flows, China has slowly become more open in terms of allowing domestic Chinese news reach the foreign community. For example, Shanghai now has the longest Metro network in the world; it is clean, fast, with very affordable ticket prices and each station is listed and announced in both Mandarin and English. However, during my stay there was an accident in one of the railway lines. I read about the accident the following day online (in an English newspaper). Only a few years ago, such an incident on a prestige project would have taken weeks to reach international sources.

The Indian media is no longer restricted and there are currently a significant number of political and corporate corruption scandals being widely published there. As several interviewees noted, it is a healthy sign that these issues are coming to the surface and being dealt with publically. The Right to Information Act of 2005, where public authorities are required to release information requested by the public within 30 days, is widely praised for improving accountability and transparency in India.

**Judicial system**

In India, legal processes can be burdensome and at times subject to influence, whereas in China compliance might be incomplete, but the rule of law is unchallenged. By contrast, in Russia rapid transition, whilst conferring many benefits, has resulted in an erosion of the primacy accorded to rule of law.

The India judiciary system is overstretched but it might be improving. There is a considerable backlog of cases and the process is slow (a large number of frivolous cases may have contributed to the current inertia). It has also been suggested that corruption is a problem within the system.

In China the effectiveness and fairness of the judicial system, interestingly, varies across the country. For example, one international company stated that they choose Shanghai to base their China office over Beijing mainly due to the more business friendly and fairer count system in Shanghai. You will find that almost all the financial entities in mainland China are based in Shanghai. They seek to be at arm length from the Government. On the other hand, industries dependent on political goodwill (e.g. infrastructure firms) are based in Beijing. Notwithstanding this, corruption is still a general problem within the Chinese judicial system.
Legal accountability is a major concern in Russia. It permeates all aspects of corporate activity and corporate governance; including minority shareholder rights. Russian courts are notoriously unreliable (one high profile case has been IKEA’s struggle to circumvent extortion and corruption in Russia). One lawyer in Moscow noted that allegedly all judges in Russia can be either bought or influence through politicians. As a result, people who invest into Russia often use sale and purchase agreements that are almost invariably under the English law structure and go through London courts and Stockholm arbitration if required. President Medvedev is credited by interviewees for ‘saying all the right things’. However, they noted that no action as such had been taken to mitigate the issues. Interviewees were also concerned that if Prime Minister Putin were to be re-elected as President in March 2012 that political reforms would be either halted or reversed e.g. further privatisation of State Enterprises. It later became clear that Medvedev and Putin had agreed in private that Putin would in effect regain control of the Presidency in March 2012. Putin officially assumed the Presidency again on May 7, 2012.

**Stock exchanges**

Russia proactively merged its two main stock exchanges in December 2012, which is seen as a positive development. China's government fully controls the flow of companies listing and adjusts accordingly. In India the NSE has overtaken the BSE in terms of credibility and momentum.

The merger of the MICEX and RTS stock exchanges is a part of Russia’s endeavour to turn Moscow into a world financial centre. Another link in this strategy is The Moscow International Business Center (also known as ‘the City’), which is an impressive area of skyscrapers, reminiscent of Canary Wharf in London. Dubai, Istanbul and Moscow are all competing for dominance as the financial centre in their time zone.

In China the stock exchange listings are under the direct control of the government, through the Chinese Security Regulatory Committee (CSRC). As such, they are used to adjust economic growth. The government adjusts the flow of capital into the financial markets according to their overall plan. The Shanghai and Shenzhen Stock Exchanges are seen as quite credible entities. However, it has been suggested that some companies bought their way onto the exchanges and subsequently closed down, with individual shares holders losing their investments. There are some positive signs of improvements; in 2010 a company got approval from CSRC and the stock exchange to list. They received money from the investors, but the media discovered a problem with the IPO. As a result, the listing was stopped and the money was returned to the investors. It was the first time in China that investors had been shielded from such financial irregularities.
The two dominant stock exchanges in India are the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The BSE can trace its history back to the 1830s but it has really developed over the past 15 to 20 years. Scams were uncovered from time to time at the BSE and the NSE has now over taken the BSE in terms of importance. Interviewees noted that the NSE is making use of high-tech trading solutions and has a robust settlement system. The regional stock exchanges have almost disappeared and are now mostly agents for the NSE. The retail equity participation has great potential for expansion. Today only around 4 percent of retail investors participate in mutual funds or equity, compared with around 20 percent in the early 1990s. Repeated crises and high market volatility due to the influx of institutional investors after the opening of the Indian stock market to international participation drove retail investors away from equity.

Financial regulators

Amongst Russia’s main financial regulators, the Central Bank (regulates retail banks) may be the most effective entity, although the Bank is ultimately controlled by the Kremlin. China’s regulators have a strong direct influence on the markets and its participants. In India, the markets are regulated by the Securities and Exchange Board of India (SEBI) and Reserve Bank of India (RBI) is the banking regulator and both are held in high esteem.

The Indian regulators have a strong direct influence on market participants and the financial markets are closely and well regulated. Notwithstanding this, market participants seem generally happy with the level of regulations and their implementation. The Indian government has set up a super-regulator, the Financial Stability and Development Council (FSDC), which is tasked with coordinating the activities of different regulatory bodies.

Chinese regulators have a strong influence on the markets and its participants. Currently they are trying to reduce inflation (a significant concern at the moment) by reducing lending. The cut in lending is achieved by setting quotas and by literally calling up banks to tell them to stop all lending. This is in contrast the 11th five year plan (2006 -2010) which focused on infrastructure investments. At that stage banks were forced to lend funds to infrastructure related companies and, as a result, there are now a considerable amount of bad loans on their balance sheets.

In Russia, the financial regulators are controlled by the government. They are still developing and are operating in a somewhat challenging and hostile environment. They recently introduced the Insider Trading Law, which is a milestone. However, market participants see the law as being too encompassing (in terms of classifying ‘insiders’) but it was considered a necessary initiative.
Concluding remarks

Russia is still in a transition period moving from a planned economy to a more market orientated economy. It has made significant progress over the past ten years, but interviewees note that there is still a long way to go. Russia has undoubtedly great potential. As one interviewee mentioned, Russia should be a bit like Canada & Australia - they all have relatively small populations, great wealth & significant resources at their disposal.

Although China has taken enthusiastically to Western brands and it is keen to learn from foreign companies both in terms of know-how/skills but also in terms of best management practices, it is still distinctly Chinese. Some observers aggregate Mainland China financial markets performance with Hong Kong; this may not be appropriate.

The India financial sector has clearly developed significantly over the past decade and there is still potential for considerable growth. India also has a significant agricultural sector that plays a central role in the domestic economy. "Inclusive growth" and "corporate social responsibility" have in recent years become buzz words in India. It will be interesting to see over the coming years how the strong growth of the Indian economy will get translated into further benefits for the wider society.

Among Russia, India and China, it appears that India has made most progress in increasing openness and accountability, on the basis of my fieldwork findings.

Analyses of this nature raise complex issues of comparability, and this brief overview is not meant to provide a definitive answer. There remain considerable advantages to investing and doing business in all three countries - indeed the BRIC economies as whole offer substantial and attractive alternatives to opportunities in G7 economies.
Publication of photograph of default borrower in newspapers cannot be stated as coercive step to collect the loan

S.T. Tamil Selvi Vs. SBI, SARB, Chennai
W.P.No.199 of 2012
M.P.No.1 of 2012

Of late, the Banks/FIs are adopting newer and newer methods for recovery of its dues from the default borrowers. Publication of photograph of default borrowers in widely circulated newspaper is one of such innovative method adopted by the Bank's/FIs. However, on number of occasions, in order to thwart the attempt of the Bank/FI to publish the photograph, the borrowers used to approach the Court of Law by invoking the writ jurisdiction. The borrowers would plead that publication of their photograph will violate their fundamental rights enshrined in the Constitution of India.

The right of privacy of borrowers' vis-à-vis the right of the Bank's/FIs to recovery public money were discussed in detail by the Hon'ble High Court of Chennai in Mr. K.J. Doraisamy vs The Assistant General Manager, SBI. The Hon'ble Lordship

held that from the point of view of the individual, his right to privacy is not absolute and from the point of view of the Bank, the duty to maintain secrecy is superseded by a larger public interest as well as by the Bank’s own interest under certain circumstances. The Hon’ble Court further held that if borrowers could find newer and newer methods to avoid repayment of the loans, the Banks are also entitled to invent novel methods to recover their dues.

One of our Branch borrowers - S.Tamil Selvi, aggrieved by the notice issued by our Branch, intimating for the publication of the photograph in newspaper, approached the Hon’ble High Court of Chennai by filing the writ petition of Certiorari. The borrower/petitioner alleged before the Hon’ble High Court that publication of photograph is a coercive measure to recover the dues. The borrower petitioner further alleged that if the photograph of the petitioner is published in the newspaper giving her name, it will spoil her reputation and calls this mode as a coercive recovery mode. Our Branch has contended that the loan was obtained in the year 2006. Our Branch further contended that in spite of granting so many demands, the petitioner has not chosen to repay the loan amount. In fact demands have been made time and again, even now the bank is not eager to publish the name or print the photographs if she undertakes to repay within some time limit. Our Branch further submitted that the writ petition is pre-mature and there is no coercive action and hence the petition is not sustainable.

The Hon’ble Court held that the mode of publication of photograph of default borrower adopted by the Bank cannot be called as a coercive mode. The Hon’ble Court observed that if at all, taking into consideration that the loan is granted in 2006 and till 2012, it is not settled and having now only called upon to pay and only thereafter if she fails to do so, intend publishing, cannot be stated as coercive step to collect the loan. Accordingly, the Hon’ble High Court dismissed the Writ Petition.

Hope, this judgement will add momentum in our Bank’s endeavour to publish the photographs of default borrowers so as to step up recovery proceedings.
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