A gold standard for the bullion trade

IIBX has the potential to ease the hassle involved in importing precious metals

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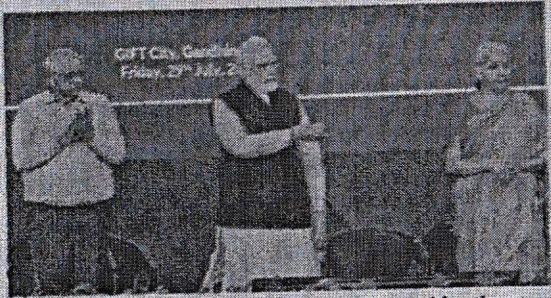
The inauguration of the India International Bullion Exchange (IIBX) at GIFT City three days ago plugs a gap in India's financial infrastructure, especially as it pertains to bullion. If the regulatory fine print is thought through carefully and well-drafted, this could ease the hassle involved in importing precious metals, either for investment or as inventory for the jewellery trade.

India is one of the largest gold importers in the world, second in the list behind China. Gold is regularly the second largest item on India's import list (behind fossil fuels) with anywhere in the range of 600-900 tonnes imported annually. Historically, whenever there's pressure on the current account, gold is one of the contributing factors.

Traditionally, families buy gold, mostly in the form of jewellery, with a surge in wedding season. It's seen as an emergency store of value in times of distress, as well as a hedge against inflation. In 2021-22, over 850 tonnes of gold was imported, at a value of over $48 billion.

The ancient system of pawnbroking, where jewellery is offered as collateral for loans,



File photo of Prime Minister Narendra Modi launching the India International Bullion Exchange in Gandhinagar

GILDED TRADE

India gold imports $ mn

FY11	40,657
FY12	56,497
FY13	53,830
FY14	28,705
FY15	34,462
FY16	31,768
FY17	27,515
FY18	33,648
FY19	32,910
FY20	28,228
FY21	34,604
FY22	46,239
Q1FY23	10,491

Source: Bloomberg/MoC
Compiled by BS Research Bureau

has been largely replaced by institutional deals. At least a dozen large listed non-banking finance companies (NBFCs) specialise in loans against gold, along with instant over-the-counter deals available from many banks. The pandemic and associated lockdowns with the large-scale spike in unemployment and medical bills to pay for many families led to an expansion in this trade, and a huge jump in the number of gold auctions, usually run by NBFCs trying to recover their capital on loan defaults.

In addition, there's consumption from the jewellery trade. India has a thriving gems and jewellery industry, which imports gold and precious stones, and sells domestically as well as exports in significant volume. There are import duties on gold, and jewellery exports involve a fair amount of paperwork to process incoming imports and the outgoing transactions for jewellers.

Jewellers, like any other business, rack up inventory based on their assessment of future demand for their value-added products and what they guess to be the price curve. Interestingly, jewellery is one item that can be bought for cash without KYC or PAN/Aadhaar document being required for cash transactions of less than ₹200,000 (KYC is required for cash transactions of above ₹50,000 for other purchases).

While bullion can be bought by individuals domestically from many sources, including banks and commodity exchanges, it is also possible to buy gold Exchange Traded Funds (ETFs). It is also possible to loan gold to the government under various gold monetisation schemes. Gold futures are also traded on the commodity exchanges, which allow speculators a chance to profit.

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What does the IIBX add to this eclectic mix? Right now, it's a cash-upfront exchange where transactions have to be settled with full value on the transaction date itself (T+0). Physical metal is involved, with contracts delivered and held in designated warehouses. A cumulative storage capacity for approximately 125 tonnes of gold and 1,000 tonnes of silver is planned at GIFT City. In addition, units in SEZs (special economic zones), which are permitted to store bullion for purposes of spot delivery contracts and issue bullion depository receipts (BDR) for trading on IIBX, may hold gold for IIBX.

There are plans to eventually move this settlement to T+2 and to introduce silver contracts. The combination of full settlement and physical delivery should cut down the scope for short-term speculation. We may assume, with fingers crossed, that the oversight mechanism will be good enough to prevent outright fraud, unlike what occurred on the National Spot Exchange Ltd where a ring of unscrupulous brokers created a system of circular trading of non-existent commodities to set up a *badla*-financing mechanism.

Only qualified jewellers can transact on the exchange. The empanelled parties must have a net worth of ₹25 crore and 90 per cent of their previous revenues must have been through goods categorised as precious metals.

Non-resident Indians and institutions and funds running gold ETFs empanelled with the International Financial Services Centres Authority (IFSCA), which is the nodal authority, can also participate. So far, some 56-odd entities, mostly jewellers (many of them listed), have signed up for the IIBX.

How does the launch of IIBX help strengthen the gold ecosystem? It removes friction from physical imports, setting up alternatives to Dubai and Singapore for imports. If IIBX takes off as conceptualised, it could become the single channel (or a near-monopoly) for bullion imports. This would aid in price-discovery, offer comfort in valuations of metal purity, reduce transaction and transport costs, and also yield more complete data regarding such transactions. Using the SEZ model, this could also conceivably ease the paperwork involved in manufacturing jewellery for exports using gold imported via this exchange.