Gold Bond

Sovereign Gold Bonds

Better option to invest in gold...

The Reserve Bank of India, on behalf of the Government of India, has come out with the fourth tranche of Sovereign Gold Bonds. The subscription will be open from July 18, 2016 to July 20, 2016 and bonds will be issued on August 5, 2016. The issue price of these bonds has been set at ₹ 3119/gram, which is derived as the average of the previous week’s closing price of gold of 999 purity.

Investors will get additional interest at the rate of 2.75% per annum on the initial deposited amount. Investors will continue to have full exposure to gold prices to the extent of amount deposited.

Sovereign gold bonds offer a good alternative to take exposure to gold as it offers additional interest. There are no annual recurring expenses as compared to gold ETFs (expense ratio in ETF is ~1%) and no storage hassle like those involved in physical gold holding.

As per Union Budget 2016-17, any capital gains arising on redemption of the sovereign gold bond scheme would be exempt from tax. If these bonds are sold in secondary market before maturity, capital gains arising on such transaction will taxed @ of 20% with indexation if sold on or after 3 years and would be subject to marginal tax rate if sold before 3 years.

Gold back in limelight

Indian gold prices have rallied around 25% since the start of 2016. Heightened risk aversion amid extreme global capital market uncertainty has turned the wave in favour of safe haven demand since the start of 2016. The risk, which was initially confined to the commodity space, started to spill over to currencies, equities and credit markets as gauged by financial conditions and high yield bond market. The recent historic global event of Brexit (UK leaving European Union) has given rise to a fresh wave of uncertainty in the global financial system. As a result, there has been a flight to safety and safe havens like developed market sovereign bonds and gold.

Exhibit 1: After delivering negative returns for three years, Indian gold prices up 25% in 2016 (YTD)

<table>
<thead>
<tr>
<th>CY06</th>
<th>CY07</th>
<th>CY08</th>
<th>CY09</th>
<th>CY10</th>
<th>CY11</th>
<th>CY12</th>
<th>CY13</th>
<th>CY14</th>
<th>CY15</th>
<th>CY16YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td>20.3</td>
<td>16.0</td>
<td>26.1</td>
<td>24.2</td>
<td>23.2</td>
<td>31.7</td>
<td>12.3</td>
<td>4.5</td>
<td>-7.9</td>
<td>-5.6</td>
<td>25.0</td>
</tr>
</tbody>
</table>

Source: Bloomberg

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Historical tranche prices

Exhibit 2:

<table>
<thead>
<tr>
<th>Issue Period</th>
<th>Issue Price ($/gram)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tranche I Nov 5- Nov 20, 2015</td>
<td>2684</td>
</tr>
<tr>
<td>Tranche II Jan 18- Jan 22, 2016</td>
<td>2600</td>
</tr>
<tr>
<td>Tranche III Mar 8- Mar 14, 2016</td>
<td>2916</td>
</tr>
</tbody>
</table>

Current Prices as on July 14, 2016 3095

Source: ibjarates.com

Medium term outlook for gold prices have improved

The investment demand for gold is also governed by the broader economic climate. Currently, there is a lot of uncertainty surrounding the negative impact of the UK leaving the European Union, currency devaluation, global economic growth prospects and economic slowdown in China. The same is likely to keep demand for gold as a safe haven asset upbeat in the medium term.

Brexit is likely to have a significant economic impact over a two to three year perspective. The expectation on the quantum of rate hike by the US Federal Reserve has declined significantly post the recent turmoil in global capital markets. The interest rate hike in general is negative for gold prices. With rate hike concerns receding, the overhang on prices has also abated in the near term.

Although the medium-term outlook remains positive, prices may consolidate in the near term given the sharp run up since the start of 2016.

Issue details

The following are the basic contours of Sovereign Gold Bond scheme:

- Eligibility: Indian entities including individuals, HUFs, trusts, universities and charitable institutions
- Rate of interest: 2.75% payable semi-annually on the initial value of investment
- Minimum investment: 1 gm, maximum investment: 500 gm
- The tenor of the bond will be eight years with a redemption option from the fifth year to be exercised on the interest payment dates
- Capital gains tax arising out of redemption shall be exempt from tax. If sold in the secondary market, capital gains arising on such transaction will taxed @ 20% with indexation if sold on or after three years and would be subject to a marginal tax rate if sold before three years
- The interest earned on gold bonds would be taxable
- Price of bond i.e. ₹ 3119/gram, has been fixed in rupees on the basis of the previous week's (Monday-Friday) simple average of closing price of gold of 999 purity published by the India Bullion and Jewellers Association Ltd
- The bonds would be tradable on exchanges
- Open for public subscription between July 18 and July 20. The bonds will be issued on August 05, 2016
This is the fourth tranche of the gold bond scheme. Subsequent tranches would be notified later.

The allocation to gold bonds should be in accordance with the overall asset allocation. Investment in gold bonds should be avoided from an absolute return basis as it continues to be driven by market determined prices.
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