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# Gold at a New High Amid Dip in Demand

Traders fear a further drop in demand if prices stay at the new high of ₹2,350 per gram

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Gold in Mumbai hit a fresh high of Rs 2,350 per gram, raising fears that demand could be hit if prices consolidate at current levels. "Currently, demand is around 60-70% of the peak but if prices remain in excess of Rs 2,300, I think business will shrink to 30-40% of the peak," said Rajesh Mehta, chairman of Bangalore-based Rajesh Exports, which posted a turnover of Rs 18,500 crore in FY11.

Demand for physical gold has not dried up completely because a section of traders is betting on price correction soon. "Around 50% traders believe that prices would climb from here and the rest feel that gold is headed for a correction after running up over the past decade. I think it's this equilibrium that's holding demand at current levels. However, I reiterate, things could get worse if prices consolidate at these levels," he added.

Demand continued to remain muted in Mumbai, the country's largest wholesale gold market that was rocked by a bomb blast last week, killing at least eight and injuring scores of others. "Panic pervades the market even now and demand is at a virtual stand-still," said Prithviraj Kothari, whose company Riddi-SiddhiBullions is a dealer that supplies gold bars to jewellers across India. "Jewellers will try and reduce their inventory rather than stocking at these levels. If buyers themselves don't come to the market, where's the point of stocking," he asked.

"Typically, jewellers would buy as much gold as they have utilised for making ornaments. Currently, if they sell a kg's worth, for instance, they are buying just 400-500 gm from dealers," Mehta said. Demand during June-July tends to reduce by an estimated 30-40% from normal levels as rural households, among the largest consumers, use their savings to buy farm inputs and re-enter the jewellery market when they harvest crops in August-September. Last year, India imported 957 tonne gold even as prices scaled beyond Rs 2,000 per gm.

The local price mirrored the metal's advance to a record $1,600 an ounce (31.1 gm) on the international market as fears of US being unable to pay its bills and the eurozone crises getting worse took centre-stage among overseas investors, who pumped money into gold. India consumes between 700 and 900 tonne gold a year with local demand being met almost wholly by imports.

The world's reserve currency and the euro are under pressure because of an easy monetary policy in the US and crises among some governments in the EU has raised fears among creditors. This has spurred investors to shift funds to commodities, especially precious metals.

Dealers are reticent about making predi-ctions on where prices will head. Only last week, Suresh Hundia, ex-president of Bombay Bullion Association, said gold could advance to Rs 2,400 a gm by the year end, while silver could test Rs 63,000 a kg. At current pace, that forecast could well be met in the next few trading sessions.

## 10 Factors Which Drive Gold Prices

Inflation, interest rate and political risk add to the metal's safe-haven appeal

**The current rate of inflation:** a rise in the inflation rate may induce movement into 'real' assets like commodities which are seen as inflation hedges

**Inflation volatility:** rising inflation volatility increases the uncertainty about future returns on non-inflation proofed assets, and also increases demand for real assets such as gold

**World income**: higher income may push up demand for jewellery and industrial uses which cannot be fully met by mining output rises in the short run

**The dollar's external value:** a US depreciation of the effective dollar exchange rate will tend to push up the US$ price of gold

**Real interest rate:** higher real interest rates increase the opportunity cost of holding gold and reduce demand, while low or negative real interest rates raise demand for gold

**Gold's Beta:** if the return on holding gold is unrelated to the stock market it can act as a diversifier in portfolios. A fall in gold's beta increases the benefit from this and will push the price up

**Financial stress measures:** during periods of financial stress investors move out of risky assets into safer holdings. A commonly-used measure of stress is the credit default premium, i.e. the difference in yield between low-rated and highly-rated corporate bonds

**Political risk:** in a similar vein to financial stress, increases in political risk are expected to raise the price of gold

**Official sector activity:** the recent rapid expansion of the US Fed's balance sheet may have pushed investors towards gold as a hedge against possible policy mistakes leading to high inflation

**Central bank gold reserve sales:** the sale of gold by central banks in the late 1990s may have artificially depressed the price in this period.

Source: Oxford Economics