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- Comex positions/ Commercial Shorts Help Indicate Price Movements
- The Indian Gold Market 2004/5
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That was the week that was.

The growing feature of the global gold markets is now, within the broad pattern of gold price movements, the gold price now rises against a falling \$ and rises against a falling €!



In this second part of this article Daman Prakash an expert on the Indian Gold market gives his views on the Indian market over the last year and the developments over that time. He gives perhaps the deepest insight into this key market for gold, that is available anywhere. Our thanks go to him for this clear positive picture and the pointers to the direction the Indian market is travelling. It could well give support to a rising gold price, in an orderly manner.

The Indian Gold Market 2004 / 2005

Level of Imports into India.

The Indian Ministry of Finance quoted net imports of around 400 tonnes of gold imported for local use, but GFMS quoted a gross figure of 500 tonnes for gold for local use as well as gold for re-export. If one excludes exported gold jewellery, the figure does bring it well below 500 tonnes.

We at the "Global Watch – The Gold Forecaster", believe the difference is significant as we will see in future years, as the Indian culture is taken overseas by the well-educated sons and daughters of India into situations where their investments into gold will rise alongside their incomes. The influence of home and their Elders will no doubt keep this custom going for many generations and hopefully improve the gold content of gold jewellery abroad, after all, in India, jewellery serves as a store of wealth, preventing the jewellery factor in the cost from lowering the relationship between the gold price and the weight of the jewellery itself. Many Middle Eastern individual and a growing number from outside these cultures are moving towards holding gold for itself, in the form of low premium priced [over the gold content] gold.



The move away from Bar and Coin.

Daman disagrees that the level of coin minting and bar hoarding has increase by 60%. He reports that ICICI sold less than a ton of coins, despite the large campaign to promote such investment levels. MMTC and other banks, Authorised Importer, have very low (dismally low) figures. After verifying his opinion with all the leading bullion dealers like Zaveri of Ahmedabad, Kiran from Jaipur, Jindal and MD Overseas from Delhi, MNC Bullion and Surana from Chennai, Ridhi Sidhi from Mumbai, little support could be found for the increase in the levels of coin minting and bar hoarding. Daman points out that the traders he spoke to, when put together account for 65% of the India's imports.

In India, such reports by the leading Importers can be validated and are correct. Due to local regulations and historic legacy of smuggling days, a large percentage of the jewellery business is still accurately recorded. On enquiry with some of the well-known and popular jewellers, Daman found that they sold paltry 1 or 2% of turnover in the form of coins or bars during the period. When given as corporate gifts they arrive in the form of 1gm, 2gm, 5gm and 8 gm. Coins, but in terms of tonnage they represent an insignificant portion.

The arrival of commodity exchanges,

The arrival of MCX and NCDEX- the multi commodity exchanges, have resulted in the removal of the need to own bar gold.

The now huge turnover in Gold and Silver futures reflects the popularity of these exchanges with investors. Most of the people, who invest in Gold physically, have shifted to these exchanges for three reasons: -

1. Without any use of 'black money' [undeclared] they can acquire more Gold and enjoy the convenience of selling their gold quickly and easily. In the past people used to buy/sell the physical Gold Bars with 'black money'.
2. Now they can deal on margin with far less money involved [close to the international price] openly huge amounts in physical gold in bar form. The Indian investor was quick to take this opportunity and evidence suggests that physical buying in bar for hoarding, has come down drastically this year.
3. The phenomenal turnover in MCX and NCDEX exchanges have, in a very short time, become possible because of the very active participation of a large number of small players even from remote areas, because of the ease of dealing provided through the use of the Cell [mobile] phone, which now attract only local charges within a State or a province's borders.

Gold Loans

A further gold market facilitating improvement have been the use of Gold Loans, whereby a jeweller could borrow physical gold at no set price but repay when he sold the jewellery at the gold price at the time of the receipt of the proceeds from the sale of jewellery. The scheme works in India first by depositing a fixed deposit of the equivalent of 110% of the value of the gold to be borrowed. Then one draws down a Gold loan at a lower rate of interest. On the Fixed deposit they earn a high rate of interest and so permit interest arbitrage. This scheme has become very popular in India and the Indian central Bank has recently allowed all banks to give Gold loans for a period of 90 days.

For the last 2 years, Scotia, the biggest player in the Indian gold market amongst the banks, has been very active and successful in giving these loans to most jewellers in town, to whom they lent as little as two thirds of a Kg at a time. MMTC has provide this scheme to many jewellers for a long time, but they have not had the same degree of success as they limit such loans to 60 days, calling for the pricing of the gold at that time. Scotia provides 180 days. SBI had limited success and only with the largest of players as they remain very bureaucratic.

The potential Bull Market not a driver in the Indian market – Jewellery promotion more so.

According to Daman the Indian market is not experiencing higher volumes because they believe the price will go higher, or to any promotion by the World Gold Council of gold bars as a pure investment, waiting for higher prices.

Daman relates this experience, "I was invited to address an elite gathering at the Institute of Valuers consisting of bankers and architects and was asked to speak on Gold and Silver valuations. In my address, I advised the audience that it is perfectly legal to own gold bars, besides informing them that unwarranted jewellery conversion wastes money. My audience reacted in disbelief! It took me a lot of explaining and persuasion, with quotes from rules framed from 1999 onwards, to convince them. In those days the possession of bars of gold of more than 50 grams would have landed a person in jail for 2 years as recently as 1992. This fear remains even among the informed sections of society."

Daman reiterates that it was jewellery that paved the way for the increased consumption we are seeing now and this was due to the promotions, with innovative designs, discounts, festivals, advertisements, fashion shows and large exhibitions, in which the World Gold Council did play an exemplary part.

Stock Market Profits - not a contributor to the increase in gold purchases.

The Indian Stock market has enjoyed a tremendous rise in the last year and more. The profits enjoyed there have not found their way into gold but into real estate. If gold were such a draw card all the jewellers, including the leaders, would not be vying with one another with huge discounts on Gold prices per gram throughout this year after taking Gold on loan from the Banks for manufacturing jewellery.

Evidence of this is that land prices in all the metropolitan areas have doubled and tripled in 2005 alone. It is urban dwellers that are investing more in life's luxuries.

A summary of the reasons for the increase in gold imports to India.

1. **Increased exports [100 tonnes +]**
2. **Gold loan schemes enabling all leaders in jewellery to launch huge discount schemes to the public.**
3. **The benefits of inter-state smuggling resulting from concessional taxes in Jaipur, Noida and Ahmedabad.**
4. **All evidences suggest that whatever tonnage of increased import has resulted only in more jewellery fabrication this year. The number of jewellery shops has multiplied in**

- India with all the large ones attracting clients with various schemes and perennial discounts as large as Rs. 40/50 per gram, equivalent to a discount of 7% to 8%.**
- 5. Their campaign is being well supported by the World Gold Council.**

The professional management of gold in Central Bank Reserves, by Argentina!

Argentina is a nation that paid a heavy price by placing its currency on a "Currency Board", holding the Peso at 1:1 with the U.S. \$. Since then it has had to battle to bring stability to the currency and encourage capital inflows to the country. But it has succeeded and out of those experiences comes an enlightened approach to using gold in a nation's reserves.

Argentina's Central Bank Juan Basco has revealed an important change in their views on gold, one that may initiate other Central Banks turning their policy on gold to one of buying it, as a reserve asset, not just selling it. Argentina has paved the way by being active in the gold market both ways, to protect its reserves and has done so effectively.

Here are some quotes from the Snr. Basco on the subject, which are key to the successful use of gold in a Central Bank's reserves: -

"Because the bank is now active in the market rather than passive, it is adopting a totally different portfolio management philosophy.

The liquidity in the gold market has been proven ample for the bank's requirements. With \$25 billion reserve assets (likely to be \$27 billion by the end of this year and compared with nine billion in 2002), the government needs to control the volatility of its portfolio and has introduced gold as part of the diversification necessary to achieve that aim.

The bank takes the view that: -

- **Gold is recovering its role as an asset that protects a portfolio from crisis.**
- **Following the recent decoupling from the euro, its role as portfolio diversifier has been further enhanced.**

In answer to the question, why the bank had decided that gold was a liquid asset, his response was that they had proved that it is – they sold a lot and bought a lot without any disruption to the market.

Part of the decision to take gold into the portfolio rests on the fact that the bank holds 30% of its reserves in non-dollar assets and it therefore wants to use gold to reduce volatility. It will not go above that of non-dollar assets percentage because of its need for dollars for international trade.

The latest figures from the IMF show that during 2004 Argentina acquired 54.9 tonnes of gold (equivalent to five days' global fabrication and bar hoarding demand).

Now isn't that an eye opener? Clearly a small country can operate in the gold market to protect its reserves and reduce volatility. On top of that, as the gold price rises, so the ability for it to function as a reserve asset this way, will grow as its liquidity grows, alongside the re-establishment of the respect for gold.

If Central Banks really want to manage their reserves properly, as guardians of the nations savings, they will take note of this example. Right now gold is proving itself in the role it has always had and acting as protection in a crisis.

So the question we ask Central Bankers is why are you still selling? Surely if you have it, it can serve in the same role, particularly for smaller countries. In the large countries it serves the same role, albeit to a lesser extent? If there was dealing in gold between the Central Banks themselves outside the open market, then the same objectives could be achieved, with willing sellers meeting willing buyers, or is that not the issue? We suspect that there are other issues, nothing to do with responsible reserve management.

Either way, we are moving to a time when Central Banks, despite a Bankers natural dislike of gold, will be keen to embrace it, if only to retain credibility.

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