PROLETARIAN POWER

PEACE, PROSPERITY AND JUSTICE ... FOR ALL

(5)

3rd August, 2023.

To

The Finance Minister,
Government of India,
134/North Block,
New Delhi - 110001.

Sir/Madam,

Sub: Sovereign Gold Bonds (SGBs):

- Is it a deeply flawed/defective product?
- Did the Government lose Rs.15,953.70 Crores under this scheme so far?

Proletarian Power, being an entity primarily focussed on macroeconomic issues, generally does not bother about individual financial products. However, Sovereign Gold Bonds (SGB) attracted our attention due to its increasing popularity among the investor community. We understand from publicly available information that SGBs are issued by the Government of India in tranches with an objective of mobilising idle gold lying with the individuals and institutions. But, looking at the way the product is designed and implemented we fail to understand how SGBs can fulfill this stated objective. Going by the scheme, we feel that SGBs are nothing but the Government initiating/opening a 'short position' in gold - plain and simple. This 'short sale' position is for 8 years with no provision for premature closure (Investors can encash them prematurely after completion of 5 years).

However noble the objective may sound, we feel that this product is deeply flawed because by selling SGBs the Government knowingly or unknowingly is betting simultaneously against (a) Gold/Commodity price, (b) US Dollar (vis-a-vis INR) and (c) interest rate cycle. This, according to us, is an extremely risky bet.

Allow us to explain:

a) Betting against Gold (commodity/metal) price: Since SGBs are uncovered short positions, the Government loses money when the gold price goes up and gains when the same goes down. Chart below shows the gold price performance since 2005. It can be seen from the chart that gold moved consistently upward.

Gold prices

Data as of 13 June, 2023

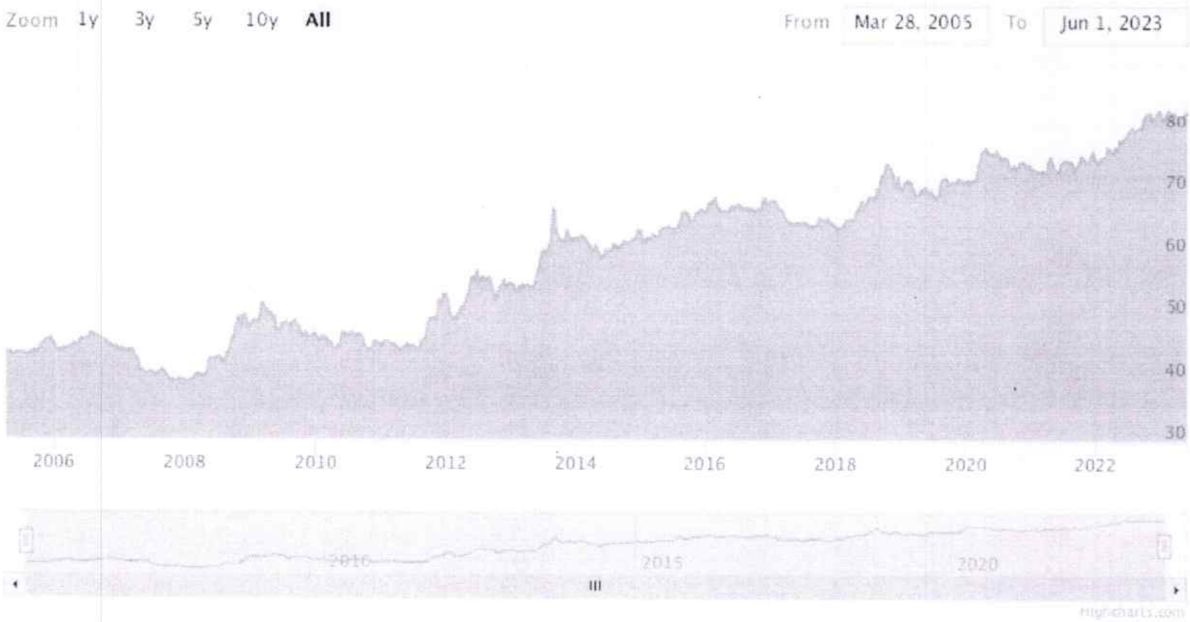
Sources: FastMarkets, ICE Benchmark Administration, Thomson Reuters, World Gold Council; Disclaimer https://www.gold.org/terms-and-conditions#proprietary-rights

Gold price in Rupees from January, 2005 to June, 2023 (Source: World Gold Council)

Over the last 20 years gold has given a Compounded Annual Growth Rate of about 12%. Gold is considered as a safe haven and a hedge against inflation. Conventionally investors (read HNIs) are advised to allocate 10 to 15 percent of their portfolio towards gold. So betting against gold is not a wise thing to do.

b) <u>Betting against US Dollar (vis-a-vis INR)</u>: Gold is an international/universal commodity and traded in US Dollars world over. So gold becomes cheaper to us if the Dollar depreciates against Indian Rupee and vice versa. If one looks at the US Dollar/INR chart below it becomes evident that USDollar consistently appreciates against Indian Rupee (There are many reasons for this). So shorting gold is a dangerous game on this count too.

US Dollar vs Indian Rupee Chart



(Source ; poundsterlinglive.com)

c) <u>Betting against interest rate cycle</u>: Another factor that can influence gold price is interest rate. When interest rates go up gold price will come down and vice versa. Interest rates move in cycles over longer periods of time (like economic cycles). In the last decade or so Developed World viz., US, Europe and Japan followed 'easy money' policies (Quantitative Easing), due to certain domestic compulsions leading to increasing liquidity and suppressing interest rates. Spillover effects of these 'easy money' policies are felt across the globe, including India. So when the Government launched SGBs it was very clear to everyone that interest rates not only were lying low but also were expected to be so for a prolonged period (US Fed and ECB started raising interest rates recently).

Further to the above a relatively recent development (in the last decade or so) seems to be central banks of different countries increasing their gold reserves. Experts call this 'Dollar fatigue'. These countries want to diversify away from the US Dollar to the extent possible. This effectively creates a support to gold price and also increases chances for its upward movement. (More details are available on the World Gold Council website).

From the above it is very clear that issuing SGBs (selling gold short) in 2015 and in different tranches thereafter is nothing but inviting a disaster. We are at a loss to understand why the Government of India took such a position.

Further due to this deeply flawed product the Government of India lost Rs.15,953.70 crores, on mark to market basis, till 2nd August, 2023 (Please see Annexure). This loss is likely to go up further because redemption of SGBs is about to start at the end of this year. We guess most of these SGBs are held by HNIs and they are the ultimate beneficiaries (The proletariat / common-man never buy digital gold/SGB/gold etfs etc). **It literally means the Government of India has handed over thousands of crores of public money to a few wealthy investors under this scheme. May we call this 'reverse Robinhood' syndrome.**

We wish the Government would probe this matter and find out how this had happened.

Thank you

Yours truly,

Sd/-

(Chandra Sekhar Gupta Boggarapu)
Founder, Proletarian Power (proletarianpower.org)
502, Vaishnavi Twins Plaza, G-90/A, Madhura Nagar,
Hyderabad - 500038.

Copy to
Governor, Reserve Bank of India, Shahid Bhagat Singh Road, Fort, Mumbai - 400001.

P.S.1: Looking from the other side SGBs have given an average return of 13.70% to the Investors (as per Economic Times Wealth - copy enclosed). This is over and above 2.5% interest paid on them. That means the investors effectively got a return of 16.2% p.a which is tax free and Sovereign guaranteed. That is obscene.

P.S.2: Gold is a commodity nobody has control over. Anything happening anywhere in the world can affect its price. Suppose Russia escalates the war by attacking Germany, a NATO member, tomorrow (god forbid) then gold price may shoot up to USD 2,500 per ounce overnight. So, speculating with gold is an extremely dangerous game particularly when India does not produce a single gram of gold..

Proletarian Power (proletarianpower.og) is a not-for-profit entity primarily engaged in analyzing the macro economic environment in India.

Annexure

Loss incurred by the Government under SGB scheme as on 2nd August, 2023.
(On Mark to Market basis)

Total quantity of gold sold under SGB scheme (in Kgs) (Source : RBI Website)	1,10,395.04
Total value of the above gold as on 2nd August, 2023. (Rs. Crores)	65,800.96
Total amount of money mobilized by the government under SGB Scheme. (Rs.in Crores)	49,847.26
Net Loss (On Mark to Market basis) - Rs. in Crores	15,953.70

Notes:

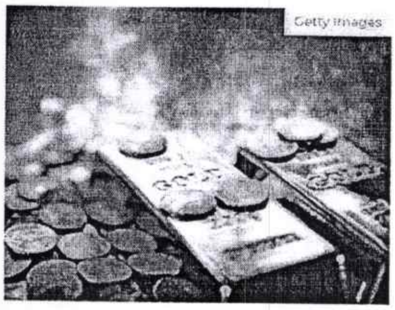
1. Gold Rate as on 2nd August, 2023 (Rs. per gram) : 5,961 (Economic Times)
2. Premature redemptions are ignored.
3. Total amount mobilized under the scheme is arrived at by multiplying the quantity of gold sold under each tranche with respective issue price.

Sovereign Gold Bonds: SGB investments have returned an average 13.7% over last 8 years

By Prashant Mahesh, ET Bureau Last Updated: May 02, 2023, 11:10 AM IST

Synopsis

An ET study of SGB returns shows investors who put money in each of the 63 issuances would have earned between 4.48% and 51.89% annualised depending on when the investment was made. These returns exclude the 2.5% interest that the government pays for holding the bond.



Mumbai: Sovereign gold bonds (SGBs) have worked well for investors in the past eight years of their existence. Investments in 66 tranches of these instruments issued by the government have yielded an average of 13.7% on an annualised basis since November 2015. Wealth advisors said the run-up in gold prices in this period amid increase in uncertainty over the global economy have boosted returns from this product.

An ET study of SGB returns shows investors who put money in each of the 63

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