Gold's Spot Discount Touches a New High

Rupee's slide creates huge disparity between gold sold in local markets and traded on bourses

RAM SAHGAL
MUMBAI

The fall in the rupee to a record low has created a never-before-seen price skew between gold sold in local markets and that traded on commodity futures exchanges like MCX. This has exposed bullion dealers and jewellers hedging on exchanges to huge losses as prices in the local market lag those on futures markets by nearly ₹2,000 per 10 gm, a record discount.

Gold on MCX rose to a record high of ₹34,622 per 10 gm on Wednesday as the rupee, weighed by concerns over a jump in the country's oil bill on fears of a US attack on Syria and rising fiscal deficit because of food security bill, plunged to a new low of 68.75 against the dollar. However, gold in the spot market quoted at ₹32694, lower than the futures price by ₹1,928 as rising price has deterred physical market buying ahead of the festival season. This skew has hit hedgers – bullion dealers and gold jewellers the most.

Gold has been rising for a month as a falling rupee takes a toll on stock and bond prices. On MCX, gold, which represents the landed price but excludes 1% VAT, has risen by 20% since July 31. However, gold in the domestic market, based on the MCX spot polled price, has risen by only 14%. It is this price lag that has hit jewellers and bullion dealers.

Here's how. Assume a jeweller buys gold in the spot market at ₹28,600 per 10 gm, the price prevailing in the beginning of August. He has to deliver jewellery to a client on August 28.

At the time of buying gold from a bank, he sells gold at ₹28,600 on MCX to guard against a fall in price in the spot market. Since he sells on MCX, a price fall in the physical market will be offset by the gain he makes by shorting gold in the futures market. This normally protects him from inventory loss. However, gold price has risen on MCX between July 31 and August 31. Gold hit ₹34,622 on MCX on August 28. This exposes jeweller to a mark-to-market loss of ₹6,022 per 10 gm (₹34,622 — ₹28,600), which translates to an over ₹6-lakh loss since the minimum exposure one has to take on MCX gold contract is 1 kilo.

In the physical market, the price between July 31 and August 28 has risen by ₹4,094 (₹32,694 — ₹28,600). So the jeweller's gain from selling a kilo worth of gold jewellery in the spot market is ₹4.09 lakh. However, on a net basis the jeweller has lost ₹1.92 lakh on a kilo, a record disparity between futures and spot price on August 28.

"The record disparity between spot and futures has wiped out the gains of dealers and jewellers in the past month," said Prithviraj Kothari, director, RiddiSiddhi Bullions, which has been hit by the rise in gold prices.

Agreed Rajesh Mehta, chairman, Rajesh Exports, an active hedger on MCX. But Mehta lays the blame squarely on government curbs on imports, such as disallowing imports through letters of credit (L/Cs) and a hike in import duty.

"There is a liquidity crunch that jewellers and dealers are facing as the government has severely crimped import routes by barring it under L/Cs and jewellers having to pay banks outright for consignments. In an era of high interest rates, access to cheap money for trade is virtually impossible. This has made it difficult for jewellers or dealers to buy from the local market and deliver on MCX to cut their losses," Mehta said.

Bet Gone Wrong

They buy gold in local market, sell in futures

Futures sale is cash settled, only difference in prices is settled

Price of gold futures is up by 20% since July end, but spot is up by just 14%. So hedgers' net loss is 6%

Discount of spot to futures at record high of 1,928