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India’s golden future

Policy success in India offers the next best hope for another sustained lift in gold prices.

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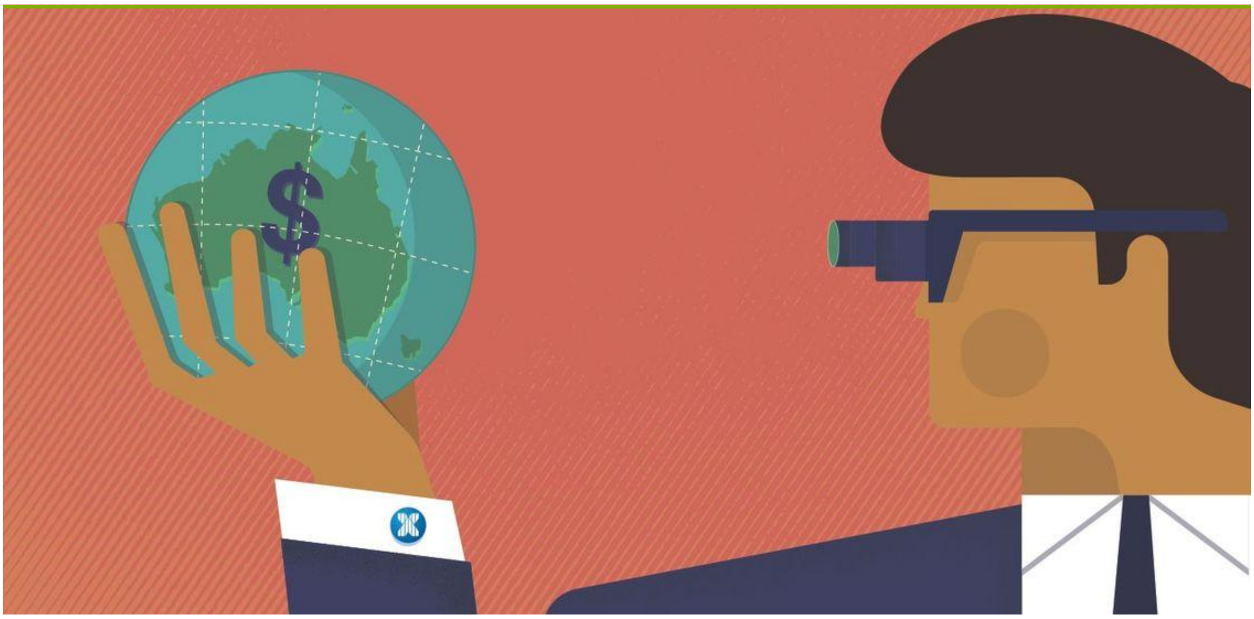

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Last week's ‘From the Capital' column described gold as the most disappointing investment of the past five decades.

Expected high inflation and fiscal profligacy had stoked beliefs that gold prices would remain on an indefinite and steep upward trend after the nexus with the US dollar had been broken in the early 1970s. Contrary to those expectations, the gold price has been prone to sit for many years at a time within relatively narrow bounds.

Ninety-six percent of the rise in the gold price over 50 years has occurred over just two periods covering only 14% of the elapsed time since 1970.

The two periods accounting for the bulk of the gold price appreciation coincided with historically significant redistributions of global wealth. In the first instance, during the 1970s, wealth was shifted from the advanced economies toward Middle Eastern oil exporters. In the 2000s, the wealth movement favoured China.

Each of these wealth transfers precipitated knock-on effects as governments, individuals and businesses made asset allocation decisions within more gold-friendly frameworks than would have prevailed in western economies.

This historical experience suggests that large upward moves in the gold price are unlikely to occur in the absence of similarly transformational economic events.

Reflecting gold's monetary connections, interest rate and exchange rate movements will show up in volatility changes rather than directional shifts in prices of the sort experienced in the 1970s and 2000s.

That said, gold does have investment advantages over other metals. The supply of physical gold is likely to grow more slowly than the value of other financial assets. In the absence of an OPEC-China type of shift in wealth distribution, the gold price could still perform more strongly than the prices of industrial metals.

> “ **Indian policymakers will need the best part of a decade to show whether they are on track**

The more exciting forecasting question is whether another globally significant economic event could drive a sustainable step change in the price of gold in the years ahead.

A change in the pattern of Indian growth stands out as the only sufficiently dramatic economic shift on the horizon.

Addressing the Australia India Institute in Melbourne last week, the chief executive of the National Institution for Transforming India (NITI Aayog), a government agency, outlined how India could sustain annual GDP growth of 9-10% and become a US$10 trillion economy by 2030.

Indian GDP growth has averaged 7.5% per year over the past 10 years, according to the International Monetary Fund (IMF). While impressive in some respects, this would fall short of what is needed to meet the country's future employment and anti-poverty goals.

Amitabh Kant, a long time senior civil servant who has led much of the official effort to rethink how business is conducted in India, outlined 10 reasons to expect India to embark on an accelerated growth trajectory.

Near the top of his list is the youthfulness of the Indian population. A low dependency ratio is the backbone of wealth accumulation, he contends.

A common theme among the 10 sources of higher growth outlined by Kant was the emphasis on reform.

While much has been made, in the case of China, of the size of the population and the potential appetite for goods and services of a billion people, microeconomic reform was of preeminent importance in putting China on a stronger growth trajectory through the 1990s. Permitting people to own their homes, for example, gave budding entrepreneurs security to build businesses that had not previously existed.

Kant outlined a range of reforms that would underpin India's future growth. These included uniform taxes across states, universal access to banking through biometric identification, private operation of publicly funded infrastructure, an emphasis on creating a data-rich digital economy, fast transport links and unfettered foreign investment outside defence industries.

India's potential transformation differs in some important respects from China's modernisation route. China's growth explosion was the flip side of five decades of economic and social repression whereas India's policymakers must contend with a history of more liberal governance practices and democratic traditions.

Unusually deft policy hands will be needed over the next 15-20 years to secure sufficient electoral support as judgements about distributional equity are enmeshed in quests for public office.

India's 2018 starting point on the road to a ten trillion dollar economy is an estimated $2.9 trillion output value, according to the IMF. India is aiming for a similar trajectory as China achieved in its prime growth years. China boosted the value of its economic output from $2.8 trillion in 2006 to $9.6 trillion in 2013.

Among its challenges, India will have to accommodate the move of some 500 million people from rural communities into cities over the coming 30 years. This shift, says Kant, will require a different world model for how cities are organised. Already expensive land, fuel and water render development models based on availability of cheap or plentiful resources redundant.

Kant also argued that the program to propel the Indian economy toward its ambitious goals would require the country to penetrate global markets. It would need to build internationally competitive manufacturers and participate in global supply chains.

Improved agricultural productivity would also be needed. Changing agricultural practices will require central government engagement with the 27 Indian states with responsibility not only for farming but a myriad of social and economic policies critical to development success.

Indian policymakers will need the best part of a decade to show whether they are on track to realising their ambitious plans. Even if India makes a fist of its development ambitions, a lengthy wait similar to that which prevailed in the 1980s and 1990s while China built momentum could remain on the cards for the gold market.

Uncertainties abound but, India aside, there is no other currently evident catalyst for a third epochal rise in gold prices to mirror those which occurred in the 1970s and 2000s.

John Robertson is the chief investment strategist for PortfolioDirect, an Australia-based equity research and resource stock rating group. He has worked as a policy economist, business strategist and investment professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia.