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Paper gold in emerging markets: What are the opportunities and challenges for investors?

Dr. Nimisha M.N.
Assistant Professor, Department of Management Studies, St. Aloysius College, Elthuruth, Thrissur, Kerala
Email - nimishanandan111@gmail.com

Abstract: *For a long time, gold has been seen as a safe-haven investment, especially in difficult economic times. Those who want to invest in gold can purchase both real and paper gold. Investments in gold stored on paper or digitally are referred to as "paper gold," without actual physical possession. Compared to purchasing actual gold outright, paper gold has several benefits, such as easier trading and higher liquidity. To choose the ideal option for investing goals, it is imperative that one thoroughly examine each option's distinctive features. This article looks into the different methods available in India for purchasing paper gold.*

Keywords: *Paper gold, investments, liquidity.*

1. WHAT IS PAPER GOLD?

Savings may be securely invested in a variety of opportunities to earn a respectable return. The necessity of waiting for a payoff is the fundamental characteristic of an investment. An investor's portfolio should include gold as a crucial asset since it not only provides stability for returns but also presents a chance to increase the investor's wealth. A longer-term increase in the demand for gold jewellery and investments is anticipated as consumers have adjusted their pricing expectations upward. This trend is expected to continue as local investors acquire gold for wealth accumulation purposes. Due to its emotional appeal as well as its significant cultural and economic worth, gold is in high demand among all age groups[1]. However, it is now evident that more and more Indians are realising that gold needs a position in their financial portfolio in addition to the bank safe or the cabinet at home. Gold is typically purchased by investors as a risk-diversion technique.

For many years, people have seen gold as a haven asset- especially during difficult economic times[2]. Physical gold and paper gold are the two main ways to invest in gold. Paper gold, in contrast to real gold, is backed only by the paperwork and has no intrinsic worth. Paper gold is a financial instrument that represents the value of gold but does not represent ownership of the precious metal[3]. Investors can access a changing gold price without owning actual gold bars or coins by holding paper gold. As opposed to long-term investing, this investment is particularly beneficial for trading in the short term. According to the definition of paper gold, a few examples are gold certificates, exchange-traded funds, gold futures accounts, pool accounts, and accounts for holding gold[4].

2. ADVANTAGES AND DISADVANTAGES OF PAPER GOLD INVESTMENT :

Investors may enter the gold market with paper gold without needing to possess actual gold. The liquidity and accessibility of paper gold is one of its main benefits. Paper gold assets are more liquid than actual gold since they can be exchanged quickly and easily. Paper gold is also more affordable for private investors since it can be bought and traded in smaller quantities[5]. For instance, it is feasible to acquire paper gold in amounts as little as one gram or even 500 milligrams, yet it is impracticable to buy gold jewellery in such small quantities.

Paper gold as a trading opportunity rather than a long-term investment opportunity, is seen to be more profitable. The first benefit of employing paper gold is the cost savings in storage. One might not want to keep their money at home if they invest the majority of it in actual gold. When one keeps them away from home, they will additionally want a locker.

Naturally, the cost of storage services must be taken into account; this lowers the return on gold. The lower danger of theft is another benefit of paper gold[6].

Paper gold investments are also more susceptible to market volatility and swings than actual gold investments, which makes them less stable. Before investing in paper gold, it is important to understand the dangers and do extensive research to make sure the investment choice has trustworthy counterparty risk mitigation procedures, which is the possibility that the other party to the transaction won't be able to uphold their half of the agreement. During times of crisis or economic unrest, paper gold may not be as accessible, which might cause market volatility and lower the value of paper gold assets. Investors must have faith that the entity supporting the investment will uphold its promises because paper gold is sometimes guaranteed by a financial institution or the government[7].

The price of physical gold assets is expected to rise during a financial market catastrophe, making up for any losses from speculative paper gold investments. Therefore, in such a situation, keeping a diverse portfolio becomes essential[8]. The golden rule is to mitigate risks and strengthen the durability of your overall gold holdings by combining both physical and non-physical gold assets.

One can invest in paper gold using the following ways:

- **Gold Exchange-Traded Funds (Gold ETFs)**

Open-ended mutual funds based on fluctuating gold prices are called Gold Exchange-Traded Funds. Gold ETFs are one method of acquiring paper gold. These investments are made possible via the BSE (Bombay Stock Exchange) and NSE (National Stock Exchange), with gold serving as the underlying asset. A cost-effective alternative to actual gold, which sometimes implies high purchasing and selling costs. Additionally, investing in gold ETFs offers pricing transparency, and ensures people have a clear understanding of the value of their investment[9]. Investors must pay an expense ratio, which is normally about 1%, as well as broker fees even though gold ETFs typically do not impose entry or exit fees. Every time a person buys, brokerage fees are charged. The operational costs of the fund are covered by the expense ratio, and broker fees are payable for each transaction involving the purchase or sale of gold ETF units[10].

ETFs might be an excellent choice if one doesn't have enough money to purchase an ounce of gold. One may invest in less than an ounce of gold using ETF stocks or equivalent alternative assets. Investing in such ETFs is far less expensive than purchasing and selling actual gold, which carries large transaction costs[11]. Units of the gold ETF can be bought all at once. As an alternative, they can use a SIP (Systematic Investment Plan) to make periodic investments. Through these ETFs, anyone can purchase as little as 500 milligrams of gold. Investors get a paper document that monitors the gold price when they invest in paper gold, such as by buying shares of a gold exchange-traded fund. In such circumstances, the ETF and its affiliated companies may issue more shares to ease price pressure. Typically, the backing for these new shares is either physical gold or gold derivatives (such as futures contracts)[12].

Due to this, an upward thrust in the call for ETF shares results in more stock turning into reachable in place of a charge increase[13]. The ETF (and its business partners) will sell a part of its real belongings and use the proceeds to redeem current stocks if there is insufficient for those shares and the price falls[14]. But, if it does not own actual gold and runs out of coins (for example, because of the disintegration of the futures market), it could be unable to compensate the investor for its gold proportion, which might result in an ETF default[15]. However, those ETFs may not be able to redeem all of their shares if the gold derivatives fail, or there is a main decline in the call for those shares. Therefore, if the fund continues to less real gold, investors can find themselves unprepared in times of want.

- **Digital Gold**

People may now buy gold coins, bars, and jewellery online for a comparable experience to buying physical gold, but the entire transaction takes place in the digital world. The process of buying digital gold is similar to buying actual gold, with the exception that everything is done online. With the introduction of digital gold, gold has expanded in accessibility, use, and availability. Coins, bars, and jewellery are now available for purchase online. The online gold vendor will keep the buyer's gold in safekeeping. Digital marketplaces are available for buying and selling gold[16].

- **Sovereign Gold Bonds (SGB)**

If one wants to add gold to their financial portfolio, sovereign gold bonds can be useful. One can choose between price changes and a fixed interest rate of 2.5 percent. SGBs are government securities that have been divided into grams of gold. The bonds are preferred over gold in their physical form because they pose less of a theft risk[17]. Simply told, they are replacements for actual gold. It is distributed in instalments by the Reserve Bank of India and is accessible in paper and dematerialisation form. The nominal value of the Bond shall be the simple average closing price for the week before the subscription period. There are no additional expenses for purchasing these bonds[18].

Because the investor receives the current market price of the gold at the time of redemption, investment in SGBs has the benefit of protecting the quantity of gold purchased. The government issues these bonds, but they are not immediately available to investors; instead, a window is opened for the issuing of new Sovereign Gold Bonds at predetermined intervals. Typically, this occurs once every two to three months. Investors must purchase older issues, which are sold on the secondary market if they want to purchase SGBs within these timeframes[19].

- **Gold Mutual Funds**

Investing in gold mutual funds is another way to buy gold. These funds are managed by qualified professionals who buy gold ETFs. With the help of this investment, one may diversify their portfolio and reduce overall risk[20]. Traders can pick out a SIP with those mutual funds to put money into gold often and as a result, achieve the blessings of RCA (Rupee price Averaging)[21]. A dematerialisation account is not required for buyers to invest in the price range.

3. CONCLUSION :

While there are benefits to buying paper gold in India, it is important to thoroughly weigh your alternatives before making a choice. Before choosing between SGBs and Gold ETFs, investors should carefully consider their investing goals and preferences taking into account the variations in maturity, liquidity, and taxes. Since SGB matured in the eighth year, it is a good alternative for long-term investors. Before making a final choice, one should also think about the taxes on earnings from these investing possibilities. In terms of taxation, there is a sizable distinction. In the event of redemption, income generated from SGB gains is tax-exempt. Given that they mature in the eighth year, sovereign gold bonds are a good choice for long-term investors.

In contrast, Gold ETFs offer more liquidity than SGBs, making them better suited for investors looking for more trading flexibility. The tax implications of various investing possibilities must also be taken into account. SGBs and Gold ETFs have considerably different tax consequences. Gains from the redemption of SGBs are not subject to taxation. In contrast, after accounting for the benefits of indexation, long-term capital gains on Gold ETFs are taxed at 20%. Investors should carefully consider their investing goals and preferences taking into account the variations in maturity, liquidity, and taxes.

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