

Our Views

Gold is the New FDI

Since the severe foreign exchange crisis of 1991, one word that has become familiar to every Indian household is Foreign Investment, or FDI. The primary role of foreign investment was to balance our balance of payments, provide additional capital to a capital-starved economy, and support the stability of our currency. The question today is whether gold could perform the same role that FDI has long been expected to play.

Over the past ten years, foreign investment, both direct and portfolio, amounted to about \$400 billion. During the same period, India's gold imports accounted for between \$450 and \$500 billion, forming a substantial part of the import bill. Annual gold purchases typically range between \$35 and \$55 billion constitute a major share of total import expenditure, contributing heavily to the merchandise trade deficit. It is clear that the inflows from FDI almost compensate for the outflows caused by gold imports. The problem is that these purchases of gold are locked into unproductive household savings rather than being directed into the creation of productive assets.

India today is the largest holder of gold. In 2019, the World Gold Council estimated that Indian households had accumulated up to 25,000 tonnes, making India the single largest gold holder in the world. Indian households collectively own significantly more gold than the combined reserves of the ten largest central banks. The value of this household gold is estimated at about \$3.2 trillion, equivalent to nearly 75 per cent of India's nominal GDP. If this stock of gold were channelled into the productive sector for capital formation, it could replace much of what FDI provides.

Avoiding the nearly \$500 billion outflow on gold imports over the past decade and a half would also have significantly improved India's balance of payments, bringing it closer to equilibrium and reducing the persistent deficit. Gold imports are among the largest items in India's import bill and have long been a major driver of the imbalance in external accounts. Official gold exports remain low at

about \$10 to \$15 billion, while unrecorded exports are estimated at \$50 to \$100 billion. The result is a gold trade deficit of around \$400 billion, which has had a deep impact on India's trade balance and foreign exchange outflows.

India's overall trade deficit over the last decade stands at about \$1,700 billion. Of this, gold accounts for nearly \$400 billion. If the gold trade deficit were excluded, the adjusted trade deficit would fall to roughly \$1,300 billion, narrowing the gap significantly.

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India's attraction to FDI stems from the promise of capital, technology, global knowledge, and foreign exchange. FDI introduces efficiency, innovation, and international benchmarks, but much of the technology can also be purchased separately. Its most important contribution has been the supply of capital and foreign exchange, both of which strengthen the balance of payments and help manage the trade deficit. Since April 2000, India has attracted about \$750 billion of cumulative equity FDI, underscoring its position as an appealing investment destination. Yet, if the true strength of FDI lies in the capital it provides, India's vast household gold holdings already represent a comparable or greater pool of wealth. The real challenge is not the absence of capital but how to unlock and channel this domestic stock into productive use. If that can be achieved, reliance on foreign inflows could be reduced and India's own wealth could become a sustainable driver of growth.

Our foreign exchange reserves include about \$225 billion of US Treasuries, which generate yields ~4%. In comparison, gold, which accounts for around 10 per cent of India's foreign exchange reserves, has delivered a ten-year compounded annual growth rate of above 12 per cent in dollar terms. While gold is undoubtedly more volatile and Treasuries provide steady liquidity and income, the higher returns on gold make a strong case for reconsidering the composition of reserves, particularly for a country like India where gold holdings are substantial.

The paradox is illustrated by the record repatriation of nearly \$100 billion by overseas investors in FY25, compared with ~\$90 billion in the previous year. While FDI helps capital formation, a large share of the value created eventually flows back outside the country in the form of profit repatriation and dividend payments.

Economic policy must evolve with the times. In 1991, India urgently needed FDI. Today, however, capital is no longer scarce. On the contrary, large amounts of capital now flow outward through overseas investments and repatriations. These trends demonstrate India's maturity as a market. What is needed now is a creative scheme to draw out the massive reserve of gold held by Indian households and channel it into the productive economy. This would generate much-needed capital from domestic sources and ensure that the benefits remain within the country.

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