Causal Relationship between Gold Price and Sensex: A Study in Indian Context

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ABSTRACT

Gold has been used around the world as an instrument for investment to hedge against inflation or in the form of jewellery. All these factors are the reason for hyping the demand for gold day by day. As per world gold council gold demand in India is about to rise 33% by 2020.The cumulative annual demand will be excess of 1,200 tonnes by 2020.Recently India has become the largest consumer of gold and price of gold is likely to breach Rs 32,000 mark in the next calendar year. There is an inverse relationship between gold price and dollar. In this paper, an attempt has been made to investigate the existence of unidirectional or bidirectional relationship between gold price and Sensex for the period of 10 years (2002-2012). The results of the analysis show that there is no causality between the gold price and Sensex.

Keywords: *Gold Prices, Stock Market Return, BSE, Volatility, Co-integration.*

I. Introduction:

Gold appears to have its own “logics” and mystique. It has traditionally been very conservative investment due to it's relatively scarcity, but it tends to accurate reflector of short term fear about the economy in general. Gold has traditionally been considered an attractive investment in India and its excellent performance in recent years has substantially confirmed the wisdom of that tradition. When markets are volatile and investors panic they tend to move out the risky assets such as stock and invest into assets such as gold. Gold like virtually all commodities is traded on a dollar dominated basis. In times of crisis, capital often flow out of emerging markets currencies. This makes it a doubly attractive investment for Indian investors in volatile times, the rise in the rupee price of gold is fuelled by both the increase in international gold prices and by the appreciation of the dollar against the rupee.

Gold as an investment option was dramatically illustrated in early 2009. Gold surged even as global stock markets plunged and the rupee briefly traded at Rs. 51 to the dollar.

Prior to the introduction of liberalization and globalization policies, gold prices in India showed an increasing trend (Figure-1). In the post liberalization period, the average annual prices of gold also showed an increasing trend from the year but, it showed a decreasing trend in 1997 and 1998 and again showed an increasing trend in the year 2000. From 2002 to 2012, gold prices are continuously increasing. The domestic gold price in India is continuously increasing due to its heavy demand in the country. There are several reasons gold has high demand in India. The first reason is security; gold offers full security as long as it is retained by central banks. There is no credit risk attached to gold. Secondly, gold is able to maintain its liquidity even at times of crisis situations like high global inflation or political turbulence. The third reason for holding gold is to build a diversified portfolio. Gold also has taken the role of an asset of last resort. World Economic History shows that countries have repeatedly used gold as security against loans when they have had difficulties with their Balance of Payments and have felt the need to borrow on the international capital markets.