Gold Exchange Traded Funds

Why in News?

In July 2022, **Gold** [Exchange Traded Funds (ETFs)] witnessed a net outflow of **Rs 457 crore as investors parked their money in other asset classes** as part of their portfolio rebalancing strategy.

- This was in comparison to a **net inflow of Rs 135 crore in June 2022.**

What are Gold Exchange Traded Funds?

- **About:**
  - **Gold ETF**, which aims to track the **domestic physical gold price,** are passive **investment instruments** that are based on **gold prices and invest in gold bullion.**
  - Gold ETFs are units representing **physical gold which may be in paper or dematerialised form.**
    - **One gold ETF** unit is equal to **1 gram of gold** and is backed by **physical gold of very high purity.**
    - They combine the **flexibility of stock investment** and the **simplicity of gold investments.**
- **Advantages:**
  - There is **complete transparency** on the holdings of an ETF.
  - Gold ETFs have much **lower expenses as compared to physical gold investments.**
  - **No wealth tax, no security transaction tax, no VAT and no sales tax** is levied on ETFs.
  - There is **no fear of theft** as ETFs are safe and secure as units held in Demat Account of the holder.

What could be the Reasons for the Outflow?

- Investors' expectations of **a rising interest rate cycle** leading to a fall in gold prices.
  - The fall in the gold price impacted the net flows into the gold ETFs.
- **A falling rupee** is another factor that has likely impacted the demand and supply dynamics of gold.
  - It has been witnessed globally too, with gold ETF's posting significant outflows on the back of lower gold prices.

Exchange Traded Fund

- **An Exchange-Traded Fund (ETF)** is a basket of securities that **trade on an exchange, just like a stock.**
- ETF reflects the **composition of an Index**, like BSE Sensex. Its trading value is based on the **Net Asset Value (NAV)** of the underlying stocks (such as shares) that it represents.
- ETF share prices **fluctuate all day as it is bought and sold.** This is different from **mutual funds** that only trade once a day after the market closes.
- An ETF can own hundreds or thousands of stocks across various industries, or it could be isolated to one particular industry or sector.
- **Bond ETFs are a type of ETFs** which may include **government bonds, corporate bonds, and**

state and local bonds—called **municipal bonds.**
    - **A bond** is an instrument that represents a **loan made by an investor** to a **borrower** (typically corporate or governmental).
- Besides being cost efficient, ETFs offer a diversified investment portfolio to investors.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Q. Indian Government Bond Yields are influenced by which of the following? (2021)

1. Actions of the United States Federal Reserve
2. Actions of the Reserve Bank of India
3. Inflation and short-term interest rates

Select the correct answer using the code given below.

(a) 1 and 2 only
(b) 2 only
(c) 3 only
(d) 1, 2 and 3

Ans: (d)

Explanation:

- Bond is an instrument to borrow money. A bond could be issued by a country's government or by a company to raise funds.
- Bond yield is the return an investor realizes on a bond. The mathematical formula for calculating yield is the annual coupon rate divided by the current market price of the bond.
- Movements in yields depend on trends in interest rates, it can result in capital gains or losses for investors.
- A rise in bond yields in the market will bring the price of the bond down.
- A drop in bond yield would benefit the investor as the price of the bond will rise, generating capital gains.
- Fed tapering is the gradual reduction in the bond buying program of the US Federal Reserve. So, any actions of the United States Federal Reserve impact the bond yield in India. **Hence, 1 is correct.**
- The actions of the RBI plays a crucial role in determining the yield of government bonds. The sovereign yield curve has a special significance for monetary policy in influencing a wide array of interest rates in the economy. **Hence, 2 is correct.**
- Inflation and short-term interest rates also influence the yield of government bonds. **Hence, 3 is correct.**
- **Therefore, option (d) is the correct answer.**

Q. With reference to 'IFC Masala Bonds', sometimes seen in the news, which of the statements given below is/ are correct? (2016)

1. The International Finance Corporation, which offers these bonds, is an arm of the World Bank.
2. They are rupee-denominated bonds and are a source of debt financing for the public and private sector.

Select the correct answer using the code given below:

(a) 1 only
(b) 2 only
(c) Both 1 and 2

(d) Neither 1 nor 2

Ans: (c)

Explanation:

- The World Bank Group, which is a vital source of financial and technical assistance to developing countries, consists of five distinct yet complementary organizations, viz.,
- International Bank for Reconstruction and Development (IBRD),
- International Development Association (IDA),
- International Finance Corporation (IFC), **hence, statement 1 is correct.**
- Multilateral Investment Guarantee Agency (MIGA),
- International Centre for Settlement of Investment Disputes (ICSID).
- Masala Bonds are rupee-denominated borrowings issued by Indian entities in overseas markets. Masala means 'spices' and the term was used by International Finance Corporation (IFC) to popularise the culture and cuisine of India on foreign platforms. The objective of Masala Bonds is to fund infrastructure projects in India, fuel internal growth via borrowings and internationalize the Indian currency. **Hence, statement 2 is correct.**
- **Therefore, option (c) is the correct answer.**

Sources: IE