INDIA'S FOREIGN EXCHANGE RESERVES ON A RISING SPREE

BWR ECONOMIC BRIEF **APRIL 18, 2024**

Rising trend in India's foreign exchange reserves – touched a record high in April 2024

Summary

India's foreign exchange reserves have been on a rising trend for the past few weeks in 2024 and touched all-time high of $648.6 billion (bn) for the week ended April 5, 2024. This increase in forex reserves was by $70.1 billion since March 2023 till April 5, 2024 and this marked the seventh straight week of rise. In the previous week ending March 29, 2024, India's forex reserves had increased by $2.95 billion to a new high of $645.6 billion.

India's foreign exchange reserves consists of foreign currency assets (FCA) of the Reserve Bank of India (RBI) along with gold reserves held by the RBI and Special Drawing Rights (SDRs) of the Government of India and the reserve position in the International Monetary Fund (IMF). FCA form the biggest component of the forex reserves. The foreign-exchange reserves are assets held on reserve and managed by the RBI in foreign currencies. The movement in the FCA is mainly on account of any purchase and sale of foreign exchange by the RBI, income from the deployment of the foreign exchange reserves, external aid receipts of the Central Government and changes due to revaluation of the assets. Foreign exchange reserves are an essential component of the balance of payments.

This growth in forex reserves was mainly driven by increase in foreign currency assets which form the biggest component of the forex reserves. FCA rose by $60.9 bn during the FY 2023-24 so far till March 29, 2024. The growth was further supported by higher gold reserves, which rose $6.960 bn during the same period.

However, other components of the forex reserves-SDRs and the reserve position in the International Monetary Fund registered a decline of $247 million and $506 million, respectively during FY 2023-24 till March 29, 2024.

According to the RBI, the foreign exchange reserves at $645.6 bn is equivalent to 11.3 months of projected merchandise imports in FY 2023-24 and 99.6% of outstanding external debt at end of December 2023.

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India's foreign exchange reserves have grown strongly over the years with reserves growing from $42.3 bn in FY 2000-01 to $578.4 bn in FY 2022-23, resulting in a CAGR of 13%. The reserves further scaled to all-time high of $648.7 bn on April 5, 2024. This significant jump in forex reserves can be attributed to various factors, including a rise in foreign direct investments, increased exports particularly in the IT sector and service space, higher capital flows and economic policies by the government.

Importantly, India witnessed a significant decline in foreign exchange reserves in 2022 following the Russia-Ukraine war. The emergence of war between Russia and Ukraine led to a spike in global crude oil prices, which adversely impacted the rupee exchange rate as the Rupee breached the 80 per dollar mark. This also raised India's import bills which in turn resulted in expansion of the current account deficit. The RBI intervened in the foreign exchange market to boost its reserves through various measures, which ultimately resulted in a spike in forex reserves.

Strong forex reserves are key for the Country to withstand economic challenges and maintain financial stability.

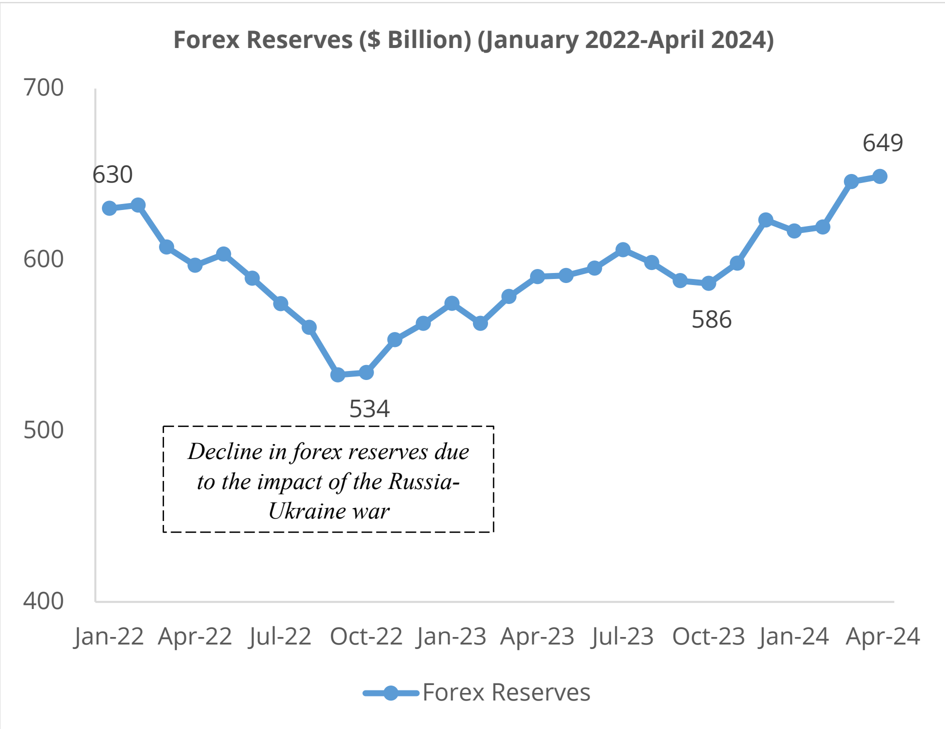
India's external sector remains strong with significant easing in current account deficit (CAD) of India led by robust merchandise and services export growth, strong forex reserves and FPI inflows. During Q3 FY 2023-24, the CAD narrowed to $10.5 bn (1.2% of GDP) from $11.4 bn (1.3% of GDP) in Q2 FY 2023-24. During April-December FY 2023-24, the CAD contracted to $31.0 bn (1.2% of GDP) as against 2.6% during same period in FY 2022-23.

Further the net FPI inflow to India stood strong at $41.6 bn during 2023-24 as against net outflows of $14.1 bn in 2021-22 and $4.8 bn in 2022-23. Notably, RBI expects the CAD for FY 2024-25 to remain manageable on the back of firm inward remittances driven by resilient India's services exports.

Importantly, hardening of international crude oil prices impacts the forex reserves position of the Country as it results in higher import bill for India and consequently lead to a decline in foreign currency assets.

Movement in Foreign Exchange Reserves

Foreign Exchange Reserves touched a record $648.6 billion - Monthly Trend



Source: RBI

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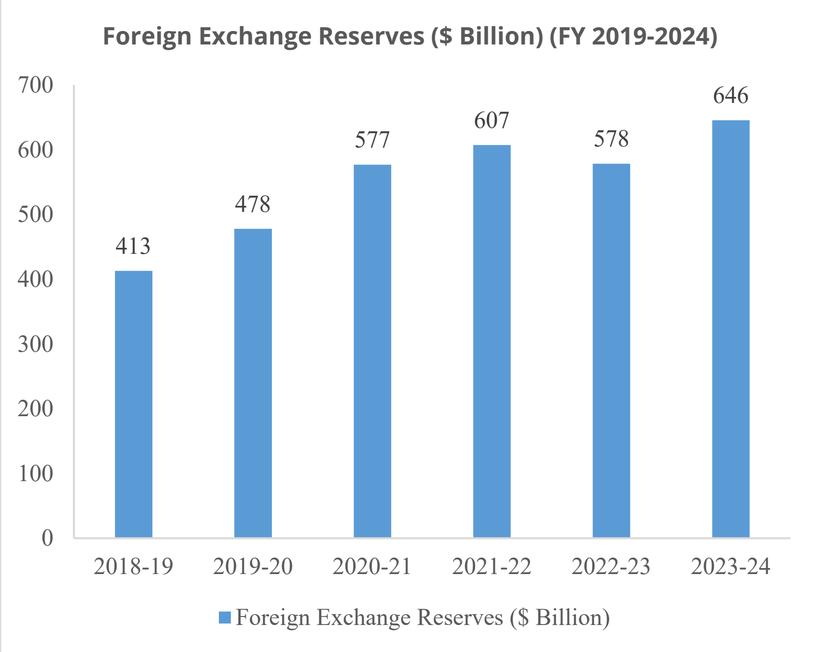
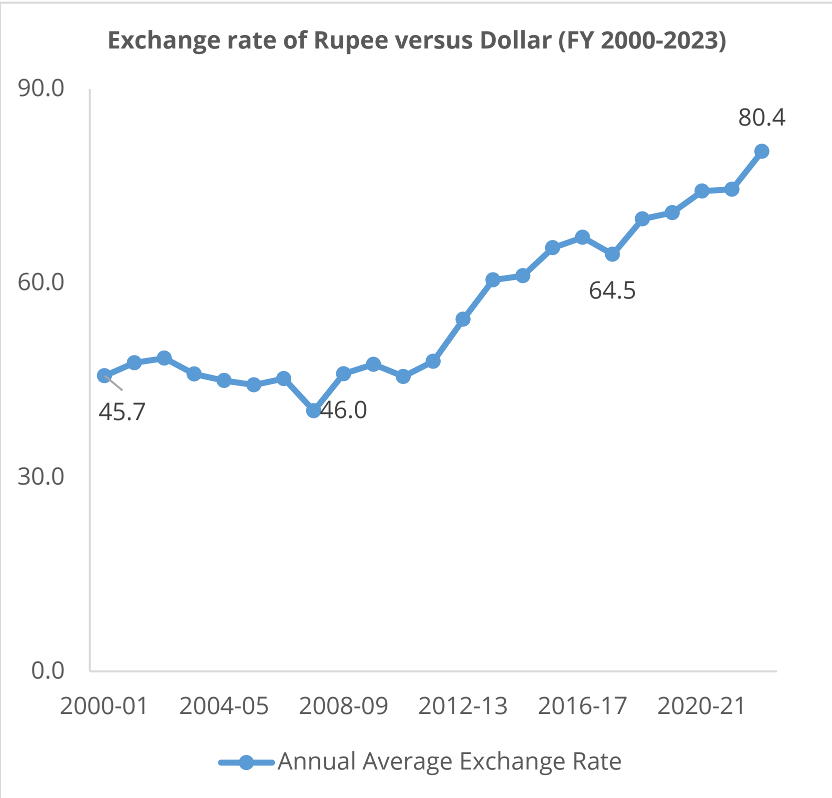
India's foreign exchange reserves rose to a record high of $649 billion on April 5, 2024 on the back of the Country's firm macroeconomic fundamentals and expansion in India's external position.

Steady rise in forex reserves help government to effectively manage external debt obligations and maintain stability in the domestic currency.



Source: RBI

**Note: Reserves value as on the last day of the financial year*



Source: RBI

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Increasing forex reserves helps or provides more room for the RBI to intervene in the forex market to stabilize the rupee when there is excess volatility in the exchange rate. The Indian rupee has remained largely range bound in 2023-24 as compared to both its emerging market peers driven by resilient India's macroeconomic fundamentals, improved capital flows, rising foreign exchange reserves. The rupee has depreciated by 1.4% against the US dollar in FY 2023-24 and this was lower as compared to emerging market peers. In the second half of FY 2023-24 (H2 FY 2023-24), the rupee depreciated 0.4% against the US dollar on the back of firm US dollar driven by rising US bond yields and caution due to geopolitical tensions in the Middle East. Importantly, hardening of international crude oil prices impacts the forex reserves position of the Country as it results in higher India's import bill and consequently lead to a decline in foreign currency assets.

Various measures announced by the RBI to boost forex inflows and push the value of rupee:

RBI had undertaken various measures in the past to boost foreign exchange inflows and these include:

- Increased external commercial borrowing (ECB) limit under the automatic route from $750 mn or its equivalent per financial year to $1.5 bn with an objective to help Indian corporates raise more funds.

- Incremental foreign currency non-resident (Bank) FCNR(B) and Non-Resident (External) Rupee deposits from July 1, 2022 up to November 4, 2022 were exempted from maintaining Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).

- Provided temporary permit to banks to raise fresh FCNR(B) and NRE deposits without reference to the extant regulations on interest rates effective from July 7, 2022.

- Raised overseas borrowing limit for companies.

- Allowed foreign portfolio investors (FPIs) to invest in government securities and corporate bonds made between July 8 and October 31, 2022

- Allowed banks to offer higher interest rates on bank deposit schemes intended for non-resident Indians (NRIs).

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Spurt in capital flows and moderation in current account deficit (CAD) has resulted in an accretion to India's foreign exchange reserves. During FY 2023-24 (upto December 20, 2023), net inflows of foreign portfolio investments (FPI) stood strong at $30.6 billion as against net outflows of $3.3 billion during the same period last year. Going ahead, India's strong macroeconomic fundamentals coupled with the moderation in the current account deficit (CAD) bodes well for the foreign exchange reserves. Further, the inclusion of Indian government securities in the JP Morgan Global Bond Index -Emerging Markets and Bloomberg debt indices augurs well for the outlook on the capital flows to India. JP Morgan is likely to add Indian bonds to its emerging markets index from June 2024. Rising foreign fund inflows into India along with a strengthening of the country's external balance with increasing exports is promising for the forex reserves outlook.

Given the resilience of the Indian economy with strong GDP growth in Q3 FY 2023-24, we expect India's forex reserves to get further boost going ahead. However, any fresh geopolitical headwinds, conflicts in the Middle-East may impact foreign fund flows and exchange rate and thus the forex reserves.

Forex Reserves of BRICS Nations (in $ billion)

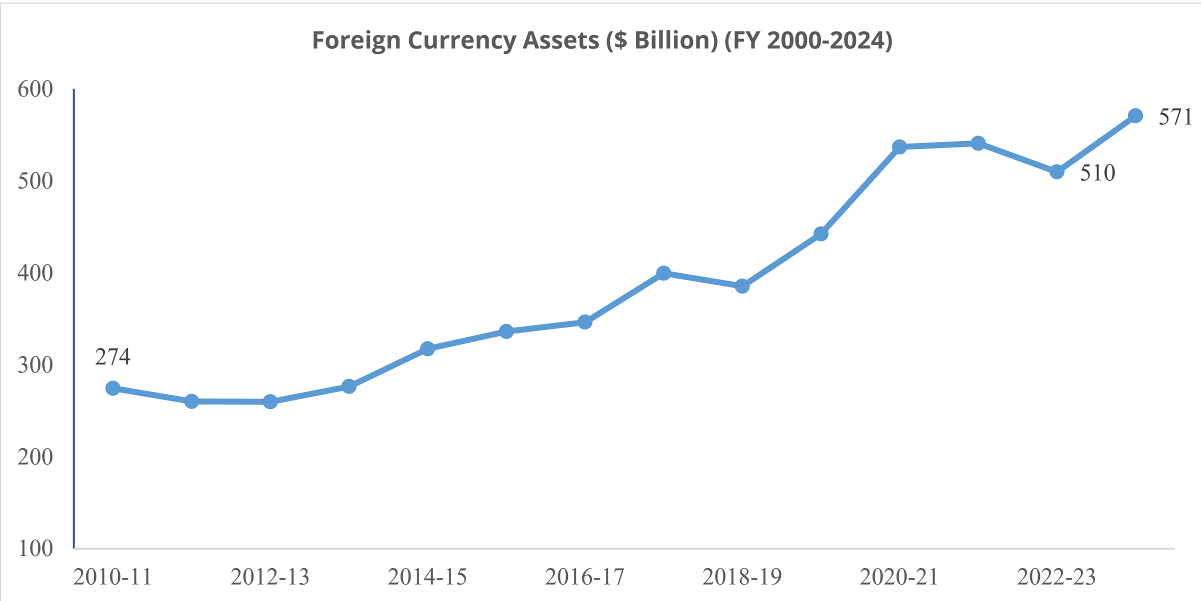
Country	2022	2023	2024*
Brazil	324.7	355.0	352.7
Russia	582.0	598.6	582.6
India	562.7	622.5	645.6
China	3,306.5	3,449.7	3,437.5
South Africa	60.6	62.5	61.2

Source: RBI

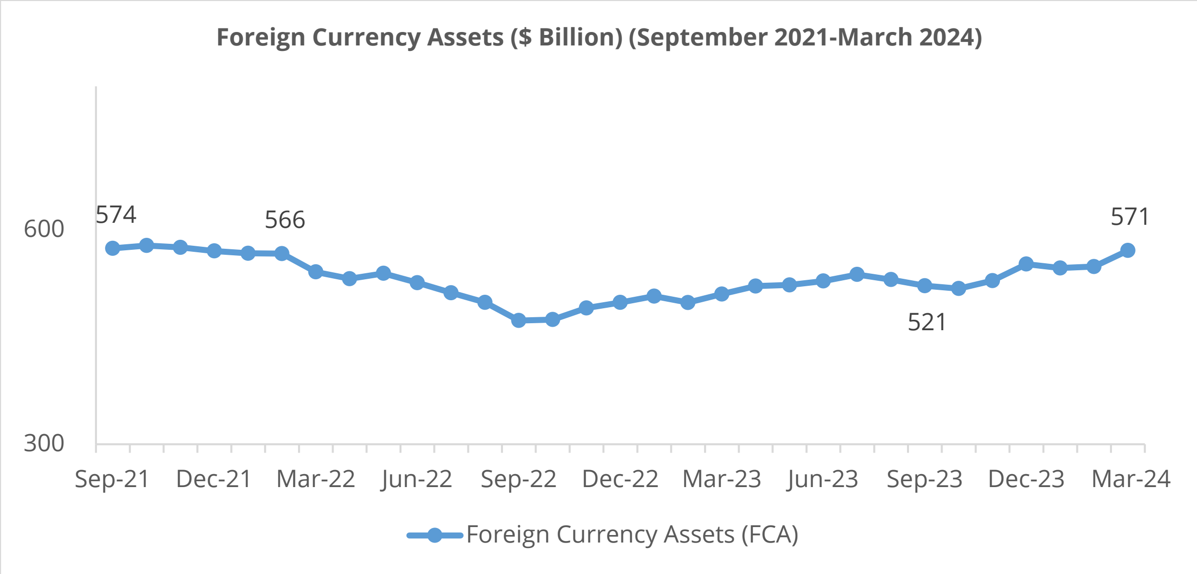
**Forex reserves for 2024 pertain to February 2024 for all countries except South Africa (which is January 2024) and India (March 2024).*

Foreign Currency Assets led the spurt in forex reserves

Foreign currency assets are the biggest component of the foreign exchange reserves. Total FCA have surged from $39.55 bn in FY 2000-01 to $509.69 bn in FY 2022-23, translating into CAGR of 12.3%. The FCA reserves further swelled to $570.62 bn as of March 29, 2024 and to $571.2 bn on April 5, 2024.



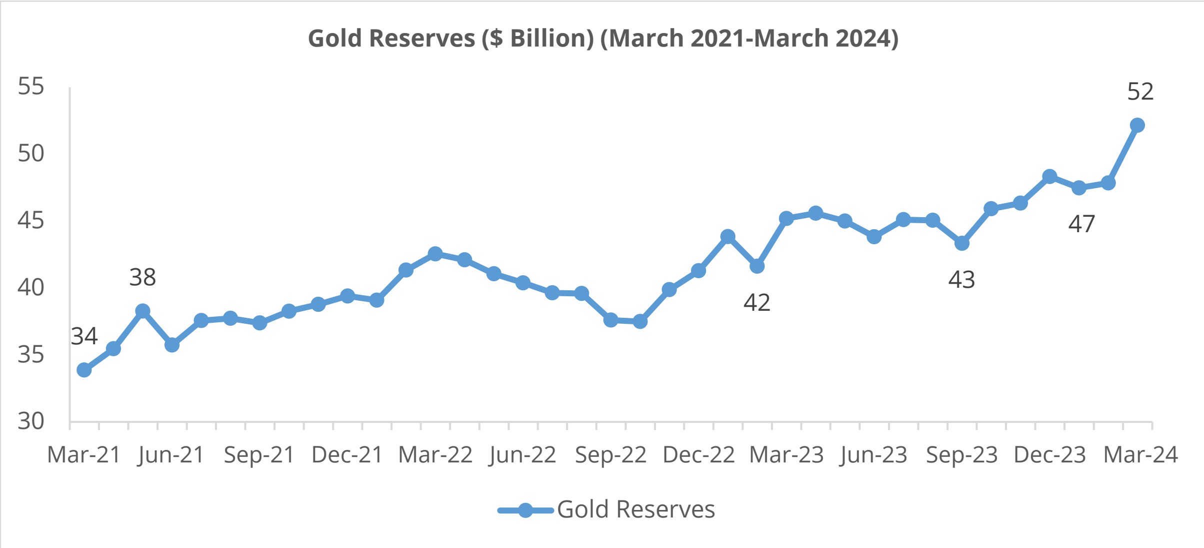
Source: RBI



Source: RBI

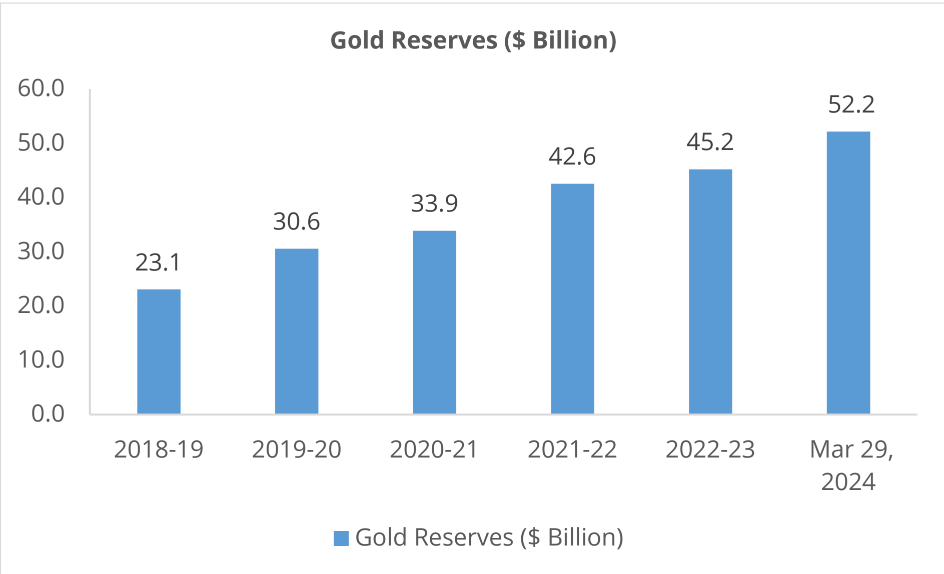
Gold Reserves: The share of gold in India's foreign exchange reserves have grown strongly over the years on the back of buying of the precious metal from the central banks amid global uncertainty and rising inflation. Central banks globally purchase gold to boost foreign exchange reserves in order to hedge foreign currency risks and to diversify their reserves. The share of gold in total foreign exchange reserves have increased from 5.9% in 2020-21 to 7.8% in 2022-23 and 8% at the end of March 29, 2024. A substantial spike in gold reserves was seen post the covid-19 pandemic. In value terms, gold reserves have grown over 50% from $33.9 bn in FY 2020-21 to $52.2 bn at the end of March 29, 2024 and to $54.6 bn at the end of April 5, 2024. At end of September 2023, total gold held by RBI stood at 800.79 metric tonnes (including 39.89 metric tonnes of gold deposits), according to the half yearly report published by the RBI. Out of the total gold holdings, 388.06 metric tonnes of gold is held overseas with the Bank of England and the Bank of International Settlements (BIS) while 372.84 metric tonnes of gold is held domestically.

Monthly change in Gold reserves position



Source: RBI

Gold reserve position (Yearly)



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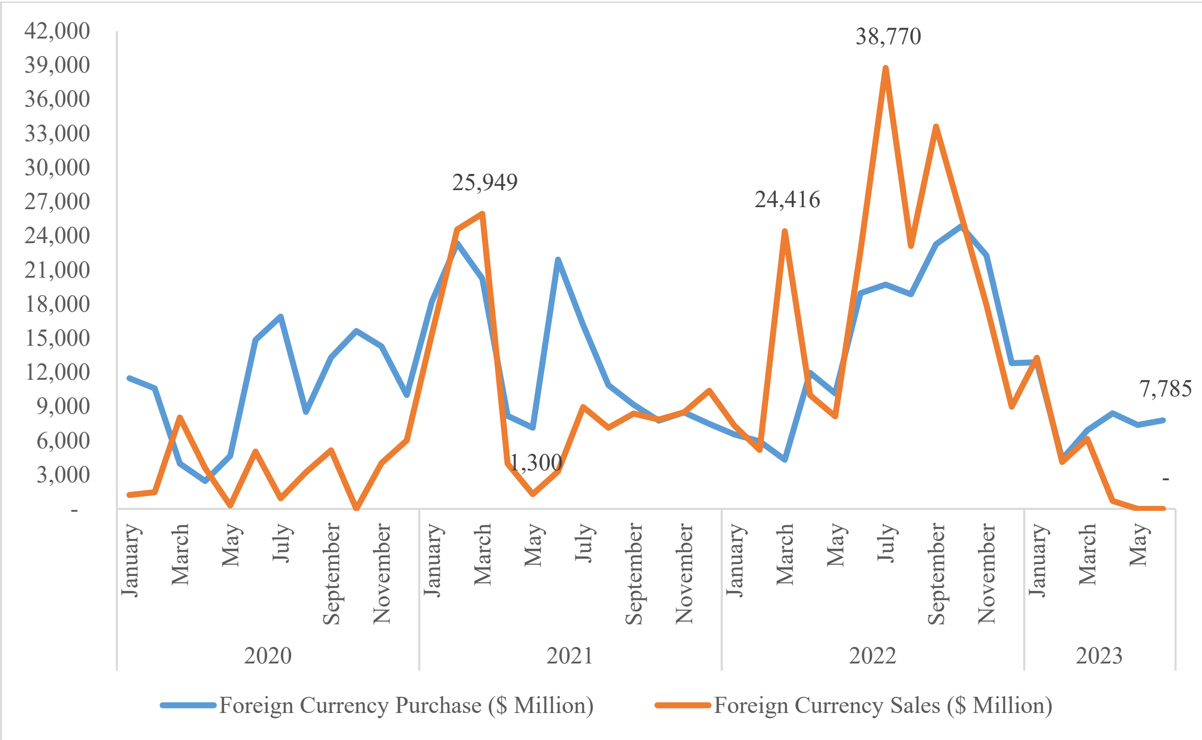
Gold reserves have witnessed tremendous growth over the years on the back of sustained buying of the precious metal by the RBI in order to diversify its forex reserves and to hedge foreign currency risks.

Source: RBI

The foreign exchange reserves are denominated and expressed in US dollar terms. The RBI intervenes in the foreign exchange markets through liquidity management to curb excessive volatility in the exchange rate. When there is pressure on the domestic currency, the RBI either buy or sell dollars in the spot and forward markets to prevent sharp appreciation or depreciation of the Indian rupee. Importantly, foreign exchange reserves help RBI to stabilize the value of the Indian rupee.

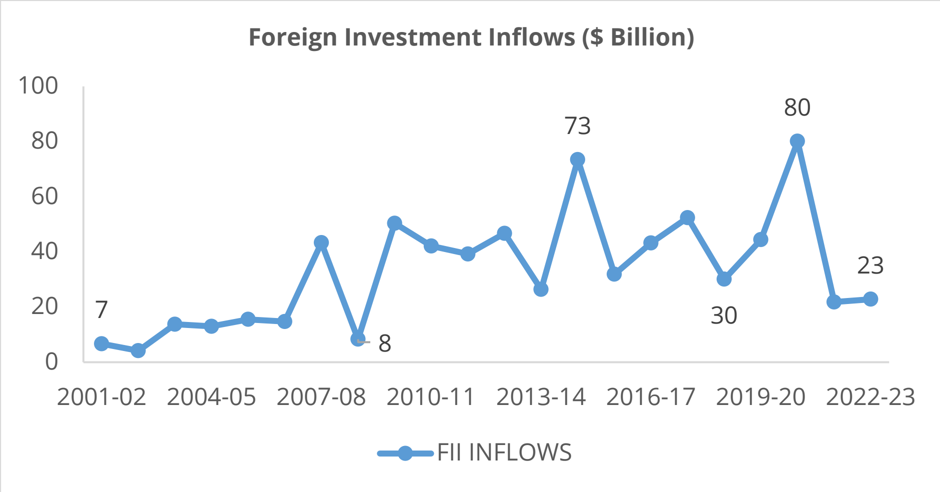
Sales and Purchases of US Dollar by the RBI (in $ Million)



Source: RBI

Factors driving the forex reserves

1. Higher FPI flows: Strength in the macroeconomic fundamentals of the Indian economy has been one of the major drivers for higher FPI flows into the Country. Net foreign portfolio investment (FPI) inflows to India during April 1, 2023 – March 14, 2024, period stood at $40.5 bn, which is the highest flow since 2015-16, according to the data published in the Reserve Bank of India's March 2024 bulletin. In February 2024, the net FPI inflows turned positive and stood at $3.8 bn led by robust flow in the debt segment during the month at $3.3 bn. Net FPI flows during March 2024 (till 14th) amounted to $5.6 bn. Increased FPI flows indicating continued foreign investor confidence.



Source: RBI

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There was a spurt in foreign investment flows from FY 2018-19 to FY 2020-21 led by increased foreign direct investment and portfolio investments.

2. Trade Balance: India's merchandise trade deficit eased to $225.2 bn during April 2023 to February 2024 period as against $245.9 bn a year ago period. A positive trade balance which is a result of higher exports over imports can result in an increase in forex reserves and vice versa.

Ease in merchandise trade deficit and positive service trade surplus led to 37.80% improvement in overall trade deficit from $116.13 bn in April-February 2022-23 period to $72.24 bn in April-February 2023-24 period.

Improvement in overall trade during April-February 2024

		Apr-Feb 2023-24 ($ Billion)	Apr-Feb 2022-23 ($ Billion)
Merchandise	Exports	394.99	409.11
	Imports	620.19	655.05
Services*	Exports	314.82	294.89
	Imports	161.86	165.09
Overall Trade (Merchandise+ Services)*	Exports	709.81	704.00
	Imports	782.05	820.14
	Trade Balance	**-72.24**	**-116.13**

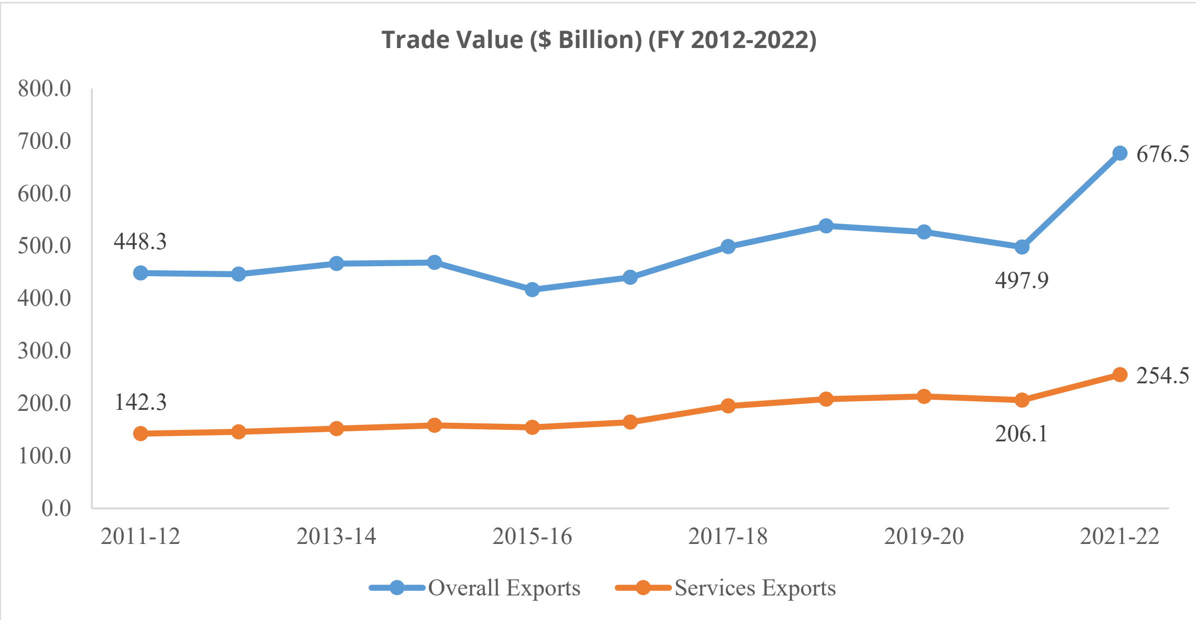
Source: Government of India, Ministry of Commerce & Industry

3. Surging foreign direct investments (FDI): India witnessed robust foreign direct investment as well as foreign portfolio investment flows in H2 FY 2023-24. Net FDI flows rose to $9.9 bn in H2 (October-January) from $5.4 bn a year ago. Net FPI equity flows increased to $8.0 bn during H2 FY 2023-24 from $3.1 bn in the corresponding period of the preceding year. Further, net debt inflows by FPIs stood at $13.3 bn in H2 FY 2023-24 as against net outflows of $0.4 bn in the same period a year ago. The increased flow of funds was supported by the inclusion of Indian government bonds in J. P. Morgan's benchmark emerging market index from June 2024.

4. Robust domestic economy: The second advance estimates (SAE) released by the National Statistical Office (NSO) placed real gross domestic product (GDP) growth for 2023-24 at 7.6% led by strong investment activity and an uptick in private consumption.

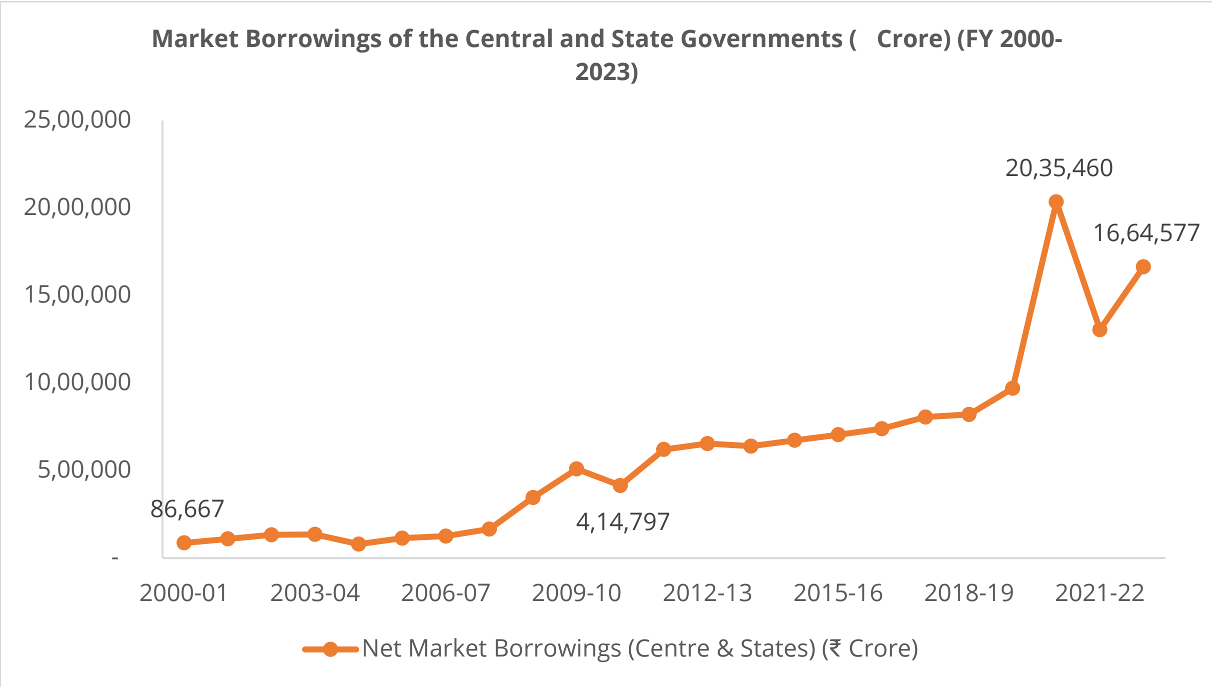
5. Inflation: Headline CPI inflation eased to 5.3% in October 2023-February 2024 as against an average of 5.5% in H1 FY 2023-24. Further, core inflation (excluding food and fuel inflation) has moderated as it fell to 3.4% in February 2024. Inflation can impact interest rates and the money flow as inflation and interest rates tend to move in the same direction.

6. Robust service exports: India's overall (Merchandise and Services) exports have demonstrated resilience over the last decade as India's overall exports (Merchandise and Services combined) expanded from $448.3 bn in FY 2011-12 to $676.5 bn in FY 2021-22 and further to $709.81 bn in April-February 2023-24. India's services exports too expanded from $142.3 bn in FY 2011-12 to $254.5 bn in FY 2021-22 and to $314.82 bn during April-February 2023-24.



Source: Government of India, Ministry of Commerce & Industry

7. Borrowings: The Union government borrow funds through the issue of government securities called government securities (G-secs) and Treasury Bills to meet its spending requirements. The government outlines the details of amount of funds it wants to borrow in the annual borrowing programme in the Budget. The Interim Union Budget for 2024-25 has budgeted gross market borrowing of ₹14.13 lakh crore during 2024-25. The borrowing by the government comes following successful gross market borrowing programme of the Central Government for 2023-24 amounting to ₹15.4 lakh crore.



Source: RBI

* Views are personal.

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