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THE JUMP IN FOREX RESERVES MAY NOT BE A POSITIVE SIGN

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How fast have India's forex reserves risen?

Between 27 March and 14 August this year, foreign exchange reserves rose 12.6% to $535.25 billion. The interesting thing is that during a similar period in 2019, forex reserves rose by just 4.5% to $430.5 billion. Clearly, there has been a very rapid increase in the country's foreign exchange reserves since March-end, after the negative economic impact of the coronavirus pandemic was first felt. Some economic and political commentators have tried to pass this increase as evidence of improvement in the overall state of the economy. But there's much more to it than meets the eye.

What does this jump in forex reserves signify?

A large part of the foreign exchange reserves is used to pay for imports. Goods imports between April and July fell 46.7% to $88.9 billion. Hence, lesser reserves have been used to pay for imports. This essentially shows a slump in economic activity since the onset of lockdown. India imports a large part of the crude oil that it consumes. During the first four months of the current fiscal year, the country imported around 82% of the total oil it has consumed. Nevertheless, the total oil and petroleum products imports have fallen by 55.9% to $19.6 billion, a clear impact of the lockdown.

So how has this impacted foreign exchange reserves?

While imports fell by 46.7% in the first four months to $88.9 billion, goods exports fell by 30.3% to $74.9 billion. Hence, trade deficit, the difference between imports and exports, fell by 76.5% to $14 billion as against $59.4 billion last year. This difference of $14 billion was more than made up for through other sources, pushing up the reserves.

What other sources have aided reserves?

Besides reduced imports, there are other factors that have pushed forex reserves up. As the price of gold has increased, between 27 March and 14 August, the value of gold held by the Reserve Bank of India (RBI) has jumped by 21.7% to $37.6 billion. Clearly, not just individuals have benefited from owning gold as it has rallied, RBI has gained too. Over and above this, with people not leaving India for holidays, business trips or education, the demand for foreign exchange while travelling abroad, has taken a beating.

Do foreign investors have any role to play?

Foreign institutional investors (FIIs) bring money primarily in dollars. These dollars need to be exchanged for rupees before they can be invested. Between 1 April and 24 August, FIIs have net-invested 77,779 crore in Indian stocks. Assuming one dollar to be worth 75, this means that FIIs have brought in more than $10 billion this year into India and this has ended up with RBI as foreign exchange reserves.

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