Forex reserves shrank faster than during 2008 crisis, taper tantrum

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Over the past eight months, global financial markets have been dealt the double whammy of the war in Ukraine and the fastest pace of US monetary policy tightening in almost two decades.

Amid these headwinds, the Reserve Bank of India (RBI) has shielded the rupee from runaway depreciation by drawing upon its foreign exchange reserves at a much faster pace than the last two phases of major external volatility that have occurred over the last 15 years.

The two phases in question are the global financial crisis of 2007-08 and the taper tantrum of 2013, during which the rupee suffered a much sharper depreciation than it has in the current scheme of things. The protection offered to the rupee by the central bank has, however, made its impact felt when it comes to reserves.

As on September 16, 2022, the RBI's headline foreign exchange reserves were at a near two-year low of $545.65 billion, down $85.88 billion than the level that existed as on February 25, a day after Russia invaded Ukraine. While some part of the fall in reserves is due to revaluation in the face of a strengthening dollar, a bulk of the decline may be attributed to the RBI's greenback sales in the currency market, analysts said.

In comparison, from end-March 2008 to end-March 2009 — a year that saw the cascading impact of the events that followed the collapse of Lehman Brothers — the RBI's reserves dropped $57.7 billion to $252 billion.

Four years later, during the period from late April 2013 to early September of that year, when the mere mention of monetary tightening by the Fed sent global markets into a tailspin, the RBI's reserves declined $21.56 billion. The reserves declined to $274.81 billion as on September 6, 2013 from $296.37 billion as on April 26, 2013.

Over the last couple of years, the RBI's reserves registered a significant increase primarily due to overseas inflows amid record low US interest rates and an improvement in the domestic current account. In nominal terms, the reserves rose $99.2 billion in 2020-21 and then $30.3 billion in the previous fiscal year.

In the last fiscal year, the reserves rose $47.5 billion on a balance-of-payments basis as against $87.3 billion in 2020-21. India recorded a current account surplus of $23.9 billion in FY21.

What really makes the impact of the RBI's no-holds-barred approach towards using reserves this time around stand out is the movement in the rupee.

In 2008, the rupee shed 19.22 per cent to the dollar, taking a more severe beating than the Philippine peso, the Taiwan dollar, the Indonesian rupiah, the Russian ruble, the Malaysian ringgit and the Thai baht.

The situation during the taper tantrum was much grimmer. From May 1 to September 3, the Indian currency shed 20.6 per cent, faring worse than ten other emerging market currencies.

So far in this calendar year, the rupee has declined by 8.2 per cent to the dollar, performing better than several other currencies.

What marks the rupee's trajectory — and the huge defence put up by the RBI — is that the dollar index has strengthened more sharply in the current situation as the Fed has embarked on its most aggressive tightening spree since 2004.

In 2008, the dollar index gained 6.1 per cent. During the four months of immense volatility in 2013 sparked by the taper tantrum, it strengthened by 1 per cent. So far in 2022, however, the index is up a massive 17 per cent.

"India's massive FX defence amounting to more than $100 billion estimated since October 21 — spot plus forwards — makes it a near outlier in the Asia FX fall. So the war chest is falling faster than the pace of the war fading. We have been suggesting the FX intervention strategy for the RBI will need to be revisited for reducing emerging bilateral imbalances," economists from Emkay Global wrote recently.

"Dislocation in forward rates, falling FX cover, still-high commodity prices, limited exchange rate pass-through to inflation and elevated INR valuations may call for the RBI to re-orient its FX intervention strategy," they wrote.

The rapid fall in reserves has huge implications. Reserves at $553.1 billion as on September 2, accounted for nine months of imports projected for the current fiscal. The level of reserves a year earlier accounted for close to fifteen months of import cover.

Moreover, a recent resumption of overseas investment in equities notwithstanding, India's current account deficit is set to rise sharply in the current year, leading to an outflow of dollars from the country. Several economists peg the current account deficit for the current year at 3.5 per cent of GDP, up from 1.2 per cent of GDP a year ago.

CRISIS MANAGEMENT

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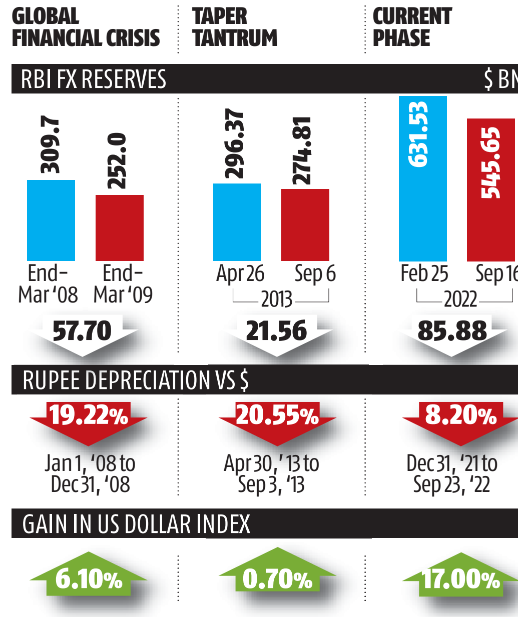

India's campaign for trade in ₹ finds fans from Russia to UAE

Indian tea exporters are getting interest from the United Arab Emirates and sanctions-hit Russia and Iran to pay in rupees, a nod toward the government's plan to settle international trade in the local currency. Buyers from those countries are keen to pay rupees for Indian shipments, said PK Bhattacharya, secretary general of the Tea Association of India, an industry group that mainly represents producers in northern regions. This follows the central bank's push to internationalise the currency, he added. "With Russia, it might see the light of the day sooner, but for other countries it might take more time," Bhattacharya said. The Reserve Bank of India in July announced a plan to allow overseas trade to be settled in rupees. The move will make it easier for Indian companies to trade with countries facing difficulties invoicing in the US dollar, such as Russia and Iran. **BLOOMBERG**