DEPLETING RESERVES STIR 2008 MEMORIES

Forex reserves set to shrink further

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INDIA'S DEPLETED FOREIGN exchange reserves are likely to drop further, falling to their lowest level in over two years by end-2022, as the Reserve Bank of India continues to defend the rupee from the dollar's rise, a Reuters poll found.

In a battle that has so far failed to staunch the rupee's fall to a record low against the greenback, the RBI has drawn down its foreign exchange reserves by nearly $100 billion to $545 billion from a peak of $642 billion a year ago, and more is coming.

Reserves are forecast to fall another $23 billion to $523 billion by the end of this year, according to the median forecast from a September 26-27 Reuters poll of 16 economists. If realised, that would be the lowest level in over two years. Forecasts were in a $500-540 billion range.

That suggests the RBI will run down forex reserves at a rate last seen during the global financial crisis of 2008, when they fell over 20%. It has already burnt reserves at a much quicker pace than during the taper-tantrum period in 2013 when the US Federal Reserve suddenly cut government bond purchases.

About a decade later, India finds itself in a similar situation. Despite regular interventions via dollar sales and expectations for more, the rupee has depreciated nearly 10% against the dollar this year and hit a record low of 81.95 per dollar on Wednesday.

"With the latest move that we have seen in the rupee, I expect the RBI to continue intervening to perhaps not try and defend a particular level of the currency, but certainly try and reduce volatility," said Sakshi Gupta, principal economist at HDFC Bank. "We would see even more interventions in the coming days to deal with the increasing pressure on the rupee and a widening current account deficit, leading to a greater drawdown in the FX reserves by the end of this year."

A few economists in the poll warned overall forex reserves could fall more than their forecasts over the coming year due to a ballooning current account deficit, which was expected to end the fiscal year at its widest in a decade.

Part of the reason for the drawdown is the RBI has lagged the Fed with interest rate hikes.

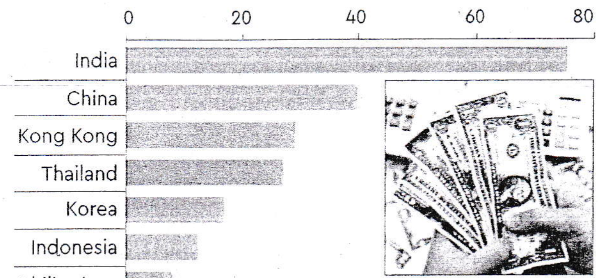
For its part, the RBI, which only started hiking in May and has raised the repo rate by just 140 basis points, appears nearly done. It is forecast to hike by a mere 60 basis points more in this cycle, with 50 due this week.

"The RBI should reduce the pace of intervention sooner rather than later to allow the rupee to trade more in line with fundamentals," said Anubhuti Sahay, senior economist at Standard Chartered. "Our ammunition on FX reserves should remain strong enough, not only for the next six months, but from a two- to three-year perspective."

—REUTERS

RESERVE DEFENCE

Spot and forward dollars spent by central banks in 2021 to defend FX ($ billion)



Source: Bloomberg