

Foreign reserves likely to show revaluation gains

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Mumbai, 29 November

The Reserve Bank of India's (RBI's) steps to ensure stability in the exchange rate amid considerable global headwinds may have led to a steep decline in foreign exchange reserves in 2022 but analysts believe that there are factors that could now lead to an improvement on the reserves front.

Key among the factors is a recent reversal in valuation of the RBI's reserves as signs of easing inflation in the US have led to hopes of the Federal Reserve slowing down the pace of its monetary tightening.

"We estimate that of the more than \$93 billion fall in foreign reserves since October 2021 to November 18, around 51 per cent was driven by revaluation losses, while the remainder was due to market intervention. These revaluation losses are likely to peak whenever the US dollar reaches its own apex," economists from Barclays wrote.

"If anything, we would incrementally expect the RBI to report some revaluation gains over the next 12 months, along with higher compensation on its foreign reserves holdings as a function of rising global interest rates. This will be positive for the current-account balance through the primary-income channel, and will marginally help mitigate pressure from the current account deficit," they wrote.

The hopes of the Federal Reserve adopting a less aggressive approach to rate hikes have led to the US dollar retracing considerably, thereby providing a favourable valuation impact for the RBI's reserves.

In the week ended November 18, 2022, the RBI's foreign exchange reserves rose \$2.5 billion to \$547.25 billion, marking the second consecutive week in which the reserves increased.

The reserves climbed \$14.7 billion the week before.

Barclays expects India's current account deficit (CAD) around 3.4 per cent of GDP — or \$115 billion — in the current financial year, up from 1.2 per cent of GDP the previous year. The foreign bank expects the CAD to moderate to 2.8 per cent of GDP in the next financial year.

The RBI's reserves were around \$631 billion in late February when the Ukraine war broke out. The conflict, followed by the US Fed's tightening cycle propelled global funds towards the dollar, exerting pressure on

emerging market currencies such as the rupee. So far in 2022, the US dollar index has gained around 11 per cent.

Reserves worth \$530 billion were equivalent to 8.6 months of imports projected for the current year, the RBI said earlier this month. The level of reserves in September 2021 accounted for almost 15 months of imports.

According to traders, however, the RBI has over the last couple of weeks begun to replenish its reserves through dollar purchases in the foreign exchange market.

With the US dollar index having declined sharply since November 10 — following the release of lower-than-expected US inflation

data — the rupee has appreciated against the greenback, providing the central bank room to add dollars to its kitty.

"They have been buying, the week before when the reserves went up by more than \$14 billion, the RBI in our estimate would have bought around \$3 billion while the rest was valuation," Anindya Banerjee, VP, Currency Derivatives & Interest Rate Derivatives at Kotak Securities, said.

Treasury officials said the RBI started purchasing dollars around the 80.50/dollar-mark and was subsequently adding the US currency to reserves around the 81 per dollar level. On November 11, the rupee strengthened to an intraday high of 80.59 per dollar. It has not returned to that level since, however.

"It is likely that the RBI would be there at any level below 81/\$1, we saw that on

one particular day when the dollar/rupee was close to 80.50/\$1, the pair closed higher by the end of the day. So, they (the RBI) would be there," Bhaskar Panda, HDFC Bank's executive vice-president of overseas treasury, said.

The domestic currency closed at 81.72 per US dollar on Tuesday. While the rupee has depreciated 9.03 per cent so far in 2022, the currency has recovered much ground from its record intra-day low of 83.29 per dollar on October 20.

Given the recent easing of the global dollar strength and the subsequent rebound in the rupee, market participants said the RBI may continue purchasing the greenback for now. "Recently, also, I understand that when it went to 81.43/\$1 three or four days ago, the RBI had started to buy dollars at that level too. Market participants say that they have been buying dollars continuously since 80.50/\$1," Anil Kumar Bhansali, head, treasury at Finrex Treasury Advisors, said.

