Decreasing foreign reserves and falling consumer confidence

■ *Dr. T.K. Jayaraman*

Though the Indian rupee recovered from the steepest fall of all times on October 11, things are yet to improve. The rupee has recovered from the record figure of ₹ 74.40 and is hovering around ₹ 73.40.

The record fall was a reaction to the most unexpected decision by Reserve Bank of India (RBI) of holding the policy rate unchanged at 6.50%.The subsequent recovery was partly due to the heavy selling of US dollars by the RBI from its reserves and partly due to a temporary retreat of petroleum crude oil price to around $ 76 from a near dangerous level of $ 80 per barrel.

The uncertainty is still continuing with the pending US sanctions against Iran, scheduled to come into effect from November 4. Once the sanctions against Iran begin, Iran's oil supply, which meets 20% of the world demand for oil would be adversely affected. More than that, what is feared is Saudi Arabia, the world's leading player is expected to take retaliatory action if the European Union takes steps against the oil kingdom for its alleged complicity of a Saudi origin journalist's murder in its consulate in Turkey.

The counter steps by Saudi Arabia would include cutting oil supply; and the oil price would rise. The benchmark Brent crude oil price, which was $ 77.62 per barrel on October 27, would hit $ 80 per barrel. Already, with a decline in oil production in Venezuela, and crisis in Libya, any new dispute between Saudi Arabia and the West would plunge the world economy into gloom and darkness.

Capital outflows

According to the National Securities Depository Limited, the monthly outflow of capital in the first two weeks of October 2018 alone is massive. It was more than ₹12,000 crore. There were only five such occurrences when outflows exceeded ₹ 12,000 crore in a given month during the last 18 years. The frequent utterances by high officials including the Niti Aayog vice chairman that India need not be worried about rupee depreciation in the context of large foreign reserves led the speculators believe that rupee fall would not be arrested. In addition, the return-hungry and risk-averting foreign portfolio investors saw the equity markets in India were weakening. To them, and investments in Indian shares and short term debt markets were no longer attractive in the context of rising interest rates in the United States.

India's elevated inflation, rising current account deficit (CAD) and growing uncertainties associated with bad loans affecting the future of the banking were also the causes for the outflow of hot moneys. The net outflows by FPIs in mid October alone, is $1.7 billion. From April to mid October in FY 2019, the net outflow is $8.7 billion, as against a net inflow of 17.9 billion during the same time last FY 2018.

Decreasing foreign exchange reserves

The more disturbing news is with regard to India's foreign exchange reserves. The reserves have gone down from a record level of $ 426.08 billion in April this year to $ 394.46 billion in the week ended October 12 (Table 1). The decrease in reserves is due to RBI's aggressive intervention in the foreign exchange market "to reduce the volatility in exchange rate", which is the limited objective, as distinguished from the deliberate efforts to stabilize the exchange rate as in the case of other Asian markets usually undertaken by central banks for "managing exchange rate". The interventions take the form of RBI's sale of dollars and purchase of rupees with the objective of cheapening the dollar and raising the value of rupee.

Table 1 - India's Foreign Exchange Reserves (US$ billion)

	April, 13	May, 10	June,15	July , 13	Aug, 10	Sep, 10	Oct, 12
Foreign Currency Assets	400.98	392.45	388.39	380.39	376.26	376.15	369.99
Gold	21.48	21.69	21.19	21.11	20.39	20.38	20.52
SDRs	1.54	0.10	1.50	1.48	1.47	1.48	1.47
Reserves in IMF	2.08	0.14	2.03	2.48	2.41	2.48	2.47
Total Reserves	426.08	392.45	388.39	380.03	376.26	376.15	369.99

Source: RBI Monthly Bulletin

The sale of dollars has led to the decrease in India's foreign reserves by $ 32 billion. The fall in reserves by $5.14 billion is the biggest drop in seven years. No doubt, it helped the rupee to recover, though slightly, from the record low exchange rate of $74.40 of October 11. The updated data reveal that the reserves have fallen by another $942 million to $393.523 billion in the week ending on October 19.

The RBI should have made these efforts much earlier. These include enabling companies to raise more money abroad and easing norms for raising foreign exchange reserves by issue of local bonds have not stopped the rupee falling. The latest update on reserves is India's foreign exchange reserves fell $942 million to $393.523 billion in the week to Oct.19 owing to a fall in foreign currency assets, according to data from the RBI. In the reporting week ended on October 19, foreign currency assets, a major component of overall reserves, fell by $922.4 million to $369.076 billion.

This only shows the absence of coordination between the government and the central bank unlike the active and concerted efforts in other regions of Asia, as witnessed in the case of the Indonesian rupiah.

No shortage of bad news

The latest disturbing news is on the fiscal deficit (FD). It is reported that the FD in the first half of FY 2018-19 has widened to 95.3% of the budgeted estimate. Therefore, it looks the budgeted goal of FD at 3.3% of GDP, especially in the context of elections coming up soon in 2019, would not materialize. So too, the goal of keeping down current account deficit (CAD) in India's balance of payments under 2% of GDP is unlikely to be realized. Agency reports from Nomura and Bloomberg have estimated that CAD for FY 2018-19 would be around 2.8% of GDP, because of falling rupee and rising oil prices, as compared to 1.9% of last FY. A rise in CAD will have an adverse impact on exchange rate as well. The rupee would depreciate further, given the other factors.

Table 2 - **Consumer Confidence**
Current Situation Index

Year	Month	Index
2017	September	95.5
	November	91.1
	December	96.9
2018	March	95.1
	May	94.1
	July	98.3
	September	94.8

Source: RBI

The results of bimonthly Consumer Confidence Survey by the RBI in six metropolitan cities, namely, Bengaluru, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi reveal that Current Situation Index (CSI), fell from 98.30 in July, 2017 to 94.80 in September, 2018 (Table 2). The reasons behind the decline in consumer confidence are fears of further depreciation of rupee, impact of depreciation on landed prices of imported goods, including crude, which are denominated in dollar, rising inflation and the widening of FD and CAD .

Agency reports from Nomura and Bloomberg have estimated that CAD for FY 2018-19 would be around 2.8% of GDP, because of falling rupee and rising oil prices, as compared to 1.9% of last FY. A rise in CAD will have an adverse impact on exchange rate as well.

The Bloomberg cites the Bank of America Merrill Lynch economist, Indranil Sen Gupta, saying it is not how much reserves you have is important, but the solution lies in luring dollar inflows by tapping overseas Indians. Already, India has been fighting a losing game with the dwindling of foreign reserves which have fallen by $32 billion since January this year.

The central bank should now reassess and consider raising the policy rate without waiting for the next meeting of the Monetary Policy Committee scheduled in December, 2018. That is one way of sending out a clear signal to the speculators that the RBI means business instead of letting the rupee to fall further. ■

— Dr T.K. Jayaraman is an Adjunct Professor, Amrita School of Business, Bengaluru Campus

[The views expressed by the author in this article is his own.]