

# How to conserve foreign reserves: possibility of international trade in rupee?



■ *Dr. T. K. Jayaraman*

The news on the external sector of India's economy, as we enter the new year is not favourable. 2023 began with challenges. They stem from both global and domestic factors. The World Trade Organization (WTO) has revised downwards its previous global trade growth forecast from 3.4% to 1%. Interest rate increases, which have been resorted to by major economies for fighting inflation have resulted in fears of recession, consequent to monetary tightening. The International Monetary Fund has comforted its 190 members with its prediction that the recession would only cover one third of the world. However, it is obvious that any recession in the advanced countries would have adverse effects on demand for goods ranging from raw materials and primary goods to manufactured consumer goods from the developing and less developed countries in the globalised world. The seemingly endless Russian-Ukraine conflict's impact on demand and supply conditions have been identified as responsible for the gloomy forecast of falling world trade.

## Widening trade deficit

The news on hand reveals that India's merchandise exports at \$34.5 billion contracted by 12% on a year on year (y-o-y) basis in December 2022. The negative momentum on a month to month (m-o-m) basis is 1.1%. According to the latest official release, India's merchandise exports, during April-December 2022, rose by 9% to reach about \$333 billion while imports rose by 25% to \$552.7 billion.

Exports of electronic goods including smartphones, recorded a growth of 52% to reach \$16.67 billion during April – December 2022 with an equally commendable performance

by exports of petroleum products. They increased to \$70.28 billion registering a similar growth rate at 52%. India's top export destination in April-December 2022 was the US with exports growing at around 7% to reach about \$60 billion, with United Arab Emirate (UAE) emerging as the second largest export destination. Exports to UAE were \$23 billion rising by 15%, followed by Netherlands, the third ranked export destination, growing 69% to reach \$ 14 billion. Exports to China which was India's fourth largest export destination in April-December 2022 declined by 36%. There was a notable decrease in non-petroleum and non-gems & jewelry exports in December 2022. It was \$27 billion, compared to \$29.52 billion in December 2021.

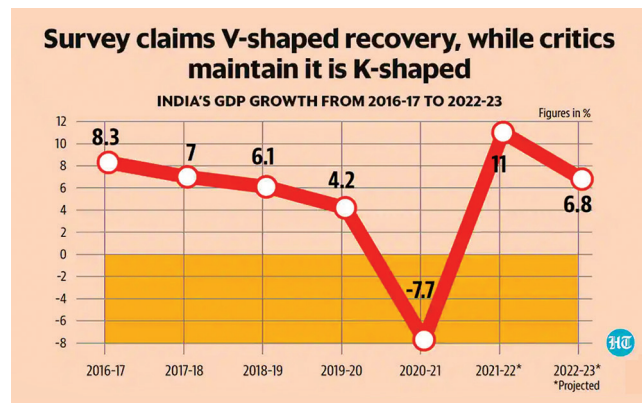
Services exports (comprising tourism, aviation, telecom, shipping, ports, communication and storage, financing, insurance, transportation, real estate, business services, software services, IT-BPM) on the other hand are expected to record \$ 236 billion in April -December 2022, compared to \$ 185 billion in the year earlier-period. In 2021-22, services exports were an all-time high of \$ 254 billion. This would amount to 20% growth in services exports in the current fiscal year. The latest assessment by Commerce and Industry Minister Piyush Goyal, in the last week of January is that exports will exceed the target of \$300 billion in 2022-23.

## Current account deficit

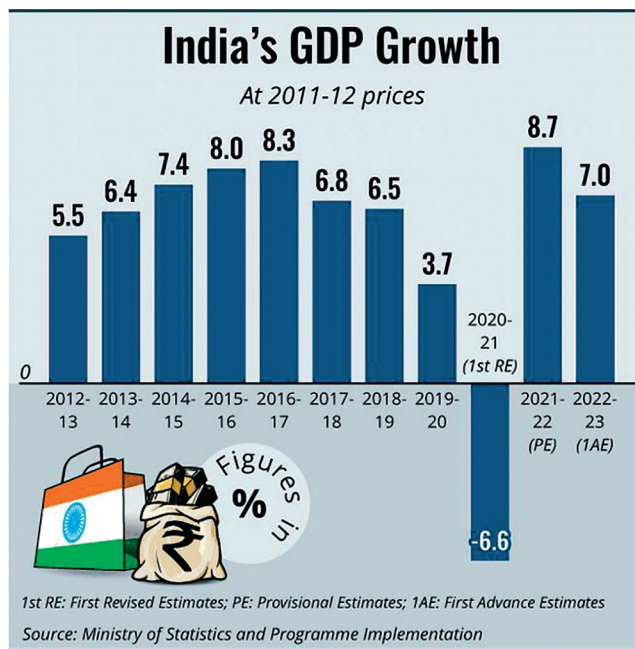
An article on State of the Economy, published in the January 2023 issue of Bulletin of Reserve Bank of India (RBI) notes that macroeconomic stability is getting further entrenched in India', with the latest data showing that the first "milestone"

of monetary policy – bringing inflation into the RBI’s 2-6% tolerance zone – was being passed”. The objective for 2023 is to tether inflation so that it aligns with the RBI’s 4% target by 2024, which would be another second milestone soon. The consumer price index inflation-based December inflation eased to 5.7% from 5.9%, which is within the RBI’s tolerance range of 2%-6% (target of 4% with a plus or minus 2% margin). The RBI has projected India’s GDP growth at 6.8% for the current fiscal year.

The article on the State of the Economy also refers to a distressing aspect, the rise in the current account deficit (CAD) in India’s balance of payments. It widened to 4.4% of GDP in the second quarter (July-September, 2022) of FY23, as the merchandise trade deficit was at an all-time high of \$83.5 billion in a quarter, with an increase in net outgo from the income account. The income account includes net income, such as those of interest and dividends and transfers. The latter include remittances, especially from India’s diaspora and expatriates working overseas. In November 2022, the chief economic advisor to the central government indicated CAD would be about 3-3.2% of GDP, which is much higher than the recorded 1.2% in last FY2022.



and safe at the “touch of the mouse”, as and when news on economic fundamentals affecting investor confidence spread on internet. In recent months such fluctuations have been causing depreciation of the rupee against the US dollar. These fluctuations are due to expectations of rise in the US interest rate for fighting inflation by its central bank. India’s forex fell to \$ 561 billion the week ending on January 13. In the week ending on January 20, the position improved. Expectations changed; IMF forecasts singled out India as a bright spot. India’s Forex level rose to \$572 billion, the highest level since early August 2022, more than the two-year low of \$524.52 billion hit in October 2022.



RBI Governor Das described the current level of forex at around \$560 billion as a “very comfortable level”, equivalent to nine months of India’s projected imports and 92% of external debt. He rejected the idea that India was “burning up the reserves” in recent months for protecting the rupee” by interventions in the market by selling dollars towards arresting the depreciation of the rupee. “You buy an umbrella to use it when it rains,” Governor Das said.

### Foreign exchange reserves

That brings us to focus on India’s foreign exchange reserves (forex) position as well as its critical role in minimizing external debt for bridging the CAD gap. India’s forex level which touched a record high at \$642 billion in September 2021 were subject to severe fluctuations due to frequent outflows of speculative, short-term (less than one year) investments, which move to countries in search of “safe and higher-returns”

India has embraced a freely floating exchange rate regime since the mid-1990s. That is exchange rate determination on a day-to-day basis by free, unhindered interaction and operation of supply and demand forces in the marketplace. Interventions by central banks to reduce “high degree of volatility” are usual and they go under the description: dirty floats. The RBI has been intervening “occasionally in the spot and forwards market to protect the rupee”, and there are instances of state-run banks purchasing dollars on behalf of the RBI, for providing more liquidity to the system.

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Madan Sabnavis

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With the predicted fall in trade in 2023 by WTO, it is likely that adding to the current level of forex reserves would be difficult and hence what can be done is to save dollars by resorting to settling international payments in rupee for countries who have considerable volume of trade. India is the world’s third-largest consumer of oil, after the United States and China. India imports nearly 84% of its crude requirement and most of the oil exporting countries, which are highly dependent on their oil exports for growth and development needs, want US dollars. So it is out of question that rupee can be used for importing petroleum crude, as the oil exporting countries would like to trade only for dollars. However, there are countries who would not be averse to using rupee for trade in regard to non-oil imports. The UAE is one of them. Secondly, Egypt which is having a dollar crunch, despite a \$12 billion help from UAE, Saudi Arabia and Qatar, was unable to clear \$9.5 billion worth imports which were locked up in Egyptian ports, was forced to devalue its currency, the Egyptian pound twice in March (the latest is from Egyptian pound 16 per dollar to Egyptian pound 24.7 per dollar) in 2022. For the fourth time in five years, the country had to approach the IMF for assistance. In December 2022, IMF approved a loan of \$3 billion to meet the balance of payment crisis.

Egypt imports wheat and other food grains and it is likely Egypt would soon join some 30 countries to consider rupee trade. The way to rupee trading was opened by the Russia-Ukraine conflict. As India was under pressure from higher

food and energy prices, it had to pivot away from traditional oil suppliers and towards discounted Russian crude. It is official as Governor Das informed Financial Times on January 8 that RBI had approved rupee accounts for seven countries.

In a well-researched article in the Hindu Business Line of January 2, 2023, Bank of Baroda’s Chief Economist, Madan Sabnavis divides India’s trading partners into two categories: (i) countries with whom India has trade deficit; and (ii) countries with whom India has trade surplus. Sabnavis points out the rupee trade is to India’s advantage where India runs deficits (India imports more than exporting and pays in rupees). Sabnavis lists out ten top most countries with whom India have trade deficits, totaling \$230 billion and it would help in conserving forex. Five of them are petroleum crude and products exporters and they may agree only in regard to non-oil trade. India’s trade deficit is estimated at around \$90 billion. The question is whether a rupee arrangement will work with any of them. It is also doubtful whether trade surplus countries would agree as they are not sure what they would do with rupees, since surplus rupees cannot be used as dollars for trade with other countries.

## वर्ल्ड बैंक, IMF ने घटाई भारत की विकास दर, क्या मंदी के हैं संकेत ?



Therefore, a group of countries is needed where members are willing to accept each other’s currencies. The countries with which India has trade surplus are Bangladesh, Nepal and Sri Lanka. The general question posed by Sabnavis is : Will it be possible to have a group of countries with similar mindsets and have Indian rupees being used within the closed user group. Only then rupee in international trade would be a reality. ■



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