

India Forex Reserves (USD) November 2024 report

By Chaitanya Sabharwal, as an intern for PredictRAM.



Introduction

This report examines recent trends in India's Forex Reserves. This report analyse factors influencing these trends and focuses the hardest on their implications on the Indian economy, some of its core sectors and some stocks within them. Before exploring all the things here, I'd like to add that Forex Reserves and the factors influencing it are some of the most important gears in the whole economic machine and need to be carefully understood.

1. Components of Forex

Forex reserves primarily comprise foreign currency assets or FCA like US Dollars, Euros, etc - this is the largest component of the forex reserve. Next are Gold Reserves, and Special Drawing Rights (SDRs) with the IMF, and Reserve Position in the IMF.

2. Importance of Forex Reserves

Forex reserves facilitate import financing, act as a cushion during economic shocks, ensure stability for the Rupee, and provide confidence to foreign investors. Forex can

also help a country with its foreign debt obligations.

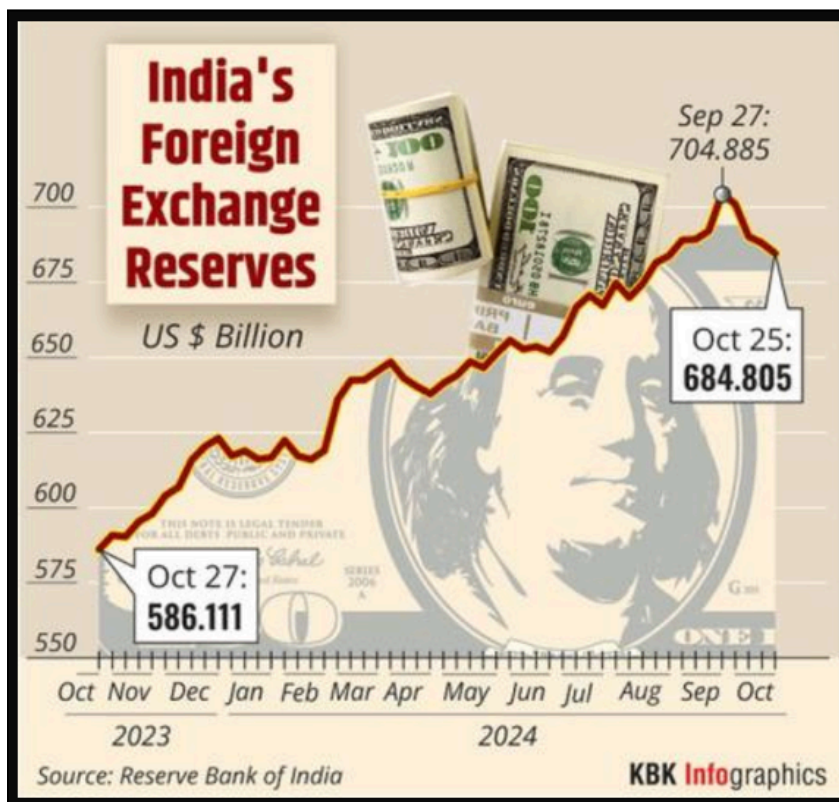
3. RBI's Responsibility

In short, the Reserve Bank of India (RBI) is responsible for managing and regulating the nation's foreign exchange reserves to ensure economic stability.

4. How India's Forex Reserves Reached Their Current Level

India's forex reserves grew over the years due to factors like increasing foreign investments, growing services exports, and remittances from Indians working abroad. All these developments are supported primarily by a strong economy - So growing forex reserves over the past 10 years is itself a testament of how well the economy has been managed.

India has attracted more foreign investments in the past 10 years than it has cumulatively attracted since independence. However, recent global events and domestic economic conditions have led to a decline.



Factors Influencing Forex Reserves

1. Global Factors:

- US Dollar Strength: A strengthening US dollar makes imports more expensive for India and can lead to capital outflows, impacting forex reserves. This is because

when the home market of the foreign investors gives them a better return, they would dilute their investments here in India and go back to their home markets.



- b. Global Interest Rate Differentials: Higher interest rates in developed economies can attract capital from emerging markets like India, leading to a decline in forex reserves. This is because the bond markets in the developed countries will start to offer better returns.
 - c. Geopolitical Tensions: Events like the conflict in the Middle East can trigger risk aversion and capital flight from emerging markets, impacting forex reserves. This is because the developed markets are slightly better placed to absorb such risks because of the financial strength they enjoy.
 - d. Global Commodity Prices: Fluctuations in global oil prices significantly impact India's import bill and subsequently, forex reserves. India's oil imports have always contributed to a big chunk of India's forex bill.
2. Domestic Factors:
- a. Foreign Investment Flows: Both Foreign Institutional Investors (FIIs) and Foreign Direct Investment (FDI) impact forex reserves. While FDI tends to be more stable, volatile FII flows can lead to fluctuations in reserves.
 - b. Trade Balance: India's persistent trade deficit, where imports exceed exports, puts pressure on forex reserves.
 - c. RBI Intervention: The RBI intervenes in the forex market by buying or selling dollars to manage the rupee's exchange rate and influence forex reserves.
 - d. Domestic Economic Growth: Strong economic growth attracts foreign investment and improves forex reserves, while sluggish growth can lead to outflows and impact reserves.
 - e. Inflation: High domestic inflation can erode the rupee's value and make imports more expensive, impacting forex reserves.

Recent Trends in Forex Reserves in India

1. What Has Changed: India's forex reserves have declined for six consecutive weeks, falling from a peak of \$704.9 billion to \$675.7 billion as of November 8, 2024.
2. Why This Change:
 - a. FII Outflows: A major factor is the significant outflow of foreign capital, primarily driven by FII selling in the Indian stock market.
 - b. China Stimulus: The introduction of attractive stimulus measures in China has diverted some foreign investment away from India.
 - c. Geopolitical Risks: Heightened tensions in the Middle East have led to risk aversion and capital flight from emerging markets, including India.
 - d. Rising Inflation: India's Core CPI Inflation Rate has risen to 6.2% in November 2024 primarily due to the increase in prices of vegetables.



3. Impact of Recent Changes in Forex Reserves
 - a. Economy:

The decline in forex reserves, coupled with FII outflows and rupee depreciation, can negatively impact investor confidence and overall economic sentiment. However the Indian economy is still looking very bright and has retained its GDP growth forecast for the full year FY25.
 - b. Sectors of the Economy:
 - i. Information Technology - With the Fed rate cuts and the depreciating Rupee, the upcoming quarters of the Indian IT companies seem to be bright and better in terms of earnings.



- ii. Pharmaceuticals - The depreciating Rupee + the passing of the Biosecure act in the US are big tailwinds for the Indian pharma industry.



- iii. Auto & Engineering - The sector has had a great run up in the past 4 years but was hit by an exhausting demand sentiment. However, it could be a temporary blip. The biggest impact of forex is normally seen in the auto parts supply side in India.



- iv. Oil & Gas - The profit margins haven't seen a terrible decline recently, probably offset by the lower crude oil prices but the upcoming times may not be easy for the sector because of high geopolitical influence. Forex reserves are thus expected to face some pressure.



- v. FMCG - Sales and profit margins of FMCG companies continue to creep amid higher inflation and higher raw material costs.



c. Stocks in Those Sectors:

- i. Information Technology - HCL Technologies and Infosys have already started making gains and are reacting positively to the expected earnings boost due to the depreciating Rupee and the Fed rate cut.
- ii. Pharmaceuticals - Mutual Funds have bought more stake in stocks like Sun Pharma, Lupin, Dr. Reddy's Labs and Divi's Labs citing continued upside in earnings.
- iii. Auto & Engineering - OEMs like Tata Motors and Mahindra & Mahindra are expected to retain their performance in the H2FY25 whereas supply side players have almost made a full recovery from their lows in October 2024.
- iv. Oil & Gas - Stocks like Reliance Industries, ONGC, Oil India are continuing their downward movement due to high uncertainty.
- v. FMCG - FMCG stocks have also fallen recently due to their bad Q2 earnings which also faced margin pressure citing inflationary environment and the failure to pass on the costs to the consumers.

Forecast and Future Outlook of Forex Reserves in India

1. Factors Influencing the Forecast: Predicting future forex trends is complex. However, key factors to consider include:
 - a. The Trajectory of FII Flows: Whether FIIs continue to sell or if there is a reversal in trend will significantly impact reserves. The November month is also witnessing heavy FII selling pressure but it has fared better than October month.

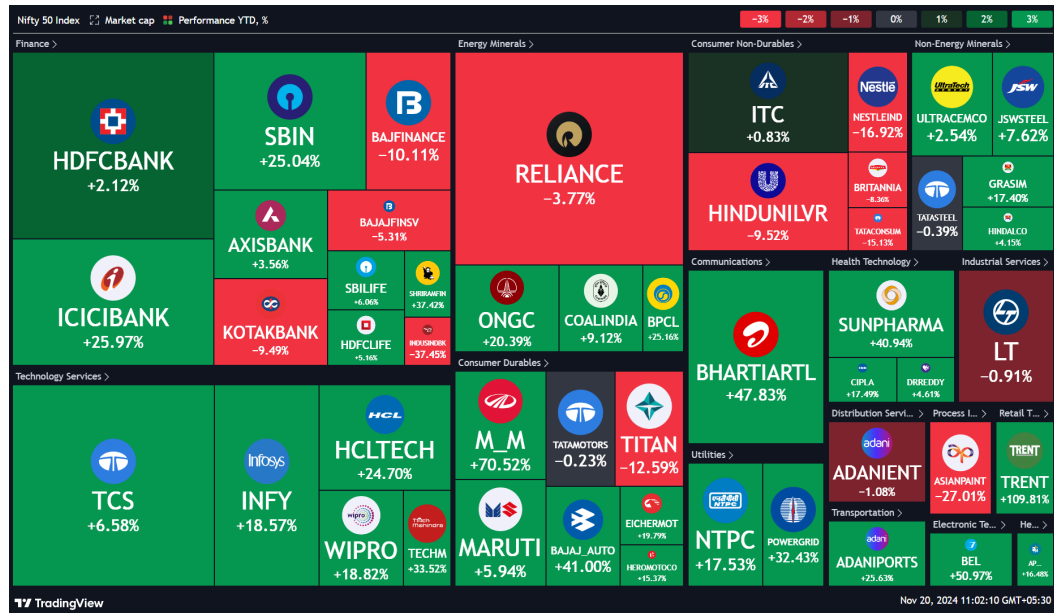
Date	FII's Net Purchase / Sales (in ₹ crores)
Nov 2024 (month till date)	-34,348.30

Oct 2024	-114,445.89
Sept 2024	12,611.79
Aug 2024	-20,339.26
July 2024	5,407.83
June 2024	2,037.47

- b. Global Economic Conditions: The US economy under the Trump presidency, developments in China, and global central bank policies will influence investor sentiment and capital flows.
 - c. Domestic Policy Response: How effectively the RBI manages inflation, supports economic growth, and addresses the rupee's volatility will be crucial.
2. Potential Impact of Forecasted Trends:
- a. Economy:

Continued forex reserve decline could negatively impact economic sentiment and potentially lead to a broader economic slowdown. Because of this, the Rupee may see continued depreciation. However, any strong recovery in the GDP numbers or Inflation will likely attract demand for the Rupee and will act as a cushion.
 - b. Sectors of the Economy:

Persistent rupee depreciation may benefit export-oriented sectors but would continue to pose challenges for import-dependent industries, potentially leading to higher inflation.



- i. Information Technology - As revenue comes in dollars, depreciation helps boost the earnings and profitability of IT companies. IT stocks surge.
 - ii. Pharmaceuticals - The competitiveness of Indian drug makers in foreign markets improves, leading to higher exports and profits. Pharma shares rise.
 - iii. Auto & Engineering - The depreciated rupee makes exports more lucrative and profitable for companies in these sectors given that they won't lose much of their existing competitiveness. Their stock prices move up.
 - iv. Oil & Gas - Import bills for crude oil and natural gas spike higher due to depreciation. Profitability gets squeezed due to inflated input costs. Stocks decline.
 - v. FMCG - Costs escalate for FMCG companies as imported raw materials become expensive. This hits profit margins. FMCG shares fall.
- c. Stocks in Those Sectors:
- i. Information Technology - HCL Technologies and Infosys are expected to gain further because of the higher exposure to the US economy and the BFSI (Banks and Financial Services Industry) segment. EPS expectations of both the companies have been slightly increased by 5 to 7% for the full year FY25.



- ii. Pharmaceuticals - EPS expectations of Sun Pharma, Divis Labs, Dr. Reddy's Labs and Neuland Labs are expected to scale up by at least 8% due to favourable business environment and forex gains.



- iii. Auto & Engineering - Supply side auto companies are expected to report at least 3% higher earnings due to forex gains. Stocks like Uno Minda and Sona BLW Precision Forgings are the two top stocks in this industry. Mahindra & Mahindra's export business and Tata Motors' JLR segment is also expected to perform better.



- iv. Oil & Gas - Due to increasing forex bills, stocks like Reliance Industries and ONGC are likely to stay under pressure.



- v. FMCG - Generally not very hard hit by the forex bills, FMCG companies are expected to stay neutral until the Food Inflation eases.



Conclusion

While India's forex reserves have witnessed a decline, the long-term outlook remains cautiously optimistic.

India's growing economy, increasing integration into global indices, and potential for attracting long-term foreign investment could boost the recovery of forex reserves in the future. India's forex reserves are expected to reach \$705 Billion and beyond by Q4FY25.

However, navigating short-term challenges like FII outflows, global uncertainties, and domestic economic pressures will be crucial for ensuring stability and sustained growth in forex reserves. Investors need to carefully monitor these evolving trends, diversify their portfolios, and focus on companies with strong fundamentals to mitigate risks. Also, Debt Funds are expected to gain some traction given India's rising financial strength.