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India's Forex Reserves Under Pressure

Deep Dive into Structural Challenges
and Strategic Imperatives



Introduction

India's economy stands at a critical inflection point. On one side, rapid GDP growth, a thriving services sector, and a robust domestic demand base have cemented its place among the world's fastest-growing major economies. On the other, the rising cost of essential imports—particularly gold and crude oil—combined with growing foreign travel and education-related outflows, is exerting significant pressure on the country's foreign exchange reserves and current account balance. Prime Minister Narendra Modi's recent appeal to citizens to curb non-essential gold purchases, reduce fuel consumption, and avoid unnecessary foreign travel is not merely a moral suasion—it is a reflection of a structural dilemma that demands urgent policy attention.

This article goes beyond the headlines to examine the intricate dynamics behind India's forex reserve trajectory, the real drivers of import dependence, the implications for investors, and the long-term policy options available. Drawing on the latest available data from the Reserve Bank of India (RBI), the Ministry of Commerce, and global economic reports, we present a nuanced, numbers-driven analysis.



The Current State of India's Forex Reserves: A Snapshot

As of the week ending May 1, 2026, India's foreign exchange reserves stood at \$690.69 billion—a notable decline from the all-time high of \$728.5 billion recorded at the end of February 2026. This represents a drop of approximately \$37.8 billion (or 5.2%) in just over two months. The pace of depletion has raised eyebrows among economists and market participants.

Breakdown of the Reserve Composition

Component	Value (Week ended May 1, 2026)	Change from previous week
Foreign Currency Assets (FCA)	\$551.83 billion	-\$2.80 billion
Gold Reserves	\$115.22 billion	-\$5.02 billion
Special Drawing Rights (SDRs)	\$18.789 billion	–
Reserve Position in IMF	\$4.863 billion	–

The decline in gold reserves is particularly noteworthy. The RBI's gold holdings—valued at market prices—fell by over \$5 billion in a single week, reflecting both sales (or revaluation) and a possible dip in global gold prices. In contrast, the FCA decline of \$2.8 billion is likely linked to RBI's intervention in the foreign exchange market to support the rupee, which has been under pressure from capital outflows and a widening trade deficit.

Historical Context: How Does Today Compare?

India's forex reserves have grown dramatically from the \$5.8 billion level during the 1991 balance of payments crisis to over \$700 billion today. However, the quality of reserves matters as much as the absolute number. The current import cover (reserves divided by monthly imports) stands at just over 10 months, which is considered comfortable by international standards—yet significantly lower than the 15–18 months cover seen in 2021–22. Moreover, the composition of reserves has shifted: gold now constitutes about 16.7% of total reserves, up from 6% a decade ago, partly due to RBI's strategic diversification but also because of gold price appreciation.

Key Insight: While \$690 billion is still a robust buffer, the rate of decline and the structural causes behind it (rather than one-off shocks) make the situation more concerning than the headline number suggests.



The Twin Dragons: Gold and Crude Oil Imports

India is one of the world's largest importers of both gold and crude oil. The two commodities together account for nearly 45–50% of the country's total merchandise import bill. Any surge in global prices or domestic demand directly translates into higher dollar outflows.

Gold: The Relentless Appetite

- **Annual consumption:** India consumes 700–800 tonnes of gold annually, while domestic production is a mere 1–2 tonnes (less than 0.3% of demand).
- **FY26 gold imports:** Reached \$71.98 billion, nearly double the \$36.5 billion recorded two years ago (FY24).
- **Quarterly demand (Q1 2026):** Total gold demand rose 10% YoY to 151 tonnes. Within this:
 - Investment demand surged 54% to 82 tonnes (driven by gold ETFs and bars/coins).
 - Jewellery demand fell 20% (due to high prices), signalling a shift from ornamental to investment use.

The paradox is stark: gold is both a cultural mainstay and an economic vulnerability. Every \$1 increase in gold prices adds roughly \$1.2–1.5 billion to India's annual import bill, given the inelastic demand. The PM's call to "postpone non-essential gold purchases for at least one year" aims to buy time for the government to explore alternative sources—such as increasing domestic recycling, promoting gold monetisation schemes (Gold Loan / Gold Bond), and negotiating with mining companies to accelerate exploration in India's gold-bearing regions (Kolar, Hutti, etc.). However, these measures have structural limitations and are unlikely to reduce dependence in the short term.

Crude Oil: The Perpetual Bleed

- **Import dependence:** India imports over 85% of its crude oil requirements.
- **Global price scenario:** In 2025–26, Brent crude averaged above \$100 per barrel, driven by OPEC+ supply cuts, geopolitical tensions, and recovering demand.
- **Under-recoveries for OMCs:** State-owned oil marketing companies (IOC, BPCL, HPCL) are facing daily losses of ₹1,600–1,700 crore (≈ \$200 million) due to suppressed retail fuel prices. The cumulative under-recovery has already crossed ₹1 lakh crore (≈ \$12 billion) in FY26.
- **Fiscal impact:** The government’s decision to stabilize fuel prices (by cutting excise duty and asking OMCs to absorb margins) provides relief to consumers but shifts the burden to the government’s fiscal deficit and the external account (through higher import costs not fully passed on).

What the PM’s appeal implicitly acknowledges: Even small reductions in fuel consumption—say, a 5% drop in petrol/diesel demand through carpooling, public transport, or work-from-home—could save \$3–4 billion annually in forex outflows. But realizing such behavioural change at scale remains a monumental challenge.



Beyond Commodities: Foreign Travel, Education, and Defence

While gold and oil dominate the narrative, the invisibles side of the balance of payments is equally important. The Liberalised Remittance Scheme (LRS) data reveals a clear trend: Indians are spending more on foreign travel, education, and overseas investments.

Foreign Travel: A \$15 Billion Leak

- **Total LRS remittances (April 2025 – February 2026):** \$26.34 billion.
- **Travel-related share:** \$15 billion (57%).
- **FY25 full-year travel outflow:** \$16.96 billion (out of total LRS \$29.56 billion).
- **Indian outbound tourists (2025):** 32.71 million, up 5.9% from 2024.

The PM’s suggestion to “avoid unnecessary foreign travel and destination weddings for at least one year” could, if followed, reduce LRS outflows by an estimated \$5–6 billion annually—a meaningful but partial plug. More importantly, the composition of travel expenditure matters: high-end luxury travel and weddings abroad (often costing millions of dollars) have a disproportionate impact on the current account.

Overseas Education and Healthcare

- **Education-related LRS outflows** in FY25 stood at approximately \$4.5 billion, growing at 12–15% annually.
- **Healthcare tourism abroad** (especially for advanced treatments) adds another \$1–2 billion.

These are largely structural, driven by a mismatch between domestic capacity and aspirations. Reducing these outflows would require massive investments in higher education and health infrastructure—medium- to long-term solutions.

Defence Imports

India remains one of the world's largest arms importers. Defence-related dollar outflows, while not always captured in LRS, are a significant drain. In FY25, defence imports were estimated at \$15–18 billion, with a large share going to Russia, France, and the US. Any escalation in global tensions could push this higher.

What Does This Mean for Investors? A Three-Dimensional View

The decline in forex reserves and the rising current account deficit (CAD) have direct and indirect implications for financial markets.

Rupee Volatility

The Indian rupee crossed the 95 per US dollar mark in early May 2026—a historic low. The RBI has been actively intervening (selling dollars) to prevent a disorderly depreciation, which is the primary reason for the decline in FCA. Strong reserves help anchor expectations, but continued depletion could erode confidence.

Investor takeaway: Expect near-term volatility. A stable rupee is in everyone's interest, but the RBI cannot indefinitely defend any level. Import-dependent sectors (oil marketing, metals, electronics) face margin pressure, while export-oriented IT and pharma benefit from a weaker rupee.

FII Outflows and Equity Markets

Foreign Institutional Investors (FIIs) have pulled out ₹1.97 lakh crore (≈ \$24 billion) from Indian equities between January and May 2026. This is driven by:

- **Higher US interest rates (Fed funds rate at 5.5%+).**
- **Strengthening dollar.**
- **Valuation concerns in Indian markets.**
- **Geopolitical risk aversion.**

Large forex reserves act as a confidence buffer, signalling that India can weather capital flight better than many peers. But if reserves continue to fall, the risk of a sovereign rating downgrade (or negative outlook) increases—which would further spook FIIs.

Bond Markets and Monetary Policy

The RBI uses forex reserves to manage liquidity. Sustained dollar selling drains rupee liquidity, potentially pushing up short-term interest rates. The government's borrowing program (₹14.1 lakh crore for FY26) adds to the pressure. Bond yields have already inched up by 15–20 basis points in recent weeks.

For fixed-income investors, this means higher yields are possible, but also higher risk of rate hikes if inflation (fueled by import costs) remains sticky.



Conclusion: Caution, Not Panic

India's forex reserves have declined from \$728.5 billion to \$690.7 billion in two months— a drop that warrants attention but not alarm. The country still enjoys an import cover of over 10 months, and remittances provide a strong buffer. However, the confluence of high gold and oil prices, surging travel outflows, and FII pullback is a reminder that external vulnerabilities persist.

Prime Minister Modi's appeal to citizens is a necessary first step, but it must be backed by coherent policy action on energy, gold, and tourism. For investors, the near-term outlook requires caution: expect rupee volatility, higher bond yields, and sector-specific headwinds. Over the medium term, India's demographic dividend and reform momentum remain intact—provided the government uses the current pressure as a catalyst for deeper structural change.

The 1991 crisis taught India the value of prudence. Today, with reserves at \$690 billion and a vibrant economy, the country is in a far stronger position—but the lessons of the past should never be forgotten.





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