Foreign Inflows and its Impact on Monetary Aggregates

Abstract

Foreign inflows play a vital role in the buildup of every economy towards the welfare and development of every individual economic units and the economy as a whole. Capital inflows are necessary for macroeconomic stability as these inflows affect a wide range of macro economic variables such as foreign exchange reserves, inflation, current account, capital account, exports, imports, exchange rates, interest rates, domestic output, foreign exchange reserves, inflation, and domestic monetary supply. In this paper the study attempts to explain the effects of inflows of private foreign capital on some major macroeconomic variables in India using monthly data for the period 2000- 2010. The analyses of trends in the context of unit root tests indicate that private foreign capital inflows and some other variables indicate instability. Whereas FDI, foreign currency reserves, wholesale price index, money supply, exchange rate, imports and exports follow an I(1) process, CMR, FPI, REER and NEER follows I(0). Co-integration test confirms the presence of long-run equilibrium relationships between a few pairs of variables. The Granger causality test shows that there is no unidirectional and bidirectional relation between any pair if variables and this lead to the Dynamic OLS estimation to find out the indirect impact of macro variables. The results show that Foreign exchange reserves being influenced by FDI, Money supply being influenced by Foreign exchange reserves and finally WPI is influenced by both M3 and Foreign exchange reserves.

Keywords: Foreign Inflows, FDI, Forex Reserves, WPI, Broad Money.