

2. Forex Reserves

Prelims Syllabus: Capital Market

Mains Syllabus: GS-III Indian Economy and Issues Relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Why in News?

- According to recent data from Reserve bank of India (RBI), India's Foreign Exchange (Forex) reserves posted a decline of USD 678 million during the week ended 21st January 2022 to reach USD 634.287 billion.

About the News:

- The slip in the reserves was on account of a drop in the Foreign Currency Assets (FCA), a vital component of the overall reserves. FCA declined by USD 1.155 billion to USD 569.582 billion in the reporting week.
- Gold reserves saw an increase of USD 567 million to USD 40.337 billion in the reported week.
- The Special Drawing Rights (SDRs) with the International Monetary Fund (IMF) fell USD 68 million to USD 19.152 billion.

About Foreign Exchange Reserves:

- Foreign exchange reserves are assets held on reserve by a central bank in foreign currencies, which can include bonds, treasury bills and other government securities.
- It needs to be noted that most foreign exchange reserves are held in US dollars.
- India's Forex Reserve include:
 - ✓ Foreign Currency Assets
 - ✓ Gold reserves
 - ✓ Special Drawing Rights
 - ✓ Reserve position with the International Monetary Fund (IMF).

Objectives of Holding Forex Reserves:

- Supporting and maintaining confidence in the policies for monetary and exchange rate management.
- Provides the capacity to intervene in support of the national or Union Currency.
- Limits external vulnerability by maintaining foreign currency liquidity to absorb shocks during times of crisis or when access to borrowing is curtailed.

Significance of Rising Forex Reserves:

- **Comfortable Position for the Government:** The rising forex reserves give comfort to the government and the RBI in managing India's external and internal financial issues.
- **Managing Crisis:** It serves as a cushion in the event of a Balance of Payment (BoP) crisis on the economic front.
- **Rupee Appreciation:** The rising reserves have also helped the rupee to strengthen against the dollar.
- **Confidence in Market:** Reserves will provide a level of confidence to markets and investors that a country can meet its external obligations.

Foreign Currency Assets:

- FCAs are assets that are valued based on a currency other than the country's own currency.
- FCA is the largest component of the forex reserve. It is expressed in dollar terms.
- The FCAs include the effect of appreciation or depreciation of non-US units like the euro, pound and yen held in the foreign exchange reserves.

About Special Drawing Rights:

- The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves.
- The SDR is neither a currency nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. SDRs can be exchanged for these currencies.
- The value of the SDR is calculated from a weighted basket of major currencies, including the US dollar, the euro, Japanese yen, Chinese yuan, and British pound.
- The interest rate on SDRs or (SDRi) is the interest paid to members on their SDR holdings.
- Recently, the IMF has made an allocation of SDR 12.57 billion (equivalent to around USD 17.86 billion) to India. Now, the total SDR holdings of India stand at SDR 13.66 billion.

Reserve Position in the International Monetary Fund:

- A reserve tranche position implies a portion of the required quota of currency each member country must provide to the IMF that can be utilized for its own purposes.
- The Reserve Tranche is basically an emergency account that IMF members can access at any time without Agreeing to conditions or paying a Service Fee.