

Dip in Forex Reserves

What is the issue?

India's foreign exchange reserves have now fallen below the \$600 billion mark amid capital outflows and strengthening dollar.

What are foreign exchange reserves?

- Foreign exchange reserves are assets denominated in a foreign currency that are held by a central bank.
- These may include foreign currencies, bonds, treasury bills, and other government securities.
- These assets are held to ensure that a central government agency has backup funds if their national currency rapidly devalues or becomes all together insolvent.
- It helps to check the balance payments and influences the foreign exchange rate of its currency and maintains stability in financial markets.
- The two most popular foreign assets are US dollar-denominated assets and euro-denominated assets.
- China is the largest foreign currency reserve holder in the world.

What about the composition of FCAs?

- The FCAs comprise multi-currency assets that are held in multi-asset portfolios as per the existing norms conforming to the best international practices.
 - The forex reserves include
 - Investments on foreign securities
 - Investments on other central banks and the BIS
 - Deposits with commercial banks overseas
 - Gold holdings

What happened to the forex reserves of India?

- The foreign exchange reserves declined from \$642.45 billion (September, 2021) to \$597.72 billion (April 2022).
- The RBI's special drawing rights and reserve position in the International Monetary Fund also dipped by \$33 million and \$26 million.
- **Reasons for the decline**
 - **Fall in foreign currency assets (FCAs)** - The foreign currency assets also include the effect of appreciation or depreciation of non-US units like the euro, pound and yen held in the reserves.
 - **Appreciation of the US dollar**- The demand for dollars remained high as the Russia-Ukraine war led to a spike in oil and commodity prices.
 - **Capital outflows by foreign portfolio investors (FPIs)** - FPIs pulled out \$21.43 billion since September 2021 as the US Federal Reserve started monetary policy tightening and interest rate hikes.

- **Effect of gold prices-** Decline in gold prices has also played a part in the decline in foreign exchange reserves.



What is the impact on the rupee?

- The rupee depreciated 57 paise and touched a low of 76.96 just below the all-time low of 76.97 to close at 76.92 against the US dollar.
- If the rupee slides further, the RBI will be forced to intervene in the forex market by selling dollars from its forex reserves.
- If the RBI gives preference to sustain the forex reserves level, there could be some rupee depreciation in the horizon.

References

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