AIR Spotlight - India's Foreign Exchange Reserves on the Rise

AIR Spotlight is an insightful programme featured daily on the All India Radio Newsonair. In this program, many eminent panelists discuss issues of importance which can be quite helpful in IAS exam preparation. In this article, the topic of discussion is India's rising foreign exchange reserves.

Participants:

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Context:

The foreign exchange reserves with the central bank increased to USD 611.89 billion.

Introduction:

- The country's foreign exchange reserves increased by $1.883 billion to touch a record high of $611.895 billion. India has reached number four in the whole world in terms of foreign exchange reserves.
- China stands at the top with $3.3 trillion followed by Japan with $1.3 trillion, Switzerland with $1.07 trillion, and India at the 4th position with $611.89 billion. India overtook Russia with $593 billion and Turkey with $541 billion.
- India is not only the fifth largest economy in the world in terms of GDP but it is also number four in terms of forex as well.

Significance of Foreign Exchange Reserves:

- The rising forex reserves could bring some comfort to the government as well as the Reserve Bank in managing the nation's external and internal financial issues at a time when the economy is facing Covid stress once again and it could have an impact on the gross domestic product growth rate for the ongoing fiscal as states are announcing lockdowns.
- It is a big cushion in the event of any crisis on the economic front and is enough to cover India's import bill for a year.
- An increase in the forex kitty could also help strengthen the rupee against the American dollar.
- Higher reserves could bring confidence to markets indicating that a country can meet its external obligations, demonstrate the backing of domestic currency by external assets, assist the government in meeting its foreign exchange needs and external debt obligations, and maintain a reserve for national disasters or emergencies.
- It also gives the country the leverage to use foreign exchange reserves freely.

History of foreign exchange reserves in India:

- In the 1960s, India had foreign exchange reserves that were barely covering 8.6 weeks of imports.
- In the 1980s, India had a forex of over $7 billion which was double the level of China.

- After the introduction of economic reforms in 1991, forex strengthened and now it is at an all-time high.

External debt and foreign exchange:

- India has an external debt of value $563 billion and the current value of foreign exchange reserves implies that India has sufficient forex to last for 15 months.

Weak or Strong Currency: Which is better?

- A mix of both currency appreciation and depreciation is appropriate for a country because a strong rupee makes imports cheaper, especially oil imports. One of the reasons behind the high prices of oil is the strong position of the dollar in the international market.
- On one side, the country wants the rupee to be stronger to keep the import bills under control, and on the other hand, there are exporters who look forward to a weaker rupee because they would be able to fetch more forex to the country.
- Healthy forex gives the Reserve Bank of India (RBI) the leverage to keep the exchange rate under control.
- If in the future, the rupee collapses, RBI with healthy foreign exchange reserves will come to the rescue through the Open Market Operation (OMO).
- However, RBI does not intervene in the daily affairs of forex and it is only during an emergency that it resorts to OMO to stabilize the exchange rate.

Purchase of US Dollars by RBI:

- The Indian economy was in the grip of inflation and the prime reason behind inflation was the fuel prices.
- A stronger dollar increased the import bill of fuel which further added to the inflationary pressure in the country.
- Hence, to control inflation in the economy, the RBI purchased billions of US dollars recently.

India as a buyer of crude oil from the US:

- India has emerged as the top buyer of US crude oil in the first quarter of the calendar year 2021.
- There are certain geopolitical reasons behind it as the US imposed sanctions then withdrew it and again imposed and then withdrew the sanctions because of issues with Iran. So, due to these reasons, India is importing crude oil from the US and stopped importing from Iran.
- It is being stated that India will resume the imports from Iran once the US sanctions are completely erased.

Factors influencing foreign exchange reserves:

- The Reserve Bank of India (RBI) generally depends on the market forces but if we talk about the factors that influence the forex, they are:
    - Foreign portfolio investments, Foreign institutional investment, and Foreign direct investment that straight away buy the capital of the country.

    - American Depository Receipts (ADR) and Global Depository Receipts (GDR).
    - Capital and Current Account Receipts.
    - Postal receipts are the deposits made by the Non-Resident Indians (NRIs). They find their own country safer to park their funds.
    - Exchange Commercial Borrowings (ECBs).
- RBI continuously monitors these sources of forex and then a decision is made whether to buy or sell foreign currency.

Utility of Foreign Exchange Reserves:

- Forex is governed by the Foreign Exchange Reserves Act. There are certain protocols under which forex can be deployed. They cannot be directly put into any project of the government.
- They are meant for certain specific pre-determined protocol-driven purposes. They cannot be used for common pools of funds of India.
- The central bank is liable to pay dividends to the government of India and as per the Bimal Jalan Committee, the share is 4.5% of the reserves.

How are these reserves kept?

- These foreign exchange reserves are deployed in US government bonds, institutional bonds, and some of them are also kept in gold reserves.
- However, the return from investing in developed countries is very minimal, nevertheless, having $611 billion reserves is very comforting for a country.

Conclusion:

India’s foreign exchange reserves position is comfortable in terms of import cover of more than 18 months and also provides a cushion against unforeseen external shocks. The government and RBI are closely monitoring the emerging external position, calibrating policies or regulations to support robust macroeconomic growth.

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