Forex Reserves

What are forex reserves?

- Foreign exchange reserves (Forex reserves) are generally defined as assets held by RBI which is denominated in other foreign currencies.
- Forex reserves include foreign currency assets, gold, special drawing rights (SDR) and reserve position in IMF.
- **Foreign currency assets** are investments in foreign bonds, Tbills, deposits with foreign central banks etc.
- It is maintained in major currencies like US dollar, Euro, Pound sterling, Japanese Yen etc and valued in terms of US dollar.
- It accounts for around 89% of total forex reserves.
- **Gold reserves** are passively managed by RBI and accounts for around 9% of total reserves.
- **SDR** is international reserve created by IMF which is allocated as per the member country's quota at IMF.
- **Reserve position in IMF** is a reserve where India can draw upon to purchase other foreign currencies from the fund.
- Generally, preferred level of forex reserves is that a country's reserves should equal short-term external debt so that a country has enough reserves to resist a massive withdrawal of short term foreign capital[1].
- RBI publishes data on forex reserves every week (on Friday).

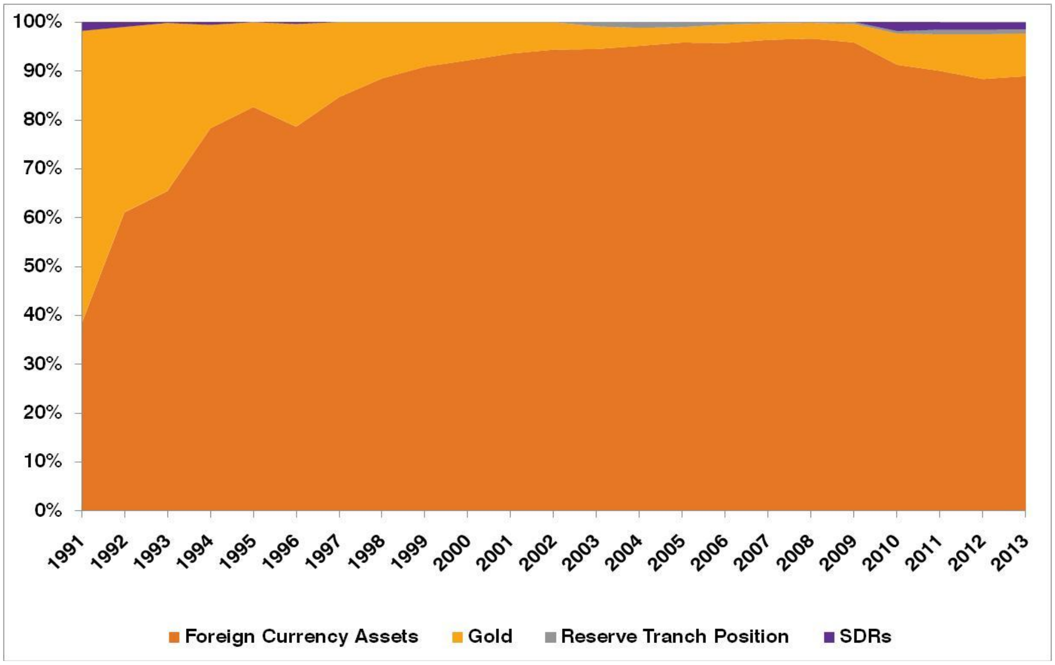
Why maintain forex reserves?

- To enhance capacity to intervene in foreign currency market.
- To limit external vulnerability by proving foreign currency liquidity to help absorb shocks during times of crisis including national disasters or emergencies.
- For backing domestic currency.
- To maintain confidence in monetary and exchange rate policies.
- To provide confidence to the markets especially international credit rating agencies that external obligations can always be met, thus reducing the overall costs at which foreign exchange resources are available to all the market participants.

[1] As per the Guidotti rule
Source: India's Foreign Currency Reserves by Y.V Reddy

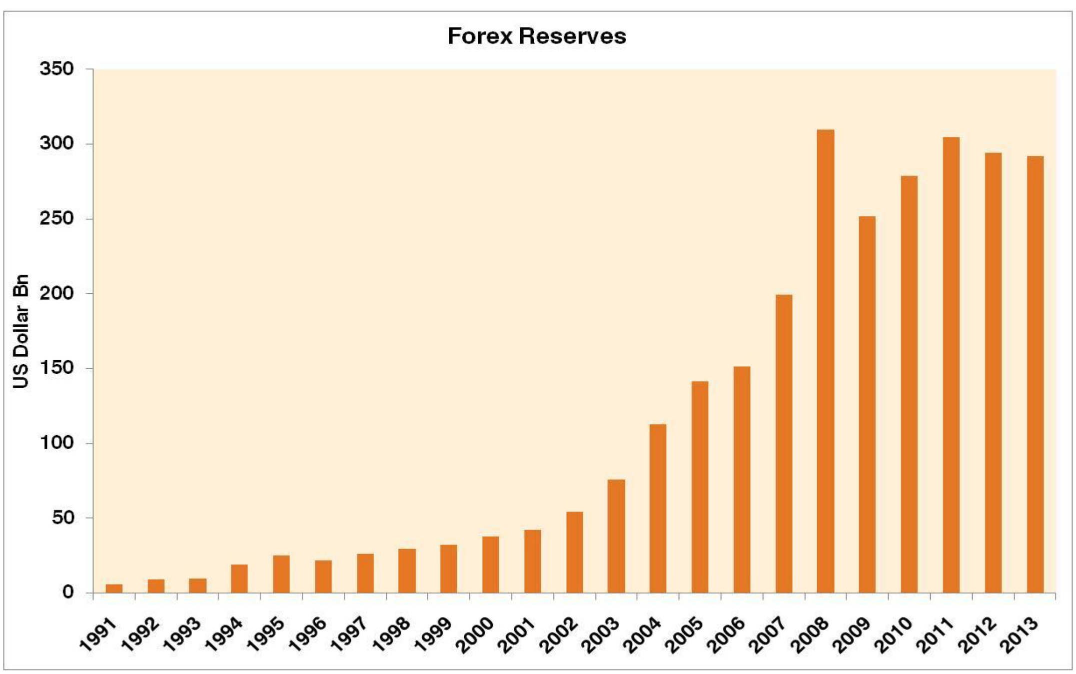
Trend in Forex Reserves

- Chart below shows the movement in composition of India's forex reserves from 1991 to 2013.



Source: RBI

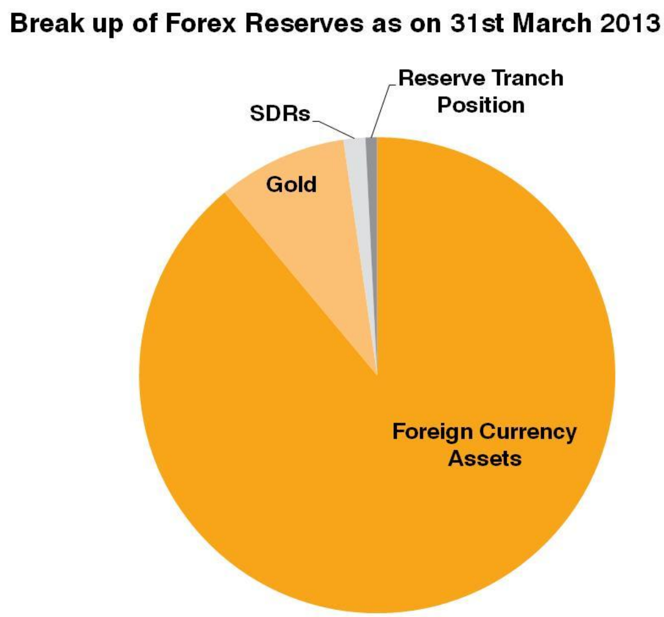
- From the above chart, we can observe that India's forex reserve has changed over the years.
- 1991, gold contributed to around 60% of the total forex reserves while foreign currency assets share was around 38%.
- This has drastically changed over the years with gold share dropping to around 9% and foreign currency assets share increasing to around 89% in 2013.
- Chart below shows trend in forex reserves from 1991 till 2013.



Source: RBI

- From the above chart, it's seen that India's forex reserves have increased significantly since 1991.
- The level of forex reserves has steadily increased from US $ 5.8bn in 1991 to US $ 292bn in 2013.

- Two factors responsible for significant addition to forex reserves over the years can be attributed to lower level of current account deficit and high capital inflows[2].
- However lately, the high current account deficit has resulted in decrease of forex reserves.
- For week ended August 2nd, forex reserves stand at US $ 277.17bn.
- Chart and table below shows forex reserves break up as on 31st March 2013.



As on 31st March 2013

	US $ Bn	% of Total Forex Reserves
Foreign Currency Assets	259.7	88.9%
Gold	25.7	8.8%
Reserve Tranch Position	2.3	0.8%
SDRs	4.3	1.5%
Forex Reserves	**292.0**	

Source: RBI

[2] Refer to ReWISE on Current Account Deficit and Capital Account of India

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