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Rise in Foreign Exchange Reserve, March 2019

Why in news?

India's foreign exchange reserves rose to a ten-month high of $411.91 billion as of March, 2019.

How has the forex reserves been?

- Forex reserves had hit a high of $426 billion in the week ended April 13, 2018.
- But it witnessed a steady slide over the following months and went down to $392 billion in the week ended October 26.
- This was on account of the RBI intervention to manage the rupee.
- In October 2018, the rupee had fallen to its all time low of 74.34 against the US dollar.
- The rupee instability was, in turn, due to sharp rise in crude oil prices and resultant pressure on India's current account deficit.
- Capital outflows by foreign institutional investors from debt and equity markets was also a major reason.

What are the recent developments?

- Forex reserves are now the highest since $413 billion recorded in the week ended June 8, 2018.
- The inflow of foreign capital into India's stock market in March, 2019 hit a high of $4.89 billion.
- This was the biggest foreign inflow into Indian stocks since February 2012.
- As a result, the stock market rose a solid 8% this March.
- Foreign investment in Indian equities stood at $2.42 billion in February, and is expected to be strong in April as well.
- The record foreign portfolio investment (FPI) inflows significantly added to the forex kitty.

What are the other driving factors?

- Both cyclical and structural factors are behind this sudden uptick in foreign investment.

- There is a fall in crude oil prices in recent months and appreciation of the Indian rupee vis-a-vis the dollar.
- The appreciating rupee helps boost returns in dollar terms for foreign investors pumping money in Indian markets.
- A rupee-dollar swap by the RBI last month also added to the forex reserves.
- [The amount of dollars raised through these operations will reflect in the RBI's foreign exchange reserves for the tenor of the swap.]
- Besides, India has emerged as the fastest-growing major economy when Chinese economy has been slowing down in the last one year.
- So investors expect India to be a major source of global growth in the coming years and thus a favourable investment destination.
- Also, there are clear signs that western central banks have relaxed the interest rates.
- E.g. the Federal Reserve and the European Central Bank have promised to keep interest rates low for longer
- This has caused investors to turn towards relatively high-yielding emerging market debt as in India.

What lies ahead?

- The return of foreign capital is certainly a good sign for the Indian economy.
- Evidently, the rupee has appreciated by about 7% since early October when it was moving around 74 against the dollar.
- But policymakers need to be careful as other emerging Asian economies will be competing hard to attract foreign capital.
- In this context, macroeconomic management is key to India to retain its image as an investment destination.
- The high fiscal deficit of both the Centre and the State governments need to be addressed as well.
- Long-pending reforms to the labour and land markets are the most pressing changes that will affect India's long-term growth.
- So to retain the investor confidence, it is essential to increase the pace of these structural reforms too.

Source: The Indian Express, The Hindu

Author: Shankar IAS Coaching Center Coimbatore

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