Rise in India's Forex

Why in news?

Covid-hit India's forex reserves jumped by a record $11.9 billion in the week ending July 31 to hit a fresh high of $534.5 billion.

How has India's forex reserves risen?

- The trend of rising foreign exchange reserves started after a sharp **cut in corporate tax rates** in September, 2019.
- The investor sentiments turned weak after the budget announcement in July to impose higher surcharge.
- Now, the investors are drawn to invest in the India as the government has decided to **reverse its budget decision** relating to higher surcharge impact on FPIs.

- During the period between September 27, 2019 and July 31, 2020, India has added 25% of the reserves it had till September 20.
- India has ranked fifth, behind China ($ 3,298 billion), Japan ($ 1,383 billion), Switzerland ($ 896 billion) and Russia ($ 591 billion).

- The rising forex reserves have come as a breather as it can cover India's import bill of more than one year.

What key factors has led to this rise in forex reserves?

- **FPI inflows:** The FPI inflows has risen following the government's decision in September 2020 to cut corporate tax rate.
- Between April and December 2019, FPIs pumped in $15.1 billion.

- **Dip in crude oil prices:** India's oil import bill has declined since February 2020.
- This is due to the global spread of coronavirus that roiled the stock markets and led to a crash in the Brent crude oil prices.
- The crude accounts for almost 20% of India's total import bill.
- Brent crude oil prices fell to levels of $20 per barrel towards March end, and

it dropped further and traded between $9 and $20 in April.
- In January, Brent crude was trading between $60 and $70 per barrel.

- **Import savings:** Lockdown across countries in response to the pandemic impacted global trade.
- It has resulted in a sharp dip in import expenditure — electronics, gold and also crude oil prices among others.

- **FDI inflows:** Between September 2019 and March 2020, FDI stood at $23.88 billion and in April and May it amounted to $5.9 billion.
- A lot of FDI has also come in June and July too.
- Thus FDI inflow has been a significant contributor to the rise in foreign exchange reserves.

- **Dip in gold imports:** Gold import has dipped sharply in the quarter ended June 2020 following the high prices and the pandemic-induced lockdown.
- According to the World Gold Council (WGC), gold imports plummeted by 95% to 11.6 tonnes in the quarter as compared to 247.4 tonnes in the same period a year ago.
- This was due to logistical issues and poor demand.

What does the rising forex reserves mean?

- It gives a lot of comfort to the government and the Reserve Bank of India in managing India's financial issues at a time when the economic growth is set to contract by 5.8% in 2020-21.
- It's enough to cover the import bill of the country for a year.
- It has also helped the rupee to strengthen against the dollar.
- The forex reserves to GDP ratio is around 15%.
- Reserves will provide a level of confidence to markets that a country can meet its external obligations.
- It demonstrates the backing of domestic currency by external assets.
- Adequate forex reserves should provide room for the RBI to cut rates and support recovery.

What does the RBI do with the forex reserves?

- The RBI functions as the custodian and manager of forex reserves.
- It operates within the overall policy framework agreed upon with the government.
- The RBI allocates the dollars for specific purposes.
- The RBI uses its forex kitty for the orderly movement of the rupee.
- It sells the dollar when the rupee weakens and buys the dollar when the rupee strengthens.

- Of late, the RBI has been buying dollars from the market to shore up the forex reserves.
- When the RBI mops up dollars, it releases an equal amount in the rupees.
- This excess liquidity is sterilised through issue of bonds and securities and LAF operations to prevent a rise in inflation.

Are forex reserves giving returns to India?

- Only gold reserves have given big returns to India.
- The RBI has not disclosed the actual returns from forex reserves.
- But the experts estimate that India is likely to get only negligible returns as interest rates in the US and Eurozone are around 1%.
- On the contrary, India could be facing a cost to keep the reserves abroad.
- Out of the total foreign currency assets,

1. 59.7% was invested in securities abroad,
2. 33.37% was deposited with other central banks of other countries and the BIS and
3. 7.06% comprised deposits with commercial banks overseas as of March 2020.

- As at end-March, 2020, the RBI held 653.01 tonnes of gold.
- Of these reserves, 360.71 tonnes is held overseas in custody with the Bank of England and the Bank for International Settlements.
- The remaining gold is held domestically.
- With gold prices shooting up around 40% to over Rs 55,000 per 10 grams this year, the value of gold holdings has shot up.

Source: Indian Express

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