# Using Forex Reserves to defend Rupee

## Why in news?

There is a debate currently over whether the RBI is right in using the forex reserves to defend the rupee.

## What is the issue?

- The rupee has crossed the 80 mark against the US dollar.
- The Indian currency has been under tremendous pressure since last October when foreign investors began pulling out funds due to the US Federal Reserve tapering its stimulus measures.
- The current spate of depreciation is more of a global phenomenon but this should not divert attention from the fact that the rupee has also been hit by weakening fundamentals, such as a widening trade deficit.
- The expansion in trade deficit due to surge in commodity prices has worsened the external account balance further, necessitating regular interventions in the forex market.
- Exports tend to be guided more by global growth conditions and if there is a slowdown here, there would be an adverse impact.

## What initiatives were taken by RBI?

> *Besides the recent hikes in policy rate, the RBI has also given banks the flexibility to solicit more NRI deposits, relaxed the rules for FPI investments in debt securities and for external commercial borrowings and allowed settlement of external trade in rupees.*

- **ECBs**- This is because ECBs today are no longer attractive, with interest rates overseas increasing.
- **NRI deposits**- Allowing higher interest rates on NRI deposits is a good regulatory move, but with deposit rates increasing in the West, savers will see this as an option which may not be significantly more attractive.
- **FPIs-** FPIs were not too interested in corporate paper to begin with, as seen by the relatively small proportion of the limits being utilised. Presently, it is just 18% of the limit permitted.
- **Forex reserves**- Using reserves to stem the fall may just mean using up resources

with no medium term gain.
- The Centre, on its part, has hiked import duty on gold in a bid to dis-incentivise imports and reduce the trade gap.

## How about using forex reserves to defend Rupee?

*There is a 11% decline in foreign exchange reserves since October 2021.*

- **Positive outlook-** The principal objective of foreign exchange reserves is to help manage an orderly movement in the currency in periods of extreme duress.
- With all emerging economy currencies depreciating sharply versus the dollar in recent months, there seems to be no harm in using the forex kitty to shore up the currency.
- External debt of India is also well under control.
- The ratio of forex reserves to external debt was 97.8%, showing that there would be no difficulty in servicing this debt.

- **Concerns**- The decline in forex reserves is due to both regular intervention as well as revaluation effects on holdings of non-dollar assets.
- Direct intervention through sale of dollars has its own limitations as it is imperative for the RBI to maintain that they do not fall below threshold levels determined by the central bank.
- The recent Financial Stability Report revealed that 44% of external commercial borrowings are unhedged and these positions can result in large losses when the rupee turns volatile.

**References**


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