Forex Reserves

Why in News

According to the **Reserve Bank of India (RBI)** data, the country's **foreign exchange (forex) reserves touched a lifetime high of USD 555.12 billion** after it surged by USD 3.615 billion in the week ended 16th October 2020.

Key Points

- **Reason Behind the Increase:**
  - The rise in total reserves was **due to a sharp rise in Foreign Currency Assets (FCAs),** a major component of the overall reserves.
  - FCA **jumped by USD 3.539 billion** to USD 512.322 billion.
- **Foreign Exchange Reserves:**
  - Foreign exchange reserves are **assets held on reserve by a central bank** in foreign currencies, which can include bonds, treasury bills and other government securities.
    - It needs to be noted that **most foreign exchange reserves are held in U.S. dollars.**
  - These assets **serve many purposes** but are most significantly held to ensure that the central bank **has backup funds** if the national currency rapidly devalues or becomes altogether insolvent.
  - **India's Forex Reserves include:**
    - Foreign Currency Assets
    - Gold
    - Special Drawing Rights
    - Reserve position with the **International Monetary Fund (IMF)**

Foreign Currency Assets

- FCA are assets that are **valued based on a currency other than the country's own currency.**

- FCA is the **largest component of the forex reserve.** It is **expressed in dollar terms.**
- FCA includes **the effect of appreciation or depreciation of non-US units** like the euro, pound and yen held in the foreign exchange reserves.
    - **Currency appreciation** refers to the increase in value of one currency relative to another in the forex markets.
    - **Currency depreciation** is a fall in the value of a currency in a floating exchange rate system.

        In a **floating exchange rate system,** market forces (based on demand and supply of a currency) determine the value of a currency.

Special Drawing Rights

- The SDR is an **international reserve asset,** created by the **International Monetary Fund (IMF)** in 1969 to supplement its member countries' official reserves.
- The SDR is **neither a currency nor a claim on the IMF.** Rather, it is a potential claim on the freely usable currencies of IMF members. SDRs can be exchanged for these currencies.
- The value of the SDR is calculated from a weighted basket of **major currencies,** including the U.S. dollar, the euro, Japanese yen, Chinese yuan, and British pound.
- The **interest rate on SDRs or SDRi** is the interest paid to members on their SDR holdings.

Reserve Position in the International Monetary Fund

- A **reserve tranche** position implies a **portion of the required quota of currency each member country must provide to the International Monetary Fund (IMF)** that can be utilized for its own purposes.
- The reserve tranche is basically **an emergency account** that IMF members can access at any time without agreeing to conditions or paying a service fee.

Source: TH