



Forex Reserves

For Prelims: Forex Reserve and its components.

For Mains: Objectives of holding forex reserves and its significance.

Why in News

According to recent data from [Reserve bank of india \(RBI\)](#), India's [Foreign Exchange \(Forex\) reserves](#) posted a decline of USD 678 million during the week ended 21st January 2022 to reach USD 634.287 billion.

- The slip in the reserves was on account of a **drop in the Foreign Currency Assets (FCA)**, a vital component of the overall reserves. FCA declined by USD 1.155 billion to USD 569.582 billion in the reporting week.
- **Gold reserves** saw an increase of USD 567 million to USD 40.337 billion in the reported week.
- The **Special Drawing Rights (SDRs)** with the [International Monetary Fund \(IMF\)](#) fell USD 68 million to USD 19.152 billion.

Key Points

- **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 US dollars.
 - **India's Forex Reserve include:**
 - Foreign Currency Assets
 - Gold reserves
 - Special Drawing Rights
 - Reserve position with the [International Monetary Fund \(IMF\)](#).
- **Objectives of Holding Forex Reserves:**
 - Supporting and maintaining confidence in the policies for monetary and [exchange rate](#) management.
 - Provides the capacity to intervene in support of the national or union currency.
 - Limits external vulnerability by maintaining foreign currency liquidity to absorb shocks during times of crisis or when access to borrowing is curtailed.
- **Significance of Rising Forex Reserves:**
 - **Comfortable Position for the Government:** The rising forex reserves give comfort to the government and the RBI in managing India's external and internal financial issues.
 - **Managing Crisis:** It serves as a cushion in the event of a [Balance of Payment \(BoP\)](#) crisis on the economic front.
 - **Rupee Appreciation:** The rising reserves have also helped the rupee to strengthen against the dollar.
 - **Confidence in Market:** Reserves will provide a level of confidence to markets and investors that a country can meet its external obligations.

Foreign Currency Assets

- FCAs 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.
- The FCAs include the **effect of appreciation or depreciation of non-US units like the euro, pound and yen** held in the foreign exchange reserves.

Special Drawing Rights

- The SDR is an **international reserve asset**, created by the 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 US 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.**
- Recently, the **IMF has made an allocation of SDR 12.57 billion** (equivalent to around USD 17.86 billion) to India. Now, the total SDR holdings of India stand at SDR 13.66 billion.

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 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: IE

PDF Reference URL: <https://www.drishtiias.com/printpdf/forex-reserves-8>

