



Decline in Forex Reserves

Why in News

According to the recent data from the [Reserve Bank of India \(RBI\)](#), India's [Foreign Exchange \(Forex\) reserves](#) declined by **USD 2.986 billion** to reach USD 579.285 billion in the week ended **26th March 2021**.

- The gold reserve component of the Forex Reserve increased whereas the other components - Special Drawing Rights (SDR), the Foreign Currency Assets (FCA) and the Reserve Position witnessed decline.

Key Points

▪ About:

- 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**.

▪ Objectives Behind 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.

▪ India's Forex Reserve include:

- [Foreign Currency Assets](#)
- [Gold reserves](#)
- [Special Drawing Rights](#)
- [Reserve position with the IMF](#)

▪ 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.

▪ Gold Reserves:

- Gold occupies a special position in the foreign reserves of central banks as it is widely stated to be **held for reasons of diversification**.
- Moreover, the unique property of gold is believed to be **its ability to enhance the credibility of the central bank when it holds adequately** and this has been proved time and again.

- Gold compares extremely **favorably to other traditional reserve assets with high-quality and liquidity** helping Central Banks **to preserve capital, diversify portfolios, mitigate risks** on the medium/long-term.
- Gold has **consistently outperformed the average returns of other alternative financial assets.**

▪ **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 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.

▪ **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.

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