Report on

Foreign Exchange Reserves

Reserve Bank of India
Central Office
Mumbai

2005-06 (covering period up to September 2005)

Content

Movement of Reserves

Foreign Exchange Reserves

The Reserve Bank of India (RBI) undertook a review of the main policy and operational matters relating to management of the reserves, including transparency and disclosure and decided to compile and make public half-yearly reports on management of foreign exchange reserves for bringing about more transparency and also for enhancing the level of disclosure in this regard. These reports are being prepared with reference to positions as of 31st March and 30th September each year, with a time lag of about 3 months. The first such report with reference to September 30, 2003 was placed in the public domain on February 3, 2004. This is the fifth report on foreign exchange reserves with reference to September 30, 2005. The report is a compilation of quantitative information with regard to external reserves, such as, level of foreign exchange reserves, sources of accretion to foreign exchange reserves, external liabilities vis-à-vis foreign exchange reserves, prepayment/repayment of external debt, Financial Transaction Plan (FTP) of IMF, adequacy of reserves, etc. In order to avoid repetition, Sections II and III of the first report, dealing with various matters relating to the qualitative aspects of management of forex reserves and cross-country comparison of disclosure in respect of management of external reserves, respectively, do not figure in this report. Interested readers may refer to March 2004 issue of RBI Bulletin or visit RBI website (www.rbi.org.in) for accessing the first report on foreign exchange reserves.

Movement of Reserves

1. Introduction

The level of foreign exchange reserves has steadily increased from US$ 5.8 billion as at end-March 1991 to US$ 113.0 billion by end-March 2004 and further to US$ 141.5 billion by end-March 2005. It stood at US$ 143.1 billion as at end-September 2005 (Table 1). Although both US dollar and Euro are intervention currencies, the foreign exchange reserves are denominated and expressed in US dollar only.

Table 1: Movement in Reserves

(US $ million)

Date	FCA	SDR	GOLD	RTP	Forex Reserves
30-Sep-03	87,213	4 (2.5)	3,919	1,203	92,339
31-Mar-04	107,448	2 (1.6)	4,198	1,311	112,959
30-Sep-04	114,083	1 (1.0)	4,192	1,303	119,579
31-Mar-05	135,571	5 (3.0)	4,500	1,438	141,514
30-Sep-05	136,920	4 (3.0)	4,712	1,423	143,058

Note: 1. FCA (Foreign Currency Assets): FCA is maintained as a multicurrency portfolio, comprising major currencies, such as, US dollar, Euro, Pound sterling, Japanese yen, etc. and is valued in US dollars.
2. SDR: Values in SDR have been indicated in parentheses.
3. Gold: Physical stock has remained unchanged at approximately 357 tonnes.
4. RTP refers to Reserve Tranche Position in IMF

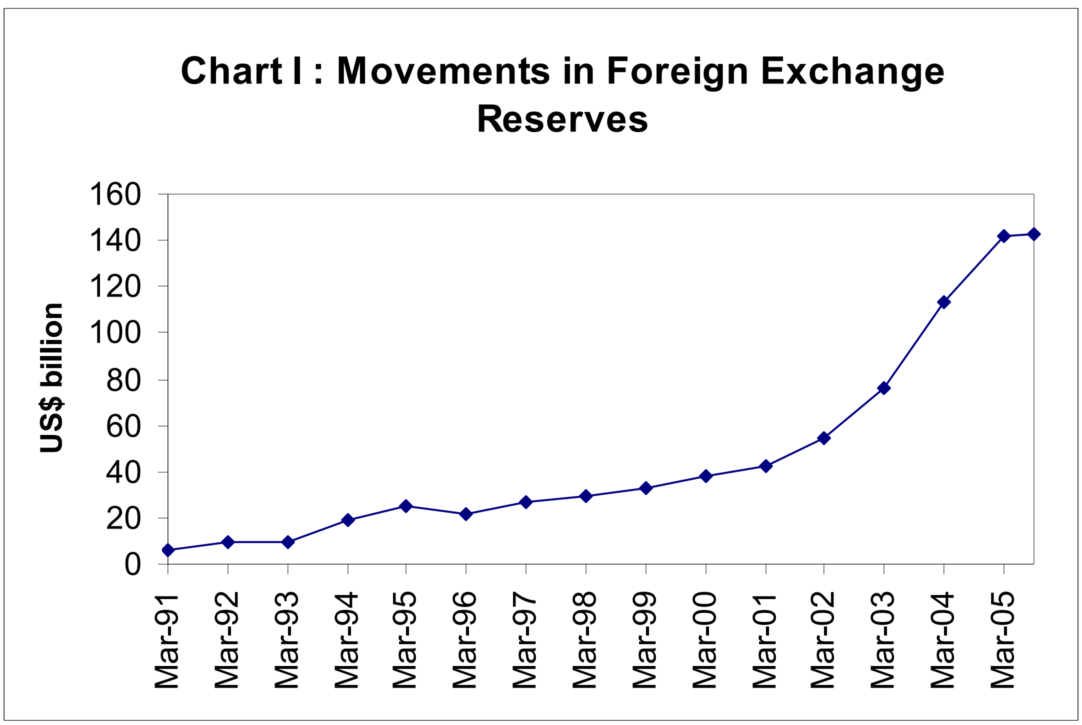
2. Review of Growth of Reserves since 1991

India's foreign exchange reserves have grown significantly since 1991. The reserves, which stood at US$ 5.8 billion at end-March 1991 increased gradually to US$ 25.2 billion by end-March 1995. The growth continued in the second half of the 1990s, with the reserves touching the level of US$ 38.0 billion by end-March 2000. Subsequently, the reserves rose to US$ 76.1 billion by end-March 2003, US$ 113.0 billion by end-March 2004, US$ 141.5 billion by end-March 2005 and further to US$ 143.1 billion by end-September 2005 (Chart 1). It may be mentioned that forex reserves data prior to 2002-03 do not include Reserve Tranche Position (RTP) in IMF, as RTP has been included as part of the forex reserves only recently. Table 2 details the major sources of accretion to foreign exchange reserves during the period from March 1991 to September 2005.

Table 2: Sources of Accretion to Foreign Exchange Reserves since 1991

(US$ billion)

Items			1991-92 to 2005-06 (up to end-September 2005)
A		**Reserve Outstanding as on end-March 1991**	**5.8**
B.I.		**Current Account Balance**	**-31.2**
B.II.		**Capital Account (net) (a to e)**	**164.1**
	a.	Foreign Investment	83.9
	b.	NRI Deposit	22.6
	c.	External Assistance	10.8
	d.	External Commercial Borrowings	21.4
	e.	Other items in capital account	25.3
B.III.		**Valuation change**	4.4
		Total (A+BI+BII+BIII)	**143.1**



3. Sources of Accretion to Reserves in the Recent Period

The increase in foreign exchange reserves in the recent period has been on account of capital and other inflows. Major sources of increase in foreign exchange reserves have been: (a) Foreign investment (b) External commercial borrowings (c) Banking capital, and (d) Other items under capital account. Table 3 presents sources of accretion to reserves during April-September 2005.

Table 3: Sources of Accretion to Foreign Exchange Reserves

(US $ billion)

Items			April-September 2005	April-September 2004
I.		**Current Account Balance**	**-13.0**	**-0.5**
II.		**Capital Account (net) (a to f)**	**19.5**	**7.4**
	a.	Foreign Investment	7.4	2.5
	b.	Banking Capital	3.0	0.6
		Of which: NRI Deposits	*0.2*	*-1.3*
	c.	Short-term Credit	0.9	1.9
	d.	External Assistance	0.4	0.3
	e.	External Commercial Borrowings	2.7	1.5
	f.	Other items in Capital Account	5.1	0.6
III.		**Valuation Change**	**-5.0**	**-0.3**
		Total (I+II+III)	**1.5**	**6.6**

An analysis of the sources of reserves accretion during the entire reform period from 1991 onwards reveals that the increase in forex reserves has been facilitated by an increase in the annual quantum of foreign direct investment (FDI) from US $ 129 million in 1991-92 to US$ 5.5 billion in 2004-05. During April-September 2005, the quantum of FDI inflows into India was of the order of US$ 2.9 billion. Outstanding NRI deposits increased from US$ 13.7 billion at end-March 1991 to US$ 33.3 billion at end-March 2004 but declined marginally to

US$ 32.9 billion as at end-March 2005. It stood at US$ 32.8 billion as at end-September 2005. FII investments in the Indian capital market, which commenced in January 1993, have shown significant increase over the subsequent years. Cumulative net FII investments, increased from US$ 827 million at end-December 1993 to US$ 25.8 billion at end-March 2004 and further to US$ 35.9 billion as at end-March 2005. It increased further to US$ 40.3 billion by end-September 2005. Turning to the current account, India's exports which were US$ 17.9 billion during 1991-92 increased to US$ 63.8 billion in 2003-04 and further to US$ 80.5 billion in 2004-05.During April-September 2005, India's exports were to the tune of US$ 43.6 billion. Invisibles, such as, private remittances have also contributed significantly to the current account. Net invisibles inflows increased from US$ 1.6 billion in 1991-92 to US$ 27.8 billion in 2003-04 and further to US$ 31.2 billion in 2004-05. During April-September 2005, net invisibles inflows were of the order of US$ 18.7 billion. India's current account balance which was in deficit at 3.1 per cent of GDP in 1990-91 turned into a surplus of 0.7 per cent in 2002-03. A surplus of US $ 14.1 billion was posted in the current account during the financial year 2003-04, driven mainly by the surplus in the invisibles account. However, this could not be sustained during 2004-05, with the current account posting a deficit of US$ 5.4 billion, driven mainly by the surge in oil prices in the international market. During April-September 2005, current account deficit widened further and was of the order of US$ 13.0 billion, driven mainly by strong import demand, both oil and non-oil.

4. External Liabilities vis-à-vis Foreign Exchange Reserves

The accretion of foreign exchange reserves needs to be seen in the light of total external liabilities of the country.

India's International Investment Position (IIP), which is a summary record of the stock of country's external financial assets and liabilities, is available as of March 2005 (Table 4).

Table 4: International Investment Position of India

(US $ million)

	Item	March 2005 P
A	**Assets**	
1.	Direct investment abroad	9,568
2.	Portfolio investment	806
3.	Other investments	17,367
4.	Foreign Exchange Reserves	141,514
	Total Foreign Assets	**169,255**
B	**Liabilities**	
1.	Direct investment in India	44,511
2.	Portfolio investment	55,467
3.	Other investments	110,154
	Total Foreign Liabilities	**210,132**
	Net Foreign Liabilities (B-A)	**40,877**

P: Provisional
Source: Official website of Reserve Bank of India (http://www.rbi.org.in)

5. Prepayment/Repayment of external debt

The significant increase in forex reserves enabled prepayment of certain high-cost foreign currency loans of the Government of India from the Asian Development Bank (ADB) and the World Bank (IBRD) amounting to US$ 3.03 billion during February 2003. During 2003-04, prepayment of certain high cost loans to IBRD and ADB amounting to US$ 2.6 billion was carried out by the Government. Additionally, prepayment of bilateral loans amounting to US$ 1.1 million was also made. Thus, the total quantum of prepayments was of the order of US$ 3.7 billion during 2003-04. During 2004-05, prepayment of bilateral loan to the tune of US$ 30.3 million was made. During April-September 2005, no prepayment of high-cost multilateral/bilateral loan was carried out.

6. Financial Transaction Plan (FTP) of IMF

International Monetary Fund (IMF) designated India as a creditor under its Financial Transaction Plan (FTP) in February 2003, in terms of which India participated in the IMF's financial support to Burundi in March-May 2003, with a contribution of SDR 5 million and to Brazil in June-September 2003 with SDR 350 million. In December 2003, SDR 43 million was made available to Indonesia under FTP. During 2004-05, SDR 61 million was made available under FTP to countries like Uruguay, Haiti, Dominican Republic and Sri Lanka. During April-September 2005, SDR 34 million was made available to countries like Turkey and Uruguay, Thus, the total quantum of India's contribution under FTP was SDR 493 million at end-September 2005.

7. Adequacy of Reserves

Adequacy of reserves has emerged as an important parameter in gauging its ability to absorb external shocks. With the changing profile of capital flows, the traditional approach of assessing reserve adequacy in terms of import cover has been broadened to include a number of parameters which take into account the size, composition and risk profiles of various types of capital flows as well as the types of external shocks to which the economy is vulnerable. The High Level Committee on Balance of Payments, which was chaired by Dr. C. Rangarajan, erstwhile Governor of Reserve Bank of India, had suggested that, while determining the adequacy of reserves, due attention should be paid to payment obligations, in addition to the traditional measure of import cover of 3 to 4 months. In 1997, the Report of Committee on Capital Account Convertibility under the chairmanship of Mr.S.S.Tarapore suggested four alternative measures of adequacy of reserves which, in addition to trade- based indicators, also included money-based and debt-based indicators.

In the more recent period, assessment of reserve adequacy has been influenced by the introduction of new measures that are particularly relevant for emerging market countries like India. One such measure requires that the usable foreign exchange reserves should exceed scheduled amortisation of foreign currency debts (assuming no rollovers) during the following year. The other one is based on a "Liquidity at Risk" rule that takes into account the foreseeable risks that a country could face. This approach requires that a country's foreign exchange liquidity position could be calculated under a range of possible outcomes for relevant financial variables, such as, exchange rates, commodity prices, credit spreads etc.. Reserve Bank of India has done exercises based on intuition and risk models in order to estimate "Liquidity at Risk (LAR)" of the reserves.

The traditional trade-based indicator of reserve adequacy, viz, import cover of reserves, which fell to a low of 3 weeks of imports at end-December 1990, rose to 11.5 months of imports at end-March 2002 and increased further to 14.2 months of imports or about five years of debt servicing at end-march 2003. At end-March 2004, the import cover of reserves was 17.0 months, which came down to 14.3 months as at end-March 2005 and further to 11.2 months as at end-September 2005. The ratio of short-term debt to foreign exchange reserves declined from 146.5 per cent at end-March 1991 to 4.2 per cent at end-March 2004 but increased slightly to 5.3 per cent as at end-March 2005 and further to 5.8 per cent as at end-September 2005. Similarly, the ratio of volatile capital flows (defined to include cumulative portfolio inflows and short-term debt) to reserves declined from 146.6 per cent as at end-March 1991 to 36.0 per cent as at end-March 2004. However, this ratio increased marginally to 36.8 per cent as at end-March 2005 and further to 40.5 per cent as at end-September 2005.

8. Investment Pattern and Earnings from Foreign Exchange Reserves

The foreign exchange reserves are invested in multi-currency, multi-asset portfolios as per the existing norms, which are similar to international practices in this regard. As at end-September 2005, out of the total foreign currency assets of US$ 143.1 billion, US$ 30.5 billion was invested in securities, US $ 64.5 billion was deposited with other central banks & BIS and US$ 41.9 billion was in the form of deposits with foreign commercial banks. (Table 5)

Table 5: Deployment Pattern of Foreign Exchange Reserves

(US $ Million)

	As on March 31, 2005	As on September 30, 2005
(1) Foreign Currency Assets	135,571	136,920
(a)Securities	36,819	30,475
(b) Deposits with other central banks & BIS	65,127	64,531
(c) Deposits with foreign commercial banks	33,625	41,914
(2) Special Drawing Rights	5	4
(3) Gold (including gold deposits)	4,500	4,712
(4) Reserve Tranche Position	1,438	1,423
(5) Total Foreign Exchange Reserves	141,514	143,059

During the year 2004-05 (July-June), the return on foreign currency assets and gold, after accounting for depreciation, increased to 3.1 per cent from 2.1 per cent during 2003-04, mainly because of the rise in short-term interest rates in the USA and lower mark-to-market depreciation on securities.