

# **Half Yearly Report on Management of Foreign Exchange Reserves**

*October – March 2015-16*



**Reserve Bank of India**

**Department of External  
Investments and Operations (DEIO)  
Central Office, Mumbai**

# Report on Management of Foreign Exchange Reserves

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# Developments during the Half Year ended March 2016

## I.1 Introduction

The Reserve Bank of India publishes half-yearly reports on management of foreign exchange reserves for bringing about more transparency and enhancing the level of disclosure. These reports are prepared half yearly with reference to the position as at end-March and end-September each year. The present report (26<sup>th</sup> in the series) is with reference to the position as at end-March 2016.

The report is divided into two parts: Part I contains the developments regarding movement of foreign exchange reserves and information on the external liabilities *vis-à-vis* the reserves, Financial Transaction Plan (FTP) of the IMF, adequacy of reserves, *etc.* during the half-year under review. Objectives of reserve management, statutory provisions, risk management practices, information on transparency and disclosure practices followed by the RBI with regard to reserve management are covered in Part II.

## Part- I

### I.2 Movement of Foreign Exchange Reserves

#### I.2.1 Review of Growth of Foreign Exchange Reserves

The level of foreign exchange reserves which stood at USD 350.3 billion as at end-September 2015 remained more or less constant before recording an improvement during March 2016 and stood at USD 360.2 billion as at end-March 2016 (Table 1 & Chart 1).

Although both US dollar and Euro are intervention currencies and the Foreign Currency Assets (FCA) are maintained in major currencies, the foreign exchange reserves are denominated and expressed in US dollar only. Movements in the FCA occur mainly on account of purchases and sales of foreign exchange by the RBI, income arising out of the deployment of the foreign exchange reserves, external aid

receipts of the Central Government and changes on account of revaluation of the assets.

<b>Table 1 : Movement in Foreign Exchange Reserves</b>					
(USD Million)					
Month End	FCA	Gold	SDR	RTP	Forex Reserves
September-15	326767	18152	4055	1314	350288
			(2889)		
October-15	330141	18692	4036	1308	354176
			(2889)		
November-15	327454	17544	3964	1285	350247
			(2889)		
December-15	327840	17240	4003	1298	350381
			(2889)		
January-16	326631	17697	3988	1293	349609
			(2889)		
February-16	325049	19325	1472	2572	348418
			(1066)		
March-16	336104	20115	1502	2456	360177
			(1066)		

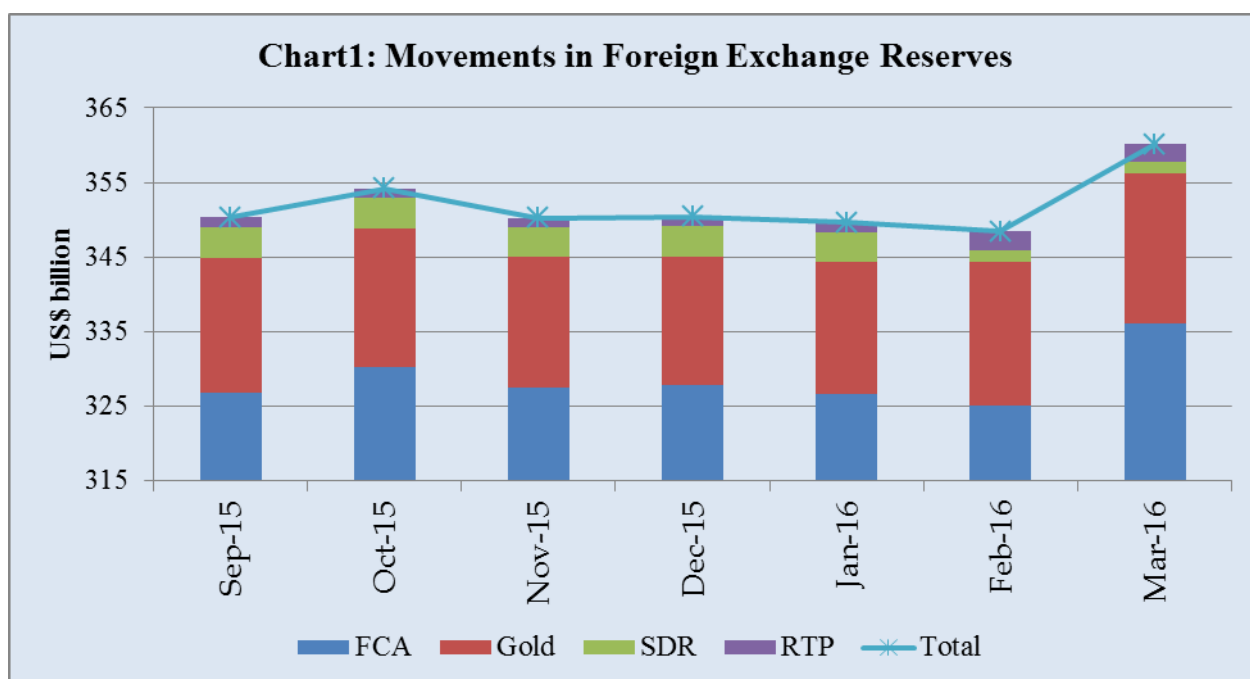
**Notes:**

(i) FCA (Foreign Currency Assets): FCA are maintained as a multi-currency portfolio comprising major currencies, such as, US dollar, Euro, Pound sterling, Japanese yen, etc. and are valued in terms of US dollars.

(ii) FCA excludes (a) investment in bonds issued by IIFC (UK) (b) SDR holdings of Reserve Bank, which is included under SDR and (c) amount lent to Sri Lanka under SAARC Swap and Special Currency Swap Arrangement.

(iii) SDR (Special Drawing Rights). (Values in SDR have been indicated in parentheses.)

(iv) RTP refers to the Reserve Tranche Position in the IMF.



## I.2.2 Sources of Accretion to Foreign Exchange Reserves

Table 2 provides details of sources of variation in foreign exchange reserves during 2015-16 vis-à-vis the corresponding period of the previous year. On balance of payments (BoP) basis (i.e., excluding valuation effects), the foreign exchange reserves increased by USD 17.9 billion during 2015-16 as compared with an increase of USD 61.4 billion during the same period previous year. The valuation gain accounted for US\$ 0.6 billion during 2015-16 as against a valuation loss of US\$ 24.0 billion in the previous year.

<b>Table 2: Sources of Variation to Foreign Exchange Reserves*</b>			
(USD billion)			
<b>Items</b>		<b>2014-15 Apr-Mar</b>	<b>2015-16 Apr-Mar</b>
<b>I.</b>	<b>Current Account Balance</b>	<b>-26.9</b>	<b>-22.2</b>
<b>II.</b>	<b>Capital Account (net) (a to f)</b>	<b>88.3</b>	<b>40.1</b>
a.	Foreign Investment	73.5	31.9
	<i>Foreign Direct Investment</i>	31.3	36.0
	<i>Portfolio Investment, (of which)</i>	42.2	-4.1
	<i>FII</i>	40.9	-4.0
	<i>ADR/GDR</i>	1.3	0.4
b.	Banking Capital, (of which)	11.6	10.6
	<i>NRI Deposits</i>	14.1	16.1
c.	Short term credit	-0.1	-1.6
d.	External Assistance	1.7	1.5
e.	External Commercial Borrowings	1.6	-4.5
f.	Other items in capital account	0.0	2.2
<b>III.</b>	<b>Valuation change</b>	<b>-24.0</b>	<b>0.6</b>
	<b>Total (I+II+III) @</b>	<b>37.4</b>	<b>18.5</b>
	Increase in reserves (+) / Decrease in reserves (-)		
*: Based on old format of BoP.			
@: Difference, if any, is due to rounding off.			
<b>Note:</b> 'Other items in capital account' apart from 'Errors and Omissions' include SDR allocations, leads and lags in exports, funds held abroad, advances received pending issue of shares under FDI and transactions of capital receipts not included elsewhere.			

## I.3 Forward Outstanding

The net forward liabilities (payables) of the Reserve Bank in domestic foreign exchange market stood at USD 4253 million as at the end of March 2016.

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

India's International Investment Position (IIP), which is a summary record of the stock of country's external financial assets and liabilities as at end-March 2016, is furnished in Table 3.

<b>Table 3: International Investment Position of India</b>			(USD Billion)	
<b>Item</b>		<b>End-Sep 2015 (PR)</b>	<b>End-Mar 2016 (P)</b>	
<b>A. Total External Assets</b>		<b>529.5</b>	<b>550.3</b>	
1.	Direct Investment	135.8	141.6	
2.	Portfolio Investment	1.7	2.5	
3.	Other Investment	41.7	46.0	
4.	Foreign Exchange Reserves	350.3	360.2	
<b>B. Total External Liabilities</b>		<b>887.0</b>	<b>911.8</b>	
1.	Direct Investment	270.8	293.4	
2.	Portfolio Investment	225.7	225.0	
3.	Other Investment	390.4	393.3	
<b>C.</b>	<b>Net IIP (A-B)@</b>	<b>(-) 357.4</b>	<b>(-)361.5</b>	

P : Provisional, PR: Partially Revised  
@ Difference, if any, is due to rounding off.

The net IIP as at end-March 2016 was negative at USD 361.5 billion, implying that our external liabilities are more than external assets. The net IIP as at end- March 2015 and end- September 2015 was USD (-) 364.6 billion and USD (-) 357.4 billion respectively<sup>1</sup>.

## I.5 Adequacy of Reserves

At the end of March 2016, the import cover increased to 10.9 months from 9.8 months at end-September 2015. The ratio of short-term debt<sup>2</sup> to the foreign exchange reserves, which was 24.2 per cent at end-September 2015, declined to 23.1 per cent at end-March 2016. The ratio of volatile capital flows (defined to

<sup>1</sup> Partially revised figures and may not tally with figures published in the previous reports.

<sup>2</sup> Redefined from 2005-06 by including suppliers' credit up to 180 days and FII investments in the Government of India Treasury Bills and other instruments and further in March, 2007 by including external debt liabilities of the banking system and the investments in the Government Treasury bills by foreign central banks and international institutions.

include cumulative portfolio inflows and outstanding short-term debt) to the reserves declined from 89.9 per cent as at end-September 2015 to 87.1 per cent as at end-March 2016.

### I.6. Management of Gold Reserves

The Reserve Bank holds 557.77 tonnes of gold; of which, 265.49 tonnes are held overseas in safe custody with the Bank of England and the Bank for International Settlements (BIS). Gold as a share of the total foreign exchange reserves in value terms (USD) stood at about 5.6 per cent as at end-March, 2016.

### I.7 Investment Pattern and Earnings of the Foreign Currency Assets

The foreign currency assets comprise multi-currency assets that are held in multi-asset portfolios as per the existing norms, which are similar to the best international practices followed in this regard. As at end-March 2016 out of the total foreign currency assets of USD 336.1 billion, USD 224.8 billion was invested in securities, USD 91.6 billion was deposited with other central banks, the BIS and the International Monetary Fund (IMF) and remaining USD 19.7 billion comprised deposits with overseas branches of commercial banks (Table 4).

<b>Table 4 : Deployment Pattern of Foreign Currency Assets</b>		
	(USD Million)	
	<b>As at end of Sep 2015</b>	<b>As at end of Mar 2016</b>
<b>Foreign Currency Assets (FCA) *</b>	<b>326,767</b>	<b>336,104</b>
(a) Securities	214,796 (65.7)	224,800 (66.9)
(b) Deposits with other central banks, BIS & IMF	97,179 (29.8)	91,639 (27.3)
(c) Deposits with overseas branches of commercial banks	14,792 (4.5)	19,665 (5.8)
* FCA excludes (a) investment in bonds issued by IIFC (UK) (b) SDR holdings of Reserve Bank which is included under SDR and (c) amount lent to Sri Lanka under SAARC Swap and Special Currency Swap Arrangement. (d) Figures in parenthesis indicate percentage to total FCA.		

## **I.8 Other Related Aspects**

### ***I.8.1 Financial Transaction Plan (FTP) of the IMF***

During the half year under review, there were (a) nil purchase transaction and (b) four repurchase transactions amounting to USD 1517.12 million.

### ***I.8.2 Investments under New Arrangements to Borrow (NAB) and Note Purchase Agreement (NPA) with IMF***

The IMF's amended and expanded New Arrangements to Borrow (NAB) became effective on March 11, 2011. India had committed to provide resources up to SDR 8,740.82 million to the IMF under this arrangement. Consequent to the payment of quota increase to IMF under the Fourteenth General Review of Quotas in February 2016, India's commitment under NAB has been reduced to SDR 4,440.91 million in February 2016. RBI has subscribed to Notes equivalent to SDR 800.69 million under NAB till end - March, 2016, as part of GoI's Contribution.

In terms of the Note Purchase Agreement (NPA) 2012, entered into between RBI and IMF, RBI has agreed to invest an amount equivalent to USD 10 billion in SDR denominated Notes issued by IMF.

### ***I.8.3 Payment of IMF's Quota Increase***

The payment of quota increase to the IMF under the Fourteenth General Review of Quotas in February 2016 resulted in the reduction in India's SDR holdings by SDR 1823.23 million.

### ***I.8.4 Bilateral Swap Arrangement between India and Sri Lanka***

Central Bank of Sri Lanka (CBSL) had signed Currency Swap Agreement (under the SAARC Swap Framework) with the RBI on March 25, 2015, which is valid till March 24, 2018. In terms of the agreement, CBSL can avail a maximum amount of USD 400 million. CBSL availed USD 400 million on March 8, 2016 for three months. Earlier, CBSL had availed USD 400 million on April 30, 2015 which was repaid on October 30, 2015.



### ***1.8.5 Special Currency Swap Agreement between India and Sri Lanka***

CBSL signed a Special Currency Swap Agreement with the RBI on March 28, 2016 under which CBSL could draw up to US\$ 700 million for a maximum period of three months. This special arrangement is in addition to the existing Framework on Currency Swap Arrangement for the SAARC Member Countries. CBSL availed of USD 700 million on March 30, 2016 for a period of three months. Earlier, CBSL had availed special currency swap facility amounting USD 1100 million on September 03, 2015 which has been repaid on March 08, 2016.

### ***1.8.6 Investment in bonds issued by IIFC (UK)***

The Reserve Bank has the mandate to invest up to USD 5 billion, in the bonds issued by the India Infrastructure Finance Company (UK) Limited. As at end-March 2016, the amount invested in such bonds stood at USD 2,100 million.

## **Part-II**

# **Objectives of Reserve Management, Legal Framework, Risk Management Practices, Transparency and Disclosure**

### **II.1. Objectives of Reserve Management**

The guiding objectives of foreign exchange reserve management in India are similar to those of many central banks in the world. The demands placed on the foreign exchange reserves may vary widely depending upon a variety of factors including the exchange rate regime adopted by the country, the extent of openness of the economy, the size of the external sector in a country's GDP and the nature of markets operating in the country. While liquidity and safety constitute the twin objectives of reserve management in India, return optimisation is kept in view within this framework.

### **II.2. Legal Framework and Policies**

The Reserve Bank of India Act, 1934 provides the overarching legal framework for deployment of reserves in different foreign currency assets and gold within the broad parameters of currencies, instruments, issuers and counterparties. The essential legal framework for reserve management is provided in sub-sections 17 (6A), 17(12), 17(12A), 17(13) and 33 (6) of the above Act. In brief, the law broadly permits the following investment categories:

- (i) deposits with other central banks and the Bank for International Settlements (BIS);
- (ii) deposits with overseas branches of commercial banks;
- (iii) debt instruments representing sovereign/sovereign-guaranteed liability with residual maturity for the debt papers not exceeding 10 years;
- (iv) other instruments / institutions as approved by the Central Board of the Reserve Bank in accordance with the provisions of the Act; and
- (v) dealing in certain types of derivatives.

### **II.3 Risk Management**

The broad strategy for reserve management including currency composition and investment policy is decided in consultation with the Government of India. The risk

management functions are aimed at ensuring development of sound governance structure in line with the best international practices, improved accountability, a culture of risk awareness across all operations, efficient allocation of resources and development of in-house skills and expertise. The risks attendant on deployment of reserves, *viz.*, credit risk, market risk, liquidity risk and operational risk and the systems employed to manage these risks are detailed in the following paragraphs.

### ***II.3.1 Credit Risk***

The Reserve Bank is sensitive to the credit risk it faces on the investment of foreign exchange reserves in the international markets. The Reserve Bank's investments in bonds/treasury bills represent debt obligations of highly rated sovereigns, central banks and supranational entities. Further, deposits are placed with central banks, the BIS and overseas branches of commercial banks.

RBI has framed requisite guidelines for selection of issuers/ counterparties with a view to enhancing the safety and liquidity aspects of the reserves. The Reserve Bank continues to apply stringent criteria for selection of counterparties. Credit exposure vis-à-vis sanctioned limit in respect of approved counterparties is monitored continuously. Developments regarding counterparties are constantly under watch. The basic objective of such an on-going exercise is to assess whether any counterparty's credit quality is under potential threat.

### ***II.3.2 Market Risk***

Market risk for a multi-currency portfolio represents the potential change in valuations that result from movements in financial market prices, for example, changes in interest rates, foreign exchange rates, equity prices and commodity prices. The major sources of market risk for central banks are currency risk, interest rate risk and movement in gold prices. Gains/losses on valuation of FCA and gold due to movements in the exchange rates and/or price of gold are booked under a balance sheet head named the Currency and Gold Revaluation Account (CGRA). The balances in CGRA provide a buffer against exchange rate/gold price fluctuations which in recent times have shown sharp volatility. Foreign dated securities are valued at market prices prevailing on the last business day of each month and the appreciation/depreciation arising therefrom is transferred to the Investment Revaluation Account (IRA). The balance in IRA is meant to provide cushion against changes in the security prices over the holding period.

### *II.3.2.1 Currency Risk*

Currency risk arises due to movements in the exchange rates. Decisions are taken on the long-term exposure to different currencies, depending on the likely movements in exchange rates and other considerations in the medium and long-term (e.g., maintenance of major portion of reserves in the intervention currency, benefit of diversification, etc.). The decision making procedure is supported by reviews of the strategy on a regular basis.

### *II.3.2.2 Interest Rate Risk*

The crucial aspect of the management of interest rate risk is to protect the value of the investments as much as possible from adverse impact of interest rate movements. The interest rate sensitivity of the portfolio is identified in terms of the benchmark duration and the permitted deviation from the benchmark.

### *II.3.2.3 Liquidity Risk*

Liquidity risk involves the risk of not being able to sell an instrument or close a position when required without facing significant costs. The reserves need to have a high level of liquidity at all times in order to be able to meet any unforeseen and emergency needs. Any adverse development has to be met with reserves and, hence, the need for a highly liquid portfolio is a necessary constraint in the investment strategy. The choice of instruments determines the liquidity of the portfolio. For example, in some markets, treasury securities could be liquidated in large volumes without much distortion of the price in the market and, thus, can be considered as liquid. Except fixed deposits with the BIS, overseas branches of commercial banks and central banks and securities issued by supranationals, almost all other types of investments are highly liquid instruments which could be converted into cash at short notice. The Reserve Bank closely monitors the portion of the reserves, which could be converted into cash at a very short notice, to meet any unforeseen/emergency needs.

### *II.3.3 Operational Risk and Control System*

In tune with the global trend, close attention is paid to strengthen the operational risk control arrangements. Key operational procedures are documented. Internally, there is total separation of the front office and the back office functions and the

internal control systems ensure several checks at the stages of deal capture, deal processing and settlement. The deal processing and settlement system, including generation of payment instructions, is also subject to internal control guidelines based on the principle of one-point data entry. There is a system of concurrent audit for monitoring compliance in respect of all the internal control guidelines. Further, reconciliation of accounts is done regularly. In addition to internal annual inspection, the accounts are audited by external statutory auditors. There is a comprehensive reporting mechanism covering significant areas of activity/operations relating to reserve management. These are provided to the senior management periodically, viz., on daily, weekly, monthly, quarterly, half-yearly and yearly intervals, depending on the type and sensitivity of information. The Reserve Bank uses SWIFT as the messaging platform to settle its trades and send financial messages to its counterparties, banks with whom nostro accounts are maintained, custodians of securities and other business partners.

#### **II.4 Transparency and Disclosures**

The Reserve Bank has been making available in the public domain data relating to foreign exchange reserves, its operations in foreign exchange market, position of the country's external assets and liabilities and earnings from deployment of foreign currency assets and gold through periodic press releases of its Weekly Statistical Supplements, Monthly Bulletins, Annual Reports, etc. The Reserve Bank's approach with regard to transparency and disclosure closely follows international best practices in this regard. The Reserve Bank is among the 81 central banks across the globe which has adopted the Special Data Dissemination Standards (SDDS) template of the IMF for publication of the detailed data on foreign exchange reserves. Such data are made available on monthly basis on the Reserve Bank's website.