Half Yearly Report on Management of Foreign Exchange Reserves

April-September 2020

Reserve Bank of India

Department of External Investments and Operations (DEIO)

Central Office, Mumbai

Report on Management of Foreign Exchange Reserves

Contents

Developments during the Half Year ended September 2020

I.1 Introduction

The Reserve Bank of India publishes half-yearly reports on management of foreign exchange reserves as part of its efforts towards enhanced transparency and levels 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 (35th in the series) is with reference to the position as at end-September 2020.

The report is divided into two parts: Part I contains the developments regarding movement of foreign exchange reserves, information on the external liabilities vis-à-vis the reserves, 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

During the half-year period under review, reserves followed an increasing trend from USD 477.81 billion as at end-March 2020 to USD 544.69 billion as at end-September 2020. **(Table 1 and 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 terms. Movements in the FCA occur mainly on account of purchase and sale 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.

Table 1 : Movement in Foreign Exchange Reserves					
					(USD Million)
Month End	**FCA**	**Gold**	**SDR**	**RTP**	**Forex Reserves**
March-20	442213	30578	1433	3583	477807
			(1045)		
April-20	443316	32277	1426	4059	481078
			(1045)		
May-20	455065	32898	1438	4158	493560
			(1048)		
June-20	465833	33905	1447	4516	505702
			(1048)		
July-20	490829	37625	1475	4639	534568
			(1048)		
August-20	498887	37848	1487	4658	542881
			(1048)		
September-20	502162	36429	1475	4621	544687
			(1048)		

Notes:

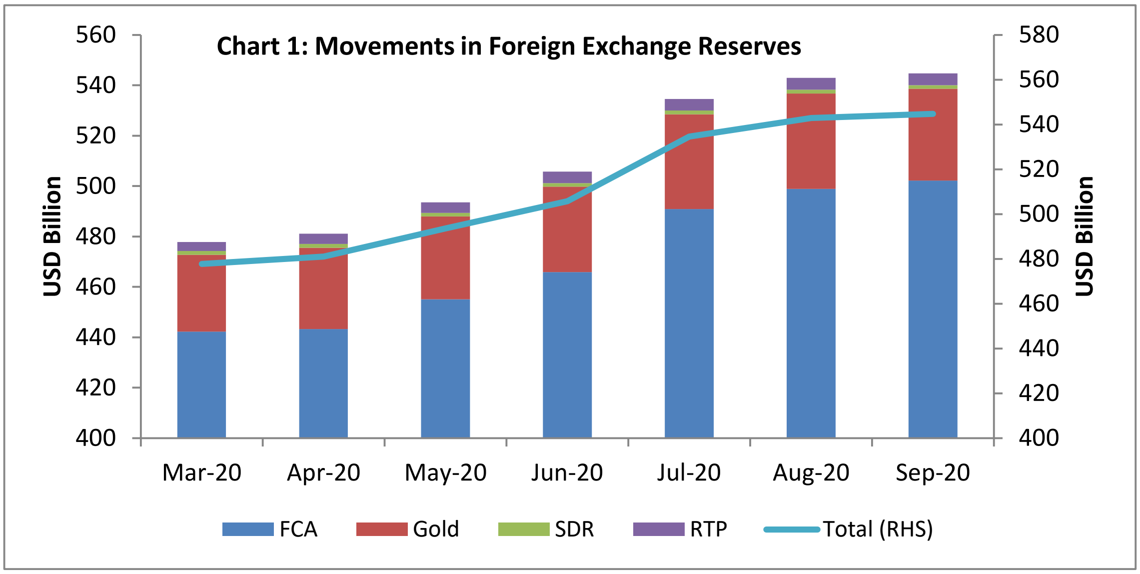
(i) FCA (Foreign Currency Assets): FCA are maintained as a multi-currency portfolio comprising major currencies, such as, US dollar, Euro, Pound sterling, Japanese yen, *etc.* and are valued in terms of US dollars.

(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 under SAARC 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.

(v) Difference, if any, is due to rounding off.



I.2.2 Sources of Accretion to Foreign Exchange Reserves

On a balance of payments basis (i.e., excluding valuation effects), foreign exchange reserves increased by USD 19.8 billion during April-June 2020 as compared with USD 14.0 billion during April-June 2019. Foreign exchange reserves in nominal terms (including valuation effects) increased by USD 27.9 billion during April-June 2020 as compared with USD 17.0 billion in the corresponding period of the preceding year.

Table 2 provides details of sources of variation in foreign exchange reserves during April-June 2020 vis-à-vis the corresponding period of the previous year. The valuation gain, reflecting the depreciation of the US dollar against major currencies and increase in gold prices, amounted to USD 8.0 billion during April-June 2020 as compared with USD 3.0 billion during April-June 2019.

Table 2: Sources of Variation to Foreign Exchange Reserves*			
			(USD billion)
	Items	**April-June 2019**	**April-June 2020 $**
I.	Current Account Balance	-15.0	19.8
II.	Capital Account (net) (a to f)	29.0	0.1
a.	Foreign Investment	18.8	0.2
(i)	Foreign Direct Investment	14.0	-0.4
(ii)	Portfolio Investment, [(of which)]	4.8	0.6
	FII	5.2	1.1
b.	Banking Capital, (of which)	3.4	2.2
	[(of which)]		
	NRI Deposits	2.8	3.0
c.	Short term credit	2.0	-0.2
d.	External Assistance	1.5	4.1
e.	External Commercial Borrowings	6.1	-1.6
f.	Other items in capital account	-2.8	-4.7
III.	Valuation change	3.0	8.0
	Total (I+II+III) @ Increase in reserves (+) / Decrease in reserves (-)	17.0	27.9

*: Based on old format of Balance of Payment (BoP).
@: Difference, if any, is due to rounding off.
Note: '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 capital receipts not included elsewhere and rupee denominated debt.
$: Updated figures available only up to June 2020.

I.3 Forward Outstanding

The net forward asset (receivable) of the Reserve Bank in domestic foreign exchange market stood at USD 13.88 billion as at the end of September 2020.

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-June 2020, is furnished in **Table 3.** During the period between end-June 2019 and end-June 2020, the external assets increased by USD 85.7 billion and external liabilities decreased by USD 20.2 billion.

Table 3: International Investment Position of India *

(USD Billion)

Item		End-June 2019 (R)	End-June 2020 (P)
A. Total External Assets		662.2	747.9
1.	Direct Investment	173.2	185.4
2.	Portfolio Investment	5.0	4.3
3.	Other Investment	54.1	52.5
4.	Foreign Exchange Reserves	429.8	505.7
B. Total External Liabilities		1113.8	1093.6
1.	Direct Investment	417.6	419.3
2.	Portfolio Investment	266.8	241.6
3.	Other Investment	429.3	432.7
C.	Net IIP (A-B)@	(-) 451.6	(-) 345.7

P: Provisional, R: Revised.
@ Difference, if any, is due to rounding off.
*: Updated figures available only up to June 2020.

The net IIP as at end-June 2020 was negative at USD 345.7 billion as against a negative net IIP of USD 451.7 billion at end-June 2019, implying that the sum of all external liabilities is more than that of the external assets in both periods.[1] There has been a decrease in the negative gap on a year-on-year basis.

[1] Partially revised figures and hence may not tally with figures published in the previous reports.

I.5 Adequacy of Reserves

At the end of June 2020, the foreign exchange reserves cover of imports increased to 14.8 months from 12.0 months at end-March 2020. The ratio of short-term debt (original maturity) to reserves, which was 22.4 per cent at end-March 2020, declined to 20.8 per cent at end-June 2020. The ratio of volatile capital flows (including cumulative portfolio inflows and outstanding short-term debt) to reserves declined from 76.5 per cent at end-March 2020 to 72.1 per cent at end-June 2020.

I.6. Management of Gold Reserves

As at end-September 2020, the Reserve Bank held 668.25 tonnes of gold (including gold deposits of 9.04 tonnes). While 366.91 tonnes of gold is held overseas in safe custody with the Bank of England and the Bank of International Settlements (BIS), 292.30 tonnes of gold is held domestically. In value terms (USD), the share of gold in the total foreign exchange reserves increased from about 6.40 per cent as at end-March 2020 to about 6.69 per cent as at end-September 2020.

I.7 Investment Pattern 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 conform to the best international practices followed in this regard. As at end-September 2020, out of the total foreign currency assets of USD 502.16 billion, USD 370.59 billion was invested in securities, USD 124.16 billion was deposited with other central banks and the BIS and the balance USD 7.44 billion comprised deposits with commercial banks overseas **(Table 4).**

Table 4 : Deployment Pattern of Foreign Currency Assets		
		(USD Million)
	As at end of March 2020	**As at end of September 2020**
Foreign Currency Assets (FCA) *	4,42,213	5,02,162
(a) Securities	2,63,449	3,70,568
	(59.58)	(73.79)
(b) Deposits with other central banks & BIS	1,47,556	1,24,159
	(33.37)	(24.72)
(c) Deposits with commercial banks overseas	31,208	7,435
	(7.06)	(1.48)
* 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 under SAARC Swap Arrangement. Note: 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 four Purchase Transactions aggregating USD 900.39 million and three Repurchase transactions aggregating USD 41.49 million under the FTP of the IMF.

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

India had committed to provide resources up to SDR 8,740.82 million to the IMF under latter's New Arrangements to Borrow (NAB). Consequent to the payment of quota increase to IMF under the Fourteenth General Review of Quotas in February 2016, India's commitment under NAB was reduced to SDR 4,440.91 million. RBI has subscribed to Notes equivalent to SDR 190.36 million under NAB till the end of September 2020, as part of Government of India's Contribution. In terms of the Note Purchase Agreement (NPA) 2016, 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 SAARC Swap Arrangement between India and Bhutan

Bhutan had availed ₹14,277.30 million, equivalent to USD 200 million on February 14, 2020 which was first rolled over on its due date of maturity on May 14, 2020 for three months. On August 14, 2020, it had availed second roll over for further three months which is due for maturity on November 17, 2020.

I.8.4 SAARC Swap Arrangement between India and Maldives

Maldives had availed USD 150 million on April 27, 2020 for six months with maturity falling on October 27, 2020.

I.8.5 SAARC Swap Arrangement between India and Sri Lanka

Sri Lanka had availed USD 400 million on July 31, 2020 for three months with maturity falling on November 02, 2020

I.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-September 2020, the amount invested in such bonds stood at USD 1.86 billion.

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 safety and liquidity constitute the twin objectives of reserve management in India, return optimization 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:

- deposits with other central banks and the BIS;
- deposits with commercial banks overseas;
- debt instruments representing sovereign/sovereign-guaranteed liability with residual maturity for the debt papers not exceeding 10 years;
- other instruments / institutions as approved by the Central Board of the Reserve Bank in accordance with the provisions of the Act; and
- 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 account of 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 commercial banks overseas. 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. The dated foreign securities are valued at market prices as on the last business day of each week and 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. 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 on the external front would pose a demand on our forex reserves and, hence, the investment strategy needs a highly liquid portfolio. 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/ commercial banks overseas / 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. There is a system of concurrent audit for monitoring compliance in respect of the internal control guidelines. Further, reconciliation of accounts is done regularly. In addition to internal audit and independent monitoring, the financial 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, at frequent 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, custodians of securities and other business partners. International best practices with respect to usage and security of SWIFT system are followed. The SWIFT Alliance Access system has been upgraded to the latest version in line with the recommendations of the SWIFT. Further, security cover was enhanced with the implementation of a tool provided by SWIFT called payment control services (PCS).

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 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.