BHARAT SCHOOL OF BANKING

FOREIGN EXCHANGE (FOREX)

Foreign-exchange reserves (forex) are **assets** of a country, generally held by the **central bank**, and held in **foreign currencies**. For **India**, **RBI** is authorized to maintain **Indian forex,** which is generally held in **US Dollar**, or other foreign currencies.

But the question is why do a **country** hold **forex reserve?**
There are few **reasons** behind this. However most important is -

- **Influence Exchange Rate -** If India has a **large** amount of **forex**, then it can target a certain **exchange rate**. For example, If India wants to **increase** the **value** of **Indian Rupee (INR), India** could sell its **dollar reserves** to buy **INR** on the **foreign exchange market**. The increased demand would **appreciate** the **INR**. In a fixed exchange rate, **forex** reserves can play an important role in trying to **keep** a **target** exchange rate.
- **Guarantor for External Debts / Liabilities -** If India holds a **large** amount of **forex**, then foreign countries, or foreign banks (like, World Bank, ADB, etc) will be much **willing** to provide **long term** or **short term loans**. Because, they will understand that **India** has the **ability to payback** the **loan**. It reflects as **credit worthiness**.

Indian forex
India has **four** types of **forex assets -**

1. **Foreign Currency Assets** - This is the **most** important part of **forex**, and holds the **maximum** portion of it. It simply means how much **foreign currency** (generally **dollar**) **India** holds (Jan 23, 2015 - **USD 2,97,510**)
2. **Gold Reserves -** This is the next most important part. How much **gold** India holds (Jan 23, 2015 - **USD 19,377** worth gold)
3. **Special Drawing Rights (SDR)** - These are the **drawing rights,** or a **claim to currency,** that a country holds with **IMF**, that can be sold or bought. Note that it can be **exchanged** with **currencies.** (Jan 23, 2015 - **USD 4,047**)
4. **Reserve Position** in the **IMF -** Also known as **Reserve Tranche Position (RTP).** It also represents a forex, to some extent (Jan 23, 2015 - **USD 1,101)**