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A STUDY ON FOREIGN EXCHANGE RESERVES AND ITS IMPACT ON INFLATION IN INDIA

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Abstract:

The rapid development of the digital economy at the national and worldwide levels in recent decades has accelerated processes of transformation of financial systems and led to financialization of the global economy. FinTech companies operating in the financial market represent a new, quite special category of parabank institutions. They are characterised by the implementation of modern technologies to develop and provide traditional financial services. It would not be possible to provide such services without the Internet and digitalisation, compatibility of electronic devices, including hardware and software, nor would it become possible without new experiences, skills and consumer confidence. This is a kind of analogy with search engines that have changed the architecture of the market and mediation and led to the transformation of business models of financial market entities, in particular banks. Purpose. This paper presents the results of the possibility of providing financial services without banks. It determines the main aspects of competition and directions of combining FinTech and banking. Methods. In evaluation of the FinTech and banking sectors, the authors have used statistical monitoring, as well as dynamic, comparative and structural analysis. Results. The results of the study show that FinTech allows creating new services that are not provided by traditional financial intermediaries. It has been proven that the limits for FinTech companies to avoid banking rules and regulations are expanding, and it is becoming increasingly difficult to prove that this is happening beyond the law or outside the law. An analysis of the global trends in the development of the FinTech industry has shown that the volume of investments in this area in 2018 was USD 111.8 billion, which is almost 6 times more than in 2013. The authors examine the main forms of interaction between banks and FinTech companies. Basic models of banks' participation in the creation of FinTech companies are substantiated. The authors of the article have analysed characteristics of the largest FinTech accelerators, identified and characterised the main risks and opportunities relating to FinTech for the banking and consumer sectors.Conclusions. The presented paper reveals the modern trends in FinTech development. They should be taken into account in defining the key determinants of the transformation of thebanking sector in relation to the formation of new business models of banks with regard to thechallenges of digitalisation.

Keywords: Bank; Banking, FinTech Company, FinTech Accelerators, Financial Market, Financial Services, Innovative Financial Technologies.

INTRODUCTION

Foreign Exchange Reserves is a deposit in the form of foreign currencies or foreign financial instruments held by the Central Bank (Reserve Bank of India), which allows the government to make their exchange rate stable and reduce the unexpected emergencies and economic shocks. Any nation would need Foreign Exchange Reserves for only two reasons. They are to synchronize its receipts and payments with the rest of the world and to withstand occasional speculative raids by dealers in the speculative market. The use of Foreign Exchange Reserves has become more popular after the decline of gold standards. Moreover, in a strict sense, Foreign Exchange Reserves constitute only foreign currency deposits and bonds held by Central Banks and monetary authorities. However, the term in popular usage includes foreign exchange and gold, special depository rights (SDRs) and International Monetary Fund reserve positions, which is to be more accurately termed as official reserves or international reserves or official international reserves.

STATEMENT OF THE PROBLEM

Foreign Exchange Reserves accumulation is a widespread phenomenon in recent years, particularly among emerging economies. The world's economic system has been characterized by significant external imbalances in the middle of last century. This global phenomenon has manifested itself clearly by accumulation of Foreign Exchange Reserves and frequent volatility of trade flows and its connective capital flows in respective countries. One major development in global financial system for the past two decades has seen the rapidgrowth of Foreign Exchange Reserves. The large accumulation of Foreign Exchange Reserves can certainly be used as the insurance against financial crisis and default risk.

OBJECTIVES OF THE STUDY

- To find out the amount of excess reserves in India during the study period.

SCOPE OF THE STUDY

The present study is an analysis towards the growth of Foreign Exchange Reserves of India since 2009-2010. The analysis also includes the assessment of relation existing between macroeconomic variables of holding Foreign Exchange Reserves and its effect on Inflation in India. The study does not cover cost benefit analysis or volatility or risk assessment of holding Foreign Exchange Reserves of India.

LIMITATIONS OF THE STUDY

The major limitations of the study are:

- The study is made only in consideration with India and not applicable to any part of the globe.
- The study fully depends on the secondary data, which has its own limitations.

REVIEW OF LITERATURE

UmeoraChinweobo Emmanuel (2013), *"Accumulation of External Reserves and Effects on Exchange Rates and Inflation in Nigeria"*tried to assess the relationship that exists between the total reserves against inflation and economic growth of the nation and the study concluded that inflation has positive and exchange rate has negative relationships with the total reserves respectively in Nigeria.

UmanathKumarasamy (2012), *"Does foreign exchange reserves affect external commercial borrowings? – Indian pragmatic indication",* used foreign exchange reserves and external commercial borrowings with equivalent amounts in United States dollar in millions. He used Jarque-Bera normality test, Unit root (stationarity) test and AugmentedDicky Fuller test and concluded that foreign exchange reserves do have effect on external commercial borrowings.

Ouyang and Rajan (2011),*"Reserve accumulation and monetary sterilization in Singapore and Taiwan".* The results of their study demonstrated that high-effective capital mobility has not undermined the ability of the Central Bank in either economy to sterilize their respective foreign exchange intervention but may make the process increasingly difficult over time.

Dominguez et al. (2010), *"Does Foreign Exchange Reserve Decumulation Lead to Currency Appreciation",*investigated the influence of foreign exchange reserve decumulation leading to currency appreciation by using intraday foreign exchange rate data and time-stamped reserve sales and found that while foreign exchange reserves decumulation occurred each day these sales led to significant appreciation of the Koruna.

Anne–Laure Delatte and JulienFouquau (2009), *"The determinants of international reserves in emerging countries: A non-linear approach",* adopted a non linear approach to examine dynamics of international reserves holdings by emerging economies. Their specification accounts for the acceleration of foreign exchange reserves accumulation that the linear specification fails to explain. In this paper, they investigated determinants of demand for international reserves with the Panel Smooth Transition model that has the great advantage to allow parameters to vary across countries and time.

Fukudan and Kon (2007), investigated the macro economic impacts of foreign exchange reserves accumulation in developing countries. The findings of their study revealed that an increase in foreign exchange reserves influences a permanent decrease in consumption, depreciation of real exchange rates, and temporal improvement in current account.

RATIO ANALYSIS TO IDENTIFY THE EXCESS FOREIGN RESERVES DURING THE PERIOD 2009-2010 to 2018-2019

Adequacy of Foreign Exchange Reserves

Excess reserve holdings have been calculated using various indicators of reserve adequacy[1]:

i.100 per cent of Short-termDebt

ii.10 per cent ofGDP

iii.3 Months of ImportCover

iv.100 per cent of Total ExternalDebt

YEAR	RESERVES/SHORT-TERM DEBT (in %)	RESERVES / 10 % GDP (in %)	RESERVES/ 25 PERCENT IMPORTS(in %)	RESERVES / TOTAL EXTERNAL DEBT(in %)
2010	1654.3	15. 21	61.41	99.55
2011	2402.12	186.65	78.10	114.85
2012	1886.66	208.35	111.50	126.12
2013	1722.72	199.49	149.14	125.61
2014	793.22	219.62	185.66	152.63
2015	857.89	270.17	251.63	111.50
2016	573.80	242.07	303.59	111.73
2017	598.71	206.20	288.31	99.93
2018	468.92	187.28	369.74	85.30
2019	377.30	180.30	489.01	75.79

Source : Compiled and calculated from Statistical Handbook of Indian Economy 2019 and RBI Bulletin.

The ratio was high during the year 2010-2011 with 2402.128 per cent, during which there was very excess reserves above the short term debt and lowest during 2018-2019 with 377.30 per cent. As the short-term debt of the nation grows, the reserves available to finance the debt in percentage continued to decrease. The value of debt and reserves increased together proportionately.

FINDINGS AND SUGGESTION

Foreign Exchange Reserves to 10 percent of GDP

The ratio of Reserves to 10 percent of GDP shows that there was no inadequacy, where there were complete excess reserves all through the study period. The ratio was high during 2014-2015 with 270. 1 percent and the lowest were during 2009-2010 with 154.21 per cent.

Foreign Exchange Reserves to 3 Months of Import Cover

The ratio of reserves to twenty-five per cent imports was its highest during 2018-2019 at 489.01per cent and the lowest was during 2009-2010 with 61.41 per cent. It is inferred from the table that there was no inadequacy in reserves to meet three months import value during the study period.

Foreign Exchange Reserves to 100 per cent of Total External Debt

The ratio shows frequent fluctuations with the certain growth of reserves and total external debt. The ratio was high during 2013-2014 with 152.63 per cent and low during 2018- 2019 with 75.79 per cent. It is inferred from the ratio that the growth of reserves was unable to meet the total external debt during the years selected for the study namely; 2009-2010, 2016- 2017, 2017-2018 and 2018-2019.

- The reserves of various export promotion zones and special economic zones can be taken up with excess reserves, which could increase exports and reduce the current account deficit in balance of payments.
- The oil prices can also be reduced to a considerable extent through proper direction of excess reserves, the result of which can reduce inflation of the nation.
- Various poverty eradication and illiteracy reduction programmes can be implemented with the help of excess reserves and the increased domesticproduction rate and the infrastructure requirement to attain the increased rate can be provided through excess reserves, which could induce Gross Domestic Product.

CONCLUSION

The theory and practice of Foreign Exchange Reserves is as complex as any other contemporary economic issue. The growth rate of Foreign Exchange Reserves in India has been significant since globalization and the respective surge in accumulation impacted the growth rate of the economy. The nation stood in the world in its own place of holding reserves as one of the emerging economies competing with the developed world. The various macroeconomic determinants influencing the holding of Foreign Reserves played a significant role and the holding of reserves had a significant impact on inflation. The inflationary trend of the nation, up to a certain extent is influenced by Foreign Exchange Reserve holdings.