

Reserve Bank of India's Statement on Forex Markets

In the past four weeks or so, for reasons which are not entirely clear (and which may presumably be related to prevailing conditions in the international equity and currency markets), foreign exchange markets in India have shown considerable uncertainty and exaggerated speculation about RBI's intentions regarding the level of the exchange rate of the rupee. In order to reduce these uncertainties, as in similar situations in the past, RBI has decided to introduce some measures. It may also be appropriate to clarify RBI stand on some of the issues that have figured prominently in the recent comments about RBI's intention.

Despite explanations by the RBI in its annual and half-yearly Policy Statements as well as in previous statements on exchange rate matters, there is some speculation among commentators and market participants about RBI "targeting" a specific exchange rate and what that rate is. RBI would reiterate once again that it does not, repeat it does not, target a particular value of the rupee in relation to the US dollar. The often cited round numbers, such as, "Rs.42", "Rs.43", or "Rs.44" simply have no significance for the management of the exchange rate by the RBI. Nor does RBI recognise any level such as "lowest ever reached in the past" or "lowest last year" or any such dividing line. While these concepts have some popular and journalistic appeal, it simply has no relevance for the management of exchange rate or any other economic variable. For example, even during period of very low inflation, every week, WPI and CPI could be projected to have reached the "highest level" even though the incremental change may be very small but this is meaningless. Unfortunately, in regard to exchange rates, it is not unusual to project even a minor change of say, a few paise, or even less than 0.25 per cent, as a major movement with important implications for future trends. This naturally affects the sentiments and behaviour of other market participants and non-experts. This excessive sensitivity to minor changes in value of the currency is unwarranted and inconsistent with the significance attached by commentators to such marginal movements in exchange rates of other international currencies.

The exclusive focus by expert commentators and media on US dollar exchange rate gives a misleading impression of what is happening to the value of the rupee in relation to other key currencies. For example, in the last one month, Rupee has actually strengthened by 3.3 per cent against Euro, and by 5.2 per cent against Pound Sterling. In relation to Japanese Yen, it depreciated only by 1.4 per cent, which was similar to the movement in relation to US dollar. Over the calendar year, however, rupee strengthened against yen by 3.4 per cent. The excessive focus on US dollar is unwarranted in considering the behaviour of the rupee (Please see Annexure for movements of rupee in relation to major currencies for various periods last year.)

Similarly, clarity is warranted in viewing movements in the level of foreign exchange reserves. RBI's foreign currency assets are held in different convertible currencies such as US dollar, Euro, Pound Sterling and Japanese Yen. These reserves are converted into US dollar at the end of every week by using closing exchange rates prevailing in the New York market for that week. Thus, as per best international practice, valuation loss/gain is fully reflected every week in the reserve movements. It is, therefore, not correct to look at this movement and derive conclusion about RBI's exchange rate intentions. The figures for net purchases and sales are published in RBI bulletin every month.

For the convenience of experts and commentators and to encourage informed judgement and debate on the external sector issues, RBI provides as much information as possible on currency movements of the rupee vis-à-vis all major currencies on a daily basis as well as RBI operations and liabilities in forex reserves through its regular weekly and monthly publications. RBI's policy approach on various relevant issues is also articulated through its annual/half yearly monetary policy statements as well as annual publications. Experts, commentators and others interested in forex markets and RBI operations are encouraged to refer to these publications which are also available on RBI Website which is updated everyday.

Reserve Bank's total foreign exchange reserves are US \$ 37.6 billion as on May 12, 2000. In the financial year 1999-2000, India's foreign exchange reserves increased by US \$ 5,546 million (or more than US \$ 5.5 billion) despite several uncertainties including sharp increase in oil prices and

Kargil developments. At their current levels country's foreign exchange reserves are comfortable and more than adequate to meet any genuine requirements of foreign exchange.

Measures

In the light of recent developments in the foreign exchange market, as on some previous occasions, the Reserve Bank of India has decided to take the following actions:

- (i) It has been decided, as a temporary measure, to impose interest rate surcharge of 50 per cent of the lending rate on import finance with effect from May 26, 2000. The interest rate surcharge will be phased out as early as possible. As in the past, essential categories such as export-related imports, bulk imports in respect of crude oil, petroleum products, fertilisers, edible oil and other essential commodities imported through Government agencies will be exempted from interest surcharge.
- (ii) Reserve Bank of India will meet partially or fully the Government debt service payments directly, as considered necessary.
- (iii) Arrangements are also being made to meet, fully or partially, the foreign exchange requirements for import of crude oil by the Indian Oil Corporation.
- (iv) Further, the Reserve Bank will continue to sell dollars through SBI in order to augment supply in the market, or intervene directly, as considered necessary to meet any temporary demand-supply imbalances. All the transactions by Reserve Bank of India will be at the prevailing market rate.
- (v) Exporters are advised not to delay repatriation of export proceeds beyond the due date. In order to discourage any delay in realisation of export proceeds, it has been decided that in respect of overdue export bills, banks will charge, with effect from May 26, 2000, interest at 25 per cent per annum (minimum) from the date the bill falls due for payment.
- (vi) As per usual market practice, FIIs will no doubt continue to take their own decisions in regard to reducing or increasing their stake in India's equity markets. While RBI welcomes these flows, it would also like to ensure that those FIIs which wish to reduce their investments can do so as easily as possible at prevailing market rates. As in the past, Authorised Dealers, acting on behalf of these FIIs are free to approach RBI to procure foreign exchange at the prevailing market rate. Depending on market conditions, RBI would either sell the foreign exchange directly or advise the concerned bank to buy it in the market.
- (vii) Banks are advised to enter into transactions in the forex market only on the basis of genuine requirements and not for the purpose of building up speculative positions. RBI would monitor the position closely.

At present no further monetary tightening or administrative measures are being contemplated.

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Movement in the Value of the Indian Rupee

<u>Year to Year</u> : (Over May 21, 1999)	The Rupee appreciated 4.8 per cent against the Pound sterling. It appreciated 13.9 per cent against the Euro. It depreciated 2.8 per cent against the US dollar. It depreciated 16.0 per cent against the Japanese Yen.
<u>Calendar Year</u> : (Over December 31 1999)	The Rupee appreciated 7.1 per cent against the Pound sterling. It appreciated 10.2 per cent against the Euro. It appreciated 3.4 per cent against the Japanese yen. It depreciated by 1.1 per cent against the US dollar.
<u>Financial Year</u> : (Over March 31, 2000)	The Rupee appreciated 6.0 per cent against the Pound sterling. It appreciated 5.0 per cent against the Euro. It appreciated 0.9 per cent against the Japanese yen. It depreciated by 0.8 per cent against the US dollar.
<u>Month on Month</u> : (Over April 20, 2000)	The Rupee appreciated 5.2 per cent against the Pound sterling. It appreciated 3.3 per cent against the Euro. It depreciated by 0.8 per cent against the US dollar. It depreciated 1.4 per cent against the Japanese yen.