Our Views

Foreign Exchange Reserves – large enough to create an Indian sovereign wealth fund

India's foreign exchange reserves for the first time crossed the US$ 600bn mark earlier this month and stood at an all-time high of $605bn on June 4th. It is indeed a jubilant milestone on various counts.

It is quite an achievement when we look back thirty years – in 1991, the Indian government had come awfully close to defaulting on its own financial obligations. The forex reserves then could have barely financed three weeks' worth of imports. The country had to mortgage its gold reserves to seek assistance from IMF to avoid defaulting on its payment obligations. This is the first time since 2010 that we have a positive foreign exchange reserve after covering our total external liability. The forex reserves as a percentage of GDP are the highest ever, despite the significant growth in GDP over the years.

This higher amount of reserve has generated considerable excitement in the financial circles. The two hotly debated questions are – first, do we need such a large reserve; and second, how do we use this effectively and productively.

On the first question, it is important to view these forex reserves against the projected imports for 2021-22 – the current level of reserves provide cover for less than 15 months of projected imports. This is significantly lower than the foreign exchange reserves of some of more developed economies like China (US$ 3.3 tn equivalent to 16 months of import), Switzerland (US$ 1.4trn equivalent to 39 months of import) and Japan (US$ 1tn equivalent to 20 months of import). Of course, we are significantly better than emerging economies. In addition, a holistic assessment of the risks, changes in the market circumstances and requisite cushion against unforeseen external shocks, is required to ascertain the adequacy of the reserves.

The second question regarding deployment or investment of these reserves has also generated multiple suggestions. Today, the RBI invests these reserves only in gold and in sovereign debt. Options suggested by various financial experts include deploying these funds for import of capital goods for infrastructure development and to build long-term productive capabilities. Given the record pile up of reserves, the RBI in its latest annual report has acknowledged the need to explore new asset classes and markets for deployment of the foreign currency assets. The idea is to diversify the portfolio and seek higher returns.

In my view, to manage these foreign exchange reserves, we could derive some learnings from China which is managing exceptionally large reserves. China invests its forex reserves through two main investment vehicles: SAFE (State Administration of Foreign Exchange) and CIC (China Investment Corporation). SAFE is under the control of the Chinese central bank, People's Bank of China. It has diversified its investments across geographies such as Australia, UK, France, USA and Germany. The investments are primarily focused on four sectors: financial, energy, real estate, and to a lesser extent agriculture sector.

China Investment Corporation (CIC) is the official Sovereign Wealth Fund (SWF) of China. It invests in public market equity and bond, hedge fund, private equity fund. It also specializes in making direct investments in long-term assets and in key state-owned financial institutions in China.

The need to set up a sovereign wealth fund, with expert investment professionals at its helm, to manage India's gigantic reserves cannot be more underscored. We need to also use our resources to invest in and to acquire strategic assets overseas. The structure of the fund management vehicle will be critical to ensure a fine balance between strategic and return-led investments. I would argue that a SAFE/CIC kind of sovereign wealth fund should be created to manage some part of India's forex reserves.

https://economictimes.indiatimes.com/markets/stocks/news/is-it-time-for-indias-own-sovereign-wealth-fund/articleshow/83660296.cms

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