External Sector

- All economic activities of an economy which take place in foreign currency fall in the external sector such as balance of payment, export, import, foreign investment, external debt, current account, capital account, exchange rates etc.

Forex Reserves

- Foreign exchange reserves are assets denominated in a foreign currency that are held on reserve by a central bank.
- These may include foreign currencies, bonds, treasury bills and other government securities.
- India is the 6th largest Foreign Exchange Reserve holder in the world (Economic Survey 2022-23)

RBI's Forex Exchange Reserves

- Total Reserves = 46,49,018 crores/561,267 million USD
- Foreign Currency Assets=41,09,014 crore/496,072 million USD
- Gold = 346376 crore/ 41817 million USD
- SDRs = 151307 crore/ 41817 million USD
- Reserve Position IMF = 42321/5111

Special Drawing Rights (SDR)

- SDR is an international reserve asset, created by the IMF in 1969.
- Value of the SDR is based on a basket of five currencies: Dollar, Euro, Renminbi, Yen and Pound Sterling.
- It is neither a currency nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members.

Remittances into India

- **Migration and Development Brief (World Bank):** India has become the world's largest recipient of Remittances, receiving USD 87 billion (a gain of 4.6 % from previous year) in 2021.
- India is followed by China, Mexico, the Philippines, and Egypt are top remittance recipients.

- United States being the biggest source, accounting for over 20% of all Remittances.
- India is the largest recipient of remittances in the world receiving US $ l00 bn in 2022 (Economic Survey 2022-23). As on Dec. 2022, Forex Reserves Stood US $ 563 bn.

Exchange Rate

- Exchange rate is Price at which one currency is converted into or exchanged for another currency.

Various Exchange Rates Mechanism

Fixed Exchange Rate

- Complete intervention of Authority (government or central bank) in determination of the currency exchange rate.

Floating Exchange Rate

- Market forces (demand and supply) determine the value of currency No role of authority

Managed Floating Rate

- Exchange rate is largely determined by market forces.
- In crisis, central banks may intervene to stabilize the exchange rate.
- India has been operating on a managed floating exchange rate regime since march 1993.

Pegged Float Exchange Rate

- A currency is pegged to international hard currency.

Nominal Effective Exchange Rate (NEER) VS Real Effective Exchange Rate (REER)

Nominal Effective Exchange Rate (NEER)

- Weighted average of bilateral nominal exchange rates of the home currency in terms of foreign currencies.
- It is the exchange rate of one currency against a basket of currencies, weighted according to trade with each country (not adjusted for inflation).

Real Effective Exchange Rate (REER)

- Weighted average of nominal exchange rates, adjusted for inflation.

- It is calculated on the basis of NEER.
- Captures inflation differentials between country and its major trading partners and reflects the degree of external competitiveness.

Currency Convertibility

- Currency convertibility is the ease with which the currency of a country can be freely converted into any other foreign currency or gold at market determined exchange rate.

Partial Convertibility

- Portion allowed by the government which can be converted into foreign currency with least restrictions. Also known as Dual exchange system.

Full Convertibility

- Freedom to convert domestic currency into any foreign currency and vice-versa without any regulatory intervention.
- Dual exchange rate system got automatically abolished and LERMS was now based upon the open market exchange.

Foreign Exchange Market

Revaluation: Government or the central bank Value of its currency increases.

Devaluation: Government or the central bank Value of its currency decreases.

Appreciation

- Value of its currency is determined by the market forces of demand and supply
- Happens when Supply of currency decreases
- Associated with floating exchange regime

Depreciation

- Value of its currency is determined by the market forces of demand and supply
- Happens when Supply of currency increases
- Associated with floating exchange regime

Impact of Revaluation / Appreciation Vis-A-Vis Devaluation / Depreciation

- Revaluation/Appreciation
- Exports become expensive
- Imports become cheaper
- Value of the remittances decreases

- Overall Inflation decreases
- Devaluation/Depreciation
- Exports become cheaper
- Imports become expensive
- Increase in aggregate demand
- Increase in inflation

Balance of Payment (BOP)

- A systematic record of all economic transactions between the residents of one country with the residents of the other country in a financial year.
- It consists of balance of trade, balance of current account and capital account.
- **Positive Balance/Trade Surplus:** When a country exports more than its imports.
- **Negative Balance/Trade Deficit:** When imports are greater than its export.
- **Balance of Trade:** Difference between the monetary value of a nation's exports and imports over a certain time period.

BoP divides transactions in two accounts:

(1) Current account and

(2) Capital account

Current Account

- Records imports and exports of visible and invisibles
- Short term implication transactions Covers only earnings and spending.
- Excludes any borrowings and lending.

Components

- Visible trade (Export and Import of goods -Merchandise transactions)
- Invisible trade (Export and Import of services)
- Unilateral transactions

Deficit

- If the value of the goods and services imported exceeds the value of those exported.
- Current Account deficit = Trade gap (export – import) + Net current transfers (foreign aid) + Net factor income (Interest, Dividend)

Surplus

- If the value of the goods and services exported exceeds the value of those imported.

Capital Account

- Shows capital expenditure and income for country
- Long term implication transactions
- Only includes borrowings and lending by a country

Components

- Foreign Direct Investment (FDI)
- Portfolio Investment (FPI)
- Loans / External commercial borrowing (ECB)
- Non-resident's investment in Bank, Insurance, Pension schemes.
- RBI's foreign exchange reserve

Deficit

- When more money is flowing out of a country to acquire assets and rights abroad

Surplus

- Money is flowing into the country, but these inflows reflect changes in the ownership of national assets by way of sale or borrowing.

Trade Balance

- Monetary difference of the total export and import of an economy in one financial year is called trade balance.
- **Top exports from India**
  - USA
  - UAE
  - China
  - Hong Kong
  - Singapore
- **Top Imports to India**
  - China
  - USA

- UAE
- Saudi Arabia

- **Top Export Products**
  - Petroleum products
  - Pearls, precious and semi-Precious stones
  - Drug formulations, biological
  - Gold and other precious metal jewellery
  - Iron and steel
- **Top Import Products**
  - Petroleum products
  - Mineral fuels including oil
  - Gems, precious metals
  - Machinery including computers, Organic, Electrical machinery
  - Pharmaceuticals products.