

Abstract

In all the emerging economies including India since the liberalization phase of 1990s there has been a huge upsurge in accumulation of foreign exchange reserves and has crossed the prescribed limits. The main reasons can be precautionary, mercantilist or the asymmetric exchange rate interventions by RBI. Thirty three billion dollars were the excess foreign exchange reserves in 2005-06. There is a cost of holding foreign exchange reserves and it was estimated to be around 4.75 and 3.50 percentage of GDP in 2004-05 and 2005-06. In this study we estimate the reserve demand by taking into account the impact of factors such as opportunity cost of holding the reserves and the exchange rate volatility defined as 8 weeks rolling standard deviation. We found that the total forex reserves of most of the emerging countries after reaching a peak in mid 2000s started falling after the post sub-prime crises which hit the world economy during 2008.