



Apr 16th, 2:35 PM - 3:50 PM

Comparative Study: Factors That Affect Foreign Currency Reserves in China and India

Ana Maria Romero
Illinois Wesleyan University

Diego Mendez-Carbajo, Faculty Advisor
Illinois Wesleyan University

Follow this and additional works at: <https://digitalcommons.iwu.edu/jwprc>

Romero, Ana Maria and Mendez-Carbajo, Faculty Advisor, Diego, "Comparative Study: Factors That Affect Foreign Currency Reserves in China and India" (2005). *John Wesley Powell Student Research Conference*. 3.

<https://digitalcommons.iwu.edu/jwprc/2005/oralpres6/3>

This Event is protected by copyright and/or related rights. It has been brought to you by Digital Commons @ IWU with permission from the rights-holder(s). You are free to use this material in any way that is permitted by the copyright and related rights legislation that applies to your use. For other uses you need to obtain permission from the rights-holder(s) directly, unless additional rights are indicated by a Creative Commons license in the record and/ or on the work itself. This material has been accepted for inclusion by faculty at Illinois Wesleyan University. For more information, please contact digitalcommons@iwu.edu.

©Copyright is owned by the author of this document.

Oral Presentation O6.2

**COMPARATIVE STUDY: FACTORS THAT AFFECT FOREIGN CURRENCY
RESERVES IN CHINA AND INDIA**

Ana Maria Romero and Diego Mendez-Carbajo*
Economics Department, Illinois Wesleyan University

Foreign currency reserves in Asia are at an all-time high since the Asian crisis in 1997, despite experts predictions that increased capital mobility and funds from financial institutions like the International Monetary Fund would decrease the need for foreign reserves. It is speculated that this hoarding of reserves is a by-product of a country's exchange rate regime. To test whether the exchange rate regime significantly affects a country's level of reserve holdings, China and India were selected as comparison countries in this study. China and India rank second and fifth in world reserve holding, respectively, and have reserve holdings that have been growing exponentially. They also have different types of exchange rate regimes; China has a fixed exchange rate while India has moved towards a more flexible managed float regime. However, both countries have been experiencing rapid growth due to the somewhat recent openings of their economy, making a comparison between the two viable.

According to Aizenmann and Marion (2002) two variables have been consistently found to affect reserves: exchange rate variability and economic openness. This paper tests if these variables affect reserves in China and India. Exchange rate variability refers to the variability in the exchange rate, computed from daily nominal exchange rate data. The variable was used with a lag, and it is expected to have a positive effect, since the theory is that increased volatility yesterday would encourage more reserves today. Economic openness is a variable calculated as real imports over real GDP. The theory behind this variable is that the more open an economy is, the more vulnerable it is to external financial shocks, leading a country to hoard more reserves to protect itself. Preliminary results suggest these variables are strong predictors for Indian reserve holdings, but not for China.