*This is part of our Forex Focus Series**

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India's
Foreign Exchange Reserves:
Are they adequate?

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<u>India's Foreign Exchange Reserves : Are they adequate?</u>

"Forex Reserves crossed USD 700 Billions" screamed the newspapers a few months ago. We wondered; should we consider it an achievement; should we celebrate it?. Agreed, India and Indians still suffer from 1991 memories when our coffers were empty (Courtesy stupid politicians and the dimwit bureaucrats). We faced humiliation in international financial markets. We physically airlifted gold abroad and eventually 'opened up', which every political party and politician wants to take credit for . Thus we are accustomed to think that more foreign exchange reserves means more strength. That, according to us, is over simplification. How and why. Let us see.

India built its reserves out of deficits not out of savings/surplus. Further these funds are invested (understandably) in low yielding assets. Thus they are very costly. Having said that, we know India needs these reserves to hedge variety of risks ranging from local currency, that is INR, stability to meeting forex payment commitments to giving confidence to the investors, both domestic and foreign, to take care of unexpected development (like the US, Iran war that we are witnessing now) and so on. But at the end of the day we should not forget that they are costly. They, of course, are needed. So, India should have 'ADEQATE; reserves, neither too much - to save on costs - nor too little - to avoid associated dangers.

Coming back to the USD 700 Billion figure, are they adequate or inadequate or excessive. Our honest answer is 'We don't know'. We don't think anyone knows it either. As already said these reserves are essentially a risk hedging mechanism. So to know the 'right amount' of reserves required we should know the amount of the risk we want to hedge first. We should know the size and nature of the risk we are trying to hedge. It may not always be easy to quantify the risk. That does not mean that we will have no estimates at all. Otherwise it will be like shooting arrows into darkness.There are a variety of foreign currency flows, into and out of India, continuously - 24/7. Each one of them has its own peculiarities/characteristics. While some of them are fairly predictable, others are highly unpredictable. In case of flows where predictability is difficult, some kind of system should be developed so that their movements can be restricted to a range. Further any risk hedging mechanism should simultaneously focus on reduction of risk itself so that hedging costs can be lowered. We are not sure whether the Government of India has any such mechanism/model that monitors and contains risks. Further reducing risk need not always be by increasing the moat size. In a given situation a variety of counter strategies can be developed, deployed to keep the risk under check. This, of course, requires imagination, visualisation and out of box thinking. This in turn requires a certain depth of knowledge and a firm grip over the subject (That is not easy to come by). Do 'Our Rulers' possess such skills? Our guess is as good as yours.

We are only leaving hints (and our thoughts) here. We are not digging into details. Collecting data for the past twenty-five/thirty years, collating it, interpreting it and drawing meaningful conclusions is a huge task which we are not equipped for.

To conclude, we would like to say - **We do not know whether India's Foreign Exchange Reserves are adequate or inadequate or excessive** (Going by the past performance of the government we suspect that 'Our Rulers' do know it either).

**Forex Focus Series is an initiative under which Proletarian Power examines closely different kinds of Foreign Exchange transactions that take place on a regular basis. Under this initiative we plan to study different categories of foreign exchange flows, both inflows and outflows, and their impact on the economy in general and on the Proletariat/Working-class/Common-man in particular.*

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