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**Statement by Mr. Fayolle on Seminar--Reserve Accumulation and International
Monetary Stability
(Preliminary)
Executive Board Seminar 10/2
May 28, 2010**

We thank staff for a thought-provoking set of papers and welcome this opportunity to discuss avenues towards a more stable international monetary system. The current system, although somewhat resilient, is no stranger to the deep-rooted causes of the global financial crisis. It is likely to face increasing pressures as the trend in reserve accumulation and resulting imbalances continue to grow. Ultimately, by providing wrong incentives to both reserve issuers and reserve accumulators, the system encourages policies that may eventually be unsustainable.

This debate is paramount given the purpose of the Fund and its core mandate. The medium to long term nature of the issue at stake is one more reason to assess where we are heading and how to pave the way towards a more stable international monetary system. The Fund is the right place to engage in this debate in an open, concerted and cooperative way, addressing both sides of the issue.

Demand side: Reserve accumulation

We agree with staff analysis regarding the causes and effects of the rapid growth of reserves over the past decades. The absence of automatic adjustment is one of the reasons behind persisting imbalances. Staff is right to note that some policy choices may affect these trends. Especially when associated with an undervalued currency, the build-up of reserves can lead to serious medium-term distortions, costs and risks, both at the global level and domestically. To address these issues, several ongoing initiatives are much welcome and need to be pursued:

- § first, strengthened international cooperation, through the G-20 mutual assessment process and possibly through a more efficient surveillance framework for the Fund; the latter could helpfully encompass a better monitoring of capital flows. Consideration should also be given to a multilateral framework for managing capital flows, as eloquently outlined by staff in paragraph 29. The Fund also has a role to play in helping countries develop more efficient domestic capital markets.

- § second, more efficient and flexible global financial safety net, with a central role for the Fund. On this, the ongoing work on the reform of the Fund's financing role, including an enhanced FCL, looks promising.
- § last, we look forward to the upcoming staff report on assessing reserve adequacy. Work in this area could be helpful to foster a more ambitious quid pro quo approach.

Supply side: Towards a multipolar system?

Staff rightly emphasizes the risks associated with a system based on a single currency.

Yields artificially maintained below market equilibrium can create incentives for excessive risk taking, and sustained government deficits eventually raise the question of debt sustainability, thus undermining the store of value feature of reserve assets and the very foundation of the system. As other currencies emerge as credible reserve assets, a gradual move towards a more "multipolar system" is likely. International collaboration could facilitate such process of diversification of reserves while providing incentives for reserve issuers to pursue sound macroeconomic policies. Nevertheless, such multipolar system could also lead to other sources of instability, with more volatile exchange rates between major currencies depending on growth and interest rates differentials.

Clearly, a higher share of SDRs in such a system could bring an important element of stability. The value of the SDR is indeed much more stable than that of its components, and the SDR by itself provides a degree of diversification. We acknowledge that some features of the SDR and the SDR market can be seen as impediments for the promotion of a larger role of the SDR. Nevertheless, these could be overcome, and we would stress that, as an already known and available instrument, the SDR represents a pragmatic way forward. **We therefore encourage staff to continue their work on the following ideas:**

- § How to increase the liquidity of the SDR market? Adequate incentives to develop a private SDR market could be instrumental to this objective, with banks that could start to accept deposits denominated in SDRs and sovereigns, other IFIs or companies would start to issue instruments in SDRs. In the case of sovereigns, we would echo staff's point that if some countries with fixed exchange rates were to peg to the SDR, some automaticity would be introduced in the global adjustment process. Staff outlines several interesting initiatives in the paper and its Supplement 1: (i) the creation of a clearing-compensation system for SDR-denominated instruments; and (ii) the promotion of a wider invoicing of international trade and finance in SDRs, including commodity prices.
- § Bearing in mind global liquidity conditions, regular modest allocations of SDRs could be envisaged for the SDR to complement other currencies in reserves. Alternatively, SDRs could be regularly generated, be held in escrow in the SDR Department, and only allocated in the case of shocks along with the re-institution of a reconstitution requirement.
- § Such initiatives could easily be complemented by more symbolic albeit useful measures: publication by the Fund of all reports with data in SDRs, dissemination of most financial and economic statistics in SDR, calculation of SDR exchange rates with a higher frequency, broadening of the list of prescribed holders, lending and

repayment to the Fund under arrangements directly in SDRs.