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

We thank the staff for the two detailed and interesting papers that explore the process driving the accumulation of international reserves and the associated potential risks to the international monetary system. The staff develops thought-provoking lines of discussion about possible avenues to enhance the international monetary system. We welcome a fruitful discussion about the risks of reserve accumulation and those associated with potential remedies.

Status quo and recent experience

Overall, despite recent market volatilities, we deem the international monetary system to be relatively resilient for the foreseeable future. It seems highly probable that the US-dollar will remain the main reserve currency, while at the same time a trend towards a multi-polar reserve world is discernible. This latter development would be further strengthened once the Renmimbi becomes fully convertible. Fundamentally, the use of international currencies is an issue subject to independent decision by private and public market participants and should neither be fostered nor hindered by public entities.

Turning to the reserve build-up, it is essential to analyse the fundamental factors that lie behind any increases. Part of the increases is noticeably linked to a precautionary savings motive, hence self-insurance. As countries with larger reserves were less affected by the financial and economic crisis, this is understandable and should not be viewed as overly problematic. What should concern us more are non-precautionary reserves, in particular combined with pegged-exchange-rate regimes and a related underlying development strategy.

The Fund must continue to monitor risks linked to substantial increases in reserve accumulation. This requires careful analysis of: global liquidity conditions, any potential magnification of risks by rapid capital flows, subsequent overheating risks and excessive asset price or real estate price developments, risks of exchange-rate misalignments and

potential risks of imbalanced trade flows generated by excessive reserve accumulation. *Staff comments would be welcome on how well the Fund currently captures these risks by its surveillance arsenal and how possible changes to the surveillance framework – as part of the ongoing discussion of the future IMF mandate - could reinforce substantive obligations on the membership, if needs for policy actions become apparent.*

Looking at recent developments, it is worth noting that much of the substantial increase in reserves has been exchange-rate driven. In 2009, over half of the reserve build-up has taken place in China. This indicates that exchange-rate related factors are significant in the overall reserve build-up. This conclusion is substantiated by the fact that the so-called ratchet effect discussed in the paper is at least also partly attributable to countries mimicking this exchange-rate strategy. This also has implications going forward as the calculations presented in the paper imply a vast increase in the demand for reserves over the coming years. *We would invite staff to explain those calculations and their underlying assumptions in more detail. How much of this increase is essentially an extrapolation of recent trends? Staff comments are welcome.*

Role of global financial safety nets

Whether global financial safety nets are able to reduce the need for own reserves is an open issue which needs to be studied carefully. A potential financial safety net provided by the IMF is in our view only one element in the broader range of instruments available at the global and regional level. In particular, incentives for national and private crisis prevention efforts should not be undermined and existing layers of responsibilities between international institutions, central banks and national governments should be respected. The potential adverse consequences of distortions for the stability of the international monetary and financial system and the financial integrity of the IMF and its shareholders should not be underestimated.

If countries feel that their composition of reserves is accompanied by an excessive reliance on a particular currency, a gradual diversification seems to be a sensible avenue to pursue. From this perspective, if countries are willing to share the relevant information, an advisory role of the IMF could be contemplated. This could help in keeping possible disruptive side effects in check. However, as a smooth process is in the self-interest of a country that attempts to diversify, it is unclear how substantial the value-added of such an initiative would really be.

Pursuing policies that help lower the volatility of flexible exchange-rates and capital transactions have certain merits. However, target zones are for a variety of reasons a more difficult path to follow, not least because of the potentially arising disconnect from the real economy. The Fund has at times stressed the potential role capital inflow restrictions could play, however a case-by-case approach is advisable taking into account necessary financial sector reforms in major financial centres.

Role of SDRs

Many important questions remain as regards to the promotion of SDRs as a substitute reserve asset, and the costs and unintended consequences of such a strategy should be carefully taken into account. In our view, the following issues need to be addressed (and staff comments would be welcome):

- *What principles would govern the issuance of SDR's to ensure that any distorting incentives and open stability concerns are properly addressed?*
- *If a basket solution is proposed, the question arises why the reserve holders haven't mimicked that already in view of the presumed benefits?*
- *The proposal to establish a substitution account has been discussed since the first SDR allocation. Since then, no convincing solution has been found to the issue of moral hazard and burden sharing associated with it.*

The introduction of a global currency, the bancor, seems farfetched. Experience shows that it remains unclear where the benefits of such a move would lie, in particular if weighed against the surrender of monetary sovereignty. Where would the necessary trust come from, that any money-emitting institution must command in order to be able to effectively issue a currency that agents want to transact in or use as store of value?