Office Memorandum

To: Members of the Executive Board — December 3, 2013

From: The Secretary

Subject: **Assessing Reserve Adequacy—Further Considerations—Statement by the European Central Bank Representative**

Attached for the **information** of Executive Directors is a statement by the European Central Bank representative for the Executive Board discussion on Assessing Reserve Adequacy—Further Considerations, to be held on Wednesday, December 4, 2013.

Att: (1)

Other Distribution:
Department Heads

FO/DIS/13/189

December 3, 2013

Statement by the ECB representative on Assessing Reserve Adequacy – Further Considerations

(Preliminary)

Executive Board Meeting

December 4, 2013

We welcome the analysis by IMF staff exploring possible ways to augment the guidance offered in its 2011 paper on Assessing Reserve Adequacy (ARA).

We agree with the approach taken by staff to assess reserve needs using relevant economic, financial and structural characteristics (maturity, depth and underlying liquidity of its financial markets, as well as its exchange rate regime and economic flexibility) rather than by relying on standard country classifications. However, the analysis conducted in the paper still broadly relies on the latter, which makes it difficult to assess the validity of some results.

As regards the scope of the analysis, we consider that its focus on the precautionary motive is exceedingly narrow. While we agree that reserves are effective external buffers for a number of countries, strong fundamentals and a sound policy framework should remain the best protections against potential vulnerabilities. In the face of financial stability challenges, macro and micro-prudential policies, rather than reserves, should be used as a first line of defence in preventing and managing currency and maturity mismatches in domestic financial systems. Furthermore, excessively high levels of reserves, especially when associated with an undervalued currency or an inflexible exchange rate regime, may generate global externalities in terms of global liquidity conditions, global exchange rate configurations and distorted trade flows. Staff could have discussed all aspects related to reserves accumulation, including global externalities, in this paper rather than leaving these issues to be addressed in other multilateral and bilateral surveillance products.

The current ARA framework – even including its proposed refinements - still has limitations in quantifying the optimal range of reserves. Such quantification typically depends on modelling choices and is very sensitive to the assumptions made. In this context, we welcome the proposal by staff that efforts be made to fill reserves data gaps. This would not only provide aggregate reserves data to aid comparability across members, but would also help to better inform bilateral and multilateral surveillance.

We concur with staff's assessment that some mature market economies may need to hold precautionary reserves in order to address severe financial market dysfunction. At the same time, with regard to reserve currency issuers and countries with predictable access to reserve currencies, their need for precautionary reserves is likely to be limited. We would have welcomed a more in-depth discussion on assessing reserve needs and supportive policies for currency unions, given the number of IMF member countries participating in such arrangements. The lack of more elaborate analysis calls for caution when formulating guidance for reserve levels in currency unions.

Finally, with regard to emerging and developing countries, we would agree that the general guidance provided by the ARA metrics has worked relatively well, subject to refinements for specific types of economies, as suggested in the staff report. Where possible, such refinements should be made in a systematic rather than ad hoc manner in order to promote consistency and transparency.