Peter Pang: Policies adopted by authorities in different jurisdictions with respect to international reserves

Welcoming remarks by Mr Peter Pang, Deputy Chief Executive of the Hong Kong Monetary Authority, at the International Monetary Fund Independent Evaluation Office (IEO)/Hong Kong Institute for Monetary Research (HKIMR) Workshop, Hong Kong, 24 March 2011.

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It is a pleasure to welcome all of you to this event co-hosted by the Hong Kong Institute for Monetary Research (HKIMR) and the Independent Evaluation Office of the IMF.

The HKIMR, as some of you already know, is a subsidiary of the Hong Kong Monetary Authority. Its objectives are to promote research on longer-term and wider policy issues of relevance to the monetary and financial development of Hong Kong and the Asia region; and to foster cooperation and cross-fertilisation of research efforts between academics, international financial institutions and the HKMA research activities.

For this reason we are particularly pleased to co-sponsor this workshop which deals with the important topic of policies adopted by authorities in different jurisdictions with respect to international reserves and with the advice the IMF gives in this regard in its consultations with policy authorities.

The accumulation of international reserves has become one of the issues at the center of debates about the functioning of the current international monetary system as well as about reforms of this system.

One lesson that authorities in this part of the world drew from the financial crisis in the late 1990s was that strong policy fundamentals are not always enough to guard against the vagaries of international capital flows. A sizable cushion of international reserves is important as a buffer to guard against sudden changes in market sentiments that can lead to capital outflows and pressures on the currency.

Starting shortly after the Asian financial crisis reserves were thus accumulated in the region to build up such buffers.

But holding large amounts of reserves is of course costly as they are typically invested in highly liquid assets with relatively low yields compared with some alternative uses of the funds. It is partly for this reason that authorities in the region have taken steps to create a mechanism for pooling some of their reserves in the form of the Chiang Mai initiative which started in year 2000 and its multilateral extension which was agreed on in 2010.

While the size of the pool of reserves under the Chiang Mai agreement is relatively modest compared to the potential needs for some of the larger economies in the region, the importance of the agreement goes far beyond the aggregate amount of reserves involves. It reflects a desire by authorities in the region to foster financial cooperation in the region while at the same time creating arrangements which will help safe-guard financial stability.

But the accumulation of reserves in the region in recent years is not only the result of a desire to build buffers against future shocks. It is also the consequence of large capital inflows into Asia in the wake of the financial crisis in the United States and Europe. Loose monetary polices in response to the subdued economic prospects in these regions as well as the strong growth performance in Asia have led to large-scale capital inflows into many economies in Asia.

The reversal of such inflows could put domestic monetary and financial stability in jeopardy if they lead to overshooting of interest rates and asset prices. The recent experience of the region at the height of the global financial crisis in 2008 raised the concern that even reserves considered of very high levels in normal times may not be sufficient to cushion the forces of abrupt outflows. This has led to discussions about the need to reform the international monetary system, including the creation of a global financial safety net.

While I understand that the evaluation the IEO is undertaking on IMF advice and country perspectives on international reserves will not deal with all the questions related to reform of the international monetary system, I am sure it will provide very useful inputs into this process.

I am therefore very pleased that the HKIMR and the IEO has brought together such a distinguished group for this workshop, and I look forward to very interesting and fruitful discussions.

With these words of welcome I now turn the floor over to Mr. Moises Schwartz, the Director of the IEO to set the scene for the discussion of the workshop.