CENTRO DE ESTUDIOS MONETARIOS LATINOAMERICANOS

# XII BIS–CEMLA Roundtable, This time on Reserve Management and FX Intervention

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## <u>Closing Remarks</u>

Good afternoon to all. I would like to thank everyone for the effort put into the successful completion of this **BIS–CEMLA Roundtable on Reserve Management and FX Intervention**. We have spent a day and a half discussing topics that are of great relevance for policy makers in our economies. Being more specific, we have debated several issues regarding the design and implementation of International Reserves Accumulation, FX Intervention and International Reserve Management policies. We have learnt valuable experiences from various participants.

We should reflect on those experiences to extract the right lessons for each economy. In effect, each economy has unique features and not all policies are equally applicable. Moreover, given the ever-changing conditions in global financial markets and the world economy, policy makers need to continuously inform themselves on the latest policy experiences and research.

International Reserves are the central pillar of a country´s Financial Safety Net. Now, while accumulating International Reserves serves several purposes, as insurance it´s a second-best option. In effect, a cooperative equilibrium in which a global fund provides universal insurance would be a Pareto improvement. The IMF´s GFSN, regional arrangements like FLAR and others, are proxies for this. However, there are reasons why such an equilibrium is fragile and relatively unfeasible in practice.

Most countries expressed the need to accumulate International Reserves as insurance. Basically, no one expressed worries about overvalued exchange rates. A few years ago, this probably would have been different. There is a clear trend for International Reserves to increase. This is a reflection not only of the increase in the amount, but also of the volatility, of capital flows. Uncertainty about monetary policy in AEs, the nature of new players in international financial markets like Global Asset Managers, which increases the probability of herd-like type behavior, the concentration of investments in vehicles like ETFs, crowded trades, issues of market micro structure and some EMEs own vulnerabilities, make this, I believe, an understandable trend.

We also have considered Foreign Exchange Interventions, which have been a key policy tool for several EMEs. It is fundamental for economic policy makers to have a timely and correct assessment of the shocks that affect the exchange rate. Are they transitory or permanent? Are they monetary or real? Are they fundamental or liquidity? This increases the probability of implementing a successful intervention. It is as relevant to know when and how to intervene, as it is to know when not to intervene.

As argued, policy makers should closely assess the nature of the shocks that are motivating the rationale for intervening. There are cases for which an intervention would probably not be warranted. For example, a permanent real shock to the terms of trade or to the real exchange rate. An intervention would be inefficient, in at least, two ways. On the one hand, the intervention would delay an adjustment that will eventually take place. On the other, a portion of the reserves would be wasted. Both of these operate against consumption smoothing. In general, FX intervention should not be taken to be a panacea. In effect, interventions are no substitute for proper and adequate macro management.

Issues concerning instruments, timing, degree of transparency, and stealthiness of interventions depend on market conditions, market players, own vulnerabilities, etc. In this context, not too long ago the perception was that rules-based interventions were preferable, because they add credibility and transparency. Recent experiences have provided novel rationales favoring discrete interventions. An element of surprise might be key to impose some discipline on agents that could be taking advantage of predictability components in rules-based interventions. This has led to a positive relative reassessment of discretionary interventions.

Most countries expressed as the main reason for FX intervention proper liquidity provision. No one here mentioned macro objectives like trying to maintain stable consumption patterns under stress conditions. All countries present agreed that International Reserves Management and FX interventions are useful policy tools, but they should fit within a framework of appropriate macroeconomic management.

We have underscored some features of reserve management that make it unique, highlighting its difference from regular portfolio management. As a key feature, we have underscored that the cost of maintaining International Reserves has increased. This has been, directly, due to their magnitudes, and, indirectly, given the prevalent low level of interest rates associated with AEs financial assets. Consequently, reserve managers seem to have expanded the universe of assets in which they invest their reserves. Such an expansion has involved multi-factor portfolios, leaving well-known results such as the two-fund theorem behind. Also discussed was how the accumulation of high levels of international reserves has led to some potentially adverse implications, like wrong incentives for the fiscal authorities and/or, more generally, moral hazard.

Finally, the fact that reserve managers share common asset positions, portfolio selection, and risk management tools, has raised some concerns that during financial stress periods, the shifts in their portfolio positions might bring about spillovers in global financial markets. A similar phenomenon has been documented in the private sector, given comparable features in Global Asset Management Companies (see, for example, Feroli et al., 2014, and also Ramos-Francia et al. 2018) and also in Pension Investment and Insurance Companies.

Thank you very much.

## References

Feroli, Michael, Anil K. Kashyap, Kermit Schoenholtz, and Hyun Song Shin (2014). "Market Tantrums and Monetary Policy," paper presented at the 2014 U.S. Monetary Policy Forum, New York, February 28.

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