



The different shades of reserve accumulation

In this first section, we differentiate the main reserve holders into four analytical clusters to identify the drivers. We then distill these drivers into a simple top-down model of global FX reserves to project the trajectory in the near future. The last section resumes the cluster approach in discussing structural changes and the longer-term outlook. The FX implications are flagged throughout the analysis.

Asia accounts for more than half of global central bank reserves, making the region the biggest swing factor in anticipating how reserve trends will evolve. China alone accounts for 30% of global reserves, while Taiwan, Korea, India, Hong Kong, Singapore, and Thailand also rank among the Top 15 reserve holders (Figures 1 and 2). DM central banks hold a third of global reserves, with Japan and Switzerland the key accumulators over the past decade and a half. Large oil exporters account for 10% of central bank reserves, with Saudi Arabia and Russia the main contributors. Other large oil exporters like Qatar or the UAE, which are also believed to have significant investable FX funds, hold them mostly unreported in sovereign wealth funds (SWF). Non-Asia EM accounts for another tenth with Brazil, Mexico and Turkey having the deepest pockets. Lately, we have started to see reserves fall in China and oil-producing nations, while growth has flattened out in the other country groups (Figure 3).

Our starting point in forecasting reserve developments is to identify the sources of reserves built up in the past fifteen years. Governments typically accumulate reserves for two objectives. The 'mercantilist' objective is to preserve a developing economy's surpluses with a view to optimizing the investment of these savings, not least inter-generationally. Typically, such reserves originate in large current account surpluses, often inflated by commodity windfalls, and are most likely to be held in SWFs, China being the main exception.

The second objective is to hold reserves as a precautionary buffer against excessive currency volatility or sudden capital stops. Central banks guard economies against potentially flighty 'hot money' by absorbing capital inflows. Foreign liabilities pose particular risks if they are of shorter maturity than foreign assets or denominated in foreign currency. Such mismatches characterized many national balance sheets in the early stages of EM catch-up growth and had dire consequences during the debt and currency crises of the late 1990s.

