



Advanced economies unlikely to engage in interventions again

In the advanced economies holding reserves of any note—Switzerland and Japan—we expect no further accumulation in the foreseeable future. The Swiss experiment with a permanent exchange rate peg could not be repeated credibly. Instead, the SNB stands ready to intervene sporadically against acute safe-haven inflows. In order to do so credibly in the future, the SNB will probably seek to reduce its balance sheet. The SNB would likely adopt a more gradualist approach than the Danish National Bank, which has recently sold the reserves accumulated during the post-SNB speculation against its own peg aggressively back into the market (Figure 23).

Figure 23: SNB could follow Danish example of freeing up space on balance sheet for future credibility



Source: Deutsche Bank

Figure 24: A very undervalued JPY should mean any BoJ intervention is a long way off



Source: Deutsche Bank, Hiver Analytics

Medium-term, the SNB faces the predicament of sterilizing the potential inflationary pressure created by excess liquidity in the banking system. Indeed, we think it is more likely that inflationary pressure will eventually develop on the back of excess domestic liquidity than be imported through a weakening exchange rate vis-à-vis the Eurozone. Hence, the SNB may choose to sterilize past interventions rather than to reverse them by selling EUR/CHF. This means that there would be no need to swap non-EUR reserves into EUR; CHF liquidity could be mopped up by selling foreign assets in proportion to the current allocation, with only negligible ramifications for non-CHF exchange rates such as EUR/USD.

The Bank of Japan is unlikely to intervene directly in the foreign exchange market to build reserves in the near future. Even if there is another bout of safe-haven driven inflows, the fact that the JPY is trading near *undervaluation* extremes should make BoJ comfortable with accommodating some appreciation from very cheap levels (Figure 24). BoJ's last major bout of intervention took place when JPY was trading at overvaluation extremes.

FX and fixed income implications

The fact that two thirds of global reserves are held in dollars means that a sell-off should be bullish USD against other reserve currencies. This is because as central banks prop up their currencies against the dollar, they also sell other reserve currencies against the USD so as to keep their FX allocations constant. Indeed, fluctuations in EUR/USD are tightly correlated with changes in global reserves (Figure 25), though this correlation naturally captures causality in both directions.

To start with, we again estimated a simple OLS model of the relationship between EUR/USD and global FX reserves to gauge the impact of an unexpected fall in global reserves worth \$200bn, amounting roughly to Chinese outflows in August and not even taking into account more consistent selling by other EM and OPEC