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Global Reserves Management
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1.1 Introduction
Foreign exchange reserves held by central banks rose to 6.4 trillion dollars in 2007 from 1.5 trillion a decade ago and are expected to rise further in the coming years. Sovereign wealth funds (SWF) manage assets in excess of 2.5 trillion dollars, and total reserves managed jointly by central banks and SWFs are forecasted to top 10 trillion dollars very soon. This chapter presents motives behind this reserves growth and proposes a concept of OCHAR – Opportunity Cost of Holding Ample Reserves – which is defined as a forgone GDP growth resulting from too conservative reserve management by central banks. We estimate OCHAR for a sample of 33 countries which accounted for 80% of total central bank reserves in 2007. We also argue, that unlike in the twentieth century, where central banks used to be very secretive institutions, twenty-first century central banking is characterized by widespread knowledge sharing and transparency. Therefore best practices, such as inflation targeting or efficient reserve management, spread out quickly and are adopted by an increasing number of central banks. Thus central banks collectively embarked on a reserves diversification journey, and it appears that we can speak of the global reserves management in the twenty-first century. At the end of the chapter we put forward several hypotheses of what could be the consequences of this diversification journey. It seems that relative prices of various assets will find new steady states, which may have little in common with relative valuations seen in the twentieth century. We also expect that slowly, over time, US “exorbitant privilege” will be eliminated. Finally we consider global stability risks in the context of the new reserves management style adopted by central banks. We postulate that due to the increasingly global nature of shocks, as long as central banks and governments in countries which are stakeholders of global imbalances focus their actions on maintaining global price and financial stability, central banks in smaller emerging markets can afford to improve reserve management without incurring additional stability risk.
1.2 The origins of the sharp rise in foreign exchange reserves

In 2007 foreign exchange reserves held by central banks and sovereign wealth funds likely topped 9 trillion dollars. According to IMF COFER (Currency Composition of Official Foreign Reserves) database central bank reserves stood at 6.4 trillion dollars at the end of 2007 and assets under management by SWFs were estimated at around 2.5–3 trillion dollars.\(^1\) Oil prices will likely continue to rise in the next decade after the present global slowdown is over and China’s large trade surplus will take time to reverse amid the Chinese tradition of saving a large part of their income, which suggests that further growth of central bank and sovereign wealth funds assets should be expected in the coming years.

The large and unprecedented rise of foreign exchange reserves led to many attempts to explain the reasons behind this trend. In January 1999 Martin Feldstein, the President of the National Bureau of Economic Research, the famous US think tank, wrote an article in the aftermath of the Asian crisis arguing for the need to keep large foreign exchange reserves that would serve as source of protection, flexibility and trust.\(^2\) In March 1999 Alan Greenspan, Federal Reserve chairman, spoke on this issue during the World Bank conference.\(^3\) In those days economists focused their attention on the need to build large reserves to hedge emerging markets against capital flight and sudden stops. Economists discussed whether rules of thumb such as maintaining a reserves coverage

![Figure 1.1](image-url)  
*Source: IMF COFER database, 2007.*