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IMF Overemphasized Reserve Buildup Risks, Audit Report Says

By Sandrine Rastello on December 07, 2012
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The International Monetary Fund overemphasized the risks posed by countries amassing reserve assets, the fund’s internal auditor said in a report that may embolden economies such as China and South Korea that are accumulating foreign currencies.

“The IMF has not presented a persuasive analysis of why excessive reserves constitute a major problem for the international monetary system,” according to the report by the fund’s Independent Evaluation Office obtained by Bloomberg News.

China, which has the world’s largest stockpile of reserves amounting to $3.29 trillion as of Sept. 30, has been accused by the U.S. of keeping its currency weak to promote exports. Developing nations buffeted by the financial turmoil of the late 1990s have defended their accumulation of reserves as buffers that helped them weather the global crisis of 2008.

“Emerging markets are going to find a lot to like in this report,” Eswar Prasad, a former head of the China division at the Washington-based lender and a senior fellow at the Brookings Institution in Washington, said in a telephone interview. “It will give them a tool to push back against IMF criticism of reserve-building.”

IMF spokesman William Murray declined to comment on the report, which he said would be discussed at a meeting of the fund’s executive board today. He said the report will be released after the meeting, along with responses by IMF management and staff.

‘Not Helpful’

The IMF’s focus on reserves “was not helpful in that it stressed the symptom of problems rather than the underlying causes, and it did not appear to be different from the longer- standing concerns about risks from global imbalances,” according to the report, entitled “International Reserves: IMF Concerns and Country Perspectives.”

The report dates the increased focus on reserves to 2009, a time when the IMF also started promoting a new precautionary loan with no conditions for countries with sound economies. Then-Managing Director Dominique Strauss-Kahn suggested that member nations could borrow from the IMF rather than build up reserves.

Two years later, the fund staff developed a new reserve adequacy metric to use during its regular assessment of countries’ economies. The metric defined upper and lower bounds for the appropriate level of reserves.

Reserve Adequacy

"Many authorities were uneasy about potentially prescriptive assessments of reserve adequacy based on this indicator, especially at a time of heightened uncertainty in the global economy," according to the report. It found discussions on reserves during these evaluations didn't take enough into account countries' specific circumstances and recommends that indicators be applied more flexibly.

In its assessment of the South Korean economy in September, for example, the IMF staff wrote that "there is no need for further reserve accumulation beyond what would be needed to keep pace with rising foreign liabilities over time." South Korea's reserves were $326 billion as of November, the fourth-largest in Asia.

An IMF report on Brazil's economy suggested diverging views between the staff and Brazilian authorities on whether the country should accumulate more reserves.

"Staff noted that reserves were now at the top end of a range of adequacy metrics and that sterilization was particularly costly in Brazil," according to the report dated June 22. "The authorities considered that given continued elevated global risks, there remained a premium for some further reserve accumulation."

Flexibility

The report to be released after the executive-board meeting recommends that reserve adequacy indicators be applied flexibly. It doesn't criticize the IMF's assessment of member countries' exchange rates, questioning instead the use of reserve accumulation as a focus in itself.

People interviewed for the report "considered that the views of influential shareholders regarding the IMF's inability to influence China's exchange rate policy in the last decade were an important factor explaining why concerns about the stability of the international monetary system were expressed in terms of excessive reserve accumulation," it said.

The report said IMF discussions with China, for instance, rightly concentrated on the country's current-account surplus and exchange-rate development. For Japan and Switzerland, two countries that boosted reserves, the talks centered on the reasons leading to that policy, it said.

In an echo of frequent criticism by emerging markets such as Brazil that the impact of rich nations' policies on the rest of the world is not given enough attention, the report called on the fund to make an analysis of all the risks threatening the international monetary system before looking at reserves.

"In some ways this is a bit unfair to the IMF," Prasad said. "It's not like they're not already doing some of the stuff that's in the recommendations."

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