A century and a half of central banks, international reserves and international currencies. Barry Eichengreen and Marc Flandreau. Discussion by Linda Goldberg

Norges Bank conference “Of the Uses of Central Banks: Lessons from History”, June 5-6, 2014 Oslo Norway

Talk overview

Fascinating paper by Barry Eichengreen and Marc Flandreau.

Rich historical perspective on CB foreign reserves management, since mid 19th Century -- 150+years

- Covers mix of bullion (gold/silver) and foreign currency assets,
- Evolving management of the asset portfolio,
- Role of geopolitics, including for reserve currency status.

Narrative approach, without extensive numerical details.

Skillful reliance on historical references

-- leave to other historians to debate choices.

My comments cover:

- Key lessons of the paper (interpretation of evidence, relevance)
- Other issues that could be addressed.

Key Lessons

Central bank asset holdings from experience *of a few countries*:

- Mix of bullion (gold/silver) held through mid to late 1800s
  - Settlement of international debt and debt service
  - Underpin money issuance / constrain actions of CBs
    - History contains a mix of proportional systems

- Foreign currency assets generally were not held until later.
  - Initially held to facilitate international transactions.
  - But, such asset holdings were resisted:
    - Bankers already provided transaction/ FX support privately.
    - Lack of trusted network among CBs.
    - Law and policy makers constrain CB risky investments.
  - Later, government backing promoted specific currencies to dominate reserves (Bagehot)

Key Lessons (2)

Evolving management of the asset portfolio

- Only some currencies achieved reserve currency status
- Details provided on role of Geopolitics in supporting this status

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- Paper motivation in Borio, Galati, Heath 2008 … Modern practice has moved more toward *active portfolio management.*

- *Suggestion: Need more elaboration on how and why this occurs, building on particular themes stressed in BGH.*

- BGH Ad hoc survey among 28 central banks finds:
  - Diversity in behaviors, very conservative bias in portfolios
  - Risk tolerance comes with the size of the portfolio;
  - Increased CB accountability and transparency generate need for assessing risk /return tradeoffs.

Comments (1)

(with apologies for a standard critique)

1) Elegant elaboration of historical record, *for a couple of countries*.

- How much of the world functioned this way?
- What other models of reserve or financial management?
- Did alternative choices lead to substantially different or improved real and financial system activities/ outcomes?

Comments (2)

2) What quantitative and prescriptive lessons from history?

Historical narrative can be supplemented by more detail on quantities, composition, outcomes

- What conditions determine the right volumes of reserves?
- What is the right composition?
  - Consider relative importance of facilitating transactions, insuring against payments disruptions, geopolitical motives
  - Consider heterogeneity by trade and financial system development
  - Differences between industrialized and developing countries
  - What consequence of exchange rate flexibility?
- Is “keeping up with the Jones” a new problem?

Comments (3): Questions about reserve portfolios

- Current experience: extreme heterogeneity across countries
- Usual discussion focus is on developing countries (China, Asia)

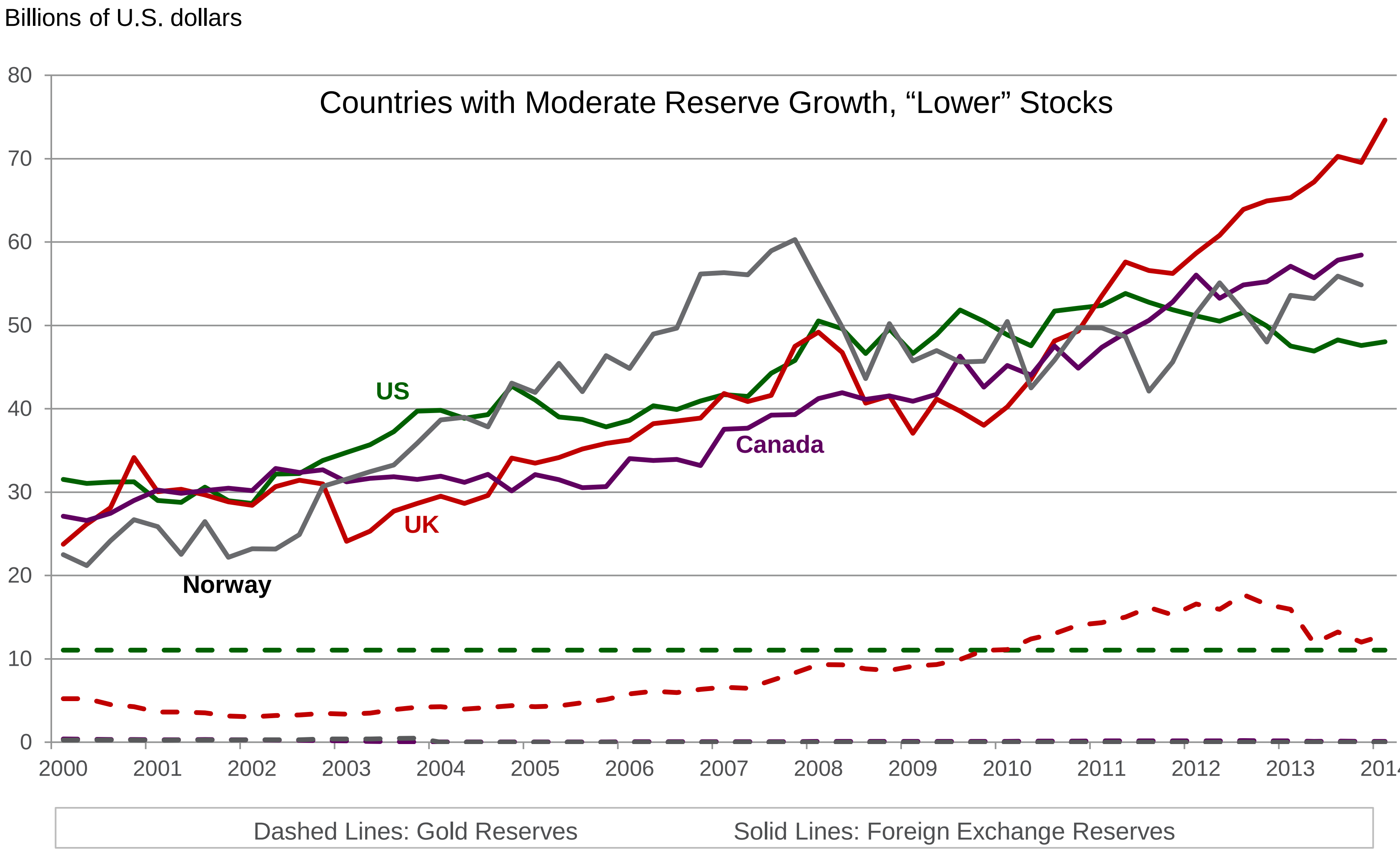
Comments (4): Questions about reserve portfolios

Many issues arise for industrialized countries*

- Lots of diversity

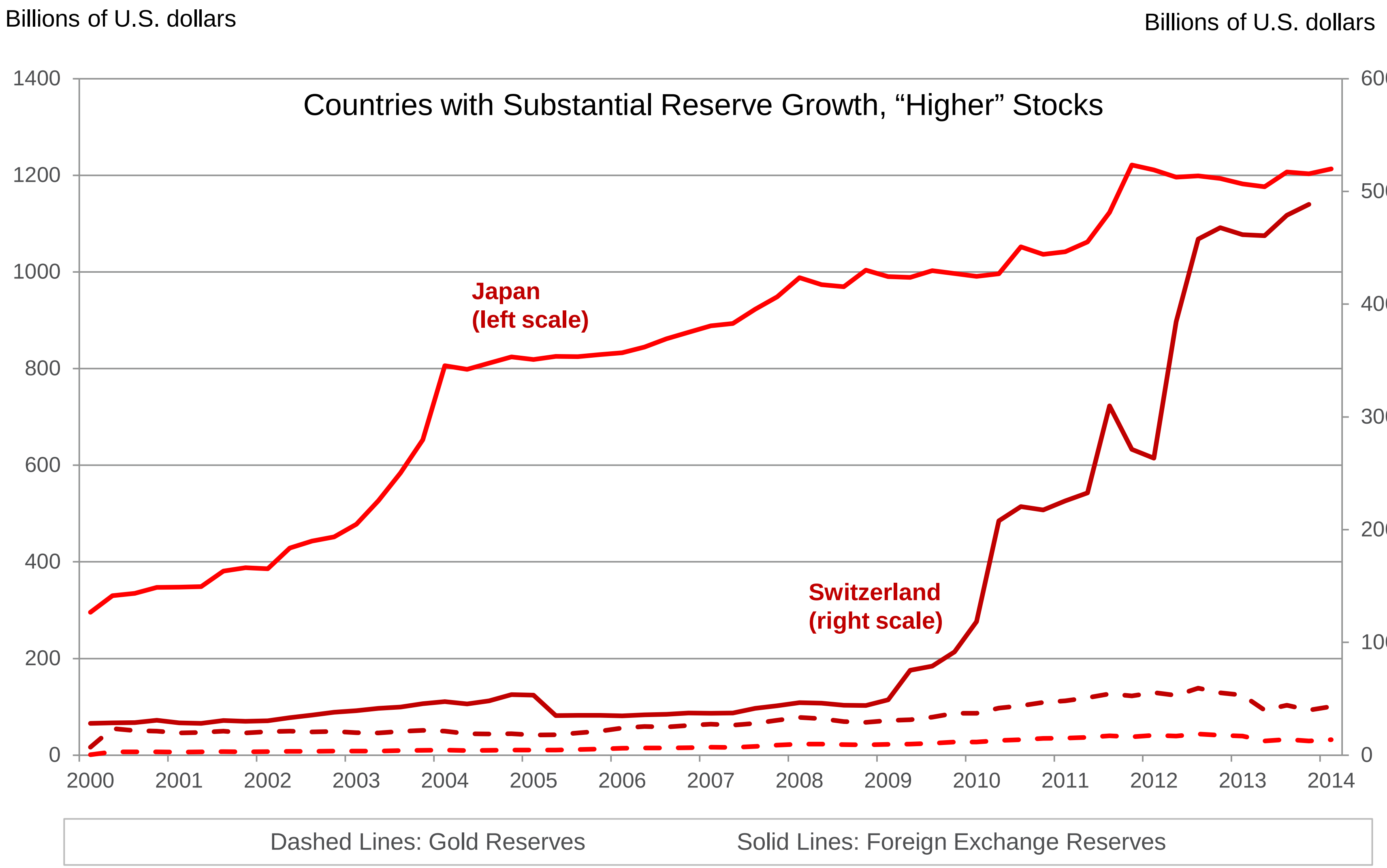
*"Do Industrialized Countries Hold the Right Foreign Exchange Reserves?" FRBNY *Current Issues* 2013, Goldberg, Hull and Stein

Foreign Exchange Reserves (1)



Source: International Monetary Fund International Financial Statistics (IFS) database, Foreign Exchange Series 1d.d .

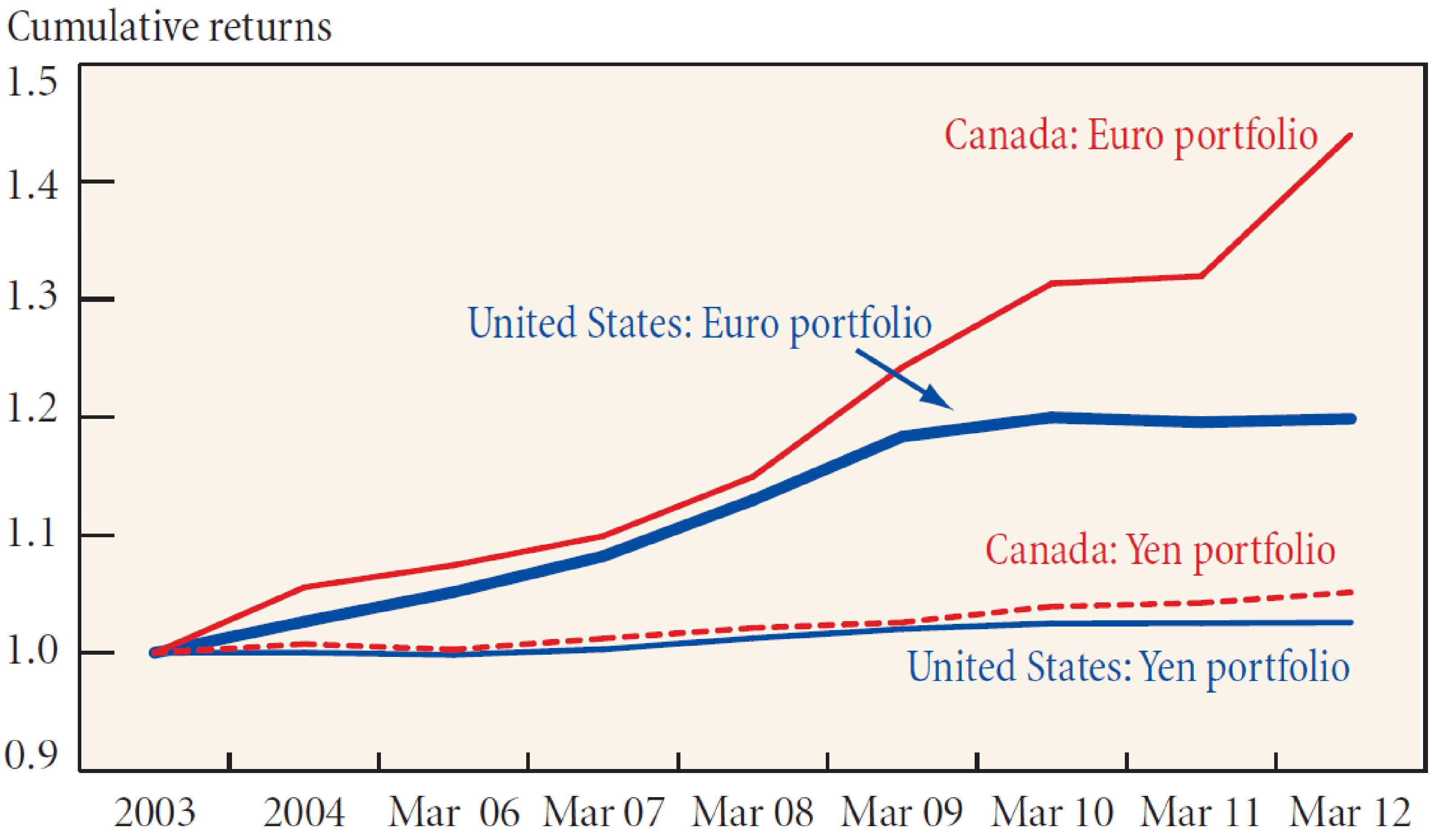
Foreign Exchange Reserves (2)



Comments (5): Questions about reserve portfolios

- Why is gold still held?
- Why do balances persist in some countries?
  - Exchange rate stabilization: Possible transitory accumulation to resist currency appreciation; are reserves ever large enough to resist depreciation?
  - If international financial flows and linkages are sufficiently high, no (reasonable) level of reserves provides insurance
  - Implies steady state holdings can be optimally low.
- Work on establishing other approaches to insurance international cooperation, liquidity backstops, structure of international financial ties of banks: any historic lessons?
- With even “lower” reserve volumes, more active portfolio management and more instruments can be considered.

Euro and Yen Portfolio Returns, Bank of Canada and the Federal Reserve: 2003-12



Source: Department of Finance Canada, *Report on the Management of Canada's Official International Reserves*, 2004-12; Federal Reserve Bank of New York. From Goldberg, Hull, and Stein 2013.

Overall

Rich historical interpretation and fact finding by Barry Eichengreen and Marc Flandreau covers 150+ years of Gold and FX

Brilliant and well-written paper.

Answers some questions,

Opens the door for more work,

A pleasure to read,

An honor to discuss.

Thank you.

Percent Share of Foreign Currency Assets in Central Bank Portfolios

	U.S. Dollar Assets		Euro Assets		Japanese Yen Assets		Other Assets	
Country	2000	2011	2000	2011	2000	2011	2000	2011
Canada[a]	49.4	60.4	47.3	39.3	3.3	0.3	0	0
United Kingdom	36.2	28.3	41.9	59.1	21.9	12.6	0	0
Euro Area	96	76.9	-	-	4	23.1	0	0
Switzerland[b]	40	26	44	52	4	9	12	13
United States	-	-	47	53	53	47	0	0

Sources: Department of Finance Canada, Report on the Management of Canada's Official International Reserves, 2003-11; Bank of England, U.K. International Reserves and Foreign Currency Liquidity Template; European Central Bank, annual reports, 2006-11, and "Portfolio Management at the ECB," Monthly Bulletin, April 2006; Swiss National Bank, annual reports, 2000-11; Federal Reserve Bank of New York.

Note: The numbers in the table are presented as reported in the source documents.

a Currency share data are publically unavailable for the Bank of Canada in 2000, so 2003 data are given instead.

b Other currencies held by the Swiss National Bank include the British pound, Canadian dollar, and Danish kroner.

Some references

- "What If the U.S. Dollar's Global Role Changed?" Linda Goldberg, Mark Choi, and Hunter Clark. Federal Reserve Bank of New York Liberty Street Economics Blog, October 2011.

- "The international role of the dollar: Does it matter if this changes?" 2013. Linda Goldberg in *Global Interdependence, De-Coupling, and Re-Coupling*, edited by Frank Westermann and Yin-Wong Cheung (MIT Press and CES IFO).

- "Do Industrialized Countries Hold the Right Foreign Exchange Reserves?" Linda Goldberg, Cindy Hull and Sarah Stein. *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, vol. 19 no.1 2013.