Official international reserves keep dropping

After surging for several years, official international reserves are declining. More specifically, the declines are focused in China and emerging oil-producing nations.

Also known as foreign exchange reserves, they are often seen as insurance for tough times. China and a number of other emerging nations have amassed large cushions over the last decade, and the struggles some of them are now experiencing mean the reserves are being put to use.

In oil-producing nations, the problem, of course, stems from the commodity’s low price. They can offset some of the drop in revenue by selling reserves. This move also helps support the value of their currency and prevent other problems, such as high inflation and difficulties in paying back foreign currency denominated loans.

Russia has been especially active in striving to curb the ruble’s depreciation. Along with the blow dealt by weak oil prices, the country is being hurt by trade sanctions imposed because of its involvement in the conflict in Ukraine. Russian foreign exchange reserves fell about US$130B in 2014. They were more stable in 2015, as Russia has abandoned the idea of supporting the ruble at all costs. Total depletion of the reserves in the fairly near future could have been even more costly in terms of finance and the economy.

China’s case differs from that of the oil producers. Since the 1990s, it has been amassing foreign exchange reserves to help maintain an undervalued exchange rate and a trade surplus. The reserves flirted with US$4,000B in 2014, then dropped by around US$750B. Slowing economic growth in China and a variety of concerns, particularly about overinvestment and the debt load, boosted capital outflows. The U.S. dollar’s heavy appreciation since mid-2014 has also reduced the need to amass reserves. In contrast, China is now acting to support its currency, tapping into its reserves.

The drop in reserves in China and oil-producing nations is only being partially offset by increases elsewhere in the world. Here, Switzerland stands out due to the actions of its monetary authorities who have kept the franc’s rise. Swiss reserves are poised to exceed Saudi Arabia’s. Japan ranks second for the size of its foreign exchange reserves, but they have been relatively stable since 2011.

Implications: Countries that are struggling usually use their reserves to compensate for lost revenue and capital outflows, or else to support their currency. That being said, the action does not always work miracles, as demonstrated by Russia’s inability to stabilize the ruble. When reserves drop too quickly, it becomes hard for a country to keep using them, and the threat of a financial crisis rises. Globally, the main issue with a drop in foreign exchange reserves is the decrease in the global stock of savings. Over the longer term, if reserves keep declining, this could put upside pressure on global interest rates.

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