

Too Much for Self-Insurance? Asian Foreign Reserves

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Summary

This paper attempts to identify whether the recent foreign reserve accumulation in Asian economies has been too extraordinary to recover the moderate level of reserves which depleted at the time of the currency crisis in 1997-1998. Taking previous explanation about the accumulation of reserves into account, this paper focuses on the self-insurance motives. First, we examine whether the Asian countries' foreign reserves were too small to avert speculative pressures at the onset of crisis in 1997, by using the level of reserves numerated by various economic fundamentals such as broad money, import coverage and short-term external debt.

Our results show that the estimated threshold level of reserves are less than the traditional rule of thumb on reserve holdings of three months imports, or the Guidotti rule of coverage of short-term external debt. Although the actual values of these reserve indicators at the second quarter of 1997 in some countries did not meet the traditional rule or the Guidotti rule criteria, they were larger than the estimated threshold value of reserves. Still, reserves in terms of short-term external debt were apparently not sufficient to avoid speculative attacks. Therefore, Asian countries had not always run short of reserves, but it is hard to interpret that Asian economies had enough reserves before the crisis of 1997.

The estimated probabilities of 25% of currency devaluation within three months ahead vary from time to time, among countries, and among reserve indicators. The devaluation likelihood was modest in the mid 1990s, but then it showed a big jump in 1997 in Indonesia, Thailand, Korea, and Philippines.