

Discussion of “The currency composition of international reserves, demand for international reserves, and global safe assets”
by Aizenman, Cheung and Qian

Paul Luk,
Hong Kong Baptist University

Summary

- A reduced-form model to examine determinants of the international reserves (IR) currency composition.
- Panel data: 58 countries, 2000-2017 annual data.
 - 23 ADVs; 35 EMDEs.

$$Y_{i,t} = \alpha + \mu_i + \varphi * Y_{i,t-1} + \beta * X_{i,t-1} + \varepsilon_{i,t}$$

- Dependent variable: logit transformation of share of big four currencies (usd, euro, yen, pound).
- Estimator: dynamic panel-data system GMM estimator.

Main findings

- Share of IR in *big four* currencies:
 - Exhibits inertia.
 - Increasing in trade with *big four* countries.
 - Increases in share of int'l debt denominated in USD and EUR (balance-sheet insurance channel).
 - Exhibits scale effect (diversify when IR is large).
 - Increases with low availability of global safe assets.
 - Falls after 2008 GFC; with some determinants reversing signs.
- In general, effects are more significant for EMDEs than ADVs.

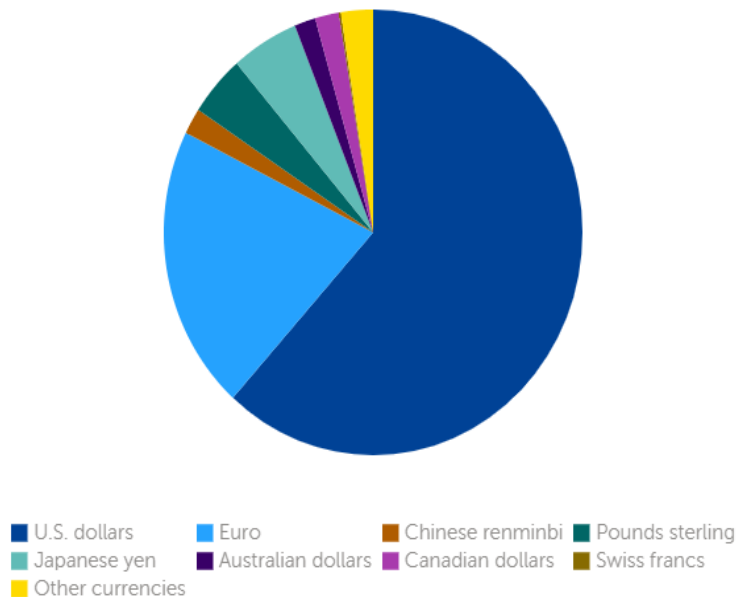
Contributions

- There is a large literature studying the determinants of the size of IR, but little is said about currency composition of IR.
 - There is little theoretical guidance.
- This paper provides a rich set of empirical results to be understood.
- This study sheds light on recent debates about the effects of supply of global safe assets, VIX and QE tapering.

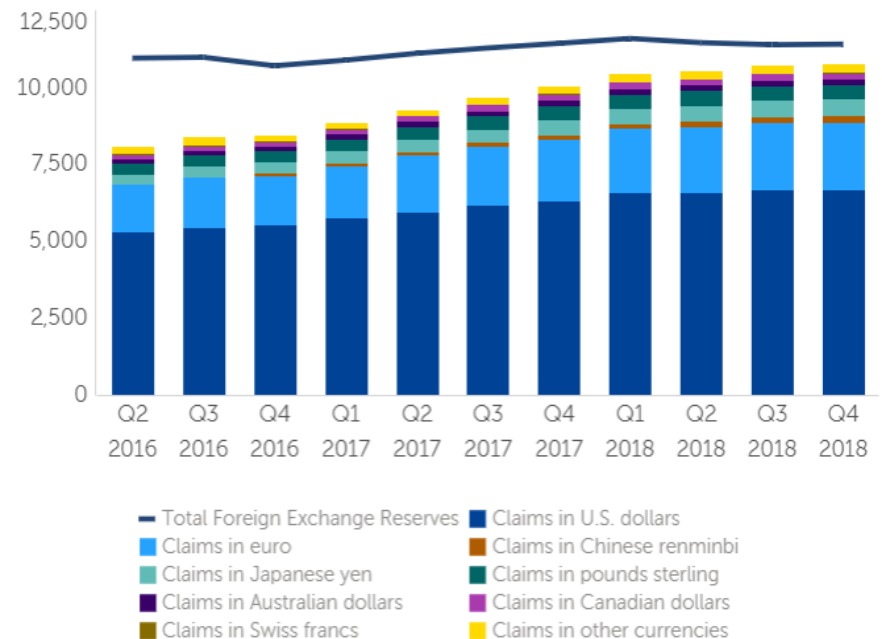
Comment 1: dependent variable

- Given the special status of USD (>60% in IR), why not just single out USD?

World - Allocated Reserves by Currency for 2018Q4



World - Official Foreign Exchange Reserves by Currency (US Dollars, Billions)



Comment 2: balance-sheet insurance channel

- The paper motivates “balance-sheet insurance channel” by Bocola and Lorenzoni (2017).
 - A multiple equilibria story.
 - But the story refers to a positive correlation between the share of foreign currency debt and the *size* of IR.
- The specification here is about the share of foreign currency debt in total external debt and *currency composition* of IR.
 - The channel is not so clear to me.
 - Simple currency mismatch story or something else?

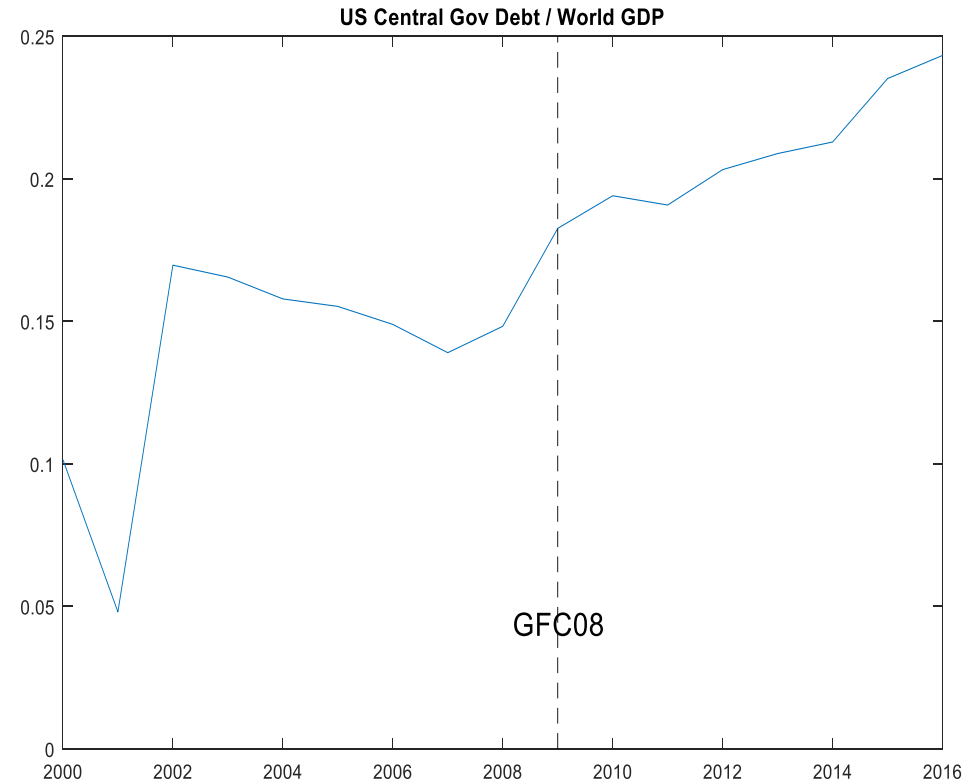
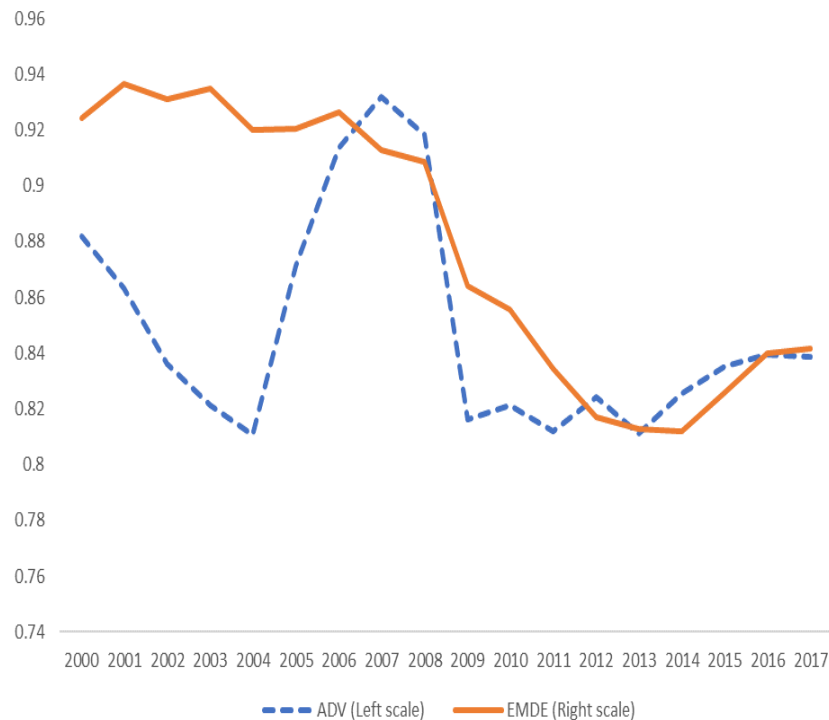
Comment 3: Global Safe assets (GSA) and GFC08 dummy

- The paper finds that a shortage in GSA is correlated to a shift in IR demand towards *big four* currencies.
 - Explanation: “*insufficient supply of GSA during turbulent market condition... countries would like to have sufficient liquid reserves.*”
- Potential missing variable bias.

Comment 3: Global Safe assets and GFC08 dummy

- When a GFC08 dummy (1 if year > 2008) is included, the significance of GSA disappears.

The average share of big four currencies in IR

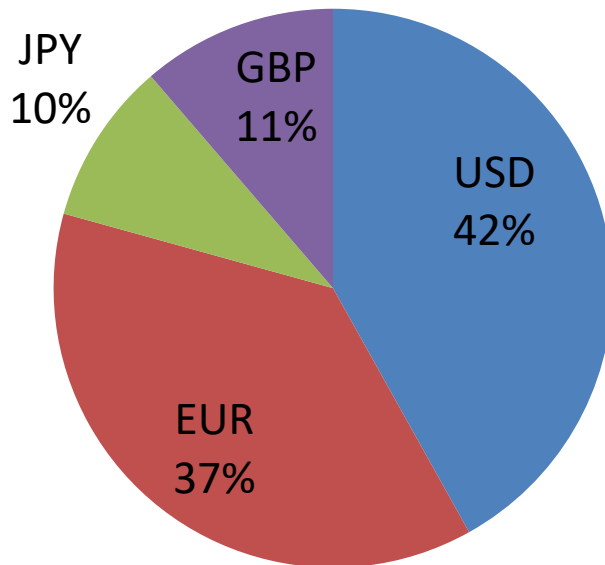


Source: World Bank WDI

Comment 4: China and SDR

- Any fall in *big four* shares following the change in SDR shares in 2016?

2011-2016



After Oct 2016

