

External Shocks, Reserves Accumulation, and Sustainability of BOP Policies in Southeast Asia

Huw Lloyd-Ellis* and Salem Nechi†

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Abstract

In this article we argue that the evaluation of the southeast Asian economies' international reserves policy could be significantly improved through the systematic use of information provided by global markets. We use cointegration tests as basis for the estimation of a long-run reserve demand functions in the economies of emerging Asia. Using cointegration techniques to adjust standard errors, our results reveal that a significant part of foreign reserves holdings in emerging Asian economies is driven by exogenous shocks to these economies. In fact, while we find evidence of positive structural breaks in the demand for international reserves by the southeast asian economies in the aftermath of the financial crisis of 1997-98, the results indicate that a policy shift only cannot account for the actual level of reserves accumulated. Subsequently, we use the information contained in exogenous shocks (shocks to a set of internationally traded asset returns and to terms of trade) to assess the adequacy of the current policy of reserves accumulation.

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Keywords: Reserves, External Shocks, Policy Shift, Sustainability.

*Professor of Economics, Department of Economics, Queen's University, Kingston, Ontario, Canada. lloydell@econ.queensu.ca

†PhD Candidate, Department of Economics, Queen's University, Kingston, Ontario, Canada. nechis@econ.queensu.ca