

Abstract

The first part of the thesis uses vector autoregressions to examine the influence of foreign reserves on macroeconomic variables. The results suggest an economically significant influence on both household consumption and gross capital formation in Brazil, Chile, Argentina, and Indonesia, while in the Philippines and South Korea the influence seems rather weak. However, there is some uncertainty surrounding the results and the relationships may be unstable through time, suggesting that the question is worth revisiting in the future.

The second part deals with the management of foreign reserves and investigates whether the long-term management by the Monetary Authority of Singapore, which entails the objective of providing a regular income stream to the government budget, could be an option for other central banks. Given the similarity of objectives, the discussion builds on a comparison with the management practices of large U.S. university endowments and suggests that the comparison seems to yield interesting insights pertaining to asset allocation. However, constraints stemming from the size of central bank portfolios and challenges having to do with expertise and management may have implications for the overall stability of investment returns. Given the specific character of a central bank, three potential threats to central bank independence are discussed: the issue of accountability for running the portfolio, risks to central bank equity and the problem of "quasi-fiscal dominance". These suggest the usefulness of shared decision-making between central bank and governments, the need for an "equity buffer", and strict spending rules and ring-fencing of proceeds. Under those conditions, the objective does not interfere with the traditional objectives of a central bank.

JEL Classification E21, E22, E44, E58, F31, G11, G15

Keywords central banks, monetary policy, foreign reserves, asset management, VAR model, consumption, investment

Title Should Central Banks Try to Make Profit on their FX Reserves?