



Sovereign Reserve Management

Global Securities Research

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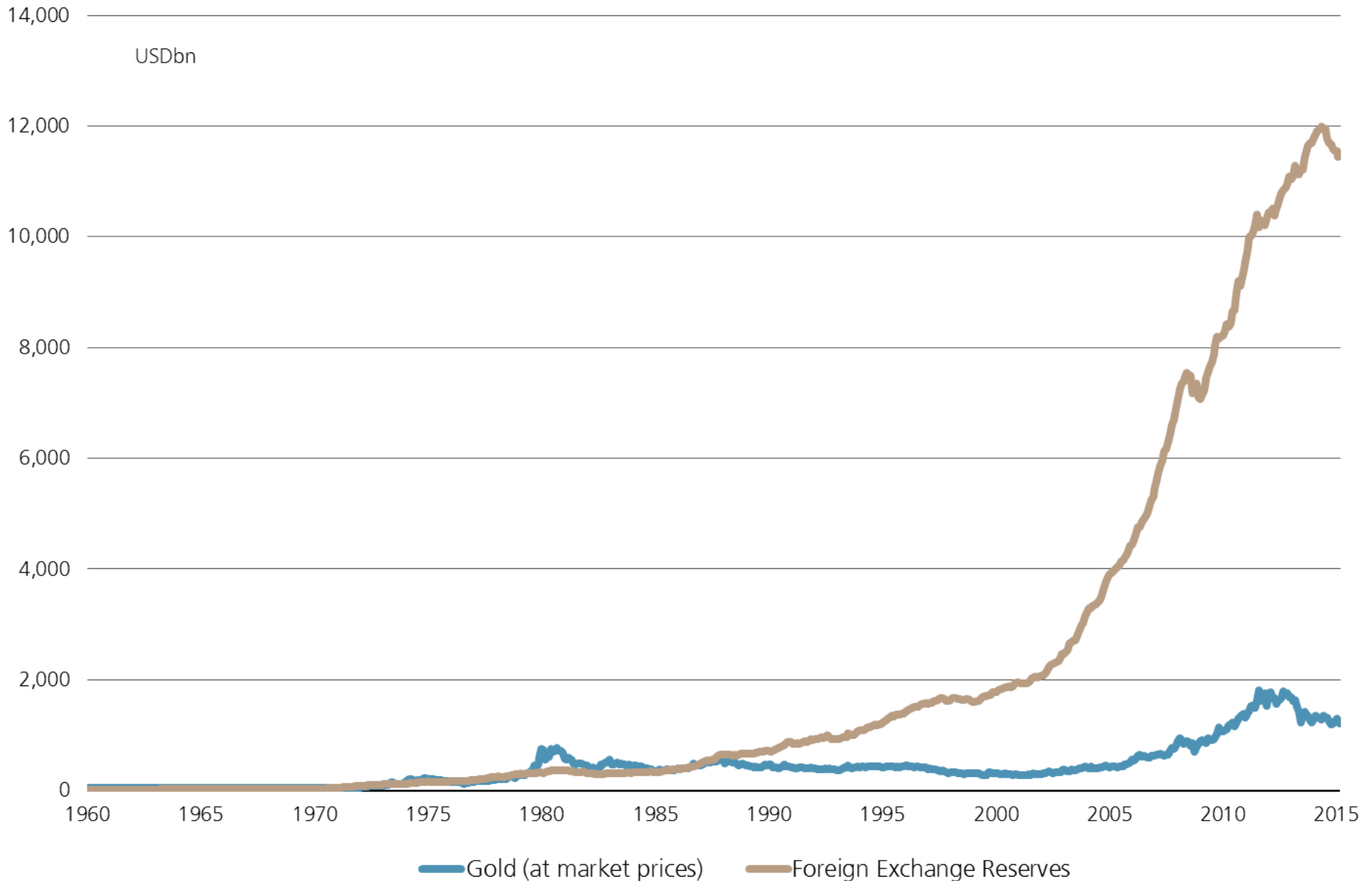
The brave new world of sovereign reserves

- Trends in reserve accumulation, and their drivers
- Moves to reserve diversification
- Central banks as capital providers
- The futility of currency wars
- The survey

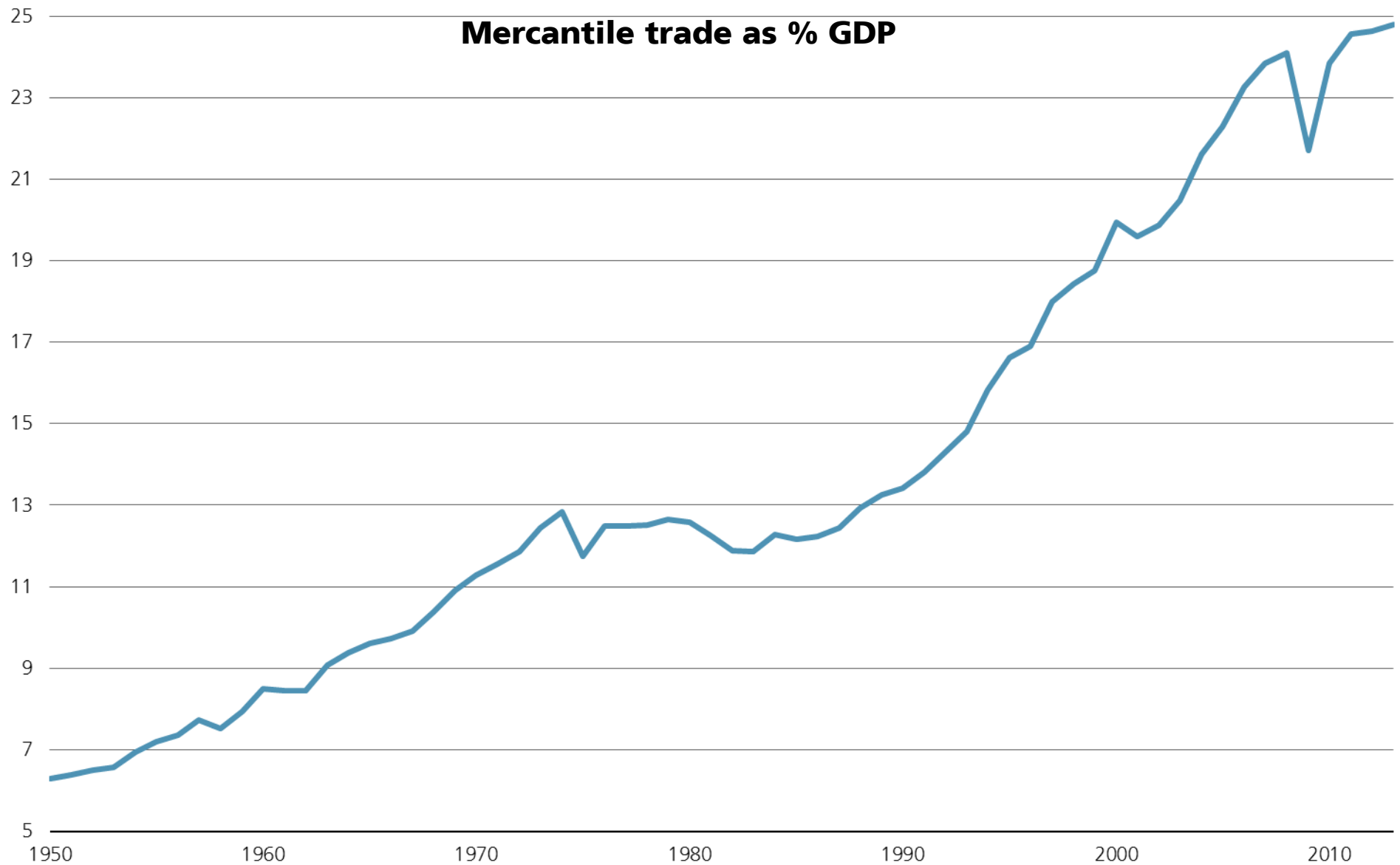
Section 1

Trends in reserve accumulation and their drivers

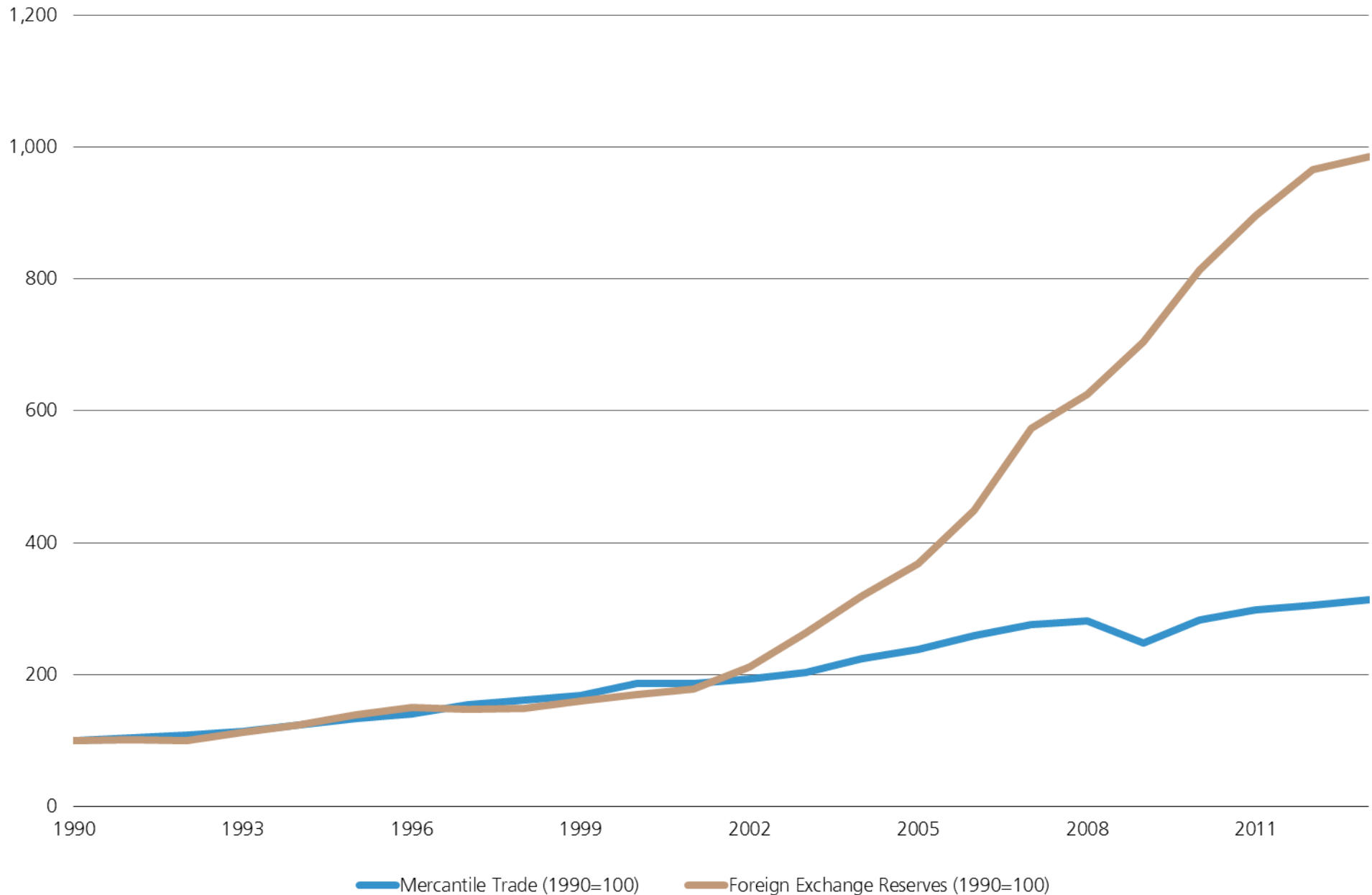
Central bank reserves: rising even when falling



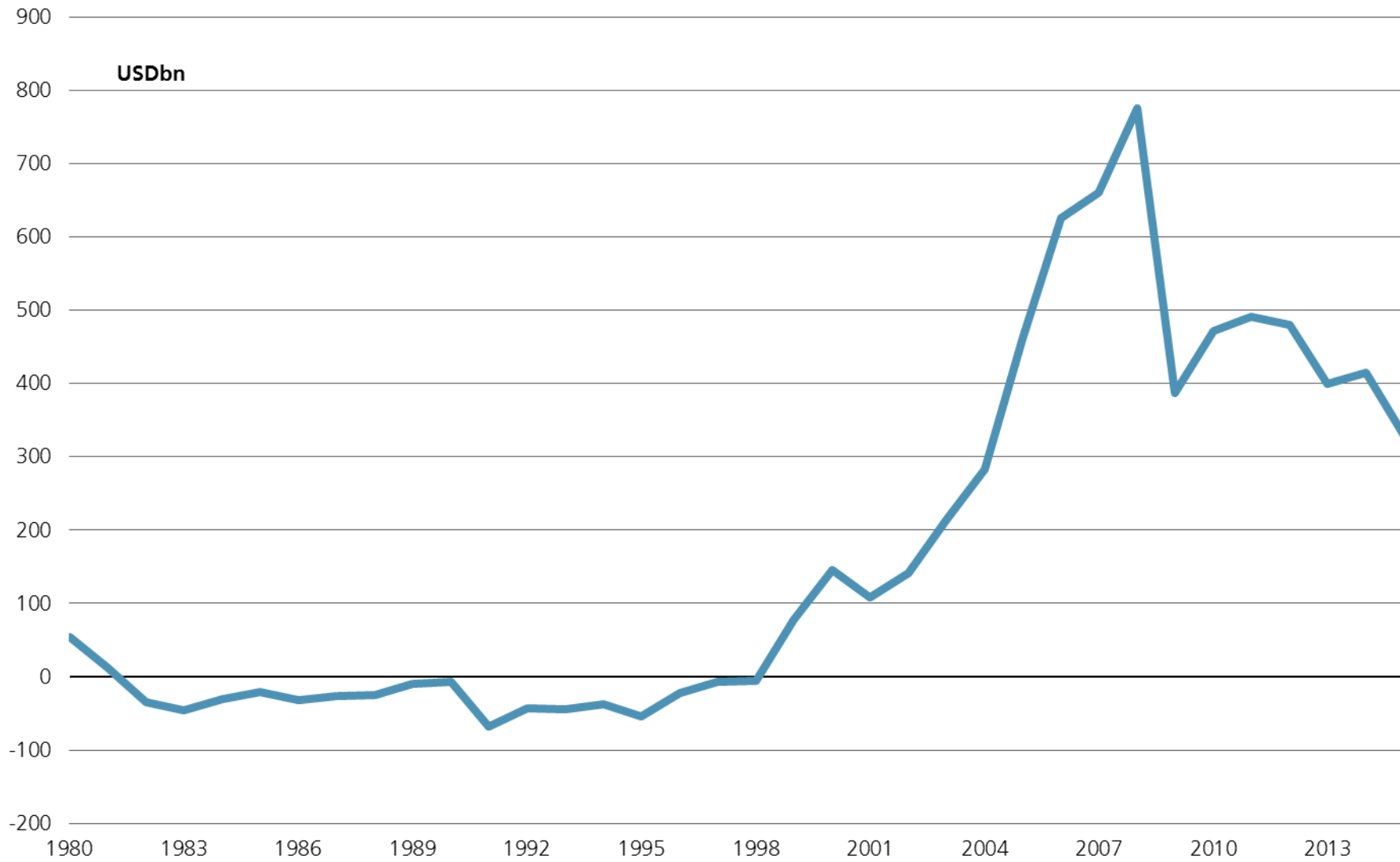
Trade protection?



Reserves outstrip trade growth, telling us something

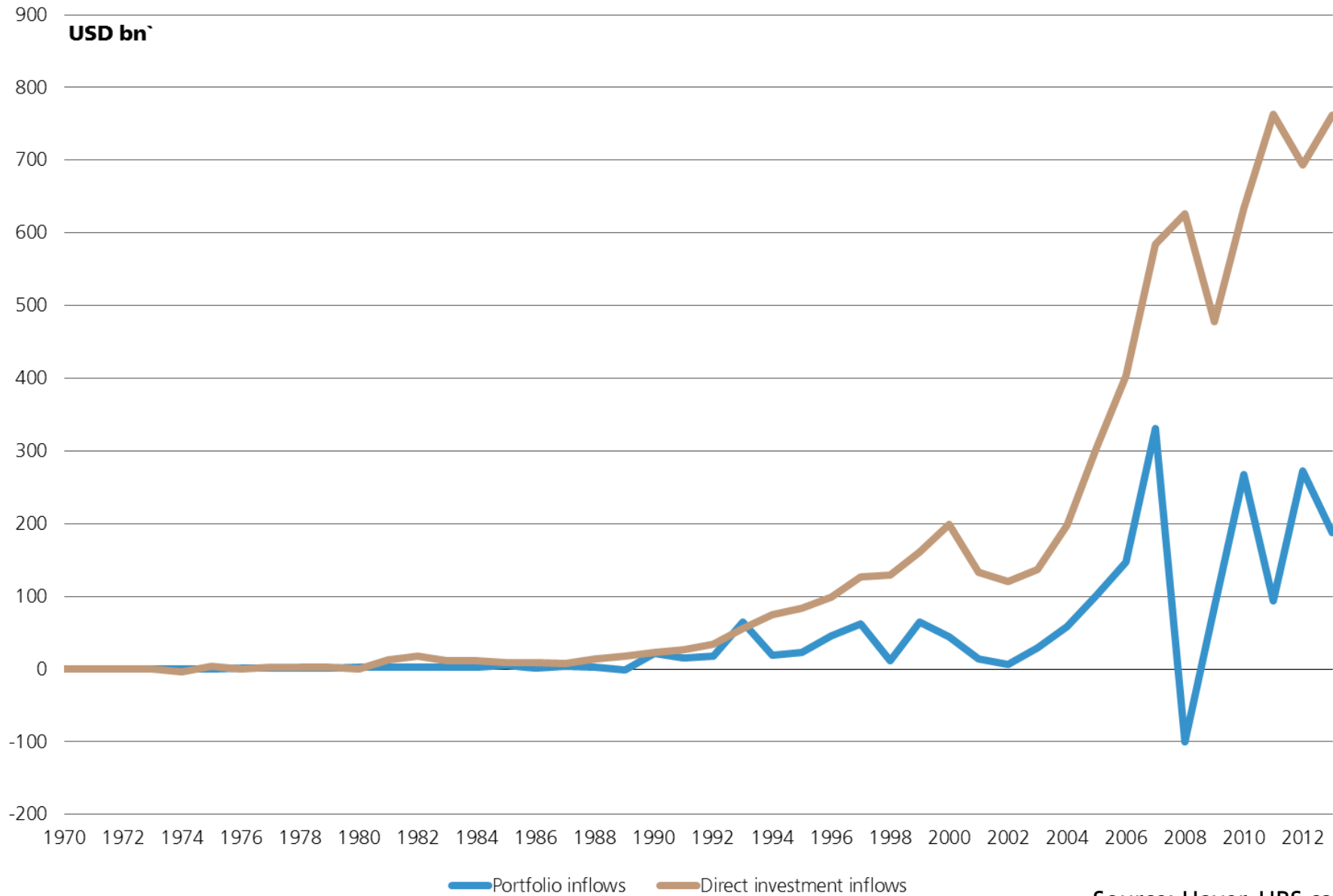


Fixed exchange rate regimes – fewer imbalances



Source: Haver, UBS calculations

Fixed exchange rate regimes still attract FDI



Source: Haver, UBS calculations

What is the optimal amount for foreign reserves?

Old system

- Imports
- Short term external debt
- Banking system's foreign currency deposits
- Foreigners' holdings of domestic assets

Now add?

- Trade finance needs – in a more cash based trading system
- Short term external corporate debt
- Banking system funding needs
- Returns for government

How much is too much?

- Reserves represent "lost" domestic living standards
 - Low return environment if you are lucky (negative returns when domestic quantitative policy aims conflict)
 - War for capital
 - Home country bias?
-
- After twenty five years of inexorably rising foreign exchange reserves, has the trend run its course? And will it reverse in absolute or relative terms?

Section 2

Moves to reserve diversification

Diversification tension

Safe havens?

- Bonds: See Greece
- Cash: See Cyprus
- Gold: See gold
- Credit: See bubbles
- Equities: See Japan

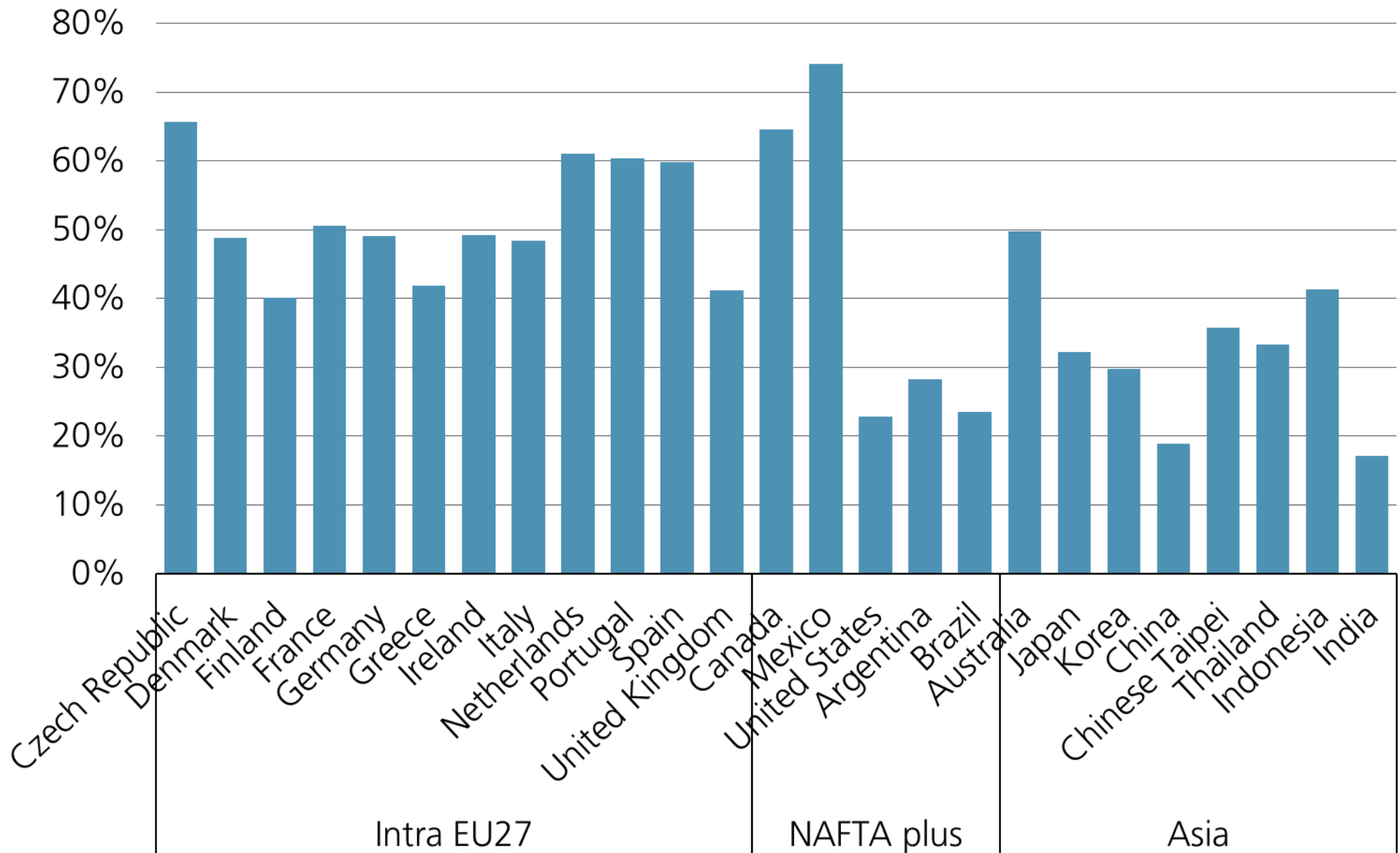
Low return environment

- What are central banks (as monetary policy setters) trying to achieve?
- Why this is a problem for central banks (as investors)

Political balances

- Returns in a time of political need
- What happens if it all goes wrong?

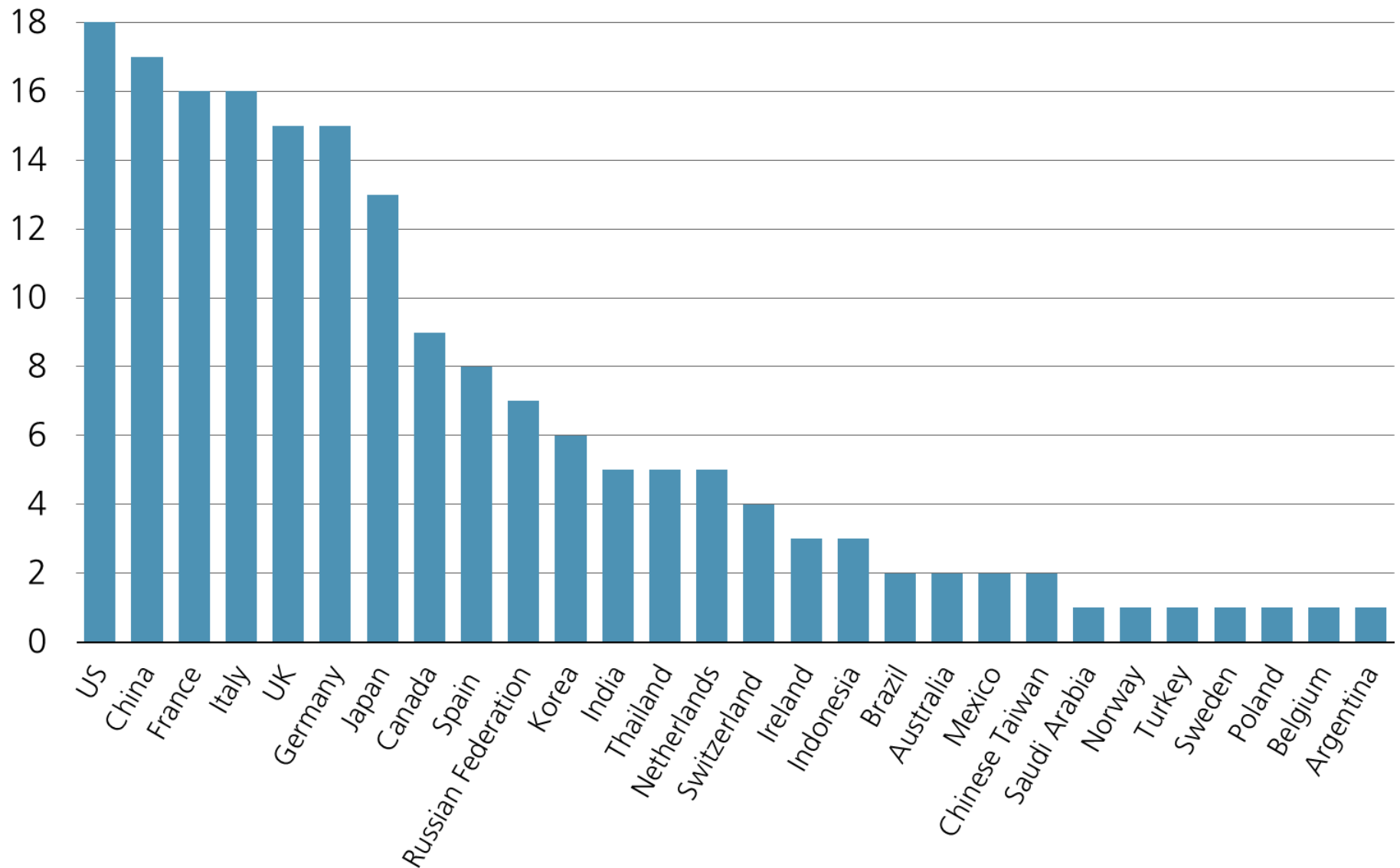
Parochialisation – are there limits to diversification?



UBS

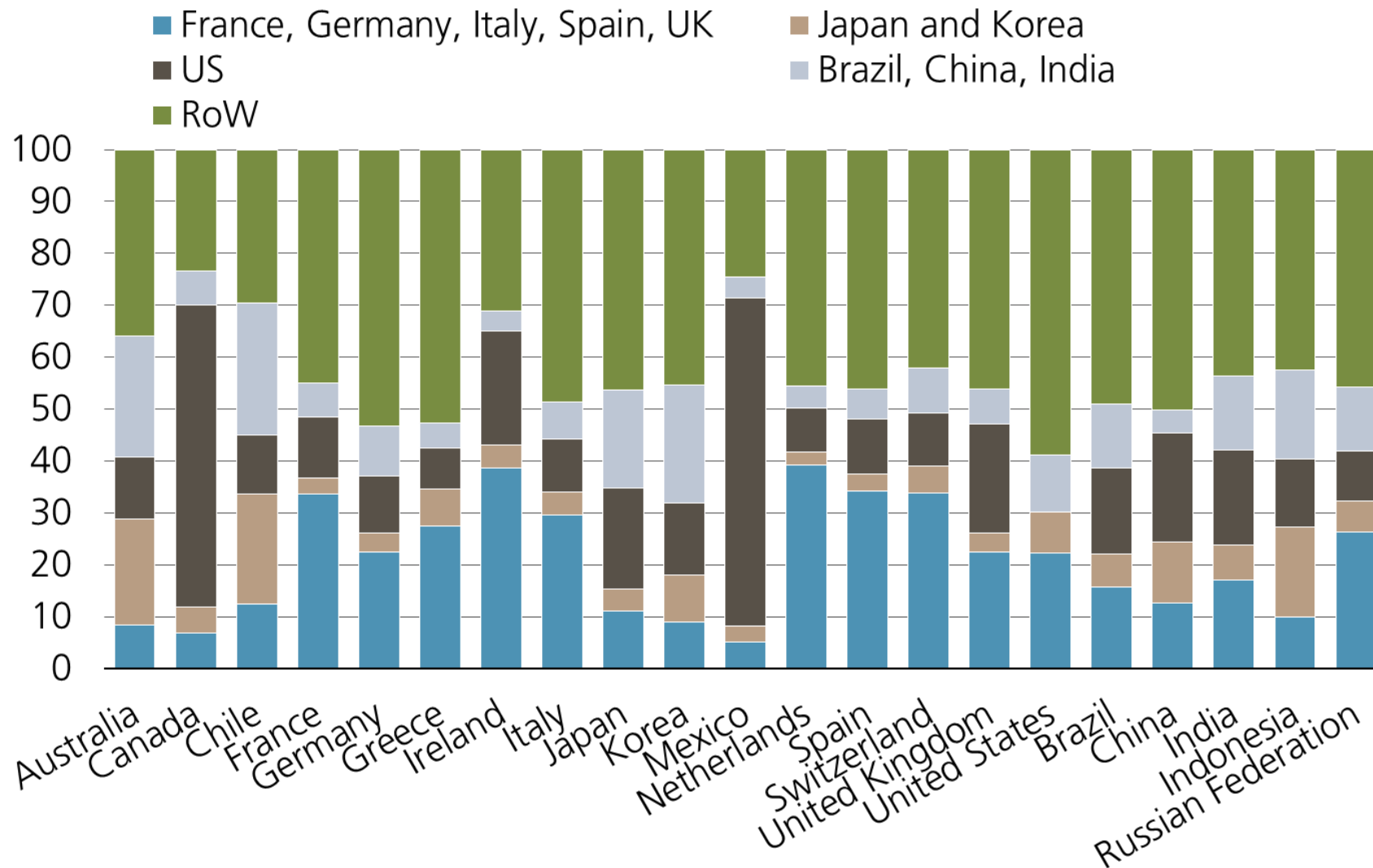
Source: OECD Value in Trade database 2009, UBS

Number of sectors in which a country is a top 10 exporter (out of 18 possible sectors in an economy)



Where do you really export to?

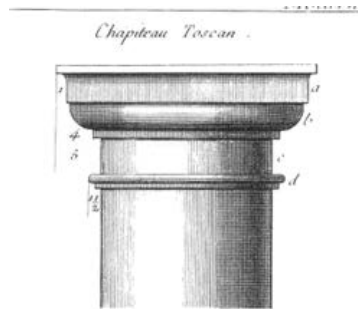
Domestic value added embodied in final demand as a % of total domestic value added in final demand *OR Whose growth really matters to you?*



Section 3

Central banks as capital providers

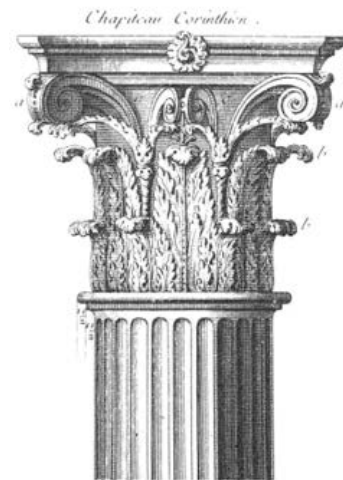
The three pillars of central bank wisdom



Quantitative Policy

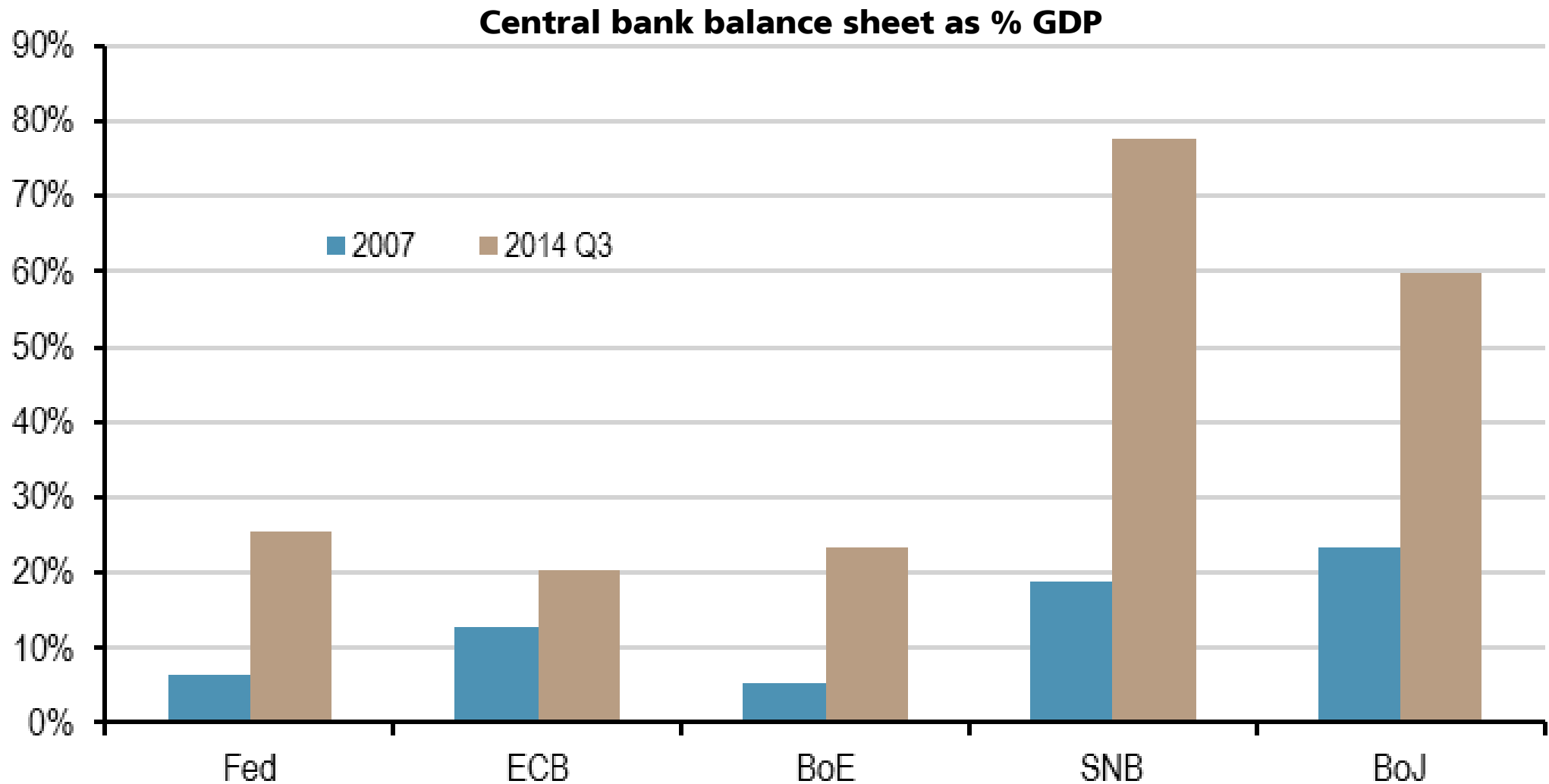


Regulatory Policy



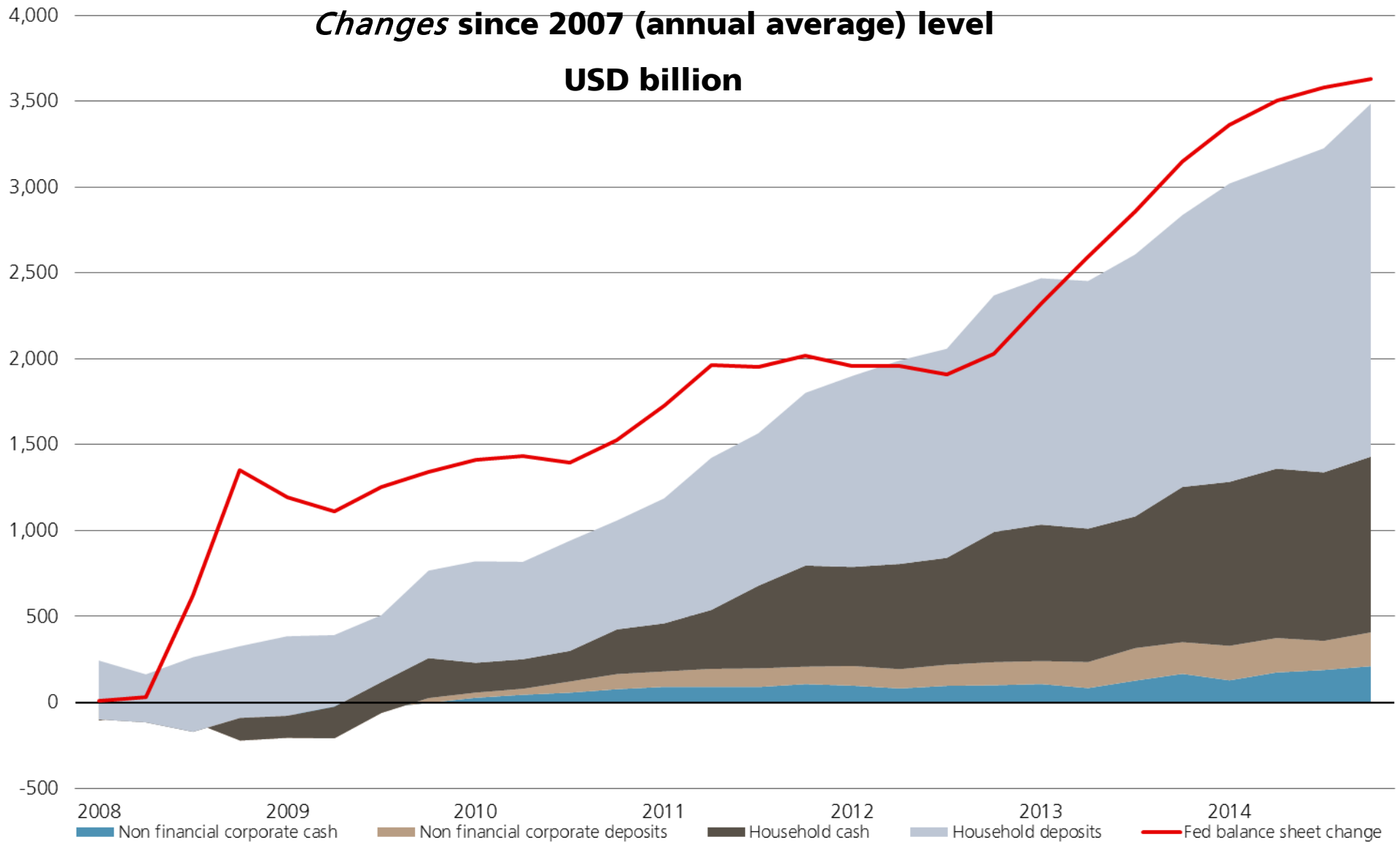
Monetary Policy

Central bank liquidity – the power of the printing press?

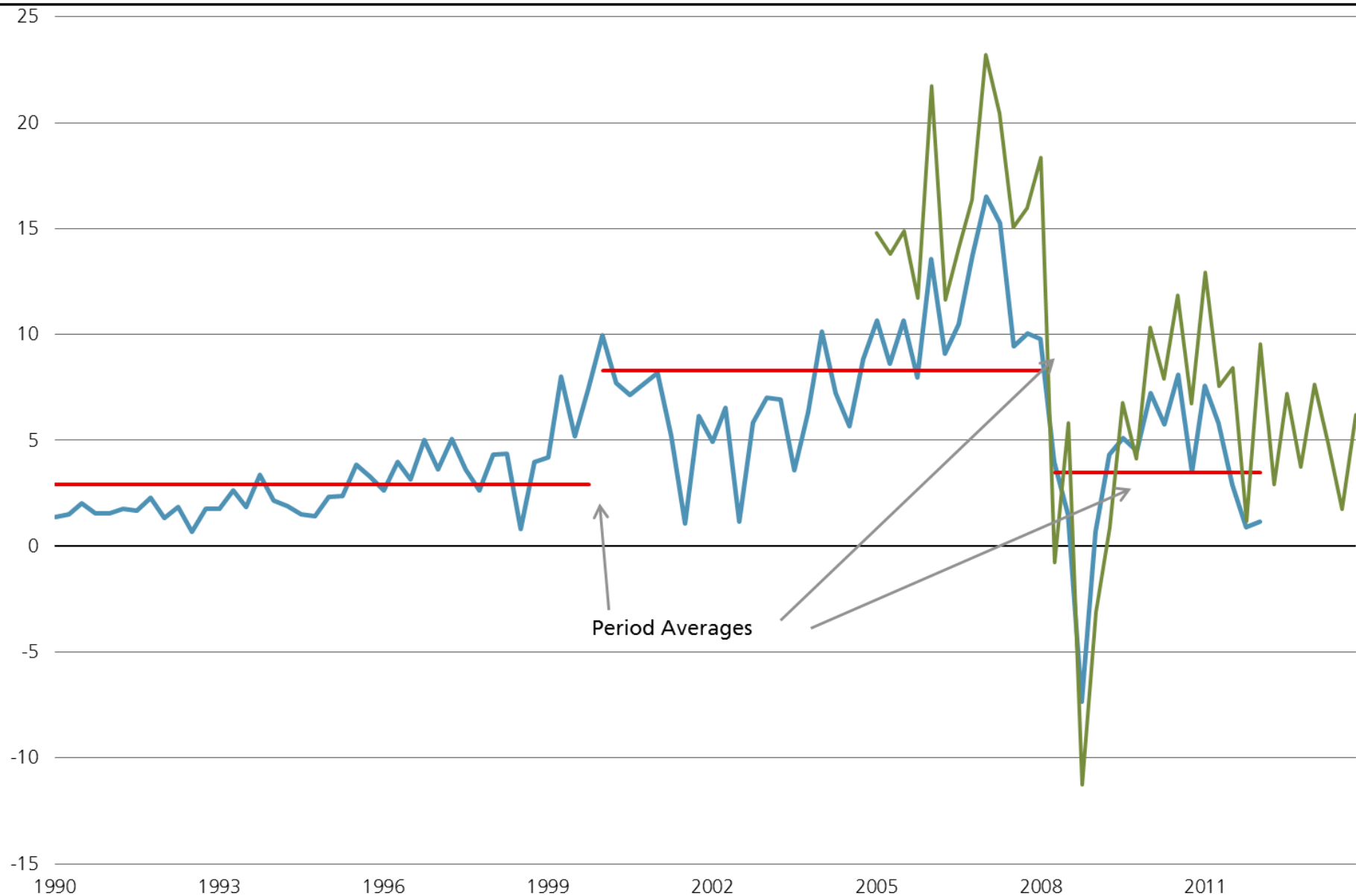


Source: UBS

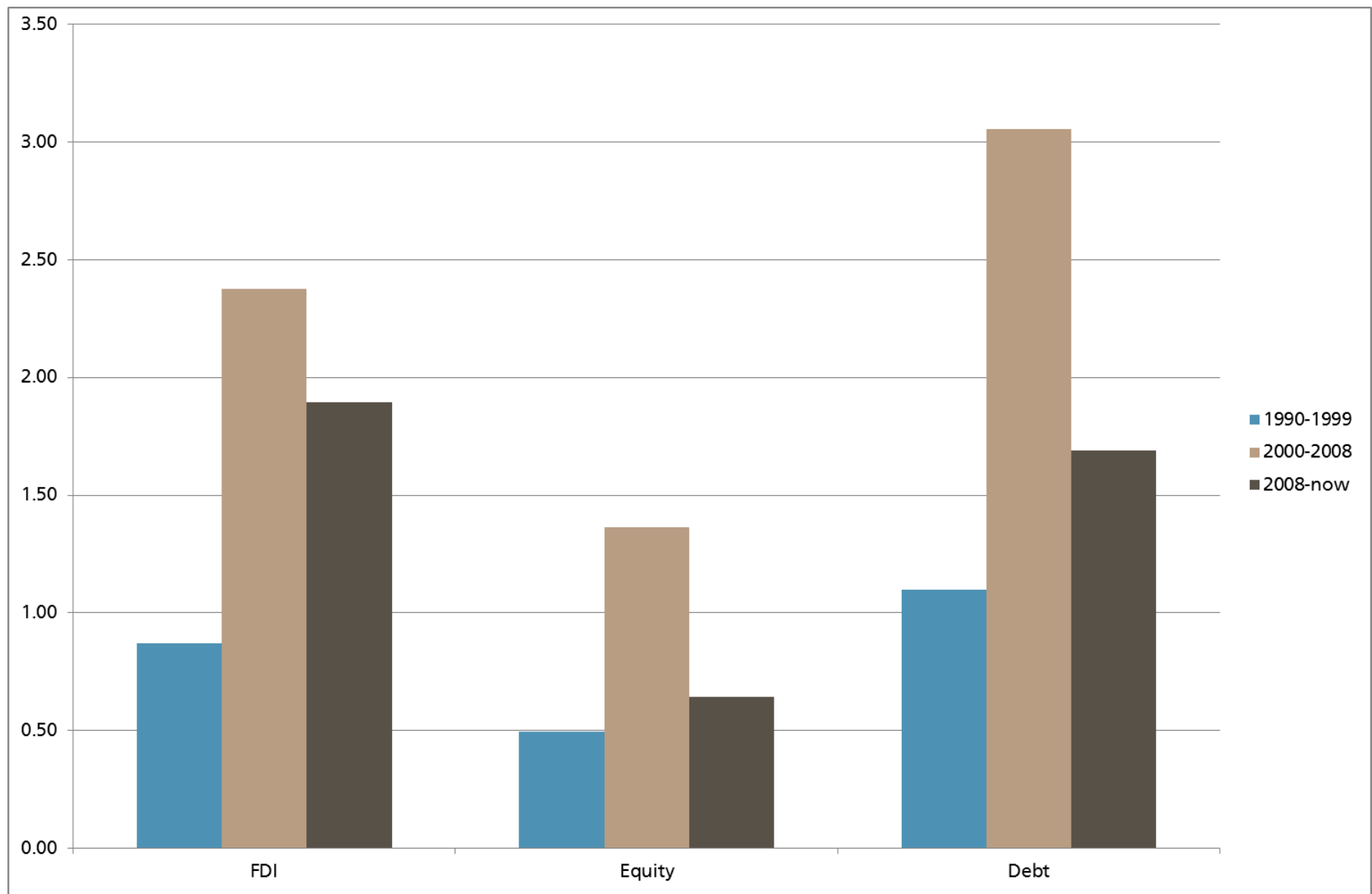
Follow the money – the only game worth playing



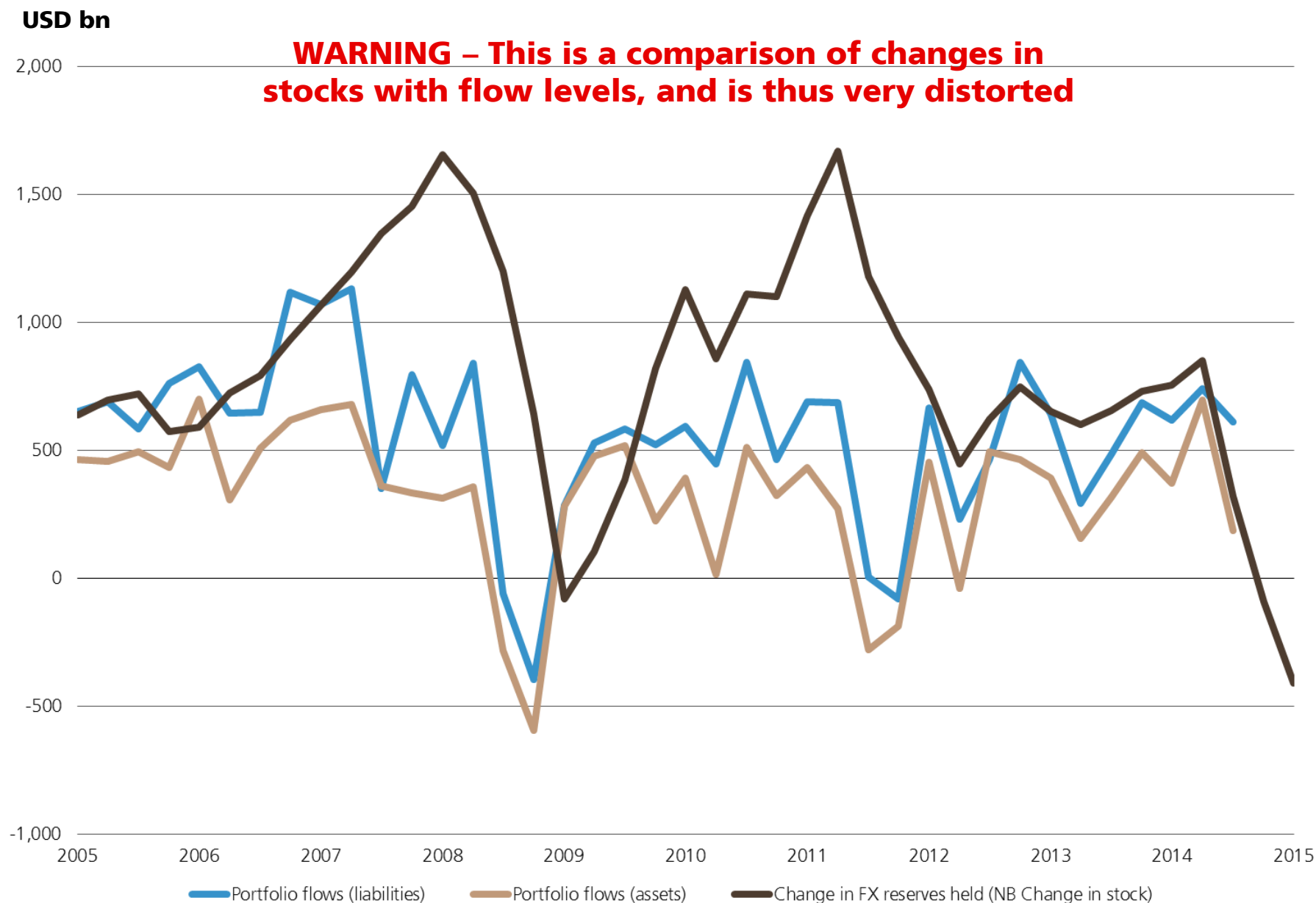
Capital inflows as % GDP – the reversal of globalisation?



Breakdown of capital flows



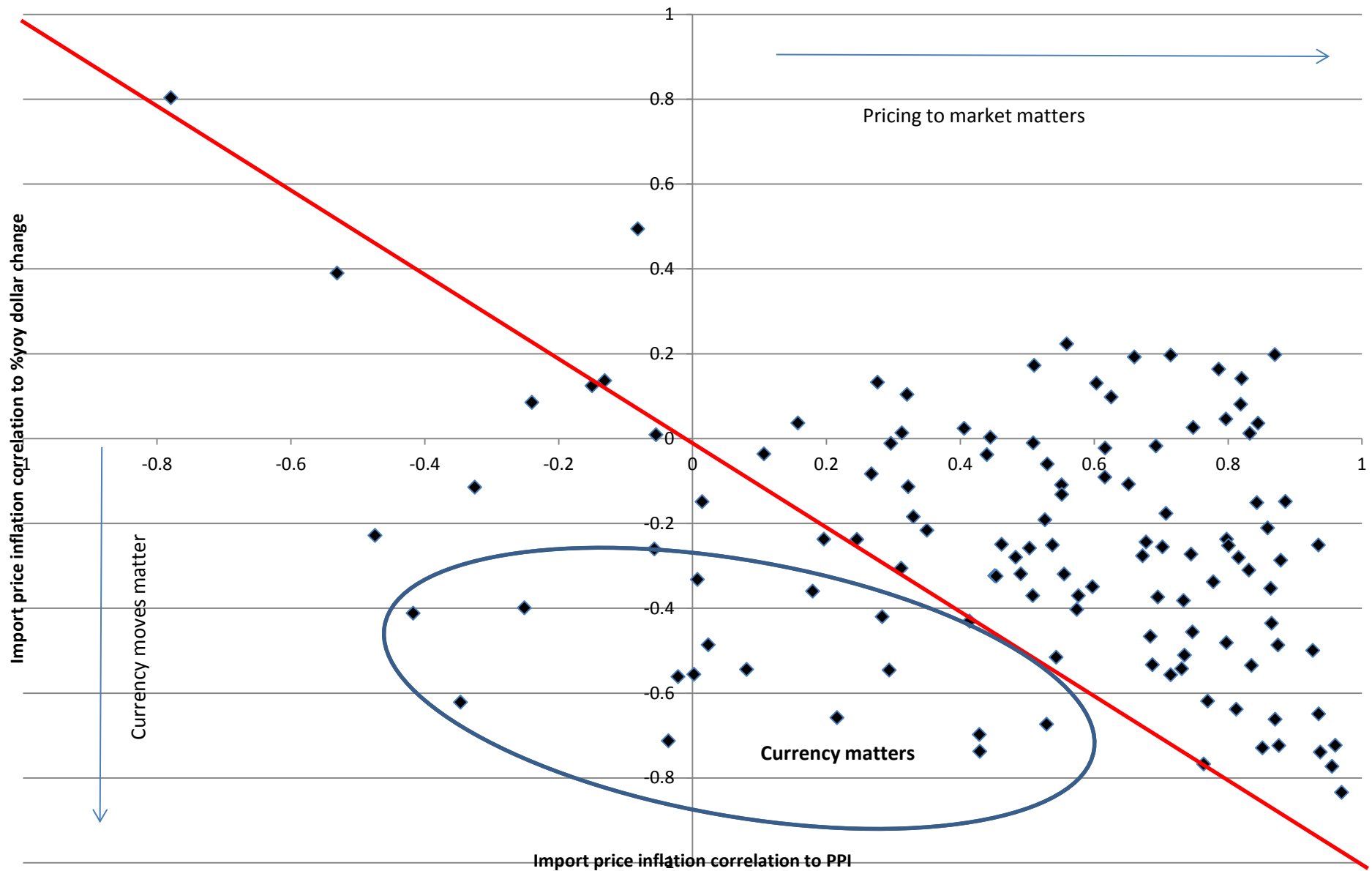
Change in reserves versus portfolio flow measures



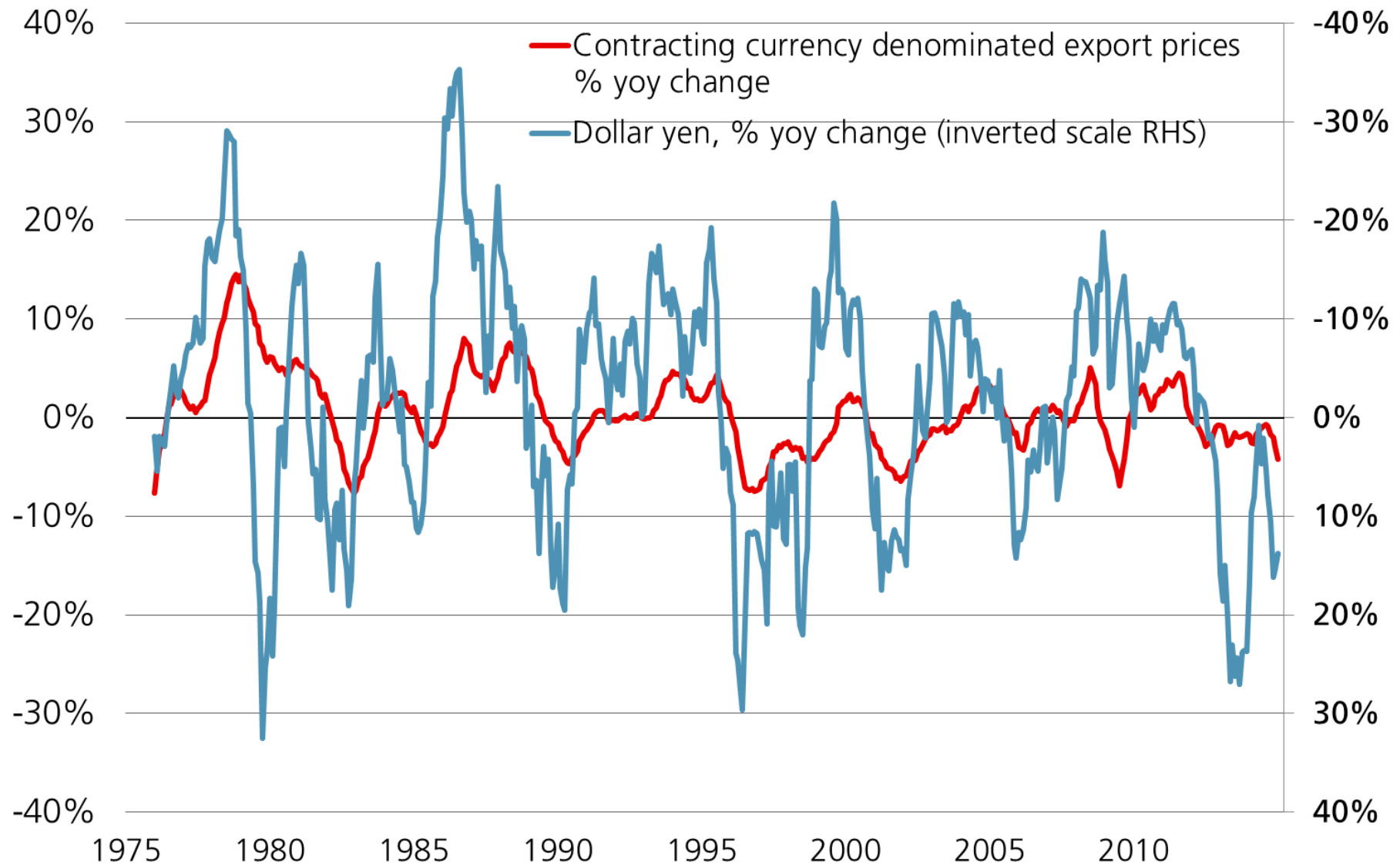
Section 4

The futility of currency wars

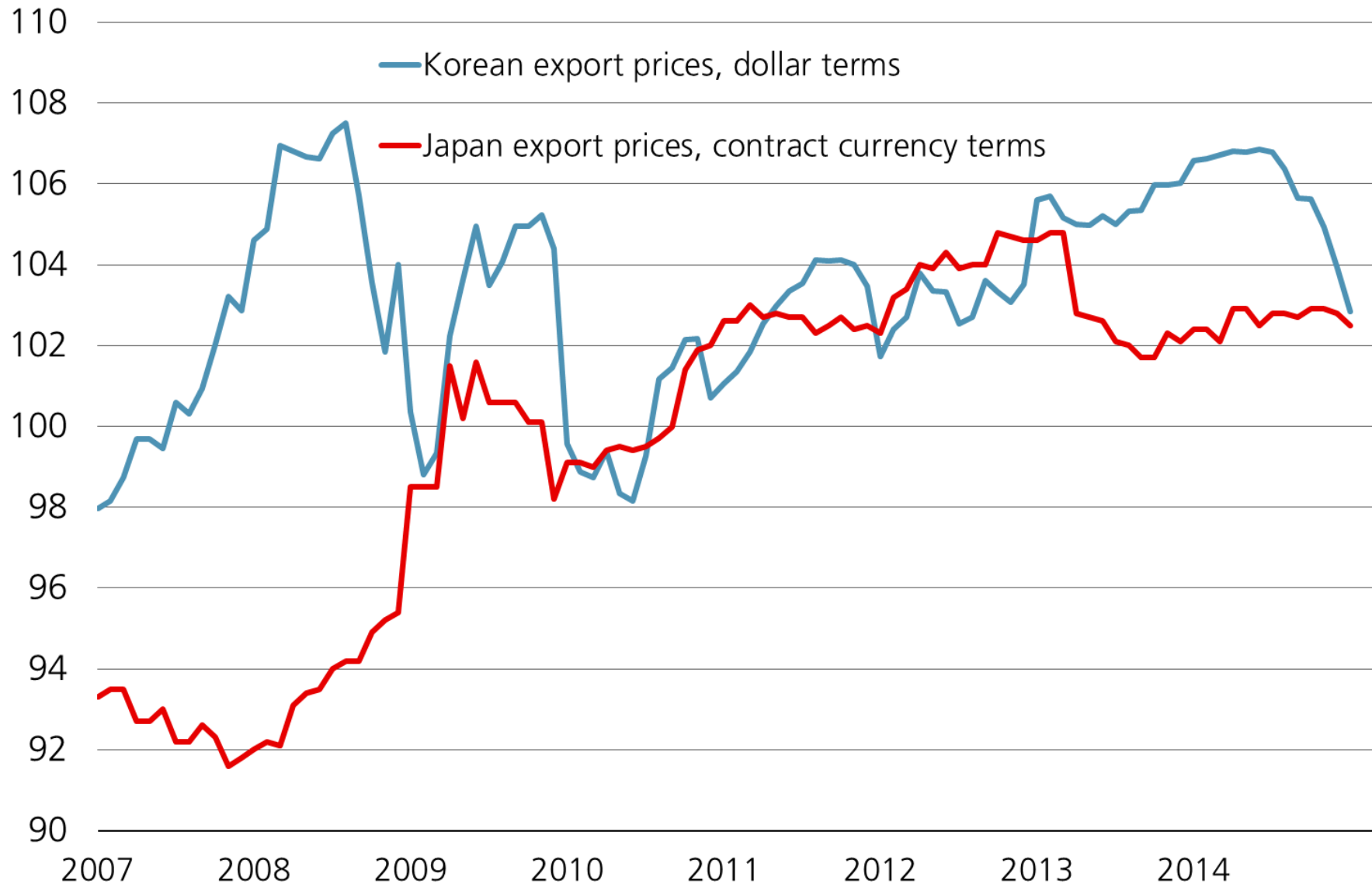
US sector correlations since 2007 – pricing to market dominates



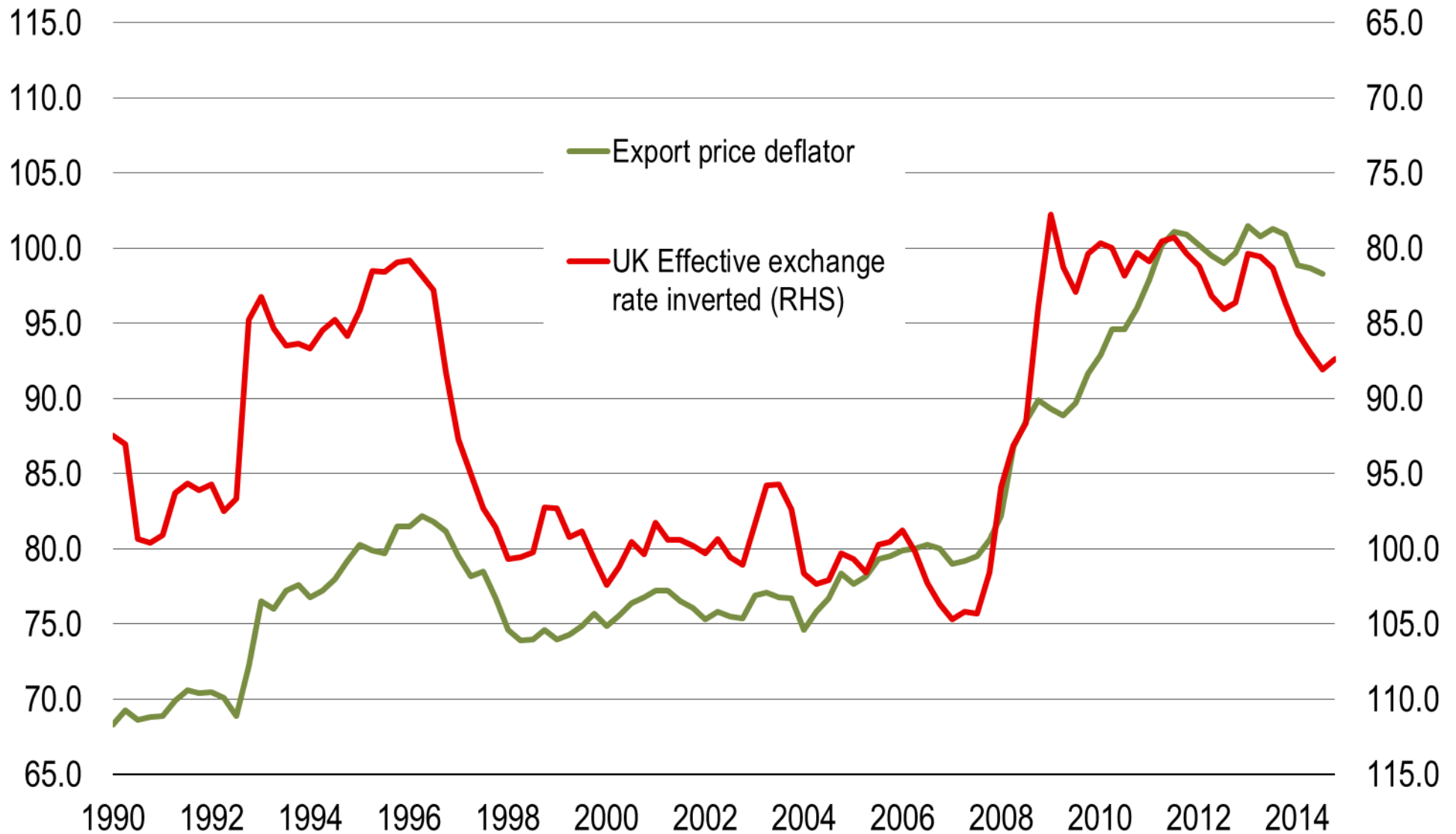
Pricing to market, Japan style



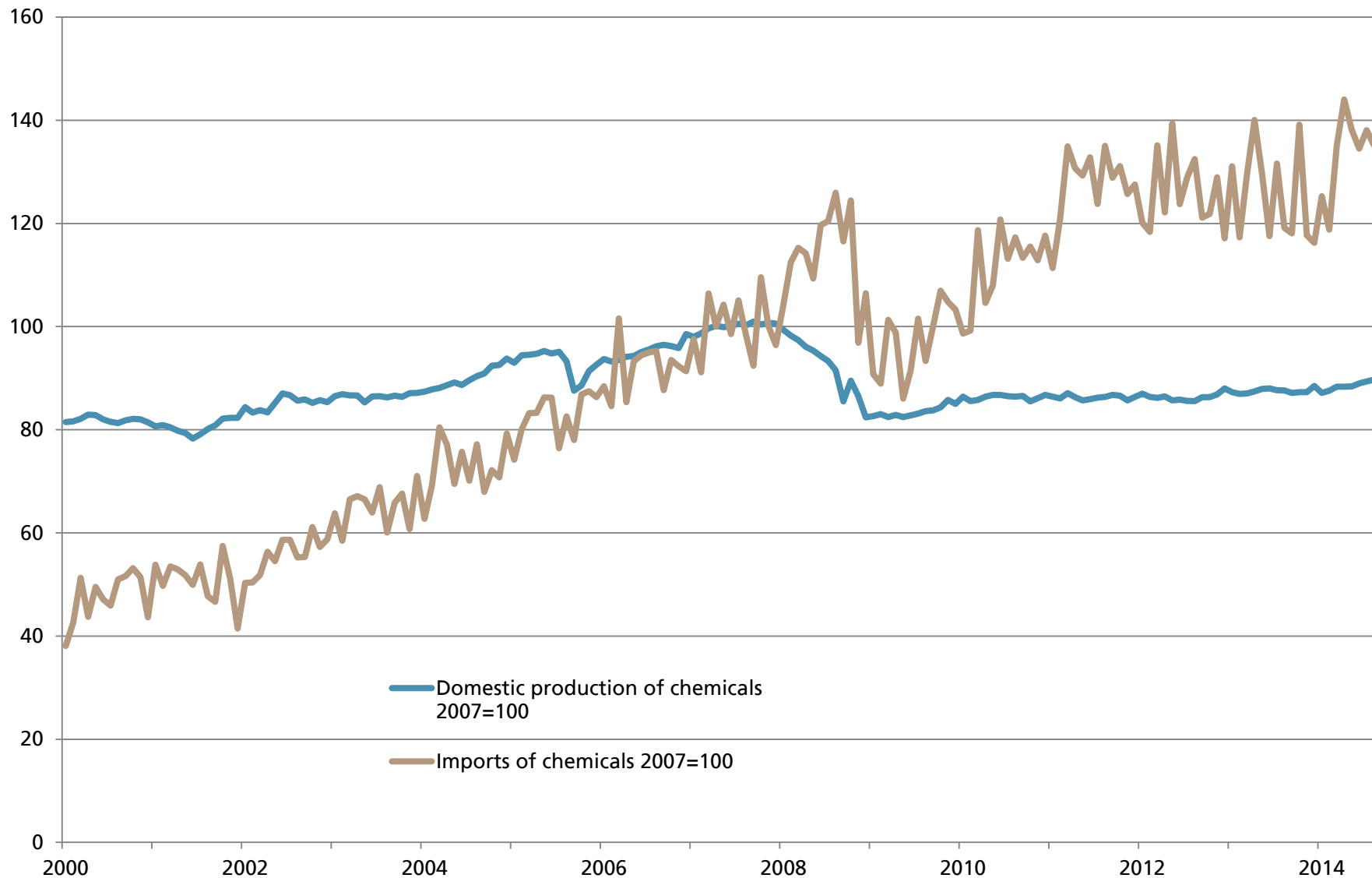
Beware complaints: Transport sector export prices



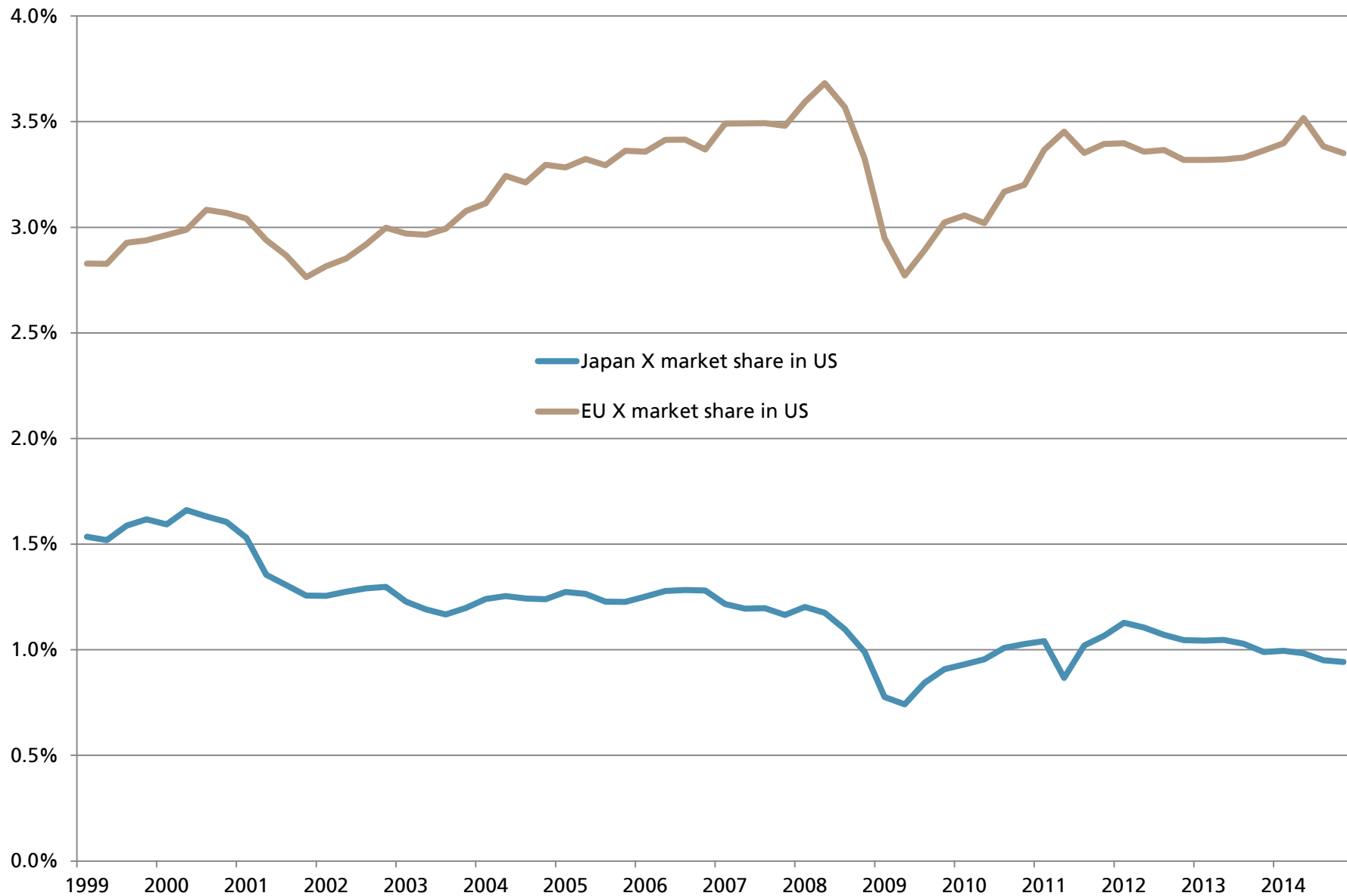
Pricing to market, UK style



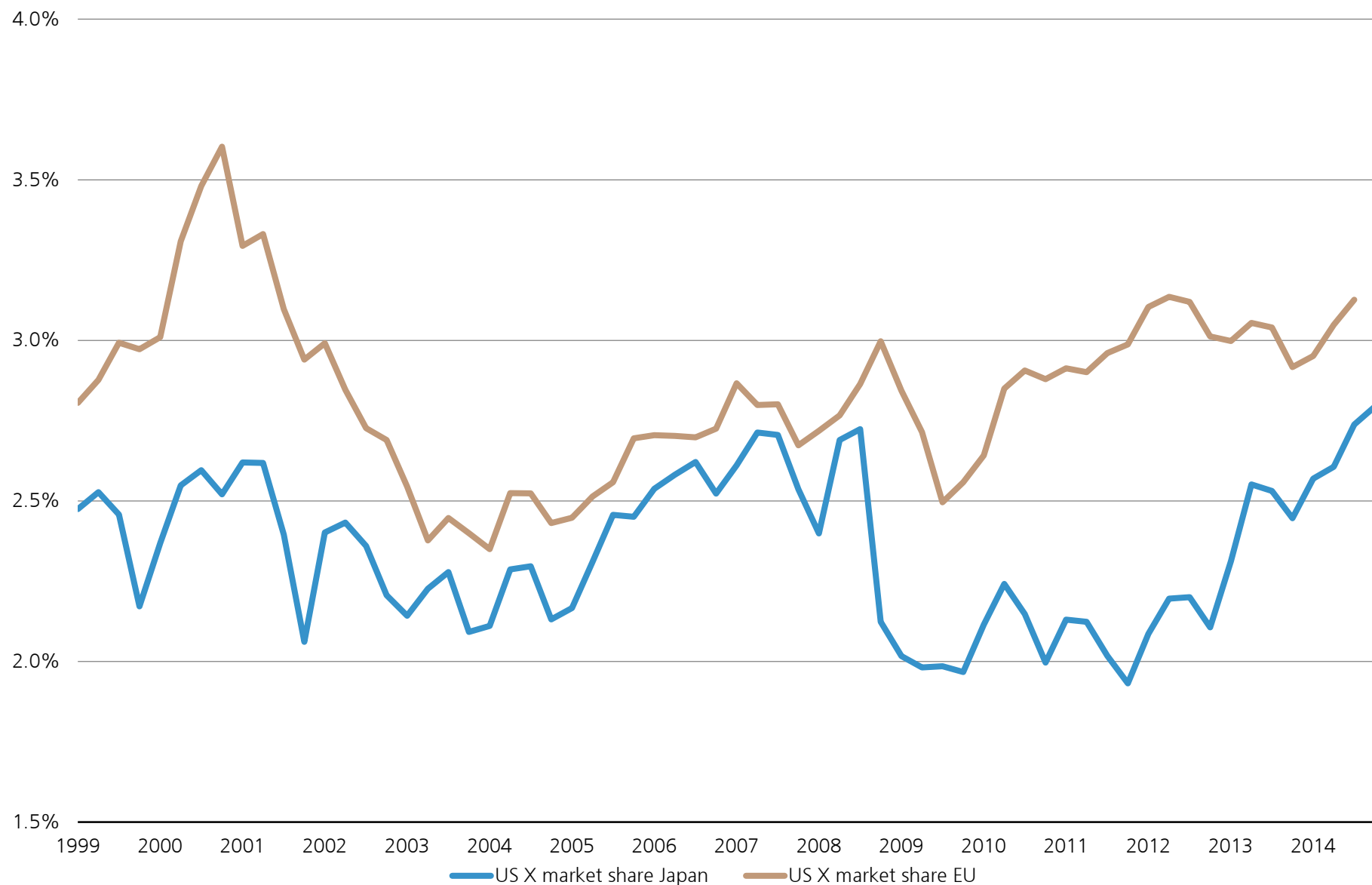
US Chemicals – imports and production



European and Japanese exporters to US fail to gain competitiveness



US exporters to Japan and Europe gain competitiveness

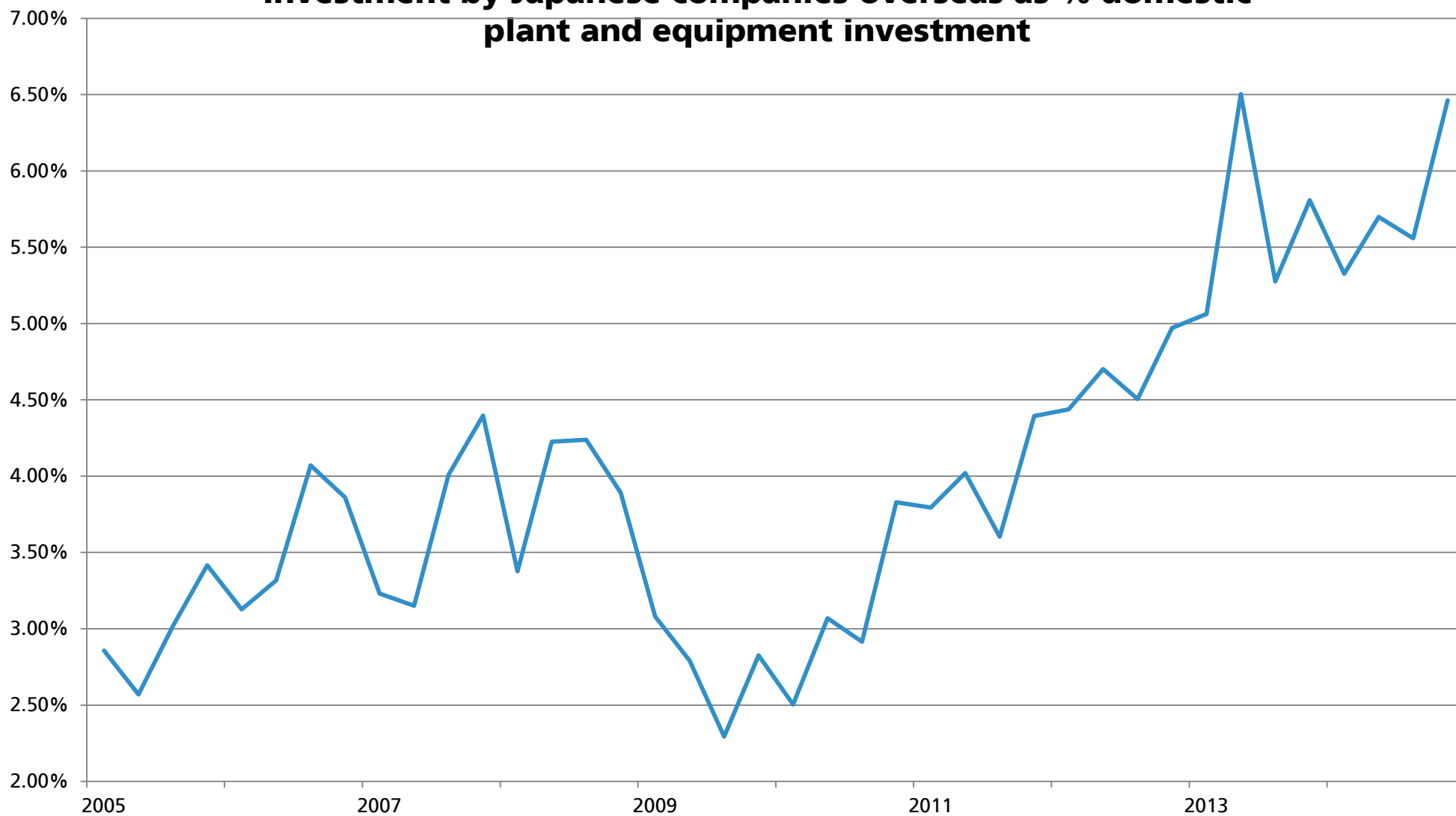


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Source: UBS

Japanese hollowing out as the yen weakens

**Investment by Japanese companies overseas as % domestic
plant and equipment investment**



Section 5

The Survey

As in previous years, prior to our Conference a number of our guests responded to an informal and non-scientific poll on various issues surrounding the key themes affecting the sector. The results of some of these polls have been compiled and presented in this document. The results of these polls represent the views of the voters and not necessarily those of UBS

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