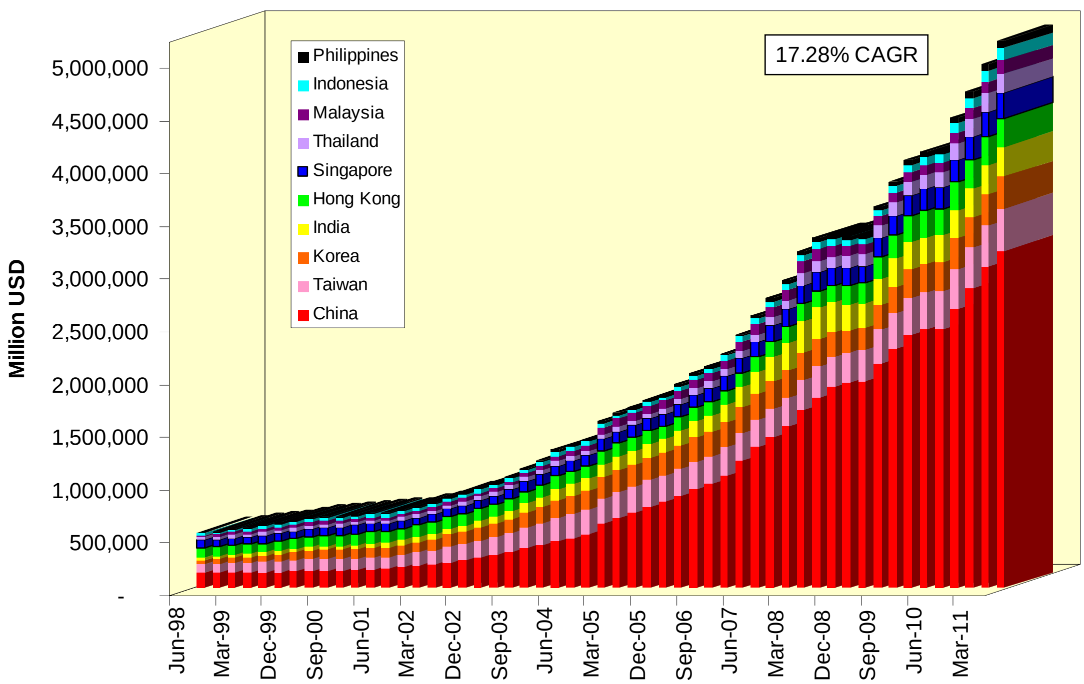
Asian Exporters Building Reserves

Let's assume for the sake of argument you are a hibernating animal. You would be spending your autumn stuffing your face in a manic attempt to build up fat reserves so you could curl up in a ball and sleep through the winter. Come to think of it, this describes the behavior of some acquaintances from bygone days.

Now, as this is a financial Website, let's switch gears and posit you are an Asian exporter whose leadership remembers the bear-like mauling the region took during the 1997-1998 Asian Crisis as yen carry trades started to unwind and foreign investors fled the scene like an afternoon interloper unsure of who just rang the doorbell.

Let's use the member countries of the Bloomberg-J.P. Morgan Asian Currency index discussed here in August and see whether they have been piling up reserves since mid-1998. The answer is a definitive, "Yes." The bloc's foreign exchange reserves increased at an average annual rate of 17.28% through June 2011; China, the holder of 31.29% of the world's reserves, has yet to report for the third quarter. If the 17.28% growth rate seems a bit gaudy and distorted by China's massive representation, take heart: If we strip China out, the annual growth rate declines to a still-impressive 12.40%.

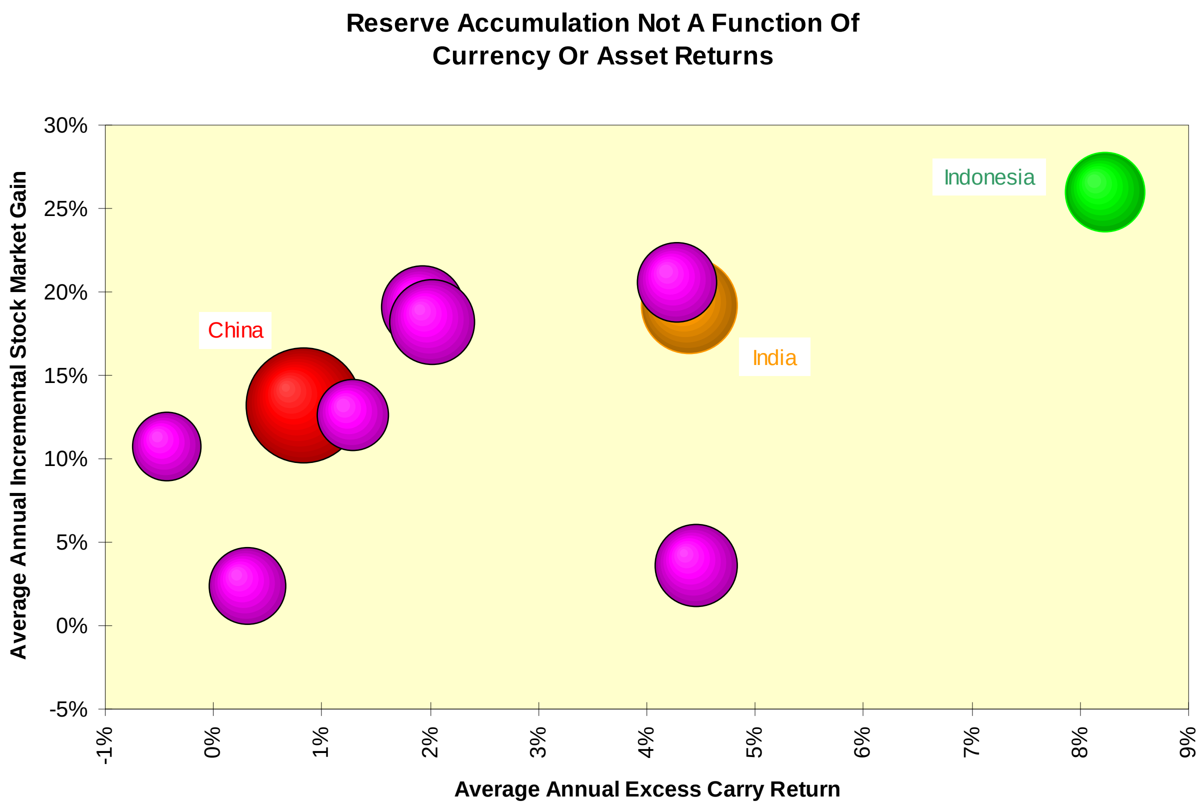
Asian Currency Index Reserves Since The Asian Crisis



Trade protectionists might argue China's average annual growth rate in reserves of 24.6% stands as prima facie evidence they used their deliberately undervalued currency to increase their current account surpluses at the rest of the world's expense. This is partly true; much of China's export advantage depended as well on their lower-cost labor and their willingness to accept higher levels of pollution and other negative externalities of industrialization than the rest of the world. If we have learned one thing globally since the first Industrial Revolution it is countries are willing to pay for environmental cleanup only after they have achieved a certain wealth level.

Besides, other countries whose currencies have advanced smartly have managed to accumulate reserves at a significant rate. India's accumulation rate has been 17.7%, and that is with an average annual excess carry return for the rupee of 4.39%. The Indonesian rupiah has had an average annual excess carry return of 8.23% and it still has managed to pile on the fat layers at an 11.9% annual clip. You do not need to have China's paltry 0.83% average annual excess carry return to be a successful exporter.

As we can see from the map below, a stronger currency and a stronger stock market tend to correlate with each other. Reserve accumulation is another matter altogether.



The final thought here is no one can know for certain whether any of this account-building on the part of the Asian exporters leaves them in a better position to withstand a future run on their currencies in a financial crisis. All of these chips stacked on the table are, as any poker player can tell you, at risk to one big losing hand.