MIRAGE OF THE INTERNATIONAL RESERVES

Ph.D. Napoleon POP*

Rezumat

Rezervele internaționale ale băncii centrale par să devină un subiect de dezbatere neprofesională creând falsa iluzie că aceasta este o simplă acumulare de valori, fără vreo utilizare importantă în administrarea ciclului curent de afaceri al unei economii prin intermediul unei politici potrivite, cum este politica monetară. Cu toate că există oameni care chiar îndrăznesc să sugereze că guvernul ar trebui să cheltuiască rezervele acumulate de banca centrală, pericolul de a lăsa astfel de mesaje să zboare aduce atingere un aspect delicat la independenței băncii centrale în contextul integrării europene. Între timp putem vedea cât este de uşor să ne băgăm în lucruri serioase, cum este rolul rezervelor internaționale chiar şi pentru dreptul de monopol al băncii centrale de a tipări bani, atunci când cumpără valută, sau importanța acestora atunci când vorbim despre credibilitatea instituției pentru cetățeni sau investitori. Articolul prezintă câteva aspecte teoretice şi practice referitoare la rolul rezervelor internaționale ale băncii centrale pentru îndeplinirea menirii ei de menținere a stabilității prețurilor, la legătura lor cu statutul politicii monetare şi a instrumentelor folosite pentru a îndeplini aşteptările credibile de ancorare a inflației. Vorbind despre rezervele internaționale nu putem trece peste prezența rezervelor de aur ca parte din aceste rezerve, considerând că mirajul acestei combinații – valută şi aur pur – merită să fie discutat, dar nu descoperit în întregime, întrucât aurul rămâne, şi ultimele cotații internaționale confirmă acest lucru, unul dintre cele mai bune active.

* *Senior scientific researcher I, Director of the Centre for Financial and Monetary Research "Victor Slăvescu", Romanian Academy.*

Abstract

The international reserves of the central bank seem to become a matter of unprofessional debate, creating the false illusion that this is a mere accumulation of value, without any meaningful use in managing the current business cycle of an economy through an appropriate policy, e.g. monetary policy. While there are people that even dare to suggest what a government should do with the reserves accumulated in the safe of the central bank, the danger to let such messages to fly around touches one of the delicate issue of the independence of a the central bank within an European context of integration. In between, we can see how easy is to mingle with serious things, as the role of the international reserves even for the monopoly right of a central bank to issue paper money, when she is buying hard currency, or their importance when we talk about the credibility of the institution for the citizens or for investors. In the article, we just try to insist on some theoretical and practical aspects related to the meaning of the international reserves of the central bank in carrying her role in preserving price stability, their connection with the stance of the monetary policy and the instruments used for the conducting credible anchored inflation expectations. Talking about international reserves we cannot skip out the presence of the gold bullions as part of them, thinking that the mirage of that mix – hard currency and the purest gold metal – deserves to be discussed, but not entirely unveiled, as the gold remains, and the latest quotations of it on international markets confirm, one of the best asset.

Keywords: central bank, international reserves, liquidity, price stability, monetary policy.

JEL classification: E31, E52, E58

A subject returning to actuality

We are watching with concern, in an unfortunate moment of the unfolding economic crisis in Romania, the manifestation of some opinions according to which any source of money should be used in order to cover the internal deficits. Even the international reserves of the National Bank of Romania (BNR) were such victims on several occasions. This is one of the unhappy examples which cast a shadow on the economic debates, but the good faith pushes us to make some major statements so that this subject doesn't end in the foggy area of the voluntarism.

A specific selectivity of the economic culture makes the international reserves of a central bank still have the image of a myth or mirage with the connotation of panacea. This false alternative, which already populates the public space and is not countered, only fuels temptations for solutions, even for the current economic crisis, which make the true economists wonder.

The mere idea that someone – the government or the Parliament – might use even part of the international reserves of BNR in order to cover some expenditure (for investment included), although the intentions go further than that, worries by the failure to know the priority objective of an European central bank within the national monetary and financial system – price stability – and by the failure to observe the full independence of action, political, financial and personal of this institution. Why? Just because the credibility of a central bank can be built on the very background of this independence, and this credibility which has a major impact on the financial and macroeconomic stability of a country.

Within this context we consider that the deviations must be controlled and that we should return to the signification of the nimbus induced by the level of the international reserves of the central bank which consists both of hard currencies and the purest gold bullion. On August 31, 2010, the international reserves of Romania (hard currencies and gold bullion) amounted to 35.781 billion euro. Is it much, is it little? Let us make some comparisons starting from the actuality of the subject under debate.

In terms of quantity, this fortune lying in NBR vaults represents about 30% of everything that was produced in Romania in 2010. All this fortune, if it were to be spent as some people want, would cover the public expenditure for only eight months of 2010 ... and then what? This is why we think that some light should be shed on the significance and role of the international reserves of the central bank, in order to channel the possible mirage determined by their level towards a functional cause of crucial interest.

It is, somehow, easy to understand the nimbus of mystery around the international reserves because on the one hand we are speaking of the gold treasure of the country, and on the other hand, much of the population – from simple citizens to investors and exporters/importers – display an increasing interest or watch with interest the evolution of the exchange rate. The population expresses by its behaviour the link, mysterious so far, between the international reserves of gold and hard currencies and what BNR does through them.

Justified questions

There are some questions asked quite often and which need a swift answer. They can be formulated, by generalization, as follows:

- Why does BNR have currency reserves while the incomes decrease and the budget cannot fund investments?
- What does BNR do with the currency reserves if it doesn't finance the deficits?
- Why doesn't BNR keep the exchange rate at the level desired by those who have credits taken in hard currencies? etc.

Starting from these questions, the answers must clarify at least two aspects: (1) present some elements of monetary theory which to update the knowledge on the sources of formation, structure and utilities of the international reserves and (2) analysis of the monetary policy seen from the angle of the international reserves of a central bank.

Elements of theory

More and more opinions were expressed lately on the use of the international reserves of BNR to increase the pensions, build highways or to modernize the agriculture.

If we would not know that, generally, the deposits of hard currency are a source of money issuing, such ideas can only spark sour smiles. This is why we should remember the messages by which BNR keeps remembering us not to forget that when the central bank buys hard currency it sells lei. Therefore, a **first conclusion is that the monetary mass in circulation actually is the equivalent of the currency reserves**. Not only must this equivalent be used for the requests mentioned earlier (as it is actually used), but this is not to be done directly, rather through the circulation of money within the national economy.

From this explanation we get to the problem of the money issuing and here we must answer the question: **which is the mission of the central bank?**

The basic function of any central bank is money issuing. But the actual national currency is not the objective of the central bank, rather something else, much more important, which actually is the basis of the national currency. The history confirms this idea by the fact that after the massive transfer of precious metals from the "New World", after 1492, the Spanish Crown didn't become wealthier. On the contrary, it went bankrupt 14 times within the span of 140 years (between 1557 and 1696). The Spanish conquistadores didn't understand in the 16th century that their national currency is not a mere artefact made of precious metals; rather it represented an intricate **relation of trust, either in the person paying in coins, or in the institution issuing that currency**.

In other words, and making abstraction of the gold used to make the coins, the currency represents the **TRUST "embedded" in a material carrier**. This carrier was an earthen tablet in Mesopotamia of 5000 years ago, the spices (pepper) and later, the precious metals: silver, gold and platinum.

Looking in the mirror, the only element which really matters when it comes to the trust in the currency is the **CREDIBILITY of the issuer**, which supports the trust of those using the currency of the issuer. This credibility is ensured not just by the institutional monopoly, given by the state, of money issuing – the case of the central bank – but also through holding international reserves in gold and hard currencies.

These reserves must not be seen as an amorphous bulk mass; they are properly structured, which leads us to the question: what are the international reserves composed of?

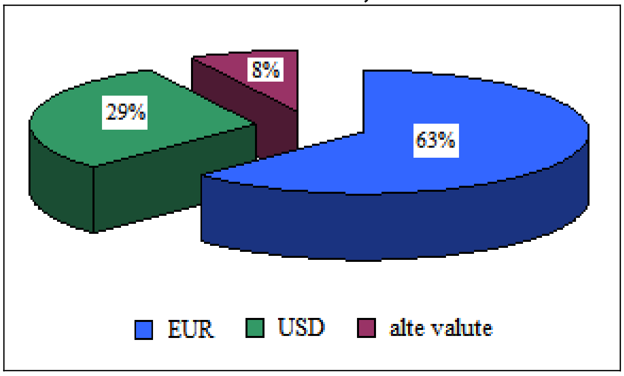
Currently, the gold and hard currency reserves of Romania consist of gold, XDR and hard currencies. Romania owns 103.7 tons of gold. Its position with the IMF represents the share of participation of each member state to IMF. The share of Romania is 1.0302 billion XDR, or 0.47% of the total amount. Proportionally to this position, Romania has 10.552 votes, or 0.48% of the total.

The deposit of XDR represents the XDR allocations made in 1972 and 1986, when the IMF considered that there was not enough liquidity within the international financial system. The new issuances of XDR have been distributed to each member state in depending on its share.

The total amount of hard currencies owned by Romania was, on September 30, 2010, of 35.781 billion euro. In the category of hard currencies, on December 31, 2009, Romania owned 63% EUR; 29% USD and 8% other hard currencies; this structure is more or less the same. It usually respects the hard currency composition of the public foreign debt so that the reimbursement of the debt doesn't produce shocks on the currency market. The international reserves of a state member of the euro zone can no longer consist of euro because this already is the national currency of that state, so the international reserves consist of the other hard currencies. The advantage, however, is that much of the foreign debt of the countries which adopted the European currency is denominated in the national currency (Greece, Ireland) which is not the case of Romania.

Chart 1

Composition of the international reserves of Romania on December 31, 2009



The composition of the international reserves by hard currency correlates with the composition of the public debt by hard currencies. Hence, the answer to the question worrying everyone: **how should we keep our savings in lei or in hard currency**, is rather clear: in the currency which denominates our debts. This is also the answer to the question in what currency shall we take credits: preferably in the currency denominating the bulk of our income, so as to avoid the currency exchange risk.

There are four sources for the formation of the international reserves of BNR. The main source is buying hard currency from the domestic currency market. This is not a simple purchase; it actually is a mechanism of monetary policy. From the perspective of the monetary policy this mechanism must be used with parsimony.

When the currency market sways a lot either side, BNR intervention only has marginal, short-term effects. Such an effect is not compatible with the monetary policy, which is part of a long-term strategy: currently this strategy is inflation targeting, usually for 8 quarters.

Another important source for the formation of the international reserves is the very administration of the international reserves by BNR. This activity is highly complex and introduces the dimension of yield optimization accompanied by the dominantly liquid character of the reserves; it also is fascinating because it introduces the evolution of the international markets within the equation of the Romanian market. Briefly, BNR experts place a part, actually quotas from BNR reserves in deposits at other central banks and in securities issued by entities with the lowest risk (USA and EU governments with ratings of at least AA, other governments with ratings AAA, supranational institutions). Therefore, the goal of the international reserves administration is to optimise the **triad liquidity – risk – yield**.

We have spoken only a little about gold so far, and **the subsequent question is, why does a central bank keep gold in reserve?**

Table 1

Practices for gold reserve administration in some European countries

Central bank from	Amount in May 2010 (tons)	Placements
Bulgaria	39.8	Deposits in corresponding banks, repo transactions, treasury
Latvia	7.8	Deposits in the Bank of England
Lithuania	5.9	Term deposits, swap for gold
Poland	103	Treasury, deposits in foreign banks
Romania	103.7	Treasury, deposits in other central banks
Slovakia	31.7	Treasury

Source: websites of the central banks

Maybe we should teach some history because we are currently witnessing a “currency war”, if we watch the dialogue between the

USA and China, and not only, on the exchange rate policy. The syntagm is not new, if we remember the situation during the early 70s which peaked when the gold standard was discarded. However, until that time we must remember the establishment of the Breton Woods system (1945), which concluded the period in which the official reserves of a country, kept in the central bank, and the official international payment means, were only in gold. After 1945, the official reserves were also kept in US dollars which were convertible in gold between 1945-1968 through FED, the US central bank. Between 1968-1973, US dollar convertibility into gold was allowed only for the central banks who owned US dollars as international reserves.

The August 1971 moment, preceded by the speech of the US President Richard Nixon, which instrumented a policy aiming to prevent the international speculations with the US dollar, and suspending temporarily the gold convertibility of the US dollar, introduced quantitative limitations and conditions for convertibility exclusively to the interest of the monetary stability of the USA. This measure came on the background of an economic crisis with two-figure inflation in the US.

After 19723, no other currency convertible with another convertible currency was converted directly in gold, which shattered the Bretton Woods system. Therefore, after the fall of this system, the international reserves were denominated in the composition we mentioned earlier, gold, XDR and hard currencies.

The public fascination for the gold bullions making the treasury of the central banks continues, although keeping them seems useless, because the gold standard no longer exists. Actually, today the gold is a source of credibility which we see in the daily evolution of the gold ounce towards new peaks. By the end on 2009, the gold ounce was rated at 1000 USD and he bets of the players predicted a rate of 2000 USD by the end of 2010. The actual quotation was 1500 USD but the growth is significant.

If the gold remains a source of credibility, then we must ask **what does a central bank do with the gold in its vaults?**

The gold deposits vary with each central bank. As mentioned, Romania has 103.7 tons of gold which it keeps in the treasury and in deposits at other central banks. Not all the central banks keep the gold this way. There are banks which prefer to make loan operations with the gold in their possession. This increases their income from the administration of the gold reserves.

The gold reserves of the central bank may also be used for other practical purposes. Thus, during moments of crisis, when a state doesn't has access to international financing, it may get hard currency by short-term swap operations with other central banks using par of the gold reserve. As soon as the funds from the international market become available, the swap operation is concluded, otherwise another swap operation is started.

Use of the international reserves

While we reject, as specialists, the innovations regarding the use of the international reserves by entities other than the central banks and to purposes other than their mission, we must ask, **what is BNR doing with the hard currencies from the international reserves?**

In order to make it easier the explanations on this topic, we divided the main utilizations of the hard currency reserves into two groups:

- Utilizations in relation with the sovereign duties of reimbursement;
- Utilizations in relation with ensuring the proper level of liquidity on the monetary market (the excess of liquidity leads to inflation, while the deficit of liquidity "smothers" the business).

The main use of the international reserves is to reimburse the foreign loans of the Romanian state. This is the argument of their structure as close as possible to the structure of the sovereign foreign debt. Thus, in the situation of the current loan within the Stand-by agreement with the IMF, BNR is the institution reimbursing the 12.95 billion euro. Each instalment received from the IMF must be reimbursed in five years from cashing it. There is a period of grace of about 3 years from the moment of signing the agreement and until the reimbursement begins. The interests and fees afferent to the loan, however, are to be paid quarterly from the signing of the agreement.

Knowing that the loan instalments from IMF join the international reserves of BNR, a legitimate question is **why doesn't BNR cover the budget deficit from the international reserves**?

In order to answer this question we need to mention that a central bank conducts its activity within a geographical and time reality. BNR is the central bank of a country which is EU member state. Therefore, BNR is part of the System of the European Central Banks (SECB) and the law of its functioning must meet some standards which define its role and attributions. Only under these conditions can we speak of an European convergence of the methodologies defining the instruments of monetary policy and of their goal, particularly for a country with derogation from the adoption of the euro.

This convergence is stated in the Treaty of accession of Romania to the EU and in the Treaty of EU functioning. There are thus, **strict limitations of the use of the international reserves of a European central bank**, related to the contribution of the monetary policy to the stability or stabilization of the macroeconomic equilibriums, which need to be supported by a proper mix of policies implemented concomitantly by the executive and by the central bank. These restrictions refer to the use of the international reserves, of the instruments and to the moments of application, to the framework and operation of the monetary policy whose goal is price stability.

Article 123 from the mentioned Treaty forbids the central banks of the member states to grant loans on overdrafts or any kind of credit facility to EU institutions, organs, offices or agents, central public administrations, regional or local authorities, the other public authorities, public bodies or enterprises from the member states. This interdiction also is mentioned in article 7 from BNR statute.

It results thus that BNR cannot finance directly the budget deficit; otherwise said, it cannot cover the expenditure of the public administration, current or of capital. We remind once more the fact that the credibility of the currency is given by the money issuing institution – the central bank – because it makes decisions regarding the amount and cost of money applicable unpreferentially; setting a particular destination, such as covering the expenditure of the public administration, is similar with client favouring, while forcing the central bank to do this would mean depriving it of its independence of action.

What would happen if a central bank would finance the expenditure of the public administration?

This is readily observable in the balance sheet of the monetary authority. When the central bank purchases bonds issued by the government, in the balance sheet there is an increase both of the governmental credit and of the governmental deposits in the central bank. Thus, the net position remains unchanged. But if the government uses the money from the bonds purchased by the central bank to make a payment to the private sector, the cash increases and the governmental deposit in the central bank decreases. **In this situation, the financing of the deficit equals the issuance f money**. Under such situation, the central bank looses its trust and credibility and willingly fuels the inflationist danger. Actually the central bank would move away from its priority objective, **price stability,** by what we call the **monetary financing of the budget financing**, forbidden by the law.

Figure 2

Simplified balance sheet of the central bank

Assets	Liabilities
Net foreign assets	Cash
Net domestic assets	Foreign liabilities
Governmental credit	Governmental deposits
Nongovernmental credit	Capital account
Other assets (net)	Not-classified liabilities

The real role of the international reserves of a central bank is closely related to the efficiency of the monetary policy whose main goal is price stability trough a low level of liquidities in relation with the economic cycle. No doubt, the accomplishment of this goal needs resources which, principially, must answer the needs for financing of an economy, usually at its potential level for non-inflationist growth.

If the international reserves of a central bank are part of those resources, another question which must be answered is, **which is the criterion used to decide the right level of the international reserves**?

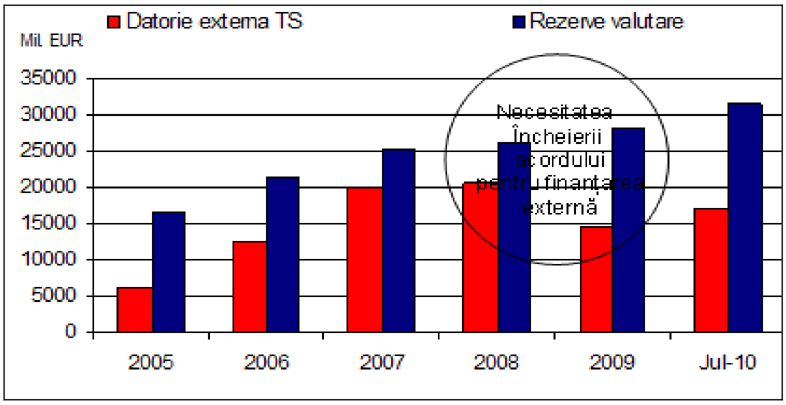
The answer to this question differs function of the external risks of that economy. Thus, when an economy has a closed capital account, meaning that the transactions of capital (foreign loans made by the private agents) are not allowed (the case of Romania until 2006), essential is the resistance with adequate resources to the risks involved by a current account which is opened from the perspective of unrestricted foreign trade and by a limited convertibility of the national currency. This risk refers to the proper financing of the imports, usually from exports and from other sources. In this case, the adequate level of the international reserves is calculated function of the number of months of import which the international reserves might support. The optimal level of the reserves is considered to be the equivalent in hard currency of 3-5 months of imports.

When an economy has the capital account opened and total convertibility, there is another source of risk emerging, the capitals which come and go freely, taking advantage of the arbitrage of short-term interest rates. The risks as associated in this case with the short-term debt (which maturates within the year). The proper level of the reserves in this situation is the equivalent of the total short-term foreign debt, governmental and private.

At the end of 2009, Romania was in a delicate position because the ratio was dangerously close to parity under the conditions in which the liquidity on the international market was very low. This is why the 20 billion euro foreign financing, from the agreement with the IMF, World Bank and EU, was needed

Chart 2

The international reserves and the short-term foreign debt



Source: BNR

The monetary policy and the international reserves

Many analyses say that the exchange rate of the leu against the euro is kept "artificially" by BNR. Usually, a central bank which doesn't target the exchange rate doesn't express on its level, and in the case of Romania which is targeting the inflation, the **only**

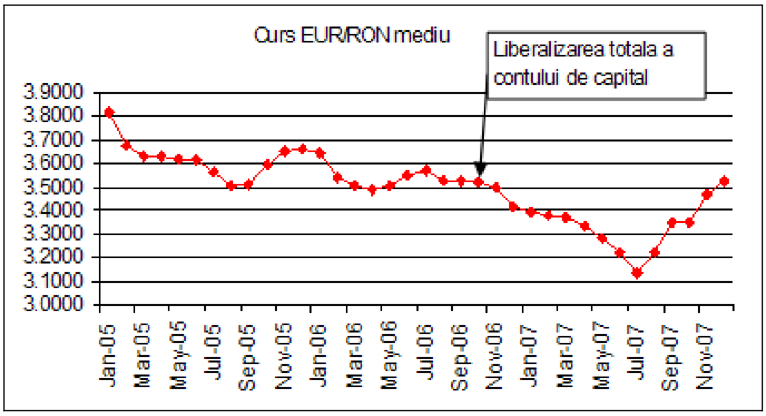
reference is the statement of a specific exchange rate policy, within the spirit of transparency.

When the inflation targeting strategy was launched, the central bank announced its exchange rate policy, controlled floating, corresponding to a more flexible exchange rate determined by the basics of the economy, according to an impossible trinity: independent monetary policy, opened capital account and fixed exchange rate. The first two conditions being accomplished in terms of the monetary policy framework, the exchange rate policy must be seen as a valve needed for the operation of the impossible trinity.

The perception of an artificial exchange rate supported by the central bank includes a basic error. It omits the fact that the international reserves are used, via the monetary policy instrument called **market operations**, to ensure a proper level of liquidity on the market. Therefore, BNR doesn't target a specific exchange rate, rather a proper level of liquidities which ensure accomplishing the price stability target, using a specific level of the monetary policy interest rate. Chart 3 shows the link between the level of liquidities and the exchange rate.

Chart 3

The international reserves and the currency market



Source: BNR

From the evolution of the exchange rate we can notice that BNR monitors two aspects when it analyses the exchange rate used on the currency market:

- it needs to reflect the economic basics (if this doesn't happen BNR intervenes, as is happened in July 2007, when the excessive appreciation compared to the economic basics determined the central bank to buy 2 billion euro, with the proper emission of lei);
- it must not be affected by an excessive volatility, which hinders the level of market liquidities, with consequences on the inflation level (situation for which we have the example of January-February 2010).

BNR uses the instruments available to it (**market operations, permanent facilities and the compulsory minimal reserves**) to influence first the volume of market liquidity. No doubt, that the liquidity in lei influences the currency market. It cannot be omitted and it is acceptable that the exchange rate can be influenced by the volume of liquidity in lei. The excessive appreciation of the exchange rate against the euro in mid 2007 was due to the liquidity produced by the opening of the capital account not to the liquidity introduced by the central bank, which had to sterilize that excess of liquidity. Thus, the purchase of 2 billion euro deposited in reserve, coming from the inflow of foreign capital with the opening of equivalent accounts in lei of the non-residents, was done by the emission of the equivalent amount of lei which has been resorbed through market operations, instrument of the monetary policy.

The compulsory minimal reserves and the monetary market

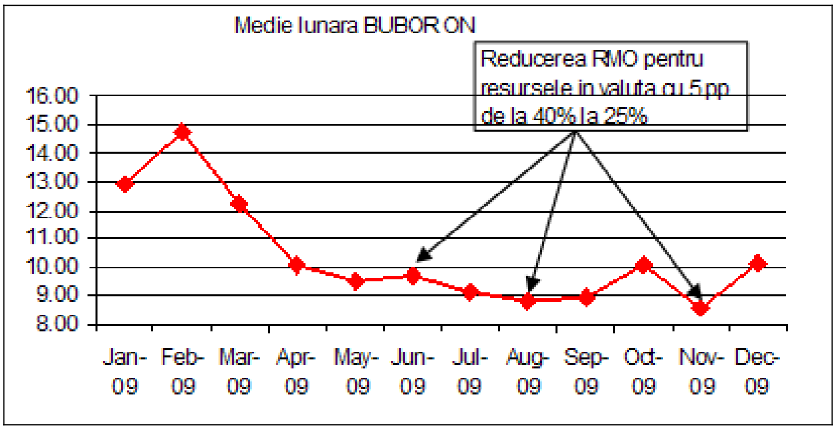
The instrument represented by the level of the compulsory minimal reserves in hard currency (CMR in hard currency) is part of the monetary policy arsenal of the central bank and we must wonder **how does it influence – as part of the currency reserves – the volume of liquidity?**

The compulsory minimal reserves for the hard currency liabilities of the commercial banks is included in the total volume of hard currencies belonging to the international reserves of BNR. The level of the compulsory minimal reserves is calculated with established formulas. When the central bank decides to decrease CMR level it leaves at the disposition of the banks a large amount of money – hard currency – for the direct (in hard currency) or indirect (through lei) crediting; while CMR increase reduces these availabilities. In principle, we are speaking of a level of liquidity regulated this time by the own money of the commercial banks.

CMR mechanism must be always used anti-cyclically, just as BNR did in 2005 and 2006 when it increased to 45% the CMR for the hard currency liabilities. In 2009, as the instalments from IMF were cashed, BNR could decrease the CMR for the hard currency liabilities and the effect was that the level of the international reserves was not affected. It is important that the effect of this relaxation was felt immediately on the monetary market by the lower interest rate for overnight loans, thus decreasing the tension of the access to short-term liquidity and of its costs for the commercial banks in difficulty, which could use the Lombard credit facility of the central bank.

Chart 4

The compulsory minimal reserves and the monetary market



Sources: BNR

The hard currency reserves and the currency market

After the total opening of the capital account and on the background of abundant liquidity worldwide, the inflow of foreign funds in Romania increased sharply starting with 2007. We are reiterating that this resulted in the excessive appreciation of the leu, and the central bank analysed it through the prism of the economic basics, work productivity. The aim of this analysis was supported by the erosion of this indicator due to the excessive increase of the nominal incomes.

This excessive appreciation induced an illusion on the value of the assets, so that the nominal variables increased – wages, credits, wealth etc. The reversed direction of the foreign funds, starting with 2008, decreased the value of the assets and ultimately even the nominal value of the assets had to be adjusted accordingly (decrease of the wages, decreased credits, balance sheet and wealth effects).

At the same time, the reversed direction of the flows of international funds also depreciated the exchange rate. When in an economy the capital account is opened, the central bank cannot and should not try to control the exchange rate, particularly in the moments of rapid evolution. The fact that this thing happens **is the signal which must warn on the credibility of the national currency against the currencies from the other states**. The attempt of the central bank to influence the exchange rate can only mask the signal sent by the market, and taking decisions in the shadow of this disguise of a reality signalled by the market is more than unproductive in terms of monetary policy efficiency

The central bank can and must act against the excessive variations which occur in moments of panic induced by the lack of transparency. Transparency and communication with the public is needed with regard to the mix of economic policies, not just with regard to the monetary policy

The hard currency reserves and the budget deficit

The resources of the state budget also include hard currency revenues from loans in foreign currencies (for instance issuances of Eurobonds, loans from the WB, EU etc.) and/or privatizations. These revenues are kept in the currency account of the state treasury opened at the central bank.

If the state has “reserves” in hard currency, the there is a legitimate question within the analysed context: how do the hard currency revenues affect the market liquidity?

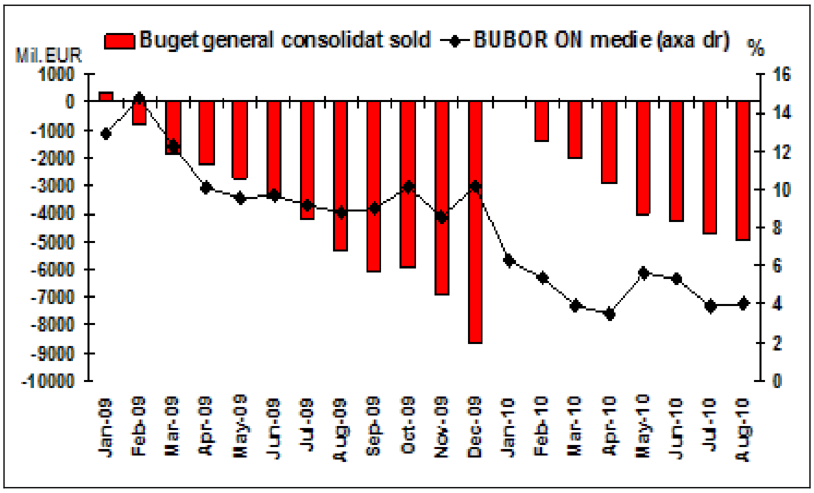
It is an established fact that BNR acts as state agent too, and the treasury account, by which the state makes payments (in lei and hard currency) is kept by BNR. The hard currency revenues of the state are kept together with the rest of the international reserves in the account of BNR treasury and are administered by the central bank.

If the state wants to make domestic payments in lei on the basis of the hard currency it owns in the account of BNR treasury, it exchanges directly at BNR that hard currency at the published exchange rate, so that the operation doesn’t affect the currency market and thus the exchange rate. In exchange, the **liquidity is affected because the volume of lei on the market will increase.**

The analysts who monitor the monthly evolution of BNR hard currency reserves volume and who consider that BNR intervened to “maintain” the exchange rate should remember that for more than one year we have been in the situation that the state is the main client looking for liquidity. The central bank is thus compelled to take into account the level of liquidity necessary on the market in order to accomplish the target inflation rate, using all the arsenal of instruments available to it, the monetary policy interest rate, the CMR and the market operations.

Chart 5

The currency reserves and the budget deficit



Source: BNR, Ministry of the Public finances

The currency reserves and the foreign imbalance

Under certain conditions, such as the situations of internal and foreign imbalances, the perception of the investors can worsen regarding the economic attractiveness of a country, particularly regarding the challenges to finance the deficits.

If the problem of the imbalances enters the sphere of the trust, then we have an answer to the question whether the international reserves of a country can heal the credibility problems of an economy.

At the end of 2008, when the access to foreign liquidity became uncertain for all the economies, Romania was very exposed in terms of the short-term debt and the credibility of the economy was falling on the background of an unsustainable deficit of the current account, which amounted to 13% of the GDP.

The described situation imposed two requirements: (1) foreign financing from IMF and (2) adjustment of the processes within the economy, so that the current account deficit returns within sustainable limits.

IMF funds allowed the stabilisation of the trust in the economy by the consolidation of the international reserves, but it is under the sign of incertitude as long as the process of internal adjustment is not finished, according to the conditions imposed through the loan agreement with the IMF.

What we are inferring from this reasoning is that the level of the international reserves has significance during moments of crisis and not only, that the international reserves can provide comfort in terms of the debts to be paid, **but by no means can they replace the process of economic reform or the inadequacy of the mix of policies** as signals of restored attractiveness and trust of the investors in the perspectives of an economy. Otherwise said, no matter how much international reserves would accumulate, it cannot replace in the eyes of the rating agencies the lack of structural reforms, and the rating agencies will produce a rating in consequence.