The cost of international reserves: An empirical analysis from Malaysia

Studies on the accumulation of international reserves by most of the crisis-hit countries have progressively gained in importance and continue to attract discussion among academics and policy-makers. Furthermore, the unprecedented increase of international reserves among the Asian crisis-hit countries (due to Asian Financial Crisis 1997/98) including Malaysia and the lack of studies on this topic underline the urgency of analyzing this issue. Thus, this paper specifically attempts to shed light on the cost of the joint decision to hold international reserves and external debt after the 1997 Asian financial crisis. The article's main findings are that holding international reserves does confer benefits on the country in terms of lower cost and improves the country's ability to protect itself from sudden shock. The results also suggest that Malaysia should hold international reserves of at least 4.96 months of imports, which is higher than the conventional rule of thumb. However, in its current international reserves position, Malaysia could finance 9.3 months of retained imports, which is too much and far above the optimal level.