International Reserves, External Debt Maturity, and the Reinforcement Effect for Financial Stability

Xingwang Qian
SUNY Buffalo State

Andreas Steiner
University of Osnabrueck

Abstract

Both international reserves and “cool” long-term external debt (LT) buttress financial stability, whereas “hot” short-term (ST) external debt jeopardizes financial stability in emerging and developing economies. This paper studies how international reserves affect the maturity structure of external debt, and, by implication, how they subsequently contribute to financial stability. We find that, among other factors, international reserves tilt the maturity structure of external debt towards more LT relative to ST debt. Thus, international reserves lengthen external debt maturity, which reinforces their contribution to financial stability in emerging and developing economies. In a theoretical model, we show that reserves stretch the maturity structure of external debt towards long-term obligations when a country balances the benefits and costs of borrowing long-term versus short-term debt. Using various regression specifications based on a sample of 66 emerging and developing countries from 1984 to 2012, we show that higher levels of reserves are associated with a higher share of long-term external debt. Further, we provide empirical evidence that reserves and long-term debt reinforce financial stabilization. Concerning the different default motivations of public and private external debtors, we study reserves’ effect on the maturity structure of public and private debt separately. We confirm that reserves lengthen the maturity of both public and private debt. The reinforcement effect of reserves for financial stability is shown thanks to longer debt maturity, public debt in particular.