Foreign Exchange Reserves

What are Foreign Exchange Reserves and who holds them?

Foreign Exchange Reserves are a country's holdings of financial assets in foreign currencies (for example, US or Australian dollars).

Since 1984, the Central Bank of Samoa has been given the statutory (legal) responsibility of maintaining and managing the country's foreign exchange reserves.

These financial assets can be in the form of savings or investments denominated in foreign currencies and held in countries the Central Bank chooses to hold reserves with.

For example, we hold our US dollar reserves in a bank or approved financial institution in the United States and our Australian dollar reserves are held in a bank in Australia. Similarly, this is done for our NZ dollar reserves and the British pound reserves.

Foreign reserves held abroad by the Central Bank are generally invested in secured and very liquid instruments[1] offered by financial institutions with high credit ratings.

This is done to ensure there are adequate foreign reserves to fund the country's international payment obligations, which include government payments, foreign debt, imports and other private sector capital and current payments.

[1] Any document with monetary value. Examples include cash and cash equivalents, but also securities such as bonds and stocks which have value and may be traded in exchange for money.

Other than the Central Bank, holders of foreign exchange reserves include the commercial banks, the Ministry of Finance and the National Provident Fund. Some other non-commercial bank financial institutions also hold some foreign reserves abroad for investment purposes, provided they have sought the necessary approval of the Central Bank.

The country's official foreign exchange reserves, however, are only those held by the Central Bank and the Ministry of Finance, in line with international standards.

Sources of foreign exchange in Samoa

Foreign exchange in Sāmoa is sourced mainly from inflows of inward remittances from overseas.

Another major avenue for inward flowing foreign currency is through Samoa's tourism sector, whereby tourists bring in their foreign currency and exchange it for Sāmoan tālā to spend in Sāmoa during their stay.

Export earnings are another, which are receipts generated from trading Sāmoa's own domestic resources including products/services, with the rest of the world. Foreign aid is yet another avenue by which Samoa obtains foreign currency.

Why do we need reserves?

We need foreign exchange reserves to pay for the import of goods and services, and to pay our overseas debts. Additionally, we need to keep enough reserves to help us in times of great need and/or unexpected natural disaster.

Samoa has a relatively small and open economy with a narrow resource base, limited land (although fertile enough for agriculture), no minerals and a small Economic Zone.

As a result, we depend heavily on the export of a limited number of commodities and few tourist accommodations (compared to neighbouring countries) for foreign exchange earnings.

Samoa is also highly vulnerable to external economic shocks of which it has no control over.

These external shocks can be adverse international export and import prices, falling international demand for Sāmoa's export of goods and services, or through the loss of production and significant infrastructural damages resulting from natural disasters.

Since the year 2000, Sāmoa has been struck by two major cyclones, Heta in January 2004 and Evan in December 2012, a major tsunami in September 2009, and significant international food and fuel price increases in 2007 to 2008.

In most of these cases, the Central Bank had to relax monetary policy and exchange controls to help the country recover through structural reconstruction and rehabilitation.

Although we were fortunate during most of these times to have international partners who provided foreign aid and/or loans in the initial aftermath of these economic shocks, the rehabilitation costs eventually lead to a run-down of foreign exchange reserves.

It is therefore important for the Central Bank to control and maintain a comfortable level of foreign reserves, not just to help meet our regular overseas commitments but also to provide a buffer to keep the economy afloat in the event of a national economic crisis.

The current target level of foreign exchange reserves must cover at least four months of imports.