XXI. Reserve Assets

Concept and Coverage

424. Reserve assets, the fourth major functional category of the financial account, is an important component of balance of payments statistics and an essential element in the analysis of an economy’s external position. Reserve assets consist of those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes. (See paragraphs 425 and 432.) The category of reserve assets, as defined in this Manual, comprises monetary gold, SDRs, reserve position in the Fund, foreign exchange assets (consisting of currency and deposits and securities), and other claims. (See paragraph 443.) Securities that do not satisfy the requirements of reserve assets are included in direct investment and portfolio investment.

425. Supplementing reserve assets are other substitute external resources, credits, and/or a variety of conditional items—all of which incur liabilities. These are virtually second-line reserves that can be readily mobilized by monetary authorities. As a result, while the significance of reserve assets within the total international liquidity framework may have narrowed, such assets still play a key role. On the other hand, authorities may utilize other means to deal with imbalances. For example, authorities may make use of Fund credit and loans from the Fund, encourage other sectors of the economy to engage in foreign borrowing, and/or alter the exchange rate or allow it to float freely, etc. The use or acquisition of reserve assets, therefore, does not necessarily reflect the degree or size of the payments imbalance of concern to the authorities. The authorities also may hold reserves for other motives—such as to maintain confidence in the currency and the economy, to satisfy domestic legal requirements, or to serve as a basis for foreign borrowing. In any event, resources that may be available in terms of external liquidity reflect a broader range of items than the components of reserve assets listed in this Manual.

Identification of Reserve Assets

426. The financial assets comprising reserves cannot unambiguously be identified in a meaningful way simply through the application of objective criteria. The readily observable characteristics of a claim—legal ownership, marketability, currency of denomination, original contractual maturity, etc.—are not sufficient to establish whether a claim is actually available to the monetary authorities to use for the indicated purposes. However, reserve assets always refer to assets that actually exist. Claims that could be created under agreements that are in force (e.g., foreign exchange that could be obtained under swaps agreements and other lines of credit or through the use of Fund credit under stand-by arrangements) do not constitute existing claims. Conversely, assets that are pledged, committed, earmarked, set aside in sinking funds, sold forward, or otherwise encumbered by the holders are nonetheless existing assets and are not precluded on those grounds alone from being included in reserve assets. However, because such arrangements may affect the availability and usability of the assets involved, supplementary information concerning the arrangements would be useful.

427. Two issues must be considered in the identification of reserve assets. First, in addition to assets actually owned, which other assets are at the effective disposal of monetary authorities? Second, of the assets controlled by the monetary authorities, which are available for use—should the necessity arise? Decisions on these matters will depend, at least in part, on the exercise of judgment.

Effective control

428. The aspect of control can be appraised only with reference to the institutional framework in individual economies. In the narrowest sense, monetary authorities control absolutely only those assets to which they legally hold title. In the broadest sense, almost any asset owned by a resident of the economy may ultimately be subject to the control of the authorities. Neither of these extreme views is useful for the balance
of payments. Instead, the concept of reserve assets should encompass those assets over which authorities exercise direct and effective control.

429. The test of such control is to be applied quite strictly. In general, only foreign claims actually owned by monetary authorities would be included as reserves. For example, the acquisition of assets through any statutory power that is maintained solely on a stand-by basis would not be considered an effective exercise of control. Also, the potential for transferring assets to or from the authorities through a change in monetary policy—and thereby inducing banks to change their holdings of foreign assets—would be deemed too indirect. Nevertheless, ownership is not a necessary condition for control. For instance, if banks hold legal title to foreign assets but are permitted to deal in such assets only on the terms specified by monetary authorities or only with their express approval, such assets would be considered subject to the authorities’ direct and effective control.

430. Except in unusual circumstances, direct and effective control is not to be construed as extending beyond the assets owned by depository institutions. That is, while certain bank-owned claims on nonresidents could be classified as reserve assets, those same claims would cease to be reserve assets if the banks sold the claims to private residents other than depository institutions—whatever the institutional arrangements in the economy might be. Authorities should be able to provide data on assets that they control (but not own) because that information would be prerequisite to effective control.

Availability for use

431. Whether an asset controlled by monetary authorities is available for use is partly dependent on any conditionality that affects the asset—including, as one main aspect, the liquidity or marketability of the asset. Owned assets (such as monetary gold, SDRs, and reserve positions in the Fund) that are immediately available can be viewed as assets in the most unconditional form. Foreign exchange holdings and other claims, in many instances, are equally available. However, a ranking of all available assets according to conditionality is not a feasible undertaking. Furthermore, such a ranking—if made—would be based on two types of judgments: (i) the precise degree of conditionality required for assets to be considered unavailable for use (in accordance with the concept of reserve assets) and (ii) the point at which the borderline between reserve assets and other assets should be drawn. A more pragmatic approach is to consider, in each case, whether there is an expectation, backed by a reasonable degree of assurance, that the conditions could be satisfied if and when it became necessary to use the asset.

Selected cases

432. Monetary authorities presumably hold or exercise control over foreign assets in order to have such assets available as reserve assets or for some other purpose. These objectives may not be mutually exclusive. For example, reserve assets in excess of immediate requirements can be invested in World Bank obligations and thus provide development aid. Assets held for both reasons are generally classified as reserve assets. In contrast, assets in the form of direct, long-term loans for development and other purposes are not classified as reserve assets. Net creditor positions in regional payments arrangements that involve reciprocal lines of credit and that require prompt settlement of outstanding drawings (e.g., monthly or quarterly) are considered as reserve assets. However, net asset balances in bilateral payments agreements have much in common with other types of tied loans that authorities make to stimulate exports, provide aid, or further other aspects of government policy. Such payments agreement balances are therefore conventionally excluded from reserve assets. Subscriptions to international nonmonetary organizations, assets redeemable only in convertible currencies and assets with uses blocked or otherwise effectively restricted by issuers are examples of assets that are not considered reserve assets.

433. Most other foreign assets held by monetary authorities are likely to be appropriate for inclusion in reserve assets. Working balances of the government qualify fully as reserve assets because, by definition, such balances are available for immediate use. Committed assets cannot be excluded because, like all other reserve assets, committed assets exist to meet requirements. An asset is no less a reserve asset simply because the specific use to which the asset is to be put is unforeseeable one. A readily repayable loan to the Fund comprises a reserve asset. Bank transfers of foreign claims to authorities just prior to certain accounting dates can result in a portion of the assets held by the authorities being committed, in effect, to the reversal of the transfer soon after those dates—whether or not the commitment is formal. While such operations undoubtedly distort the statistics on reserve assets as of a specified date, the distortion should be interpreted as the result of a seasonal influence, and the omission of
such holdings from reserve assets may be justified only as a seasonal adjustment.

434. Assets created under reciprocal facilities (swap arrangements) for the temporary exchange of deposits between the central banks of two economies warrant mention. Deposits (in foreign exchange) acquired by the central bank initiating the arrangement are treated as reserve assets because the purpose of the exchange is to provide the central bank with assets that can be used to meet the country's balance of payments needs. Reciprocal deposits acquired by the partner central bank also are considered reserve assets. Arrangements (gold swaps) involving the temporary exchange of gold for foreign exchange deposits should be treated in a similar manner. When a central bank acquires foreign exchange from a domestic bank in exchange for a deposit (in national currency) at the central bank and there is a commitment to reverse the transaction at a subsequent date, the transaction is treated and recorded as an increase in reserve assets of the central bank and an increase in the central bank's liabilities (in national currency) to the domestic bank.

435. Assets not actually owned by monetary authorities do not usually qualify as reserve assets under a strict application of the criteria discussed in paragraph 429. Nevertheless, the possibility that such assets may qualify cannot be entirely precluded. Qualification should be apparent to the balance of payments compiler: if monetary authorities are presumed to be exercising effective control over such assets, the assets must possess quite distinctive characteristics. An example would be assets that monetary authorities temporarily transfer to private deposit money banks; the transfers would be accompanied by some special inducements to hold the assets, such as agreements to repurchase the assets at prices that assure the banks of realizing profits.

Classification

437. Although individual elements of reserve assets are largely interchangeable from a functional standpoint, changes in components discussed subsequently may have somewhat differing implications for analyses of global liquidity and the balance of payments adjustment process.

438. Monetary gold is gold owned by the authorities (or by others who are subject to the effective control of the authorities) and held as a reserve asset, 10 other gold (nonmonetary gold, possibly including commercial stocks held for trading purposes by authorities who own monetary gold) owned by any entity is treated in this Manual as any other commodity. Transactions in monetary gold occur only between monetary authorities and their counterparts in other economies or between monetary authorities and international monetary organizations. Like SDRs (see paragraph 440), monetary gold is a reserve asset for which there is no outstanding financial liability.

439. Authorities who add to their holdings of monetary gold by acquiring commodity gold (i.e., newly mined or existing gold offered on the private market) or release monetary gold from their holdings for nonmonetary purposes (i.e., for sale to private holders or users) have monetized or demonetized the gold, respectively. Any increase or decrease in monetary gold holdings resulting from monetization or demonetization is treated as a reclassification of gold; such an increase or decrease is not shown in the balance of payments but is reflected in the international reserves position. If the gold being monetized or demonetized is acquired from or sold to a nonresident, that transaction should be recorded as an import or export under goods in the current account and, in the financial account, as a credit or debit under the financial item that was used to finance that import or export.

440. SDRs are international reserve assets created by the International Monetary Fund to supplement other reserve assets that are periodically allocated to IMF members in proportion to their respective quotas. SDRs are not considered liabilities of the Fund, and IMF members to whom SDRs are allocated do not incur actual (unconditional) liabilities to repay SDR allocations. The Fund determines the value of SDRs daily by summing, in U.S. dollars, the values—which are based on market exchange rates—of a weighted

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10As defined in this Manual, monetary gold is generally regarded as being at least 995/1000 pure.

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basket of currencies. The basket and weights are subject to revision from time to time. SDRs can be used to acquire other members' currencies (foreign exchange), to settle financial obligations, and to extend loans. Changes in the SDR holdings of monetary authorities can arise through (i) transactions involving SDR payments to or receipts from the Fund, other participants in the SDR Department of the Fund, or other holders or (ii) allocation or cancellation. Transactions such as those enumerated under (i) are included in the balance of payments; allocations or cancellations are not entered in the balance of payments but are reflected in the international investment position.

441. An IMF member may have, in the Fund's General Resources Account, a position that is recorded under the category of reserve assets. This position is referred to as the member's reserve position in the Fund. The member's reserve position is the sum of the reserve tranche purchases that a member may draw upon and any indebtedness of the Fund (under a loan agreement) that is readily repayable to the member. Reserve tranche purchases are purchases from the Fund of other currencies that do not cause Fund holdings of a member's currency to exceed the member's quota (minus holdings that reflect the member's use of Fund credit). A purchase from the Fund is recorded as an increase in foreign exchange holdings and a decrease in the member's reserve position in the Fund; a repurchase is recorded as a decrease and an increase, respectively. Purchases in the reserve tranche are not regarded as a use of Fund credit, are not subject to charges, and do not require repurchase. In addition to reserve tranche purchases, members may use Fund resources in connection with compensatory and contingency financing, buffer stock financing, the extended Fund facility, and the credit tranches (including policy on enlarged access) without having those purchases and holdings included in Fund holdings of member currencies for the purpose of defining the reserve tranche. A member's drawing (other than against its reserve tranche position) constitutes the use of Fund credit. (See paragraph 415.)

442. Foreign exchange includes monetary authorities' claims on nonresidents in the forms of ECUs.11

11Countries participating in the European Monetary System were issued ECUs against deposits of gold and U.S. dollars with the European Monetary Cooperation Fund. Those reserves that were not replenished are excluded from gold and foreign exchange holdings as published by the Fund, but the equivalent holdings of ECUs are included in foreign exchange.

currency bank deposits, government securities, other bonds and notes, money market instruments, financial derivatives, equity securities, and nonmarketable claims arising from arrangements between central banks or governments. (Foreign exchange covers claims that are shown as the foreign exchange component of the series for international liquidity published by the Fund in International Financial Statistics.) The instrument subclassification of the foreign exchange component of reserve assets is necessary in the context of the Fund’s compilation of global aggregates of the main components of the world financial account and for analyses of the global discrepancy in those aggregates. (The Fund adheres to strict confidentiality requirements concerning instruments.)

443. Other claims is a residual category covering claims that are not included previously and that may constitute reserve assets in the form of currency, deposits, or securities. For instance, the foreign exchange component may not invariably cover working balances abroad of government nonmonetary agencies or assets that are held by banks and subject to the control of monetary authorities.

Valuation

444. In principle, all transactions in reserve assets are recorded at market prices—that is, market exchange rates in effect at the times of transactions, market prices for claims such as securities, and SDR market rates as determined by the Fund. Monetary gold transactions are valued at the market prices underlying the transactions. For valuation of stocks of reserve assets in the international investment position, market prices in effect at the ends of appropriate periods are used.

Interpretation of Changes in Reserve Assets

445. Changes in reserve assets (within the context of broader aspects of external liquidity; see paragraph 425) are an important analytic tool for assessing balance of payments adjustment requirements but should not be viewed in isolation. Difficulties may arise, in some instances, in correctly identifying certain items as reserve assets. Similar problems pertain to the identification of liabilities constituting foreign authorities’ reserves (LCFARs). Reflecting these considerations, this chapter and Chapter 22 (covering LCFARs and exceptional financing transactions) should be considered complementary rather than mutually exclusive.