SDR supplements existing reserves and constitutes IMF's unit of account

In 1969, the IMF created the SDR as an international reserve asset to supplement members' existing reserve assets—official holdings of gold, foreign exchange, and reserve positions in the IMF. The IMF allocates SDRs to its members in proportion to their IMF quotas. Members may use SDRs to obtain foreign exchange reserves from other members and to make payments to the IMF. SDR allocations are not loans; members may use them to meet a balance of payments financing need without undertaking economic policy measures or repayment obligations. However, a member that uses its SDRs pays the SDR interest rate on the amount by which its allocations exceed its holdings. A member that acquires SDRs in excess of its allocation receives interest. Since 1970, the IMF has allocated a total of SDR 21.4 billion to its members in two series of allocations.

The SDR is also the unit of account for IMF transactions and serves a similar function in a number of other international and regional organizations and conventions. The SDR interest rate is the basis for calculating the interest charges on regular IMF financing and the interest rate paid to members that are creditors to the IMF. As of April 30, 2001, the currencies of four countries were pegged to the SDR.

How is the value of the SDR determined?

The SDR's value is based on the value of a basket of currencies. Movements in the exchange rate of any one component currency will tend to be partly or fully offset by movements in the exchange rates of the other currencies. Thus, the value of the SDR tends to be more stable than that of any single currency in the basket, which makes the SDR a useful unit of account. The basket is reviewed every five years to ensure that the currencies included in it are representative of those used in international transactions and that the weights assigned to the currencies reflect their relative importance in the world's trading and financial system. The latest review was completed in October 2000, and the IMF Executive Board decided on changes in the valuation basket, which became effective on January 1, 2001, to take account of the introduction of the euro as the common currency of a number of IMF members and to reflect the growing role of international financial markets. The new valuation basket includes the U.S. dollar, the euro, the Japanese yen, and the pound sterling. Its value is determined daily based on exchange rates quoted on major international currency markets and posted each day on the IMF's website (www.imf.org/external/np/tre/sdr/basket.htm).

SDR valuation on August 15, 2001

Currency	Currency amount	Exchange rate[1]	U.S. dollar equivalent
Euro	0.4260	0.91040	0.387830
Japanese yen	21.0000	120.56000	0.174187
Pound sterling	0.0984	1.43660	0.141361
U.S. dollar	0.5770	1.00000	0.577000
		Total	1.280378

SDR 1 = US$1.28038
US$1 = SDR 0.781019

[1]Exchange rates in terms of U.S. dollars per currency unit, except for the yen, which is expressed as currency units per U.S. dollar.

Data: IMF Treasurer's Department

How is the SDR interest rate determined?

The SDR interest rate, which is adjusted weekly, is a weighted average of interest rates on selected short-term domestic instruments in the markets of the currencies included in the SDR valuation basket. Effective January 1, 2001, the representative rates are, for the euro, the three-month Euribor (euro interbank offered rate); for the Japanese yen, the yield on Japanese government 13-week financing bills; and for the U.S. dollar and the pound sterling, the yields on the three-month U.S. and U.K. treasury bills, respectively.

Use of SDRs

The SDR is a purely official asset, which is held by member country participants in the SDR Department, certain prescribed official entities (other international lending institutions or institutions that act as a common central bank for IMF members, such as the European Central Bank), and the IMF itself. The SDR is used primarily in transactions with the IMF, either by members settling obligations to the IMF, some of which must be paid in SDRs, or by the IMF making interest and principal payments to members.

Transactions are facilitated by arrangements managed by the IMF under which 13 member countries and 1 central bank are prepared to buy or sell SDRs for currencies that are readily usable in international transactions, provided that their own SDR holdings remain within certain limits. The IMF can also designate participants whose balance of payments and gross reserve positions are considered strong enough to provide foreign exchange to other members with balance of payments needs and receive SDRs in return. However, while a planning mechanism for this purpose is prepared quarterly, in practice, this mechanism has not been used since 1987 because of the success of the voluntary trading arrangements.

The total level of transfers of SDRs decreased in financial year 2001—to SDR 17.8 billion, compared with SDR 22.9 billion the previous year and the peak of SDR 49.1 billion in financial year 1999, when the volume of SDR transactions increased significantly because of payments of quota increases under the Eleventh General Review of Quotas.

SDR allocations

One of the IMF's principal goals is to facilitate the expansion and balanced growth of international trade. This requires, among other things, adequate levels of international reserves. In case of a long-term global need for reserves, the IMF's Board of Governors can decide to supplement existing reserves through an allocation of SDRs. Such a decision for a general allocation would require an 85 percent majority, and SDRs would be allocated to all members in proportion to their quotas in the IMF. There have been two general allocations, the most recent on January 1, 1981, when SDR 12.1 billion was allocated to the IMF's then 141 member countries, bringing the total of allocated SDRs to SDR 21.4 billion.

More than one-fifth of the IMF's current members have never received an SDR allocation, because they joined the IMF after January 1, 1981. In addition, other members have not participated in every allocation. After reviewing the role and functions of the SDR in the light of changes in the world financial system and to ensure that all participants in the SDR Department would receive an equitable share of cumulative SDR allocations, the Board of Governors adopted a resolution in September 1997 proposing a Fourth Amendment to the IMF's Articles of Agreement. The amendment, when approved, will provide for a special onetime allocation of SDR 21.4 billion, which will double the current level of cumulative SDR allocations. The amendment would not affect the IMF's existing power to allocate SDRs if it determines that there is a long-term global need to supplement reserves.

The proposed amendment will become effective when approved by three-fifths (110) of the members having 85 percent of the total voting power. As of July 15, 2001, 108 members having 72 percent of the total voting power had agreed. Thus, approval by the United States and any other member would now put the amendment into effect. ■

Liquidity position

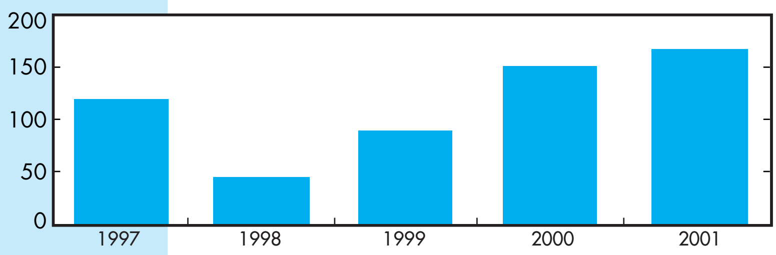
IMF's financial position remains strong

The IMF's financial position, which strengthened considerably following the 1999 increase in quotas, remained strong in financial year 2001.

The IMF's financing and other transactions are financed primarily from the quota subscriptions paid in by its member countries, although only a portion of these funds are available for financial assistance to members. Its currently usable resources consist of its holdings of the currencies of financially strong members included in the financial transactions plan (see box, page 25) and SDRs.

IMF liquidity ratio

(Percent; as of April 30)



Data: IMF, *Annual Report* 2001

The IMF does not use the currencies of members that are using IMF resources or those the IMF does not consider to be financially strong enough. Moreover, some of these usable resources will have been committed under existing arrangements and must be held for working balances. Thus, the IMF's net uncommitted usable resources represent the funds available for new financing and for fulfilling members' requests for their liquid claims on the IMF to be cashed. As of April 30, 2001, the IMF's net uncommitted usable resources amounted to SDR 78.8 billion, about 37 percent of total quotas, compared with SDR 74.8 billion a year earlier and almost four times higher than the low point that preceded the quota increase.

As of April 30, 2001, the IMF's "liquidity ratio"—defined as the ratio of the IMF's net uncommitted usable resources to its liquid liabilities—was 168.4 percent, which was more than five times higher than the low point before the 1999 increase in IMF quotas.

During financial year 2001, a number of Stand-By and Extended Fund Facility Arrangements with large undrawn balances expired—including those with Korea, Mexico, and Russia—which made about SDR 7.0 billion in funds available for new financing. In addition, the financial positions of three other countries (Korea, Oman, and Qatar) were judged to be strong enough to be added to the list of those supporting the IMF's financial operations. (Korea was included because it was considered strong enough to make early repayment of outstanding credit.) An increase in China's quota provided additional usable funds.

The IMF can supplement its quota-based funds by up to SDR 34 billion through two existing borrowing arrangements: the New Arrangements to Borrow (NAB) and the General Arrangements to Borrow (GAB) (see box, page 18). No borrowing occurred during the year, and the credit lines under these arrangements are fully available. ■