Special drawing rights: some recent developments

As a result of amendments to its Articles of Agreement in 1969, the International Monetary Fund (IMF) was empowered to create new international reserve assets in the form of special drawing rights (SDRs).[1] SDRs were created with the aim of supplementing global liquidity. They are reserve assets which, although not traded in any market, can be transferred between central banks in exchange for currencies needed for market intervention. The first allocation of SDR 9.3 billion took place between 1970 and 1972. Following a recommendation by the Interim Committee of the IMF in September 1978, it was agreed that there should be a second allocation of SDR 12 billion, in three equal annual instalments over the years 1979–81. The first of these instalments was allocated in January this year, and the United Kingdom received SDR 304 million.

At first the uses of SDRs were somewhat restricted by the IMF Articles of Agreement. However, with effect from 1st April 1978, the articles were further amended and now include the objective of making the SDR 'the principal reserve asset in the international monetary system'; a number of modifications to the SDR provisions in the Articles were made to contribute to the attainment of this objective. The main changes are outlined below.

The prior authority of the IMF is no longer required for spot exchanges of SDRs for currencies among participants in the SDR scheme. Transfers of SDRs against currency can now take place between participants subject only to the condition that the correct rate of exchange is used. Moreover, the IMF Board has been given the power to expand the ways in which participants may use SDRs (previously limited to spot exchanges of SDRs for currencies). In December 1978, it was decided to permit the transfer of SDRs between participants in loans and in the settlement of financial obligations; these decisions were followed in February this year by a further decision concerning the use of SDRs as security either by pledging or by transfer-retransfer agreement. The use of SDRs in swaps and forward transactions will now be considered by the IMF Board, together with the possibility that participants might be permitted to make donations in SDRs.

The rules governing participants' minimum average holdings of SDRs (the 'reconstitution' rules) may now be modified or abrogated at any time, and the IMF Board decided to reduce the minimum required level of average holdings over any five-year period from 30% to 15% of a participant's allocation with effect from 1st January 1979. Finally, the category of non-participants that may be permitted to hold and use SDRs (known as 'other holders') has been extended to cover all 'official entities', so that international development institutions, for example, may now be permitted to hold SDRs. So far, only the Bank for International Settlements (in January 1974), has been prescribed as an 'other holder' although the possibility of further extension of the category of 'other holders' is being considered. The SDR has, however, been increasingly used as a unit of account by a number of official institutions, and there have also been some SDR-denominated bond issues.

In addition to the changes described above, the IMF has also revised, in the light of more recent data, the composition and weighting of the baskets used to determine the valuation of the SDR and the rate of interest payable on it. The new methods of calculation are described below.

Valuation of the special drawing right

The value of the SDR is determined by the so-called 'standard basket' method, under which one SDR is equal to the sum of specified quantities of the major currencies. Between July 1974 and June 1978, the basket [2] contained the sixteen currencies whose issuers each accounted for more than 1% of world exports of goods and services over the period 1968–72. On 1st July 1978 a new valuation basket (see Table A) was introduced, based on statistics for the period 1972–76. The weightings used (see Table B) reflect the issuing countries' share of world trade during this period, except for the United States, where the weighting was adjusted to reflect the importance of the US dollar. Two currencies in the previous basket, the Danish krone and the South African rand, are no longer included, and two new currencies, the Saudi Arabian riyal and the Iranian rial, have joined the basket. Some of the relative weightings of currencies in the basket have also altered.

Table A
Units of currency in the SDR basket

US dollar	0.40	Belgian franc	1.6
Deutschemark	0.32	Saudi Arabian riyal	0.13
French franc	0.42	Iranian rial	1.7
Japanese yen	21	Swedish krona	0.11
Pound sterling	0.050	Australian dollar	0.017
Canadian dollar	0.070	Austrian schilling	0.28
Italian lira	52	Norwegian krone	0.10
Dutch guilder	0.14	Spanish peseta	1.5

[1] See the article in the June 1968 *Bulletin*, page 146.
[2] The original valuation method and the basket used from 1st July 1974 until 30th June 1978 were described in an article on page 281 of the September 1974 *Bulletin*.

Table B
Weights used to determine the currency amounts in the SDR basket

Per cent

United States	33	Belgium	4
Western Germany	12.5	Saudi Arabia	3
France	7.5	Iran	2
Japan	7.5	Sweden	2
United Kingdom	7.5	Australia	1.5
Canada	5	Austria	1.5
Italy	5	Norway	1.5
Netherlands	5	Spain	1.5

The currency amounts in Table A were calculated from the weightings in Table B on the basis of average exchange rates for these currencies during the three months ending on 30th June 1978, and certain further adjustments were made to ensure that both the old and new valuation baskets yielded the same value for the SDR on that date.

In future, the valuation basket will be adjusted at five-yearly intervals (starting on 1st July 1983), unless the IMF Board decides otherwise, so as to include the sixteen member countries with the largest exports of goods and services over a recent five-year period (for example 1977–81 for the 1983 review). However, a currency in the basket will not be replaced by another currency unless the exports of goods and services of the issuer of the other currency exceed those of the issuer of a currency in the basket by at least 1%. The weightings of each currency in the SDR basket will be adjusted on the basis of the sum (for the relevant period) of exports of goods and services of the issuing country and the amount of its currency held in other IMF members' reserves.

The daily calculation
The method of calculating the value of the SDR as described in the September 1974 *Bulletin* has not changed, but is repeated here for ease of reference.

The IMF calculates the value of the SDR daily in terms of each currency used in SDR transactions or in drawings and repurchases. This includes all the sixteen currencies in the basket together with several others.

For the US dollar, the SDR value is obtained by applying market exchange rates against the dollar to each of the other currencies in the basket. The amount of each of these currencies is thus converted into an equivalent number of US cents, and the sixteen amounts of US cents are added together to give the US dollar value of the basket and therefore of the SDR. The exchange rates used for this calculation are supplied to the IMF under standing arrangements by the authorities in major exchange markets. The rate for the yen is provided by the Bank of Japan in Tokyo. For the other currencies, the Bank of England normally provides the London market's noon rates; because of the time difference, the IMF can receive these rates at the start of the business day in Washington. If the London market is closed, the necessary rates are obtained from New York or, failing that, from Frankfurt.

In theory, it would be possible to value other currencies in terms of the SDR in exactly the same way as the US dollar. Each of the monetary authorities concerned could report to the IMF daily market rates for its currency against the other components of the basket, and the total of the local currency equivalents of the components would provide the rate for the SDR in terms of the local currency. However, this would entail a quite unnecessary burden of reporting, as well as some problems in obtaining meaningful quotations for all the relevant currencies.

In practice, therefore, a less cumbersome system is used: the value of the SDR for currencies other than the US dollar, whether inside or outside the basket, is calculated by applying local representative rates against the US dollar to the US$/SDR rate. For example, if on a particular day SDR 1 equals US$1.28648 and the representative rate for the pound is US$2.0500, then SDR 1 would equal 1.28648/2.0500, that is £0.627551. (For currencies that are quoted in terms of currency units to one dollar, the two rates would be multiplied and not divided.) The representative market rates used for calculating the SDR values of currencies other than the US dollar are supplied individually by central banks in accordance with procedures established with the IMF.

The IMF publishes daily SDR rates for about forty currencies. These are available through Reuters, and some are published daily on the foreign exchange page of the *Financial Times*. The rates are also published monthly by the IMF in *International Financial Statistics*.

The SDR interest rate

Participants in the SDR scheme receive interest annually from the IMF on their holdings of SDRs in excess of 100% of their SDR allocation and pay interest at the same rate on the amount by which their SDR holdings are below 100% of allocation. The SDR interest rate is set at 80% of a combined market rate, rounded to the nearest 0.25%. The IMF Board decided to raise the SDR rate from 60% to 80% of the combined market rate with effect from 1st January 1979. The combined market rate is the weighted average of the daily interest rates for five selected short-term financial instruments (see Table C). The rate

Table C
Composition of the SDR interest-rate basket

Weights in per cent

United States	Market yields for three-month Treasury bills	49
Western Germany	Three-month inter-bank deposit rates	18
France	Three-month inter-bank rate against private paper	11
Japan	Call money rate (unconditional)	11
United Kingdom	Market yields for three-month Treasury bills	11

is calculated each quarter from the daily rates for the six-week period ending on the fifteenth day of the month before the calendar quarter for which the rate is to apply.