Special drawing rights: further developments

On 1 January 1981 some changes were made in the procedures for valuing special drawing rights and for calculating the interest payable on them. This article describes these changes and some other recent developments, including the wider use of special drawing rights in official transactions and as a numeraire for private sector borrowing and lending.

Introduction

There have recently been a number of significant changes in the characteristics and uses of special drawing rights (SDRs). Created by the International Monetary Fund (IMF) in 1969 and first introduced in 1970 with the aim of supplementing global liquidity,[1] SDRs are official international reserve assets which can be transferred only between authorised holders; their supply, their valuation and the interest payable on them, are all determined by the IMF. To date, there have been two series of annual allocations to members of the IMF participating in the SDR scheme. The first, of SDR 9.3 billion, took place between 1970 and 1972; the second, SDR 12 billion, started in 1979 and was completed in January 1981. In the first eleven years, to 31 December 1980, SDRs have been used by participants in transactions amounting to over SDR 33 billion.

On 1 April 1978, shortly before the second series of allocations of SDRs, the second amendment of the Articles of Agreement of the IMF came into effect. The amended Articles included the objective of making the SDR the principal reserve asset in the international monetary system. The main changes in the SDR since then relate to the scope of its uses, the method of valuation, and the procedure for establishing the rate of interest payable on it. More details are provided below. Previous developments were outlined in earlier *Bulletin* articles.[2]

Valuation and interest-rate baskets

Since July 1974 the value of the SDR has been determined by the so-called 'standard basket' method, under which one SDR is equal to the sum of specified quantities of certain major currencies. Between July 1974 and June 1978 the basket contained the sixteen currencies whose issuers each accounted for more than 1% of world exports of goods and services over the period 1968–72. From July 1978 to December 1980 a revised valuation basket, still consisting of sixteen currencies but based on trade statistics for 1972–76, was in operation. In both cases the initial currency weightings that were used to calculate the actual amounts of currency in the SDR were chosen to reflect, in broad terms, those members' shares of world trade in the relevant periods. The weight for the US dollar was increased on both occasions to reflect, in addition, the particular importance of the dollar as a reserve currency.

Since January 1975, the rate of interest applicable to SDRs (see below for more details) has been calculated from the weighted average of representative short-term interest rates in the five countries whose currencies had the largest weights in the valuation basket[3]—the weights in the interest-rate basket bearing the same proportional relationship to each other as in the valuation basket.

In September 1980 the IMF Executive Board decided that the number of currencies in the SDR valuation basket should be reduced from sixteen to five with effect from 1 January 1981. This simplification brought the valuation basket into line with the interest-rate basket, and was intended to enhance the attractiveness of the SDR as a reserve asset. The amounts of each currency in the basket were recalculated in accordance with new weightings, which took account of more recent trade data and of official holdings of the basket currencies, so that from 1 January 1981 both the valuation and interest-rate baskets have comprised the five currencies with, at the start, the weightings shown in the first column of Table A.

Table A
Initial weightings in the valuation and interest-rate baskets
Per cent

Currency	New unified basket(a)	Previous baskets(b) Interest-rate	Previous baskets(b) Valuation
US dollar	42	49	33.0
Deutschemark	19	18	12.5
French franc	13	11	7.5
Japanese yen	13	11	7.5
Pound sterling	13	11	7.5
Other currencies	—	—	32.0

(a) Effective from 1 January 1981.
(b) Effective from 1 July 1978 to 31 December 1980.

(1) For the history behind the creation on the asset, see 'The place of special drawing rights in the international monetary system' in the June 1968 *Bulletin*, page 146.

(2) 'The new method of valuing special drawing rights' in the September 1974 *Bulletin*, page 281, and 'Special drawing rights: some recent developments' in the June 1979 *Bulletin*, page 188. An extensive account of developments relating to the SDR and a glossary of terms were published in the *IMF Survey* of 26 January 1981.

(3) United States, West Germany, France, Japan and the United Kingdom. The original weightings in the interest-rate basket may be found in the September 1974 article (page 283).

The next two sections describe the procedures adopted by the IMF to derive from these percentage weights the currency amounts in the valuation basket, the daily value of the SDR, and the SDR interest rate.

Valuation

The currency amounts in the valuation basket were fixed on 31 December 1980 on the basis of the previously agreed percentage weightings and the average exchange rates for the three-month period ending on that day. The currency amounts in the new valuation basket also had to satisfy the requirement that the value of the SDR in terms of any currency on 31 December 1980 would be the same under the new method of valuation as under the method of valuation in effect up to that date.[1] The currency amounts in the new basket are shown in Table B.

Table B
Units of currency in the SDR basket

US dollar	0.54
Deutschemark	0.46
French franc	0.74
Japanese yen	34.00
Pound sterling	0.071

The value of the SDR is calculated daily by the IMF, using noon middle-market rates in London, provided by the Bank of England, for the dollar against the four other currencies in the basket.[2] On the basis of the communicated rates, the Fund calculates the SDR/dollar rate by converting the amount of each of the other currencies in the basket into an equivalent number of US cents; these amounts of US cents are then totalled with a fixed amount of 54 cents for the dollar to give the dollar value of the SDR.

The value of the SDR for currencies other than the US dollar, whether inside or outside the basket, is then calculated through the US dollar value of the SDR, by applying local representative rates against the dollar. If, for example, on a particular day SDR 1 = US$1.22354 and the representative rate for the pound sterling is £1 = US$2.2146, then the sterling equivalent of one SDR would be 1.22354/2.2146, that is, £0.552488.[3] The IMF publishes daily SDR rates for about forty currencies. These are available through several wire services and some are published on the foreign exchange page of the *Financial Times*. In its monthly publication, *International Financial Statistics*, the IMF provides a record of daily rates against major currencies, and periodic rates for the SDR against the currencies of each of its members.

As the amounts of currency in the valuation basket are fixed, changes in market exchange rates cause the relative weights of the currency amounts in the basket to change over time. Table C illustrates this by reference to developments in the previous valuation basket.

Table C
Change in effective weightings in the previous valuation basket

	Units of currency	Weighting 1 July 1978	Effective weighting 31 December 1980
		per cent	
US dollar	0.40	33.0	31.4
Deutschemark	0.32	12.5	12.8
French franc	0.42	7.5	7.3
Japanese yen	21.00	7.5	8.1
Pound sterling	0.05	7.5	9.4
Other currencies	(Various)	32.0	31.0

The list of the currencies that determine the value of the SDR and the amount of each of these currencies will be revised every five years, beginning on 1 January 1986, unless the IMF Executive Board decides otherwise, so as to include the currencies of the five members of the Fund with the largest exports of goods and services during the latest five-year period preceding the revision for which full data are available. A currency in the basket will not be replaced by the currency of another member unless the value of the latter member's exports exceed those of the former by at least 1%, and it is expected that the currency composition of the basket will remain unchanged for a considerable number of years. A further element of continuity has been introduced with the Executive Board's decision that the balance of factors that underlie the percentage weights in the present valuation basket should be broadly maintained in any future revisions.

Interest rate

Participants in the SDR Department of the IMF, which now comprises all IMF members, receive interest from the IMF on the amount by which their holdings of SDRs exceed the totals they have received from the Fund in allocations, or pay interest on the amount by which their SDR holdings have fallen below their allocations. Authorised 'other holders' ofSDRs, including the IMF itself, who do not receive SDRs through the allocation procedure, receive interest on the total amount they hold. Since 1 January 1975 the SDR interest rate has been linked to a basket of certain specified short-term obligations which trade in the domestic financial markets of the United States, West Germany, France, Japan and the United Kingdom. Although originally set at 60% of this 'combined market rate',[4] the SDR interest rate has, since 1 January 1979, been calculated as 80% of the rate, and the IMF Executive Board recently agreed in principle to raise the SDR interest rate to the full 'combined market rate', in order to enhance the attractiveness of the SDR as a reserve asset.

Various changes in the calculation of the SDR interest rate took effect from 1 January 1981: amounts of currency (the same as those in the valuation basket) rather than fixed weightings are now used to calculate the rate; the interest rate for the Japanese yen was changed from the rate on call

(1) A detailed example of the valuation of the SDR on a particular day may be found on page 6 of the *IMF Survey* of 12 January 1981.

(2) If the London market is closed, the rates are provided by the Federal Reserve Bank of New York, and if New York is closed, by the Deutsche Bundesbank in Frankfurt.

(3) For currencies that are quoted in terms of currency units to one dollar, the rates would be multiplied and not divided.

(4) This was in line with the rate of remuneration paid on the usual form of creditor position which a member can hold with the IMF.

money (unconditional) to the discount rate on two-month (private) bills discounted in the private market (which is more representative of short-term money-market conditions in Japan); and the period over which the rate is calculated has been shortened.

The 'combined market rate' is the sum of the yields or rates (averaged over fifteen days) on the currency amounts, converted into SDRs, of each of the instruments listed in Table D, expressed as a percentage of the SDR.[1] On the basis of this calculation the rate of interest on the SDR is fixed at the end of every calendar quarter for the following quarter at 80% of the calculated rate, rounded up to the nearest $\frac{1}{8}$%. As from 1 January 1981, the period over which interest rates on the five market instruments are averaged for this purpose has been defined as the fifteen business days ending two business days before the new calendar quarter begins; previously the relevant period had been the six weeks immediately preceding the new quarter.

Table D
Composition of the interest-rate basket

		Currency amounts
United States	Market yield for three-month Treasury bills	\$0.54
West Germany	Three-month inter-bank deposit rate	DM 0.46
France	Three-month inter-bank rate against private paper	Fr. Fcs. 0.74
Japan	Discount rate on two-month (private) bills in Japan	¥34
United Kingdom	Market yield for three-month Treasury bills	£0.071

The IMF will revise the currencies and the amount of each currency in the basket only on the occasion of the five-year review of the valuation basket. Other elements of the interest rate will be reviewed annually, at the end of the IMF's financial year (30 April).

Wider uses of special drawing rights

The widening of the use of SDRs under the second amendment of the Articles allowed participants in the SDR Department to obtain currency through spot transactions by agreement with other participants without first having to establish a balance of payments need. In addition, the IMF was given the power to permit certain operations in SDRs whereby participants may use these assets by agreement without exchanging them directly for currency. Following a series of decisions by the Executive Board, SDRs may now be used by participants in swap arrangements, forward operations, loans, the settlement of financial obligations, in pledges, or as security in transfer-retransfer agreements, and in grants.

The IMF also has the authority to extend the range of official holders of SDRs beyond the participants in the SDR Department, to official institutions prescribed as 'other holders', who may engage in the full range of SDR transactions and operations listed above. The Bank for International Settlements was the first institution to be prescribed an 'other holder', but over the last year eight other institutions have been added to the list. These are the Andean Reserve Fund, the Arab Monetary Fund, the East Caribbean Currency Authority, the International Bank for Reconstruction and Development, the International Development Association, the International Fund for Agricultural Development, the Nordic Investment Bank and the Swiss National Bank.

In the light of the considerable volatility of exchange rates in recent years, the SDR is assuming increased importance as a unit of account in other official organisations and in the financial markets. The official valuation method, and often the actual valuation published by the IMF, has been adopted for the denomination of bond issues and banking deposits and, in recent months, of certificates of deposit and an internationally-syndicated medium-term bank credit. Interest rates on these assets, however, are usually determined on the basis of euro-currency interest rates rather than derived from the IMF interest-rate formula, which is based on the domestic instruments listed above. The simplification of the valuation basket for the SDR, which has considerably reduced the number of currencies for which matching or covering might be required in the markets, may have increased the attractiveness of SDR-denominated assets to the private sector and may act as a spur to their further development.

(1) For any given day, the contribution of each component interest rate to the combined market rate for the SDR may be calculated by multiplying the rate of interest on the particular instrument by the relevant currency amounts (as shown in Table D) and dividing the result by the value of the SDR in terms of that currency.