

# Special Drawing Rights

A Way out of Global Imbalances?



# Special Drawing Rights – Definition

- Special Drawing Rights (SDR) are the monetary unit of the reserve assets of the International Monetary Fund (IMF). The unit was created in 1969 in support of the Bretton Woods system of fixed exchange rates to alleviate the shortage of U.S. dollar and gold reserves in the expansion of international trade.
- The SDR unit is defined as a weighted sum of contributions of four major currencies, re-evaluated and adjusted every five years, and computed daily in terms of USD.
- Special Drawing Rights are not a currency, but they represent potential claims on the currencies of the IMF members, i.e. the SDR system is backed by the ‘good faith’ of the member countries. SDRs obtain their reserve asset power from the commitments of the IMF member states to hold and honour them for payment of balances. The IMF uses SDRs for its monetary unit of account.

## Special Drawing Rights – Definition

- Special Drawing Rights are allocated to member states as a low cost alternative to debt financing for building reserves. Such allocations provide an unconditional liquidity for the SDRs.
- Special Drawing Rights carry an interest rate that is computed weekly by the IMF. It is paid or received quarterly by the members for deviations of their SDR holdings from their SDR allocations.
- Special Drawing Rights are denoted with '*XDR*'.

# Special Drawing Rights – Purpose

- SDRs are used as a unit of account by the IMF and several other international organizations. A few countries peg their currencies against SDRs, and it is also used to denominate some private international financial instruments (e.g., the Warsaw convention, which regulates liability for international carriage of persons, luggage or goods by air, uses SDRs to value the maximum liability of the carrier).
- In the Euro zone, the Euro is displacing the SDR as a basis to set values of various currencies, including Latvian Lats. This is a result of the ERM II convergence criteria.

## Special Drawing Rights – Purpose

- SDRs were originally created to replace gold and silver in large international transactions and provide a cost-free alternative to member states for building reserves. Under the Bretton Woods system, the reserves of gold and U.S. dollars proved too limited to support the growth of international trade and exchange. Thus SDRs are credits that nations with balance of trade surpluses can draw upon from nations with deficits.
- It has also been suggested that having holders of US Dollars convert those dollars into SDRs would allow diversification away from the dollar without accelerating the decline of the value of the dollar.

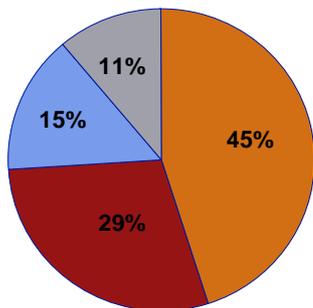
# How is a SDR structured?

- IMF is responsible for all transactions, i.e. the IMF acts as a broker
  
- 2 Types of SDR transactions
  - (a) Voluntary: Transactions take place with a voluntary counterparty
  - (b) Designation: In case no voluntary counterparty can be found, the IMF designates a counterparty, however this has not been necessary since September 1987
  
- 2 types of allocations
  - (a) General: based on long-term need to increase existing reserve assets
  - (b) Special: ensure all members of IMF the relative same amount of SDRs, since countries join the IMF at different times

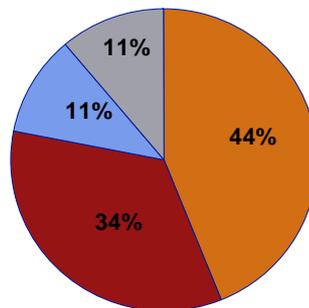
# How is a SDR structured?

- SDRs are equal to a basket of 4 currencies with FIXED amounts, however due to changing FX rates the relative weightings change with time (last revised in late 2005, next revision in late 2010)

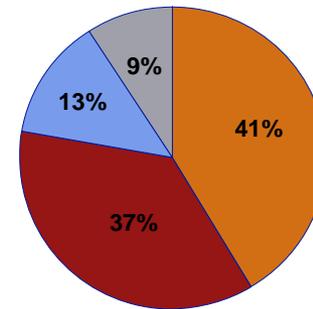
Effective January 2001



Effective January 2006



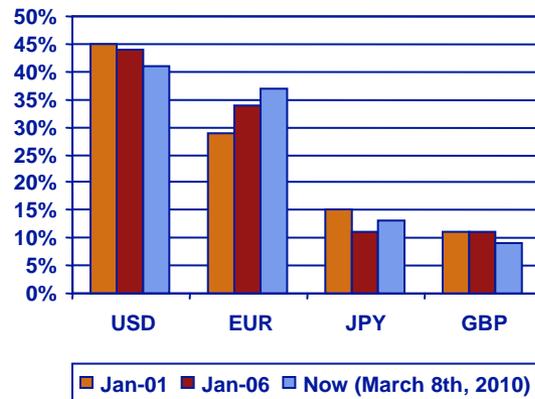
Now (08 March 2010)



Source: Deutsche Bank, IMF

# How is a SDR structured?

- Currency weightings (declining USD rising EUR) and respective currency amounts



Source: Deutsche Bank, IMF

Currency	Jan 2001	Jan 2006
USD	0.577	0.632
EUR	0.426	0.41
JPY	21.0	18.4
GBP	0.0984	0.0903

- The value of SDRs in terms of USD is calculated on a daily basis by the IMF and published every morning, Washington time: **1 SDR = 1.53156 USD** (March 8th)

# How is a SDR structured?

- If a country has more SDRs than allocated by the IMF it receives SDR interest from the IMF and vice versa (when a country has less SDRs than allocated it has to pay SDR interest to the IMF):
  - No bid/offer spread
  - IMF calculates SDR interest rates on a weekly basis. **For the week of March 8, 2010 to March 14, 2010 the SDR interest rate = 0.25 %**
  - The SDR interest rate is calculated on the basis of the 3 month Eurepo, 3 month Japanese Treasury Discount bills, 3 month UK Treasury bills and 3 month US Treasury bills

# Current Situation

- Total currency reserves: 7,515 billion USD (preliminary number third quarter 2009)
- USD accounts for nearly 65 % of allocated currency reserves, the EUR for 26 %
- In comparison SDRs only account for about 4 % of reserves
- Total amount of SDR outstanding is 204,1 billion (equivalent to around \$ 317 billion)

# Current Situation

## ■ General Allocations:

- 1970 – 72: SDR 9,3 billion in yearly installments
- 1979 – 81: SDR 12,1 billion in yearly installments
- August 2009: SDR 161,2 billion

## ■ Special Allocations:

- September 2009: SDR 21,5 billion

- Comparing the new allocations to the total amount of outstanding SDRs, it shows that the last general and special allocation represent the majority (about 89.5 %) of the SDR pool!

# Current Situation

## World Top 10

Country	SDR % of total	SDR % of total CCy reserves
USA	17.09 %	43.99 %
Japan	6.12 %	1.97 %
Germany	5.98 %	10.60 %
France	4.94 %	11.45 %
UK	4.94 %	16.84 %
China	3.72 %	0.58 %
Italy	3.24 %	6.91 %
Saudi Arabia	3.21 %	NA
Canada	2.93 %	16.95 %
Russia	2.73 %	2.03 %
<b>Sum</b>	<b>51.06 %</b>	

## Euro Top 10

Country	SDR % of total
Germany	5.89 %
France	4.94 %
UK	4.94 %
Italy	3.24 %
Netherlands	2.37 %
Belgium	2.12 %
Switzerland	1.59 %
Spain	1.40 %
Sweden	1.10 %
Austria	0.86 %
<b>Sum</b>	<b>28.45 %</b>

Source: Deutsche Bank, IMF, Bloomberg



# Current Situation

## Asia Top 5

Country	SDR % of total
Japan	6.12 %
China	3.72 %
India	1.91 %
Korea	1.35 %
Indonesia	0.96 %
<b>Sum</b>	<b>14.06 %</b>

## Rest of World Top 5

Country	SDR % of total
Mexico	1.45 %
Brazil	1.40 %
Venezuela	1.22 %
Argentina	0.97 %
South Africa	0.86 %
<b>Sum</b>	<b>5.9 %</b>

Source: Deutsche Bank, IMF

# SDR – Pros & Cons

## Pro SDR

- Stable (due to basket of currencies, i.e. diversified reserves)
- No “exorbitant privilege” for the USA
- A way for developing countries (with weak currencies) to get access to the FX market
- Less country risk for industrial countries lending currency to (in exchange for SDRs) developing nations

## Contra SDR

- Liquidity
- No private market
- Market credibility
- Shifting the problem from the USD to the SDRs
- Advantage of SDR over a diversified reserves basket
- SDR basket only consists of 4 currencies
- Geopolitical risks
  - IMF voting power
  - Limited No. of currencies

# Current Discussion

## IMF

- Next re-weighting of the SDR currency basket is in late 2010
  
- July 2009: Executive Board of the IMF approved the issuance of notes/bonds to member countries
  - Improve IMF ability to assist its members when needed
  - Maturity of 5 years
  - Denominated in SDR
  - Interest paid quarterly (SDR interest rate)
  - China interested in investing up to USD 50 billion
  - Brazil and Russia up to USD 10 billion each
  - High interest can be seen as willingness to shift the composition of reserves away from US Treasuries

# Current Discussion

## Public discussion

- July 2009: "... officials in China, Russia and India all call for an end to the dollar's dominance in the international monetary system"<sup>2</sup>
- July 2009: China proposed to increase the SDR currency basket (with the Yuan). Moreover, a SDR denominated fund was proposed into which USD reserves can be exchanged for SDRs without putting pressure on the USD

<sup>2</sup> „Yuan small step, The dollar's role as the world's main reserve currency is being challenged“, July 9th 2009, The Economist

# A Way out of Global Imbalances?

## ■ Attributes of an ideal reserve

- Stable
- Liquid

## ■ Is there an optimal reserve mix? How close can SDRs get?

## ■ Independent diversification through multiple reserve currencies?

- Most likely candidates (alongside the USD): EUR, Yen, Chinese RMBI
- Requires policy coordination between reserve issuers to keep volatility low

## ■ General Future of Reserves

- In theory the need for reserves decreases in case more currencies become floating, since central banks do not have to intervene to stabilize their currency.
- 2/3 of reserve holdings are due to insurance motives, hence third-party insurance, in theory, would be more efficient than self-insurance
- IMF credit line facilities
- SDRs versus gold