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SM/83/63

April 18, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Review of the Sales of SDRs and Proposal on the Level
of the Fund's SDR Holdings

Attached for consideration by the Executive Directors is a paper on a review of the sales of SDRs and proposal on the level of the Fund's SDR holdings. A draft decision appears on page 6.

It is proposed to bring this subject, together with the paper on a review of the Fund's income position for the financial years 1983 and 1984 (EBS/83/75, 4/18/83) to the agenda for discussion on Monday, May 16, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. W. L. Coats, Jr. (Division Chief, ext. 76508).

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Review of the Sales of SDRs and
Proposal on the Level of the Fund's SDR Holdings

Prepared by the Treasurer's Department

(in consultation with the Legal Department)

Approved by W. O. Habermeier

April 18, 1983

I. Introduction

In March, April and June 1982, the Executive Board reviewed the policy on sales of SDRs and the use of currencies through the operational budgets.^{1/} In June 1982 the Board decided that:

The amounts of SDRs the Fund will transfer to members in purchases shall be guided by the aim of maintaining, so far as feasible, the Fund's SDR holdings at a level that will average approximately SDR 4.25 billion over the period from May 1, 1982 to end-May 1983, with the level of holdings being reduced to about SDR 4.0 billion by the end of the period. The Executive Board shall review the level of the Fund's SDR holdings not later than May 15, 1983.^{2/}

This memorandum discusses the changes in the Fund's holdings of SDRs in the General Resources Account over the last year, and reviews the factors that might be taken into account in the discussion of the level of SDRs that might be maintained by the Fund prior to the coming into effect of the increase in quotas under the Eighth General Review. In the light of this review, it is proposed that the Fund would aim to reduce its holdings of SDRs to about SDR 1.5 billion by the end of 1983. It is also proposed that the matter be reviewed again toward the end of the year. The draft of the proposed decision appears on page 6.

The amount of SDRs proposed for sale by the Fund under the quarterly operational budgets and in other operations and transactions would be determined in the light of the decision on the Fund's holdings of SDRs.

^{1/} See SM/82/46 (3/1/82), "Review of the Policy on Sales of SDRs and Currencies in the General Resources Account" and SM/82/46 Supplement 1 (4/22/82), and Supplement 2 (6/7/82). For an earlier review see SM/81/37 (2/13/81), "Review of the Policy on Sales of SDRs and Currencies Through the Fund's Operational Budgets."

^{2/} See Executive Board Decision No. 7131-(82/80)S, adopted June 9, 1982.

II. Changes in Fund's Holdings of SDRs

The General Resources Account receives and disburses SDRs in a variety of ways. Some of these receipts and disbursements are made at the initiative of the Fund and some are at the initiative of members.^{1/} As a result, the Fund cannot control precisely the level of its SDR holdings at a particular time, but there is no compelling reason to seek precision in this respect in view of the continuing flows of SDRs into and out of the Fund. However, the use of SDRs by the Fund, and thus the approximate level of the Fund's SDR holdings, should not be decided on a purely ad hoc basis, but should be responsive to a guideline established by the Executive Board from time to time. In fact, the Board has decided to review the situation from time to time and "determine an appropriate range" within which the Fund will aim to maintain the Fund's SDR holdings.^{2/} One of the main ways in which the Fund can deliberately and fairly regularly influence its holdings is to determine the volume of SDRs it will sell instead of currencies in purchases under the operational budgets.

At the end of March 1982, the Fund's SDR holdings were SDR 4.8 billion. Between that time and the end of March 1983, the Fund received a total of SDR 2.9 billion in SDRs and transferred SDRs totaling about SDR 3.8 billion to members (Table 1). As a result, the Fund's SDR holdings fell by almost SDR 0.9 billion over that period to about SDR 3.9 billion. In the operational budget for the period March-May 1983 (EBS/83/149) it is estimated that by the end of May 1983 the level of the Fund's SDR holdings would be SDR 3.6 billion and the average holdings for the period April 1982 to May 1983 would be SDR 4.3 billion. These figures compare with target holdings of SDR 4.0 billion by the end of the period and target of SDR 4.25 billion for the average over the period contained in the Board's decision of last June. The actual results differ from the target amounts mainly because of unforeseen delays in

^{1/} As regards inflows of SDRs to the General Resources Account, a member is required to pay charges in SDRs, while repurchases may be made in SDRs if a member wishes and the Fund is obliged to accept the SDRs. The Fund also receives interest on its SDR holdings in SDRs. In addition, members have been given the option to pay 25 per cent of the increase in quotas authorized under the Eighth General Review in SDRs or in the currencies of other members prescribed by the Fund. On the outflow side, members are not obliged to accept SDRs in any transaction or operation except replenishment and then only up to the member's acceptance limit. However, the Fund normally offers SDRs to members as an alternative to currencies in all operational payments it makes to members. Significant amounts are accepted in remuneration payments; and SDRs have been accepted in repayment of loans and in payment of interest. In addition members accept SDRs willingly in purchases, since the Fund is operating a simple mechanism for simultaneous exchange into currencies if the purchasing member should so wish.

^{2/} Executive Board Decision No. 6275-(79/158)G/S, adopted September 14, 1979 (see Appendix).

Table 1. Transfers of SDRs to and from
the General Resources Account

March 31, 1982 - March 31, 1983
(In millions of SDRs)

| | | |
|--------------------------------------|--------------|-----------------|
| Fund's SDRs holdings: March 31, 1982 | | 4,772.3 |
| A. <u>Inflows of SDRs</u> | | |
| Repurchases | 672.8 | |
| Charges | 1,500.1 | |
| Quota payment | 83.4 | |
| Interest and assessment | <u>659.3</u> | +2,915.6 |
| B. <u>Outflows of SDRs</u> | | |
| Refunds of service charges | 21.9 | |
| Purchases | 2,490.1 | |
| Payment of interest to lenders | 223.8 | |
| Repayments to lenders | 31.4 | |
| Payment of remuneration | 860.6 | |
| Sales of SDRs to members for charges | <u>129.5</u> | <u>-3,757.4</u> |
| Fund's SDRs holdings: March 31, 1983 | | <u>3,930.5</u> |

Note: Details do not add to totals due to rounding.

using SDRs in purchases, which raised the average holdings associated with a given end of period level. Given the uncertainty in the timing of the use and receipt of SDRs by the Fund, there is no guarantee that it will be possible to achieve simultaneously both the desired average level of SDR holdings over a 12 month period and a particular level at year-end. Since the average balance of SDR holdings was a consideration which entered the determination of the Fund's rate of charge and rate of remuneration for the current financial year, greater weight was given to achieving the average holdings when it became evident that the two targets could not be achieved simultaneously.

The total amount of SDRs proposed for sales under the last four operational budgets (i.e., March 1982 through February 1983) was SDR 3.0 billion and the amount actually used from these budgets was SDR 2.5 billion. Over the same period the Fund used currency to the extent of about SDR 7.1 billion in purchases out of proposed use of SDR 9.3 billion.

III. Considerations bearing on the target range for the Fund's SDR holdings

The following considerations have had a bearing on the target range of the Fund's holdings of SDRs:

(i) The Fund's liquidity; (ii) the Fund's actual and prospective holdings of SDRs in relation to total allocations of SDRs; (iii) the Fund's operational need to hold SDRs; and (iv) the Fund's financial position. 1/

(i) As regards the liquidity of the Fund, SDRs are its most liquid asset because they are always usable (including for replenishment of usable currencies); by contrast, the usability of a currency at a particular time depends on whether the issuing member's balance of payments and reserve position is sufficiently strong. However, in view of the relatively low level of usable currencies in the Fund and the prospect of large inflows of SDRs toward the end of the year, it would seem reasonable to sell a relatively large proportion of the Fund's present holdings of SDRs.

(ii) The Fund's SDR holdings at present represent 18 per cent of the total allocation of SDR 21 billion against 22 per cent a year ago. It is estimated, however, that the Fund's holdings of SDRs will rise between SDR 5 to 6 billion from the increase in quotas. As a result of this and possible other net inflows the Fund's SDR holdings might rise to over SDR 10 billion, by the time all quota increases are paid. This would bring the Fund's SDR holdings close to 50 per cent of the present

1/ These aspects have been discussed in some detail in SM/82/46 and Supplement 1.

allocation. It would not be in the general interest of the smooth working of the SDR scheme for such a large proportion of the total allocation of SDRs to be held by any single holder, including the Fund itself, nor is it likely that such a large scale change in the distribution of SDR holdings could be accomplished easily. It would, therefore, be desirable for the Fund to reduce its holdings of SDRs prior to the expected large inflow resulting from the quota increases. This would also help members to avoid unwanted reductions in their SDR holdings which might result from their use of SDRs in paying the asset portion of their quota increase.

(iii) As far as operational needs are concerned, it is difficult to quantify precisely the Fund's requirement to hold SDRs for disbursements in that medium. As noted above, the Fund needs to hold sufficient SDRs to provide a readily available source for members that need them to meet obligations payable in SDRs. These obligations are (i) charges for the use of Fund credit, and (ii) the annual payments of net charges in the SDR Department. The Fund stands ready to supply SDRs to the extent needed to participants whose holdings are insufficient for these purposes. The Fund also offers to pay remuneration in SDRs. In order to be in a position to make this offer the Fund's holdings should not be less than the total of the remuneration payments. However, as the Fund receives interest on its average holdings of SDRs on the same day it pays remuneration, it can safely hold a lower amount than would be indicated by the total of remuneration payments. As an example of the magnitudes involved, the total payment for remuneration to be made in May 1983 is expected to be about SDR 1 billion, while the inflow of SDRs at that same point in time from the receipt of interest on the Fund's SDR holdings is expected to be about SDR 0.5 billion. The expected net outflow of SDRs on that day is therefore about SDR 0.5 billion. In general, the Fund should hold sufficient SDRs to enable it to fulfil its promises to offer and its obligations to supply SDRs. These various needs of the Fund can, in the view of the staff, safely be met out of a working balance of SDR 1 to SDR 1.5 billion.

(iv) As the rate of remuneration on creditor positions is at present 85 per cent of the rate of interest on the SDR, the Fund's net income increases (decreases) as a result of higher (lower) holdings of SDRs by the Fund. At the present differential between the SDR interest rate (8.52 per cent) and the rate of remuneration (7.24 per cent) a change of SDR 1 billion in the average level of the Fund's SDR holdings would affect the Fund's net income on an annual basis by SDR 12.8 million. Thus, the prospective increase in the Fund's holdings as a result of the quota increase will have a material effect on the Fund's net income.

IV. Proposed target for SDR holdings

In the light of these considerations, and bearing in mind that the level of the Fund's SDR holdings can be controlled only within fairly broad limits, the staff proposes that the Fund reduce its holdings of SDRs

to a level of about SDR 1.5 billion by mid-December 1983, by which time the quota payments are expected to begin. 1/ The amounts of SDRs to be sold under the next two operational budgets would be proposed in the light of that aim.

Without taking into account the amounts of SDRs that might be sold under the operational budgets, the net inflow of SDRs in the period end-May 1983 to December 1983 (i.e., before the quota payments) might be of the order of SDR 0.9 billion. 2/ Therefore, to achieve a level of the Fund's holdings of SDRs of SDR 1.5 billion by the end of 1983, total gross use from June to December 1983 of the order of magnitude of SDR 3 billion would be indicated. This would generally be expected to take the form of uses in purchases, though other uses are not precluded. Use of ordinary resources, including use in repayments of loans under the GAB, but excluding drawings in the reserve tranches, are expected to be of the order of SDR 6 billion over the same period. A use of SDR 3 billion would amount to approximately one-half of this total. In the light of the expected increase in SDR holdings and the rapid decline in the Fund's holdings of usable currencies that would seem to be a reasonable proportion.

Proposed decision

It is proposed that the Executive Board adopt the following decision:

In determining the amounts of SDRs to be transferred to members, the Fund will be guided by the aim of reducing the Fund's SDR holdings to a level of approximately SDR 1.5 billion by the end of 1983. The level of the Fund's SDR holdings shall be reviewed again in the light of the progress made in implementing the increases in quotas authorized under the Eighth General Review of Quotas but not later than the end of December, 1983.

1/ Starting from a level of SDR 3.6 billion June 1, 1983 this would lower the Fund's average holdings over the six-month period to the beginning of December 1983 to approximately SDR 2.5 billion. For greater detail see "Review of the Fund's Income Position for the Financial Years 1983 and 1984", EBS/83/75, dated April 18, 1983.

2/ This could be reduced to the order of SDR 0.1 billion if repayments of loans under the GAB are made in SDRs.

APPENDIX

Transfers of SDRs Under Article V, Section 3(f)

Pursuant to Article V, Section 3(f), the Fund shall provide SDRs instead of the currencies of other members to a participant making a purchase in accordance with decisions on the operational budgets taken under Rule 0-10. For this purpose, the Executive Board shall keep under review the amount of the Fund's holdings of SDRs in the General Resources Account in the light of all relevant considerations, including the relationship of SDR holdings to its other assets, and will determine from time to time the approximate range within which the Fund will aim to maintain these holdings.

Decision No. 6275-(79/158)G/S
September 14, 1979