

**INFORMAL
SESSION TO
ENGAGE**

SM/16/115
Correction 1

CONFIDENTIAL

June 10, 2016

To: Members of the Executive Board

From: The Acting Secretary

Subject: **The Case for a General Allocation of SDRs During the Eleventh Basic Period**

Board Action:

The attached corrections to SM/16/115 (5/24/16) have been provided by the staff:

Evident Ambiguity

Pages 11 and 14

**Factual Error Not
Affecting the
Presentation of Staff's
Analysis or Views**

Page 12

Questions:

Mr. Tovar Mora, SPR (ext. 36329)
Ms. Albino-War, FIN (ext. 39708)
Ms. Rosenberg, LEG (ext. 37790)

Table 2. Projected Demand for Reserve Assets: ARA-Based
(In trillions of SDRs)

	EMDCs		EMDCs ex. China	
	5-year	10-year	5-year	10-year
100% ARA threshold	0.4	2.3	0.4	1.1
125% ARA threshold	1.0	3.9	0.8	1.7
150% ARA threshold	1.9	5.5	1.2	2.4
Range	0.4-1.9	2.3-5.5	0.4-1.2	1.1-2.4
<i>Memo:</i>				<i>5-year</i>
<i>a) AEs reserve demand: standard metrics reported in Table 1:</i>				<i>0.1-0.4</i>
<i>b) Global reserve demand: a) + EMDCs 100-150% ARA threshold:</i>				<i>0.5-2.3</i>
<i>c) Global reserve demand: a) + EMDCs 100-125% ARA threshold</i>				<i>0.5-1.4</i>

Source: WEO, Fund staff calculations.
Note: For each individual country, projections calculate the gap between the *current* (2015) level of reserves and the 5 or 10-year ahead ARA metric. Individual country estimates for which the gap is **negative** are then aggregated.

Considerations for estimating global reserve demand

18. **Applying judgment to the mechanistic estimates is required.** On balance, one could argue for combining the traditional metrics for AEs with an ARA metric of 100-125 percent for EMDCs, resulting in an estimate of SDR 0.5-1.4 trillion for the global demand for reserves over the next basic period. Considerations for estimating global demand and the uncertainties surrounding these estimates are discussed below.

19. **First, there are arguments for using different metrics for the different country groups.** Estimates based on traditional metrics rely on judgments in setting the benchmarks for reserve ratios. Those judgments, for example, whether the current level of those metrics is a revealed preference, are sensitive to the selected country sample and base period. The ARA metric for EMDCs, while with its own limitations, overcomes these shortcomings of the traditional metric, by providing an estimate of the projected reserve needs to address a set of possible external sector risks estimated on historical evidence. The use of traditional benchmark metrics may also provide an imprecise estimate of non-reserve issuing AE reserve demand, but the ARA metric does not extend to AEs.

20. **Second, judgment is required as to the appropriate ARA thresholds for reserves.** Uncertainty about the appropriate reserve coverage is to some extent captured through the 100-150 percent adequacy range. Judgment at the country level is needed to determine what weights should be placed on different sources of risk and also how much of the resulting metric is reasonable to hold. Therefore, assuming that all countries hold 100 percent of the metric might be

too low on an individual country basis, while assuming 150 percent for all countries might be excessive.

21. **Third, judgment needs to be made on the scope of the country coverage.** While assessments for earlier basic periods were based on universal coverage, the Ninth and Tenth Basic Periods focused on a narrower benchmark group of 118 EMDCs (excluding China and fuel exporters) to better identify demand for precautionary motives—i.e., for those countries most likely to face difficulties accessing external liquidity.¹⁶ However, recent developments suggest that a broader approach may be more appropriate:

- **AEs.** AEs have more liquid markets and a higher tolerance for foreign exchange volatility, and episodes of market dysfunction are relatively rare and tend to be of short duration. But the global financial crisis served as a reminder that mature economies are not immune to foreign exchange and funding market stress. Indeed, several AEs with flexible exchange rates used reserves for intervention purposes (e.g., Australia and Sweden) in the immediate aftermath of Lehman’s failure in 2008. Therefore, international reserves can serve as an important buffer for mature market countries that are not reserve currency issuers—or do not have predictable access to swap lines.
- **Fuel exporters.** The accumulation of reserves by many fuel exporters is a consequence of large public savings to ensure intergenerational equity. There may be merit to consider such non-precautionary demand when assessing the global demand for reserves, in particular, if it contributes to suboptimal performance of the global economy. Going forward, the adjustment to lower oil prices in a more difficult environment could warrant greater attention to fuel exporters’ reserve coverage for precautionary purposes. That said, many fuel exporters hold large liquid positions in sovereign wealth funds that could be employed as reserve complements to meet external shocks.^{17,18}
- **China.** China constitutes an important part of EMDCs’ projected demand for reserves, and an issue arises on potential structural changes in its demand. Staff’s assessment is that, given the current economic and policy framework in China and its ramifications for global demand for reserve assets, it is prudent to include China in estimates of demand for reserves. The size of China’s demand is subject to considerable uncertainty as it will hinge on the speed of and interaction between capital account liberalization, increased exchange rate flexibility, and continued internationalization of the renminbi (RMB). On the one hand, capital account liberalization with an unchanged foreign exchange regime would increase demand for reserves. Without any other action, this increase would add SDR 1.3-2.0 trillion to the estimates for ARA

¹⁶ See footnote 9 on IMF, 2011, [“The case for a general allocation of SDRs during the tenth basic period,”](#) June.

¹⁷ Overall, fuel exporters’ estimated demand consistent with reaching ARA thresholds of 100-125 percent is estimated at SDR 53-119 billion over the next basic period.

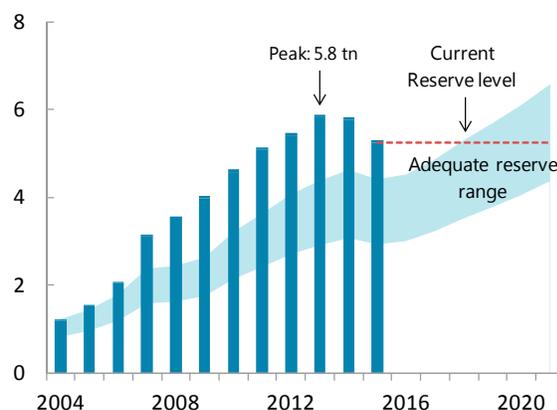
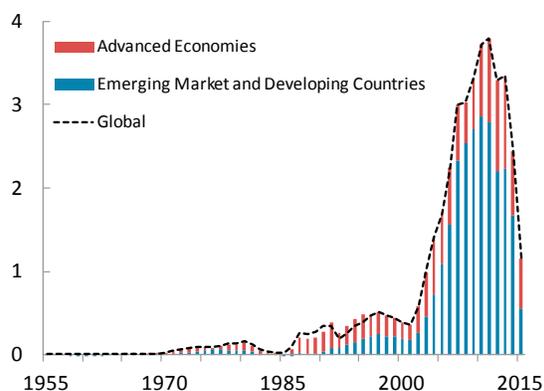
¹⁸ More generally, the accumulation of non-precautionary reserves via protracted one-sided intervention can impose a negative externality on the IMS—possibly warranting wider consideration of an SDR allocation to help diversify the supply of reserve assets. See IMF, 2010, [“Reserve accumulation and international monetary stability,”](#) April.

Figure 1. Reserve Growth

(In trillions of SDRs)

Global reserve growth in overlapping 5-year periods 1/

EMDCs: Reserve holdings and estimated ARA projections



Source: IMF, International Financial Statistics; and Fund staff calculations.

1/ Excluding gold.

Box 3. EMDC Reserve Demand

Estimates for EMDC reserve demand^{1/} in Table 2 in the main text are 'gross' estimates, measuring the increase in reserves required to eliminate the shortfall between the end-2015 levels of reserve holdings and projected reserve needs to maintain reserve ratios or reach ARA thresholds. Those estimates can be decomposed into two components: (i) the endogenous, WEO consistent, creation of reserves expected over the period; (ii) a measure of 'net' demand—the shortfall between the projected (WEO consistent) level of reserves and projected reserve needs to maintain reserve adequacy ratios or reach given ARA thresholds. Estimates place the reserve asset demand required to meet 'net' needs in the range of SDR 0.3–0.9 trillion in the next basic period consistent with meeting the 100–125 percent reserve adequacy thresholds (see text table). In short, the WEO consistent creation of reserves is SDR 0.1 trillion.

Projected 'Net' Demand for Reserve Assets: ARA-Based

(In trillions of SDRs)

	EMDCs		EMDCs ex. China	
	5-year	10-year	5-year	10-year
100% ARA Threshold	0.3	2.0	0.3	0.8
125% ARA Threshold	0.9	3.4	0.6	1.3
150% ARA Threshold	1.8	4.9	1.0	1.9
Range	0.3-1.8	2.0-4.9	0.3-1.0	0.8-1.9

Source: Fund staff calculations based on WEO.

Note: For each individual country, projections calculate the gap between the *projected* level of reserves and the 5 or 10-year ahead ARA metric. Individual country estimates for which the gap is negative are then aggregated.

1/ Demand can be influenced by recourse to the GFSN such as regional financial arrangements or bilateral swap arrangements.