INTERNATIONAL MONETARY FUND

FACTSHEET

Special Drawing Right (SDR)

The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. As of March 2016, 204.1 billion SDRs (equivalent to about $285 billion) had been created and allocated to members. SDRs can be exchanged for freely usable currencies. The value of the SDR is currently based on a basket of four major currencies: the U.S. dollar, euro, the Japanese yen, and pound sterling. The basket will be expanded to include the Chinese renminbi (RMB) as the fifth currency, effective October 1, 2016.

The role of the SDR

The SDR was created by the IMF in 1969 as a supplementary international reserve asset, in the context of the Bretton Woods fixed exchange rate system. A country participating in this system needed official reserves—government or central bank holdings of gold and widely accepted foreign currencies—that could be used to purchase its domestic currency in foreign exchange markets, as required to maintain its exchange rate. But the international supply of two key reserve assets—gold and the U.S. dollar—proved inadequate for supporting the expansion of world trade and financial flows that was taking place. Therefore, the international community decided to create a new international reserve asset under the auspices of the IMF.

Only a few years after the creation of the SDR, the Bretton Woods system collapsed and the major currencies shifted to floating exchange rate regimes. Subsequently, the growth in international capital markets facilitated borrowing by creditworthy governments and many countries accumulated significant amounts of international reserves. These developments lessened the reliance on the SDR as a global reserve asset. However, more recently, the 2009 SDR allocations totaling SDR 182.6 billion played a critical role in providing liquidity to the global economic system and supplementing member countries' official reserves amid the global financial crisis.

The SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions. In addition to its role as a supplementary reserve asset, the SDR serves as the unit of account of the IMF and some other international organizations.

Basket of currencies determines the value of the SDR

The value of the SDR was initially defined as equivalent to 0.888671 grams of fine gold—which, at the time, was also equivalent to one U.S. dollar. After the collapse of the Bretton Woods system in 1973, the SDR was redefined as a basket of currencies. Currently, the SDR basket consists of the U.S. dollar, euro, Japanese yen, and pound sterling. Effective October 1, 2016, the basket will be expanded to include the Chinese renminbi.

The value of the SDR in terms of the U.S. dollar is determined daily and posted on the IMF's website. It is calculated as the sum of specific amounts of each basket currency valued in U.S. dollars, on the basis of exchange rates quoted at noon each day in the London market.

The basket composition is reviewed every five years by the Executive Board, or earlier if the IMF finds changed circumstances warrant an earlier review, to ensure that it reflects the relative importance of currencies in the world's trading and financial systems. In the most recent review (concluded in November 2015), the Executive Board decided that, effective October 1, 2016, the Chinese renminbi is determined to be freely usable and will be included as a fifth currency, along with the U.S. dollar, euro, Japanese yen, and pound sterling, in the SDR basket.

A new weighting formula was also adopted in the 2015 review. It assigns equal shares to the currency issuer's exports and a composite financial indicator. The financial indicator comprises, in equal shares, official reserves denominated in the member's (or monetary union's) currency that are held by other monetary authorities that are not issuers of the relevant currency, foreign exchange turnover in the currency, and the sum of outstanding international bank liabilities and international debt securities denominated in the currency.

The respective weights of the U.S. dollar, euro, Chinese renminbi, Japanese yen, and pound sterling are 41.73 percent, 30.93 percent, 10.92 percent, 8.33 percent, and 8.09 percent.[1] These weights will be used to determine the amounts of each of the five currencies to be included in the new SDR valuation basket that will take effect on October 1, 2016.

The next review is currently scheduled to take place by September 30, 2021.

The SDR interest rate

The SDR interest rate provides the basis for calculating the interest charged to borrowing members, and the interest paid to members for the use of their resources for regular (non-concessional) IMF loans. It is also the interest paid to members on their SDR holdings and charged on their SDR allocation. The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term debt instruments in the money markets of the SDR basket currencies.

SDR allocations to IMF members

Under its Articles of Agreement (Article XV, Section 1, and Article XVIII), the IMF may allocate SDRs to member countries in proportion to their IMF quotas. Such an allocation provides each member with a costless, unconditional international reserve asset. The SDR mechanism is self-financing and levies charges on allocations which are then used to pay interest on SDR holdings. If a member does not use any of its allocated SDR holdings, the charges are equal to the interest received. However, if a member's SDR holdings rise above its allocation, it effectively earns interest on the excess. Conversely, if it holds fewer SDRs than allocated, it pays interest on the shortfall. The Articles of Agreement also allow for cancellations of SDRs, but this provision has never been used.

The IMF's Articles of Agreement provide for the possibility to prescribe as other holders of SDRs—that is, other than IMF members—certain types of official organizations, such as the BIS, ECB, and regional development banks. A prescribed holder may acquire and use SDRs in transactions and operations with other prescribed holders and the IMF's members. The IMF cannot allocate SDRs to itself or to prescribed holders.

General allocations of SDRs have to be based on a long-term global need to supplement existing reserve assets. Decisions on general allocations are made for successive basic

[1] The SDR basket put into place in the 2010 Review was extended through September 30, 2016 in August 2015. The respective weights at the time of the 2010 Review of the U.S. dollar, euro, Japanese yen, and pound sterling were 41.9 percent, 37.4 percent, 9.4 percent, and 11.3 percent.

periods of up to five years, although general SDR allocations have been made only three times. The first allocation was for a total amount of SDR 9.3 billion, distributed in 1970-72, the second—for SDR 12.1 billion—distributed in 1979-81, and the third—for SDR 161.2 billion—was made on August 28, 2009.

Separately, the Fourth Amendment to the Articles of Agreement became effective August 10, 2009 and provided for a special one-time allocation of SDR 21.5 billion. The purpose of the Fourth Amendment was to enable all members of the IMF to participate in the SDR system on an equitable basis and rectify the fact that countries that joined the IMF after 1981—more than one fifth of the current IMF membership—never received an SDR allocation until 2009.

The 2009 general and special SDR allocations together raised total cumulative SDR allocations to SDR 204.1 billion.

Buying and selling SDRs

IMF members often need to buy SDRs to discharge obligations to the IMF, or they may wish to sell SDRs in order to adjust the composition of their reserves. The IMF may act as an intermediary between members and prescribed holders to ensure that SDRs can be exchanged for freely usable currencies. For more than two decades, the SDR market has functioned through voluntary trading arrangements. Under these arrangements a number of members and one prescribed holder have volunteered to buy or sell SDRs within limits defined by their respective arrangements. Following the 2009 SDR allocations, the number and size of the voluntary arrangements has been expanded to ensure continued liquidity of the voluntary SDR market. The number of voluntary SDR trading arrangements now stands at 32, including 19 new arrangements since the 2009 SDR allocations.

Since September 1987, voluntary transactions have ensured the liquidity of the SDRs. However, in the event that there is insufficient capacity under the voluntary trading arrangements, the IMF can activate the designation mechanism. Under this mechanism, members with sufficiently strong external positions are designated by the IMF to buy SDRs with freely usable currencies up to certain amounts from members with weak external positions. This arrangement serves as a backstop to guarantee the liquidity and the reserve asset character of the SDR.