Review of the Special Drawing Right (SDR) Currency Basket

The Review of the Method of Valuation of the Special Drawing Right (SDR) basket is conducted every five years by the IMF’s Executive Board, or earlier if warranted by developments. The purpose of the review is to ensure that the SDR basket reflects the relative importance of major currencies in the world’s trading and financial systems, with a view to enhancing the SDR’s attractiveness as a reserve asset. The latest review was completed on November 30, 2015.

Scope of SDR reviews

The reviews cover the key elements of the SDR method of valuation. These include the criteria and indicators used in selecting SDR basket currencies, the number of currencies in the basket, and the methodology for determining currency weights. The financial instruments comprising the SDR interest rate basket are also typically covered.

The 2015 Review – SDR basket composition and size

In the most recently concluded review (November 2015), the Executive Board decided that, effective October 1, 2016, the Chinese renminbi (RMB) will be included in the SDR basket as a fifth currency, along with the U.S. dollar, euro, Japanese yen, and pound sterling.

Specifically, the IMF decided that the RMB meets the existing criteria for SDR basket inclusion (see below). As the world’s third-largest exporter (in the past five years), China met the first inclusion criterion. The IMF also determined, effective October 1, 2016, the RMB to be freely usable, thus meeting the second criterion for basket inclusion. The authorities have taken a broad set of measures to facilitate RMB operations, as a result of which, the IMF, its membership, and other SDR users now have sufficient access to onshore markets to perform Fund-related and reserve management transactions in RMB without substantial impediments. With the RMB’s inclusion in the SDR basket, effective October 1, 2016, the three-month benchmark yield for China Treasury bonds will serve as the RMB-denominated instrument in the SDR interest rate basket.

The 2015 Review—currency weights

The IMF also adopted a new formula for determining currency weights in the SDR basket to address long-recognized issues with the formula that had been in place since 1978. The adopted formula is one of the two alternatives presented in the 2010 Review of the Method of Valuation of the SDR. 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 following weights based on the new formula will be used to determine the amounts of each of the five currencies in the new SDR basket that will take effect on October 1, 2016:
The amounts of each currency in the revised basket will be calculated on September 30, 2016, in accordance with the above-listed weights. The calculation will be made on the basis of the average exchange rates for these currencies over the three months ending on that date, in a manner that ensures that the value of the SDR in terms of the U.S. dollar will be the same on September 30, 2016 under the current and revised valuation baskets. The IMF will publish illustrative currency amounts in the weeks leading up to October 1, 2016.

Until the effectiveness of the new SDR basket on October 1, 2016, the SDR basket and valuation will continue to comprise four currencies (U.S. dollar, euro, Japanese yen and pound sterling) and the amounts of these currencies in the basket will continue to be based on their respective weights at the time of the 2010 Review as indicated in the text table above.

**Criteria for SDR basket inclusion**

The current criteria for inclusion were adopted by the Board in 2000. They establish that the SDR basket comprises the currencies that are issued by members or monetary unions whose exports had the largest value over a five-year period, and have been determined by the IMF to be "freely usable". During the most recent review, which was concluded on November 30, 2015, the Board decided to expand the basket to five currencies. This change will become effective on October 1, 2016.

The export criterion, which acts as a "gateway," aims to ensure that currencies that qualify for the basket are those issued by members or monetary unions that play a central role in the global economy. This criterion has been part of the SDR methodology since the 1970s.

The requirement for currencies in the SDR basket to be also freely usable is the second criterion. It was incorporated in 2000 to reflect formally the importance of financial transactions for the purposes of valuing the SDR basket.

**The concept of “freely usable”**

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1 In August 2015, the Executive Board extended the SDR basket that was put into place in the 2010 Review through September 30, 2016.
A “freely usable” currency is defined in the IMF’s Articles of Agreement to mean a currency that the IMF determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets.

The concept of a freely usable currency concerns the actual international use and trading of currencies, and is different from whether a currency is either freely floating or fully convertible.

A currency can be widely used and widely traded even if it is subject to some capital account restrictions (in the past, currencies such as the pound sterling and Japanese yen were determined freely usable when some capital account restrictions were in place). On the other hand, a currency that is fully convertible is not necessarily widely used and widely traded.

The freely usable concept plays a central role in the IMF’s financial operations. In particular, all borrowing members have the right to receive a freely usable currency. Indeed, IMF lending operations are, in practice, conducted in freely usable currencies or SDRs, and in the latter case, borrowing members have the right to exchange SDRs into freely usable currencies. The freely usable concept seeks to ensure that a member can use the currency received from the IMF either directly or indirectly (by exchanging it into another currency without disadvantage) to address a balance of payments financing need.

Indicators used to determine free usability

The definition of a freely usable currency requires interpretation, and the determination of which currencies are freely usable requires judgment within the parameters of the legal framework, and is guided by the objective and purpose of the freely usable concept in the context of Fund financial operations.

The IMF Executive Board has relied on quantitative indicators to inform this judgment. In 2011, the Executive Board endorsed using several indicators as important factors in the free usability assessment: the shares of currencies in reserve holdings, and the currency denomination of international debt securities, and international banking liabilities as indicators for assessing wide use, and the volume (turnover) of transaction in foreign exchange markets as indicator for assessing wide trading. As part of the recently concluded review in November 2015, the Executive Board also took into account additional indicators, such as official holdings of foreign currency assets; the issuance of international debt securities; cross-border payments; and trade finance to complement those indicators endorsed in 2011.

Voting majorities needed for determining the SDR method of valuation

The method of valuation is determined by a 70 percent majority of the total voting power, provided that an 85 percent majority is required for (i) a change in the principle of valuation, or (ii) a fundamental change in the application of the principle in effect. To date, all decisions that have changed the SDR valuation method have been adopted with a 70 percent majority of the total voting power.

Next review

The next review of the method of valuation of the SDR will take place by September 30, 2021, unless an earlier review is warranted by developments in the interim.