

**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS**

**CURRENCY UNIONS TECHNICAL EXPERT GROUP (CUTEG)**

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**ISSUES PAPER (CUTEG) # 10**

**DEFINITION AND ALLOCATION OF RESERVE ASSETS IN A CURRENCY UNION**

The views expressed in this Paper are those of the author and do not necessarily represent those of the European Central Bank.

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## CURRENCY UNION TECHNICAL EXPERT GROUP

### ISSUES PAPER (CUTEG) # 10

#### DEFINITION AND ALLOCATION OF RESERVE ASSETS

1. This paper analyses the definition of reserve assets in the context of a Currency Union (CU) and the allocation of transactions and positions in reserve assets in the balance of payments, international investment position and international reserves statements of both the CU and the CU's participating countries. The general principles on the definition of reserve assets set out in the BPM5 and in the IMF "International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template" (hereinafter 'the IMF Template') should assist in identifying the key elements guiding the most appropriate reflection of reserve assets in both national and CU aggregate statistics.

#### I. Current international standards for the statistical treatment of the issue

2. The *BPM5* discusses the definition and recording of reserve assets in Chapter XXI. The definition of reserve assets is established in paragraph 424, which states that "Reserve assets consist of those *external assets* that are readily available<sup>1</sup> to and *controlled by monetary authorities* for direct financing of payment imbalances, for indirectly regulating the magnitudes of such imbalances through the intervention in exchange markets to affect the currency exchange rate, and/or for other purposes".

3. Chapter 2 of the IMF Template further clarifies the meaning of "external assets" in this definition. It states that "the reserve assets must be foreign currency assets" (paragraph 66); that "such foreign currency assets must be in convertible foreign currencies" (paragraph 67); and that they "refer to claims of the monetary authorities on non-residents".

4. Regarding the second key element in the definition of reserve assets, i.e. the "control by monetary authorities", the existing methodological guidance is contained in paragraphs 428 to 430 of the BPM5 and paragraph 68 of the IMF Template. In general, only foreign currency claims actually owned by monetary authorities would be regarded as reserve assets. Nevertheless, in cases where institutional units (other than monetary authorities) in the reporting economy hold legal title to external foreign currency assets and are permitted to do so only on terms specified by the monetary authorities or only with their explicit approval, such assets can be considered reserve assets.

5. Finally, neither the *BPM5* nor the IMF Template provide any guidance on the way reserve assets of a CU should be reflected in the statistical statements of the CU and of the CU national member states.

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<sup>1</sup> Readily available assets should be understood as referring to highly liquid, marketable and creditworthy assets, i.e. assets that are available with few constraints.

## II. Concerns/shortcomings of the current treatment

6. To sum up, the key elements in determining those (liquid) assets that qualify for reserve assets are as follows: (i) foreign currency-denominated; (ii) assets vis-à-vis non-residents; and (iii) effectively controlled by the relevant monetary authority. Within the context of a CU union, the relevant questions to be clarified are

- whether the single CU currency should be regarded as domestic or foreign currency from a national viewpoint;
- whether foreign currency assets of the CU Central Bank<sup>2</sup> (CU CB) and/or the CU National Central Banks (CU NCBs) vis-à-vis residents of the other CU member states should be regarded as reserve assets both from a CU and from a national perspective;
- what are the relevant monetary authorities at the CU and at the national level;
- to what extent the foreign assets are under the effective control of the CU CB and/or the CU NCBs.

## III. Proposed treatments

### Definition of reserve assets in a CU

- *Domestic versus foreign currency denominated assets*

7. A key question to be clarified is whether the single currency could be regarded as foreign currency from the point of view of the CU national member states' institutional units. The so-called 'dual nature' of the single currency theory sustained that the single currency of a CU area could be considered as both a domestic and foreign currency from a national viewpoint. It considers that for each Member State participating in CU, the single currency is both a "national" and a "foreign" currency, since each of them is responsible for its issuance and accepts it as a legal tender, but none of them has full control over it. Should this be the case, CU NCBs' claims denominated in the single currency and vis-à-vis non-residents of the CU or residents of other CU member states could theoretically be regarded as reserve assets in national statistics.

8. However, the institutional setting of a CU determines that the single currency, in view of its unitary nature, should be solely regarded as domestic currency in all the CU national member states. In addition, assets denominated in the single currency may be ineffective for any interventions in case of a crisis affecting the CU currency. For these reasons, it is proposed not to consider CU CB/NCBs' claims denominated in the single currency as reserve assets in CU and national statistics.

- *Foreign assets vis-à-vis other CU residents*

9. In a CU, three relevant groups of residents could be identified: (i) residents of an individual CU national member state (*domestic residents*); (ii) residents of the other CU national member states (*other CU residents*<sup>3</sup>); and (iii) residents of countries outside the CU (*non-CU residents*). Consequently, when defining reserve assets at the national

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<sup>2</sup> For the sake of clarity, let us assume that the monetary authority both at the CU and at the national level is represented by the Central Banks exclusively.

<sup>3</sup> Following the "External Debt Statistics: Guide for Compilers and Users" paragraph 2.21, the CU CB falls within this category as it should be regarded as a non-resident from the national viewpoint but as a resident of the CU.

level, groups (ii) and (iii) would comprise the relevant non-resident population, whereas only group (iii) would constitute the non-resident counterpart for identifying reserve assets at the CU level.

10. A first and immediate conclusion is that CU CB/CU NCBs foreign currency claims on non-CU residents (group (iii)) are to be considered as reserve assets both in CU and national statistics. Likewise, a second immediate result is that CU CB/CU NCBs foreign currency claims on other CU residents (group (ii)) cannot be regarded as reserve assets at the CU level, because they represent domestic (as opposed to external) assets from the CU perspective and do not thus abide by the BPM5 definition of reserve assets.

11. A less clear-cut case arises as regards the reflection of CU NCBs foreign currency claims on other CU residents in national statistics. From a strictly national viewpoint, it could be argued that these assets would fulfil the definition of reserve assets prescribed by the BPM5. However, the concept of reserve assets in a CU has a unitary nature, meaning that only one definition (concept) can apply for the whole CU and this should be consistent with that applied at national (single CU member) level for a number of important reasons.

12. Firstly, the extent to which this type of assets could be used for foreign exchange policy (intervention) purposes is questionable. Foreign currency denominated deposits held by CU NCBs in financially weak banks resident in other CU member states, which would likely not be available for use in a crisis affecting the CU financial system, would however be reflected in national statistics, leading to overestimation of reserves.

13. Secondly, an interpretation of the meaning of reserve assets at the national level might be difficult to sustain, if they are not considered as reserves for the CU at the same time, bearing in mind that the holding and management of the reserves of the CU is one of the basic tasks of the monetary authority of the CU and no longer a task of the individual CU NCBs.

14. Finally, the exclusion of these assets from the reserve assets definition at the national level would permit that the sum of the individual reserves of the CU NCBs and the CU CB would be equal to the CU consolidated reserves, enhancing transparency and credibility of the CU in exchange rate related issues. CU CB and CU NCBs reserves are to be seen as homogeneous elements of the very same aggregate, i.e. the reserve assets of the CU as a whole, and therefore the definition of reserves at national level should necessarily be consistent with the CU definition.

15. Therefore, and as a third conclusion, CU CB/CU NCBs foreign currency claims on other CU residents (group (ii)) should preferably not be regarded as reserve assets at national level. This also implies that CU NCBs foreign currency claims on domestic residents (group (i)) should a fortiori not be considered as reserve assets both at the CU and at the national level.

16. Finally, gold, special drawing rights (SDRs) and the Reserve Position in the IMF held by the CU CB/CU NCBs are to be considered as reserve assets both at the CU and at the national level.

#### **Allocation of reserve assets in a CU**

17. Once the issue of what kind of assets qualify for reserve assets in a CU, the question arises on the way the CU total reserve assets are allocated/attributed to the CU CB and CU NCBs. This allocation is important to the extent that it will subsequently determine how the overall reserves of the CU are shown in the CU CB statistics and the statistics of

the CU member states. It should be noted that whatever criteria is used to allocate the CU reserves to the CU NCBs, this will by no means alter the total reserves of the CU as a whole. Moreover, it is also worth mentioning that the analytical of this information is questionable, as they could hardly be interpreted as more than simple proportions on the total CU reserves with no economic meaning in itself. However, the allocation criterion chosen will determine the amounts of reserves shown at the national level, and this makes this criterion an undoubtedly sensitive issue because of the political dimension of the reserves figure.

18. In this regard, it is clear that the particular institutional setting of the CU may play a crucial role in determining the sharing of the CU reserves among the CU participating countries, as this question is connected with the effective control of the assets. As a first result, it can be concluded that the total reserves of the CU will always be the addition<sup>4</sup> of the reserve assets of the CU CB and the CU NCBs, whatever the institutional setting for the CU monetary authority has been established.

19. Likewise, foreign currency claims under the effective control of the CU CB will constitute the CU CB's reserve assets, whereas only those assets effectively controlled by the CU NCBs will be included in the national statistics. And this is here where the institutional setting of the CU may, or may not, offer different solutions.

20. In a decentralised model<sup>5</sup>, the monetary authority of the CU consists of the CU CB and the CU NCBs. For operational purposes, some reserve assets are retained by the CU NCBs (the so-called non-pooled reserves) while another part (the so-called pooled reserves) is transferred (for instance, in proportion to the CU subscription key) to the CU CB. As the pooled reserves are provided to the CU CB in the form of an outright transfer of ownership, a first conclusion is that these pooled reserves should be considered under the direct and effective control of the CU CB and therefore should be recorded as reserve assets of the CU CB.

21. Proportionate to the reserve assets transferred, the CU CB should recognise a liability vis-à-vis each CU NCB in its balance sheet, which is recorded as a claim on the CU CB in the CU NCB's balance sheet<sup>6</sup>. The main issue is how to treat such a claim (liability from the point of view of the CU CB) in the national statistics of the participating CU member states. Although highly dependent on the specific arrangements within each CU, a criterion that may be determinant for their final consideration might be whether or not such claims are remunerated. If so, the recommended treatment in the national balance of payments of the CU member states could be to classify these transactions as *Other investment/Monetary authorities/Assets/Currency and deposits*

22. As long as a transfer of ownership does not take place, foreign claims retained by the CU NCBs are considered to be under their direct and effective control and should preferably be recorded in national statistics as reserve assets of each individual CU NCBs. This conclusion is to be maintained even though usually these decentralised models also include provisions under which certain CU NCBs' operations in reserve assets require further approval by the CU CB in order to ensure consistency with the exchange rate and the monetary policies of the CU. However, such limitations

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<sup>4</sup> Of course, this stays only under the assumption that the previous proposals for defining reserve assets in a CU have been agreed. Otherwise, this proposition may not hold, e.g. if CU NCBs' foreign claims on other CU residents are considered reserve assets in national statistics, the addition of national data will certainly exceed the CU consolidated reserves.

<sup>5</sup> The Monetary Union in Europe could be mentioned as a valid example of a decentralised model of CU.

<sup>6</sup> For more details, see CUTEG Issue paper # 15.

requiring prior approval by the CU CB are usually confined to foreign exchange activity above a given threshold, with regard to the timing of the transaction and the manner in which the transaction is to be performed and the CU CB may only request that a transaction be delayed in very exceptional circumstances.

23. In a centralised model, the CU NCBs may act as mere branches of the CU CB and, among other activities, the CU CB may have direct and effective control of the total reserve assets of the CU (i.e. 100% of the CU reserve assets would be pooled reserves). No reserve assets could be considered as retained by the CU NCBs or non-pooled. In this case, two alternatives could be considered for reflecting reserve assets in national statistics:

- zero option : all CU reserves are shown in the statistical statements of the CU CB with no entry for reserve assets in the national statistics of the CU member states. This solution is the only one consistent with the treatment recommended for the so-called centralised model ;
- capital key option : as a mere convention with no economic meaning behind, the consolidated CU reserves (after subtracting the pooled reserves attributed to the CU CB) could be distributed and presented in national statistics according to the proportion in the capital key of the CU. Such a solution does not appear to be compatible with the definition of reserve assets put forward across this paper.

24. In both options, the ultimate implication is that a balanced national b.o.p. may be impossible to compile.

#### **IV. Points for discussion**

*(I) Do members of the CUTEg agree that the single currency, in view of its unitary nature, should be solely regarded as domestic currency in all the CU national member states? Do members of the CUTEg agree that CU CB/NCBs' claims denominated in the single currency should therefore be excluded from reserve assets both in CU and national statistics?*

*(II) Do members of the CUTEg agree that CU CB/CU NCBs' foreign currency claims on non-CU residents are to be considered as reserve assets both in CU and national statistic? Do members of the CUTEg agree that CU CB/CU NCBs' foreign currency claims on other CU residents (group (ii)) cannot be regarded as reserve assets at the CU level? Do members of the CUTEg agree that CU CB/CU NCBs' foreign currency claims on domestic or other CU residents cannot be regarded as reserve assets at national nor CU level?*

*(III) Do members of the CUTEg agree that gold, special drawing rights (SDRs) and the Reserve Position in the IMF held by the CU CB/CU NCBs are to be considered reserve assets both at the CU and at the national level?*

*(IV) Do members of the CUTEg agree that the total consolidated reserves of the CU will always be the addition<sup>7</sup> of the reserve assets of the CU CB and the CU NCBs, whatever the institutional setting for the CU monetary authority has been established? Do members of the CUTEg agree that the 'pooled' reserves, if provided in the form of an outright transfer of ownership, should be considered under the direct and effective control of the CU CB and therefore should be recorded as reserve assets of the CU CB? Do members of the CUTEg agree that, as long as a transfer of ownership does not take place, foreign claims retained by the CU NCBs are*

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<sup>7</sup> Of course, this stays only under the assumption that the previous proposals for defining reserve assets in a CU have been agreed. Otherwise, this proposition may not hold, e.g. if CU NCBs' foreign claims on other CU residents are considered reserve assets in national statistics, the addition of national data will certainly exceed the CU consolidated reserves.

*considered to be under their direct and effective control and should preferably be recorded in national statistics as reserve assets of each individual CU NCBs?*

*(V) Do members of the CUTEG agree to the proposed treatment for claims of the CU NCBs on the CU CB arising from the initial transfer of reserve assets under 'Other investment/Monetary authorities/Assets/Currency and deposits' as long as such claims are regularly remunerated?*

*(VI) What are the views of the members of the CUTEG on the possible options for reflecting CU consolidated reserves in national statistics under a centralised CU model? In this case, what are the views on the treatment of the associated income?*

**Annex 1**

**Definition and allocation of reserve assets in a CU**

		<b>Currency of denomination</b>	<b>Residence of debtor</b>	<b>Type of asset <sup>1</sup></b>	<b>NATIONAL</b>	<b>CU CB</b>	<b>TOTAL CU</b>	
<b>Assets on the Balance Sheet of the CU CB</b>	Foreign currency	Non-CU	Deposits placed with foreign branches of CU resident banks		RA	RA		
			Other assets		RA	RA		
		CU	Deposits placed with CU resident banks		OI	-		
			Other assets		PI/FD	-		
	Domestic	Non-CU			PI/OI/FD	PI/OI/FD		
		CU			PI/OI/FD	-		
<b>Assets on the balance sheet of the CU NCBs</b>	Claim on the CU CB	Domestic	CU		OI	OI	-	
	Other claims	Foreign currency	Non-CU			RA		RA
			of which	Deposits placed with foreign branches of CU resident banks		RA		RA
			Other CU	Deposits placed with other CU resident banks		OI		-
				Other assets		PI/OI/FD		-
		Domestic	domestic	Deposits placed with domestic banks		-		-
				Other assets		-		-
			Domestic	Non-CU			PI/OI/FD	
		Other CU				PI/OI/FD		-
	domestic				-		-	
	Gold, SDRs and Reserve Position in the Fund					RA		RA