

# GoldMoney Insights®

## The IMF's Special Drawing Rights, the RMB and gold



At the latest G20 meeting, China's central bank vowed to promote the use of SDRs in the Chinese economy, just four months after the IMF decided to include the RMB as part of the currency basket underlying SDRs. Adding the RMB marks only the 5<sup>th</sup> time the Fund changed the composition of the basket since formally moving away from a gold based system in 1974. However, as history shows, the SDR has been unable to maintain value as gold has. Adding the RMB to the basket will hardly change that.

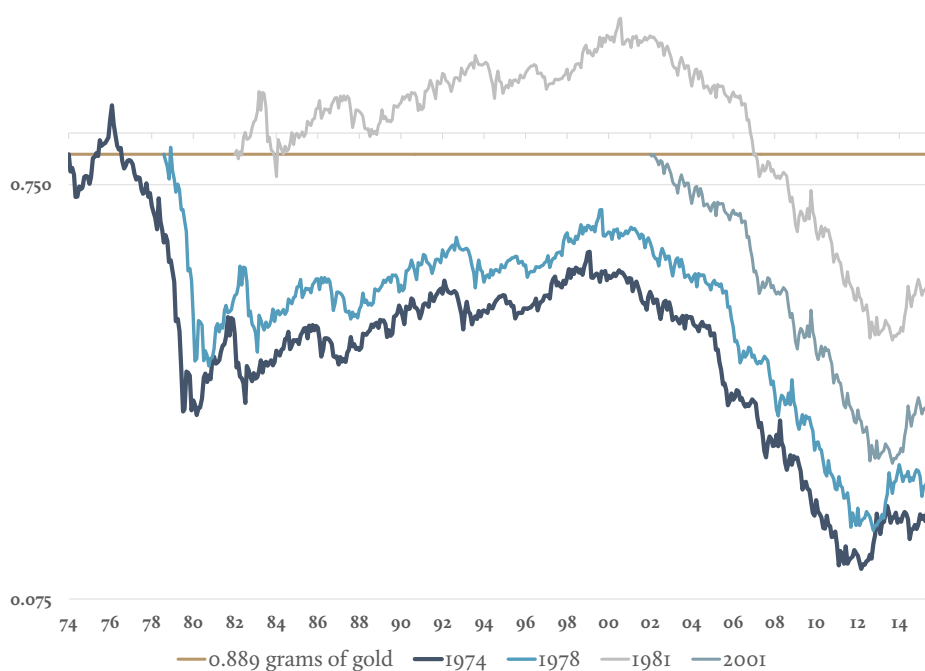
On April 1, 2016, China's central bank Governor Zhou Xiaochuan announced that the Chinese government will take actions to promote the use of SDRs in its domestic economy. The announcement was made at the end of a meeting of the G20 in Paris, which is hosted by China this year. China will start to use both the USD and SDRs when reporting its foreign reserves. In addition, the country will also consider issuing bonds denominated in SDRs. This comes five months after the International Monetary Fund (IMF) decided to include the Chinese Renminbi as a fifth currency to the basket of Special Drawing Rights (SDR) along with the U.S. dollar, the Euro, the Japanese yen and the British pound. The change takes effect on October 1, 2016. This marks the first major change of the constituents

**STEFAN WIELER & JOSH CRUMB**  
RESEARCH@GOLDMONEY.COM

of the basket since 1981 when the IMF dropped 11 out of 16 currencies in the original basket. However, when the SDR was introduced in 1969, it was not based on a basket of currencies but linked to gold, 0.888671 grams to be precise, which, at the time, equaled exactly 1 US dollar. The SDR basket based on the original weighting of 16 currencies declined around 87.7% in value vs gold until today. Similarly, the basket introduced in 1978 has lost 84.4%. The smaller 5 currency basket introduced in 1981 is down 55.5% and the current basket is down 77.0% since its introduction in 2001.

### The currency baskets declined between 56% and 88% vs gold since their respective inception

Log scale



Source: Bloomberg, IMF, GoldMoney Research

Taking interest payments into account hardly changes the outcome. It is obvious today that for net holders of SDRs, breaking the link to gold had a negative im-



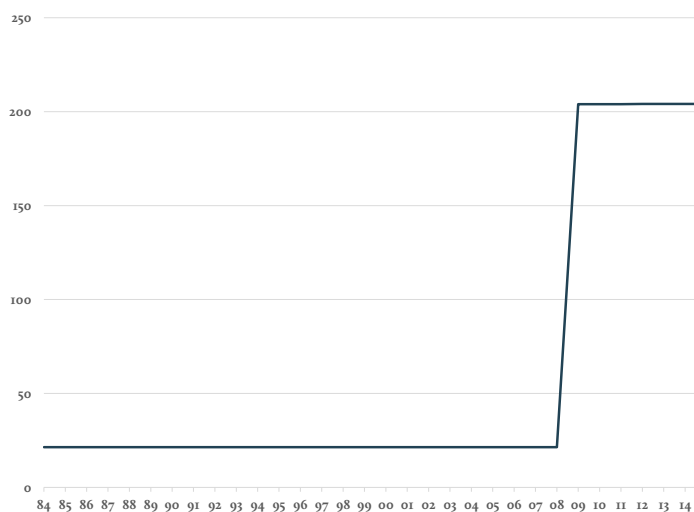
pact on their reserve value. This is hardly surprising as any currency has underperformed gold over the past 10 years and any timeframe beyond that. Hence, it's not that the currencies in the basket were Summary poorly chosen or poorly weighted, no combination would have managed to do better than gold, whether the RMB would have been part of the basket all along or not. While it is far too early to conclude that China is challenging the dollar's dominant reserve position, RMB inclusion in the SDR will nevertheless have a profound impact on perceptions not only of China's growing economic power generally but monetary power specifically. But while the impact of the inclusion of the RMB should not be underestimated, it is unlikely that this will change the trend that gold outperforms any fiat currency.



## The IMF's Special Drawing Rights, the RMB and gold

In 1969 the International Monetary Funds (IMF) introduced the Special Drawing Right (SDR) in order to supplement reserve assets of member countries. At the time the US was tightening their monetary policy which meant there was a shortage of USD as a reserve currency and the hope was that the introduction of SDRs could alleviate the issue. An SDR is the equivalent of foreign exchange reserves for a member country. It can only be held and used by member countries, the IMF itself (which uses it as a unit of account), and certain designated official entities. It cannot be held by private entities or individuals - although private SDRs could be created and used, that market never developed. SDRs can be created only through an allocation by the Fund and the stock can only be reduced by a cancellation by the fund. An allocation gives the member country a low cost way to add to its international reserves. SDRs have played a minor role of global reserve assets in the past. In 2009 the fund sharply increased the allocation to the equivalent of SDR 204 billion (equivalent to about USD318 billion) as a response to the global financial crisis (see Figure 1).

**Figure 1: Although the total allocation of SDR has exploded in 2009, SDRs still account for only 3% of global reserves**  
Billion



Source: IMF, GoldMoney Research



Since then the number of SDRs has been stable again. Even with this nearly 10-folding of SDR allocation, SDRs make only about 3% of global reserves at this point according to the IMF. In 1972, SDRs accounted for 9.5% of all non-gold reserves.

On November 30, 2015, the International Monetary Fund (IMF) decided to include the Chinese renminbi as a fifth currency to the basket of Special Drawing Rights (SDR) along with the U.S. dollar, the Euro, the Japanese yen and the British pound. This marks the first major change of the constituents of the basket since 1981 when the IMF dropped 11 out of 16 currencies in the original basket. However, when the SDR was introduced in 1969 it was not based on a basket of currencies but linked to gold. 0.888671 grams to be precise, which, at the time, equaled exactly 1 US dollar. In other words, the SDR and the US dollar were equal in value, because both were defined in gold. However, as the USD was devalued against gold and other currencies several times over the coming years while SDRs continued to reflect 0.888671g of gold, SDR values in USD terms rose steadily.

When the US, under President Nixon ended the convertibility of the USD to gold in 1971, SDRs continued to be linked to gold for a while but eventually the IMF abandoned the link in favor of a basket of currencies in June 1974. The original basket consisted of 16 currencies of the world's largest exporters at the time. 16 was chosen because that brought the cut-off point to be included in the basket to 1% of global exports. While the weightings have changed more often, the constituents of the basket has changed only a handful of times. In 1978 the basket was altered by excluding the Danish krone and the South African rand and including the Saudi Arabian and Iranian rial. Importantly, in these early days, the interest rate on the basket was not determined on the weighted interest rate of the currencies in the basket but on a much smaller basket of just 5 currencies, the USD, JPY, DEM, FRF and the GBP which at the time had the most developed financial markets. This increasingly led to dichotomy between the valuation of the basket and the interest calculations and thus in 1980 the IMF board decided to unify the two baskets, including only the 5 currencies of the G5. And until recently, the composition of basket has remained unchanged for 35 years, apart from merging the DEM and the FRF into the EUR in 2001.

On November 30, 2015, the IMF announced to include the RMB in the SDR basket, starting October 1, 2016. The RMB will have an initial weighting of 10.9%



in the basket. The IMF's decision to include the RMB came mainly at the expense of the EUR and the GBP. The EUR weighting was reduced from 37.4% to 30.9% and the GBP weighting from 11.3% to 8.1%. The USD weighting was only slightly reduced from 41.9% to 41.7% and the Japanese yen went from 9.4% to 8.3%. Apart from prestige, the Chinese will benefit from being included in the SDR in that central banks will now be more willing to hold RMB as part of their reserves.

**Figure 2: The value of SDRs was initially based on a specific weight of gold, but was later replaced by a basket of currencies and changed several times**

Currency	Effective July 1, 1969	Effective July 1, 1974	Effective July 1, 1978	Effective January 1, 1981	Effective January 1, 2001	Effective October 1, 2016
Gold	100.0%	-	-	-	-	-
US Dollar	-	33.0%	33.0%	42.0%	45.0%	41.7%
Euro	-	-	-	-	29.0%	30.9%
German Mark	-	12.5%	12.5%	19.0%	-	-
Japanese Yen	-	7.5%	7.5%	13.0%	15.0%	8.3%
French Francs	-	7.5%	7.5%	13.0%	-	-
British Pound	-	9.0%	7.5%	13.0%	11.0%	8.1%
Chinese Renminbi	-	-	-	-	-	10.9%
Italian Lira	-	6.0%	5.0%	-	-	-
Dutch Guilders	-	4.5%	5.0%	-	-	-
Canadian Dollar	-	6.0%	5.0%	-	-	-
Belgian Francs	-	3.5%	4.0%	-	-	-
Saudi Arabian Riyal	-	-	3.0%	-	-	-
Swedish Krone	-	2.5%	2.0%	-	-	-
Iranian Riyal	-	-	2.0%	-	-	-
Australian Dollar	-	1.5%	1.5%	-	-	-
Danish Krone	-	1.5%	-	-	-	-
Spanish Peseta	-	1.5%	1.5%	-	-	-
Norwegian Krone	-	1.5%	1.5%	-	-	-
Austrian Shilling	-	1.0%	1.5%	-	-	-
South African Rand	-	1.0%	-	-	-	-

Source: IMF, GoldMoney Research

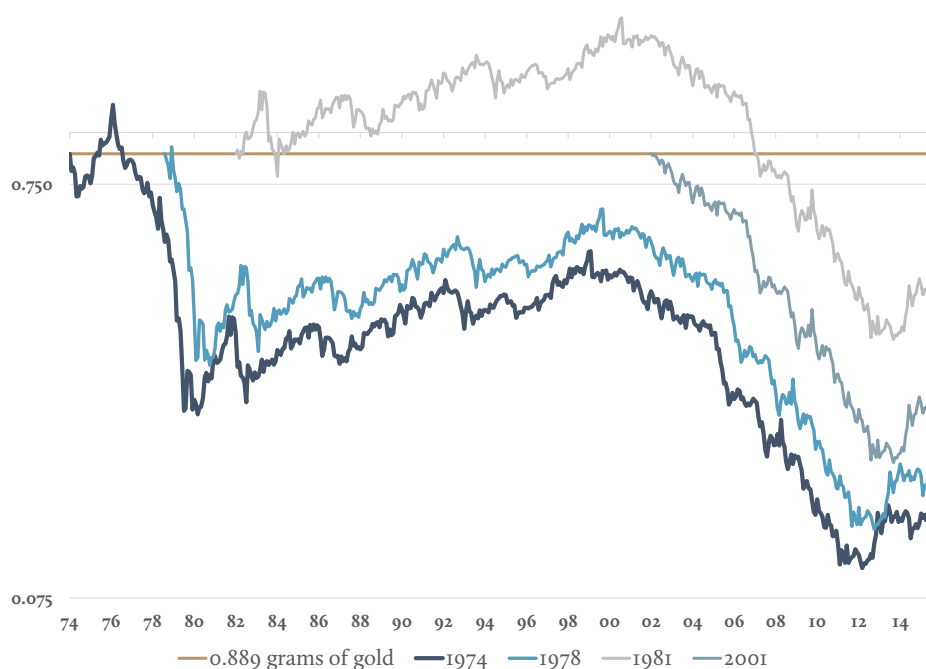
We would like to use this historical event to examine how the value of the SDR evolved over time, from the time it was linked to gold to the current basket. Figure 3 shows how the value of the original baskets evolved over time, measured in gold.



The SDR basket based on the original weighting of 16 currencies declined around 87.7% in value vs gold until today. Similarly, the basket introduced in 1978 has lost 84.4%. The smaller 5 currency basket introduced in 1981 is down 55.5% and the current basket is down 77.0% since its introduction in 2001.

**Figure 3: The currency baskets lost between 50% and 86% vs gold since their respective inception**

Log scale



Source: Bloomberg, IMF, GoldMoney Research

The fund pays interest to SDR holders and charges the equivalent rate on the net cumulative allocations of each participant. Hence, a member country with more SDR holdings than allocation is a net interest payment receiver. The interest rate is determined by the IMF and published weekly on its website, back to January 2000. This allows us to account for interest payments as well when comparing to the performance in gold. We used the 4 currency basket introduced in January 2001 as it is the only one where the IMF provides a full set of interest rates



throughout the baskets existence. We find that even including interest rates, the currency basket declined 73.6% vs gold over the nearly 15 years since introduction.

It is obvious today that for net holders of SDRs, breaking the link to gold had a negative impact on their reserve value. This is hardly surprising as any currency has underperformed gold over the past 10 years and any timeframe beyond that. Hence, it's not that the currencies in the basket were poorly chosen or poorly weighted. No combination would have managed to do better than gold, whether the RMB would have been part of the basket all along or not. While it is far too early to conclude that China is challenging the dollar's dominant reserve position, RMB inclusion in the SDR will nevertheless have a profound impact on perceptions not only of China's growing economic power generally but monetary power specifically. But while the impact of the inclusion of the RMB should not be underestimated, it is unlikely that this will change the trend that gold outperforms any fiat currency.

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