



IDA18

**Effective Foreign Exchange Rates
for Use in the IDA18 Replenishment**

**International Development Association
IDA Resource Mobilization (DFIRM)**

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Selected Abbreviations and Acronyms

IDA	International Development Association
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
SDR	Special Drawing Right

Effective Foreign Exchange Rates for Use in the IDA18 Replenishment

1. **Averaging period.** For IDA replenishments, partner contributions announced in pledge currencies are translated into SDR terms by using a set of average foreign exchange rates over an agreed reference period. Since IDA7, partners have chosen to determine the reference period at the beginning of the replenishment discussions. In setting the reference period, partners have agreed to use the following criteria:

- *Sufficient lead time should be allowed to determine the pledge currency amounts that partners will contribute to meet a specific percentage burden share or SDR amount in the replenishment.* Since partners would need to obtain authorization for their pledge currency contributions, they should be able to calculate well in advance the necessary pledge currency amounts.
- *The reference period chosen should cover an upcoming period to avoid using known foreign exchange rates to the extent feasible.* This was seen as the most equitable approach, avoiding the risk of selecting among different sets of foreign exchange rates that could be more favorable to some partners and less so to others. Defining the reference period at the beginning of the replenishment discussions and basing the foreign exchange rates on future dates will meet this criterion.
- *The method for determining exchange rates should mitigate short-term currency fluctuations.* Using average foreign exchange rates over several months would serve this purpose. Except for IDA10, partners have usually selected a reference period of six months (see table).

IDA Replenishments: Exchange Rate Averaging Periods			
Replenishment	Discussions Completed	Exchange Rate Averages Adopted	Length
IDA7	January 1984	June 10 – December 9, 1983	6 months
IDA8	December 1986	March 1 – August 29, 1986	6 months
IDA9	December 1989	May 1 – October 31, 1989	6 months
IDA10	December 1992	March 1 – June 30, 1992	4 months
IDA11	March 1996	June 1 – November 30, 1995	6 months
IDA12	November 1998	March 1 – August 31, 1998	6 months
IDA13	July 2002	April 1 – September 30, 2001	6 months
IDA14	February 2005	April 1 – September 30, 2004	6 months
IDA15	March 2007	April 1 – September 30, 2007	6 months
IDA16	March 2010	April 1 – September 30, 2010	6 months
IDA17	March 2013	March 1 – August 31, 2013	6 months

2. **The SDR basket has been reviewed by the IMF Executive Board and a new basket will come into effect on October 1, 2016.** The SDR basket composition is reviewed every five years by the IMF and the current SDR basket was put into place following the 2010 Review. In the most recent review (concluded in November 2015), the IMF decided that, effective October 1, 2016, the Chinese Renminbi

will be included as a fifth currency, along with the U.S. dollar, Euro, Japanese Yen and Pound Sterling, in the SDR basket.

3. **Analysis based on historical foreign exchange rates indicates that the difference between the new and the old SDR basket is minimal in the short-run.** During the transition from the present to the new basket, the currency amounts in the new SDR basket will be adjusted to ensure that the value of the SDR is the same before and after the revision.¹ This IMF policy ensures that the exchange rates between national currencies and the SDR will not change during the SDR revision day. In addition, simulations performed by the IMF with the current SDR basket show that the properties of the SDR, its value in U.S. dollar terms and its volatility would stay broadly similar under the new changes. Our own analysis also indicates that SDR exchange rates based on the estimated new basket are not significantly different from SDR exchange rates based on the old basket.

4. **While the reference exchange rates will be used to determine IDA's agreed lending envelope at the time of the final pledging session, IDA's actual commitment authority for IDA18 will be determined by the subsequent hedges executed by IDA.** Following the December pledging session, IDA confirms partners' payment schedules and executes foreign exchange hedges to ensure stability in IDA's commitment authority.

5. **As per previous replenishments, given that not all partner contributions are fully hedged, countries with high inflation rates are required to contribute in SDRs and a replenishment inflation threshold needs to be established.** Recognizing the potential loss of replenishment resources caused by currency depreciation due to high domestic inflation, in previous replenishments, partners have agreed that countries with high inflation rates – exceeding an annual average threshold over a specified period of time – would denominate their IDA contributions in SDRs. For IDA9 and IDA10, the applicable threshold was an average inflation rate of 15 percent over the three-year period prior to the replenishment discussions. For IDA11 through IDA17, the inflation threshold was an average inflation rate of 10 percent.

Recommendations

6. **There are two recommendations for IDA Deputy approval at the first replenishment meeting in March 2016 related to effective foreign exchange rates for use in the IDA18 Replenishment:**

- a. It is recommended that a six-month averaging period from March 1, 2016 through August 31, 2016 be adopted for setting the IDA18 reference exchange rates.²
- b. It is also recommended that an average annual inflation rate threshold of 10 percent over the three-year period of 2013-2015 be used to determine partner countries with high domestic inflation rates.

¹ IMF policy paper "Review of the Method of Valuation of the SDR", November 2015.

² This is one month earlier than the averaging period used from IDA13 to IDA16 in order to allow the MDRI cost update provided for the October meeting to be prepared using the final IDA18 reference exchange rates. This would allow earlier reporting of the final MDRI costs for donors' budgeting purposes.