

DANMARKS NATIONALBANK

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Denmark contributes to a strong IMF



A well-functioning IMF is a matter of Danish interest

The IMF promotes global economic and financial stability. An important element of this effort is the IMF's lending to countries in financial difficulty, i.a. countering global and regional contagion effects. A precondition for successfully performing this task is that the IMF is sufficiently funded.

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Denmark has made new loan commit- ments to the IMF

The IMF's lending capacity has been considerably expanded due to e.g. the global financial crisis, the European debt crisis and the following high uncertainty. On Denmark's behalf, Danmarks Nationalbank has increased Denmark's total commitments to the IMF.

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Low risks associated with loans and com- mitments to the IMF

The IMF enjoys a very high degree of financial credibility and generally funds its lending by drawing on several member countries' quotas and loan commitments. Historically, the IMF's drawings on Danmarks Nationalbank's commitments have been modest.

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The main objective of the IMF is to promote global economic and financial stability. A well-functioning IMF with sufficient funding is therefore a matter of Danish interest, as Denmark is a small, open economy and therefore highly dependent on and exposed to external conditions. As part of the effort to secure a strong Danish economy, and given our capacity to contribute, Denmark makes substantial resources available to the IMF's lending facilities via Danmarks Nationalbank. The IMF currently has a considerable lending capacity that may be used in the event of extensive stress scenarios such as a new financial crisis, which may hit some countries particularly hard. Moreover, a strong IMF as such could have a stabilising impact on the global financial system, since it reinforces confidence in the IMF's crisis management abilities, thereby reducing the risk of e.g. capital flight.

Over the last decade, the lending resources of the IMF have been increased significantly in response to events such as the global financial crisis and the European debt crisis. Denmark, via Danmarks Nationalbank, has contributed in this connection by increasing its total commitment to the IMF. Danmarks Nationalbank's potential credit exposure to the IMF has increased from kr. 24 billion in 2008 to almost kr. 136 billion now. However, it is highly unlikely that the actual exposure will approach this level. The current exposure is considerably lower, just under kr. 17 billion, and besides, the credit risk is very low. As a last resort measure, Danmarks Nationalbank also has the option to reject further drawings on the Danish commitments.

Danmarks Nationalbank's financial accounts with the IMF are distributed on several arrangements. Like all other member countries, Denmark is assigned a quota in the IMF, which constitutes the actual membership contribution to the IMF. In addition, Danmarks Nationalbank has made voluntary loan commitments to the IMF on Denmark's behalf via the multilateral New Arrangements to Borrow (NAB), via a bilateral loan agreement with the IMF and via loan commitments to the IMF's Poverty Reduction and Growth Trust (PRGT). The total Danish commitments to these three voluntary arrangements with the IMF amount to approximate-

The International Monetary Fund provides financial assistance to crisis-ridden countries

Box 1

The purpose of the International Monetary Fund, IMF, is to ensure the stability of the international monetary system. An important element of this task is first and foremost to prevent balance of payments problems in countries. The IMF contributes to reducing macroeconomic vulnerabilities inter alia by continuous surveillance of the member countries' economies, i.e. the Article IV consultations. In addition, the IMF may provide technical assistance to countries in need of assistance for developing and implementing their economic policies.

Another important element is to provide loans to member countries that have or could potentially incur balance of payments problems. The IMF's special lending arrangements can help to buoy up individual member countries at risk, while at the same time preventing problems in one country from spreading to other parts of the global financial system. The country-specific requirements of an IMF lending arrangement will also help to ensure that borrowers implement the reforms and economic measures required in order to restore economic sustainability in the countries in question.¹ Moreover, an IMF programme, including faith in the IMF's expertise when it comes to laying down the right terms and conditions to be met by the borrower, may act as a catalyst for further funding by e.g. regional or bilateral lenders.

The IMF's lending is funded primarily by IMF membership contributions, i.e. quotas, and secondly by member countries' commitments to various voluntary IMF lending arrangements. Danmarks Nationalbank is responsible for managing Denmark's financial accounts with the IMF.

¹ See Gade et al. (2014) for a more detailed description of the IMF lending arrangements.

ly 3 per cent of Denmark's gross domestic product (GDP) and almost two times Denmark's size in the IMF, measured by the quota. This is above average compared with other countries.¹

The following provides a detailed account of Danmarks Nationalbank's financial accounts with the IMF, including the extensive adjustments made or decided upon in 2016. The analysis also describes how

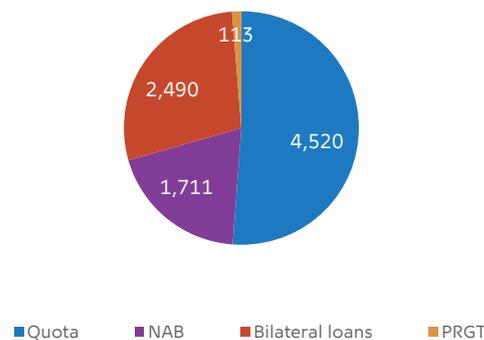
¹ See Gade et al. (2015) for a comparison of financial contributions across regions.

The IMF's total resources and Denmark's commitments

Chart 1

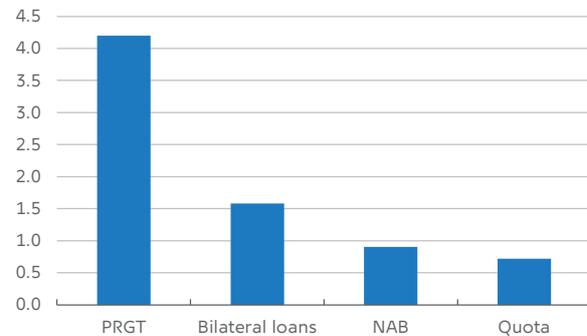
The IMF's total resources

Kr. billion



Denmark's share of the IMF's resources

Per cent



Note: The resources and Denmark's Nationalbank's commitments have been updated at the end of 2016 and converted into kroner using the exchange rate applying at 30 December 2016. Note that Denmark's relatively large share of the total PRGT commitments mainly reflects the fairly small number of countries contributing to the PRGT. This share is expected to fall somewhat as more countries are planning to update their PRGT commitments during 2017.

the IMF's drawings on Danish loan commitments function in practice and how they affect Denmark's Nationalbank's foreign exchange reserve and balance sheet.

Quotas – membership contributions to the IMF

At the core of the IMF's total resources are the membership contributions from the individual countries, known as quotas. As in listed financial enterprises, the share capital contributed, for the IMF the quota subscriptions can be used for e.g. funding lending activities. Likewise, the quota share, or ownership share in the IMF, also determines a member country's influence on the governing bodies of the IMF.² The latter gives member countries an incentive to seek to obtain the largest possible quota share. In addition, quotas determine the access limits on loans from the IMF.³

IMF quotas are assigned based broadly on the member countries' relative positions in the world economy.⁴ The total quota size, and its distribution across member countries, are adjusted in connection with regular *quota reviews*. The most recent quota review was approved in 2010⁵, but did not become effective until January 2016. In that connection, the IMF's total quota resources were doubled from SDR 238.5 billion to SDR 477 billion with a view to ensuring that the IMF has sufficient resources to meet future lending requirements and that the quotas make up a larger share of the IMF's funding. As a result of the review, Denmark's total quota was increased from SDR 1.6 billion to SDR 3.4 billion (from kr. 17.9 billion to kr. 32.6 billion) and now constitutes 0.72 per cent of total IMF quotas. In this context, it should be noted that the aggregate quota increase did not boost the IMF's lending resources, it simply altered their composition.

2 See Gade et al. (2015) for a description of the IMF's governance.

3 Unlike pure share capital, the quotas do not earn dividend. Furthermore, member countries do not pay up their full quota share; most of it is a standing loan commitment on which the IMF can draw as required. Another difference is that the member countries themselves may temporarily draw on the quota resources paid to the IMF without losing their IMF membership rights.

4 Quotas are denominated in Special Drawing Rights (SDRs) – a kind of artificial currency (see the SDR section later in this article). Quotas are allocated on the basis of, inter alia, the quota formula (see Gade et al. (2015) for an explanation). Quotas may also be allocated on an ad-hoc basis, taking into account other factors than those included in the quota formula.

5 See Bohn-Jespersen (2010).

The reason is that the total commitments to the IMF's voluntary loan arrangement, the NAB, were reduced correspondingly – see below.

In practice, an increased quota allocation in connection with a quota review means that a member country must pay up more funds to the IMF. Generally, one fourth of the quota must be paid to the IMF, typically in SDRs or hard currency, i.e. global reserve assets. The remaining three fourths are held at the disposal of the IMF in local currency in an account at the national central bank and constitute a further *drawing right* on the quota. In other words, the IMF can use this drawing right to request further resources if, say, it needs to fund further lending. The difference between a member's total quota and the IMF's holdings of the member's currency is known as the *reserve tranche position* and is equal to the share of the quota that has been paid to the IMF. A member country's reserve tranche position is a claim on the IMF. Given that this claim on the IMF can be exchanged for hard currency to remedy balance of payments problems, Danmarks Nationalbank's reserve tranche position is included in the foreign exchange reserve.⁶

Although a member country's reserve tranche position initially constitutes approximately 25 per cent of its quota, it may vary over time. When the IMF disburses a loan, it is funded on a broad basis by drawing on the quotas of several member countries, i.e. the IMF asks the member countries to pay up further reserve assets. This means that the reserve tranche position increases, and the IMF's holdings of the local currency are reduced by a corresponding amount. Conversely, the IMF may increase its holdings of local currency by repaying reserve assets to a member country, so that the reserve tranche position is reduced. The same applies when a member country makes purchases in its reserve tranche position to gain access to hard currency.

6 Purchases in the reserve tranche position to remedy balance of payments problems differ from actual IMF loans in the sense that such purchases are not subject to repayment requirements and conditionality, while a loan may, for example, entail that the borrower country promises to implement a number of reforms as part of a comprehensive financial assistance package (see IMF (2016)). Due to Denmark's strong balance of payments and substantial foreign exchange reserve, the reserve position has never been reduced at Denmark's initiative.

Denmark's quota in the IMF 1984-2016 Chart 2



Note: The IMF's holdings of Danish kroner or further drawing right on the quota is the balance of the IMF's account at Danmarks Nationalbank. The reserve tranche position is defined as the quota less this drawing right.

Source: IMF.

Chart 2 shows the development in Denmark's quota and reserve tranche position with the IMF since 1984. It is seen that the quota has increased as a result of the IMF's regular quota reviews – notably the 2010 review, which became effective in 2016. The fluctuations in the reserve tranche position reflect the IMF's lending activity over time and the fact that the IMF funds its lending activity primarily by drawing on resources from the member countries that are assessed to have the capacity to contribute. Since Denmark is among these countries due to a strong balance of payments and a substantial foreign exchange reserve, the reserve tranche position has risen in periods when the IMF has increased its lending activities, e.g. in connection with the financial crisis and the European debt crisis. Another factor affecting the reserve tranche position is that the IMF has used various sources of funding for its lending activities over time, such as drawing on voluntary borrowing arrangements in certain periods. An explanation of Danmarks Nationalbank's current low reserve tranche position is thus not only that the IMF's outstanding loans are lower than some years ago, but also that the IMF to a large extent funded its post-financial crisis lending by means of non-quota resources.

The IMF's voluntary borrowing arrangements

The quotas are central to IMF's financial resources and constitute a solid "first line of defence" during

economic crises. As previously stated, the IMF has also regularly supplemented its quota resources with voluntary loan commitments from member countries. The ambition is to ensure that the IMF always has sufficient resources to fund its lending activities – also in periods with extensive global economic distress.

Among the voluntary borrowing arrangements, generally with the participation of member countries with robust economies, a distinction is made between commitments to

- the standing borrowing arrangement New Arrangements to Borrow (NAB)
- temporary bilateral loan agreements, and
- borrowing agreements with the IMF's Poverty Reduction and Growth Trust (PRGT).

All these arrangements can be seen as a sort of credit line, allowing the IMF, with certain restrictions, to draw on the countries' loan commitments. Loans under these arrangements are kept separate from the IMF's drawings on member countries' quotas and hence do not affect their reserve tranche positions. Chart 3 shows an overview of Danmarks Nationalbank's commitments to the IMF's voluntary borrowing agreements and how they have evolved since the financial crisis.

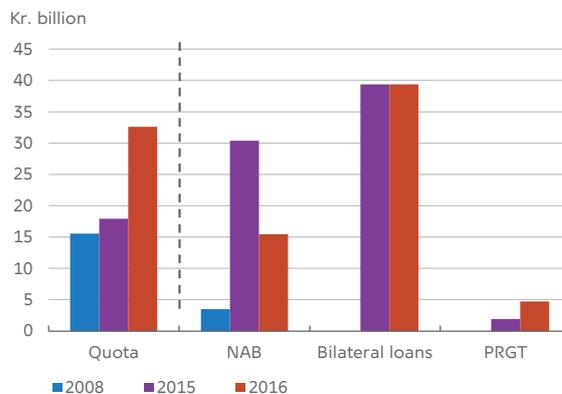
New Arrangements to Borrow (NAB)

The NAB is a multilateral borrowing arrangement between the IMF and currently 38 member countries and institutions⁷. The NAB is the IMF's "second line of defence" for funding its lending activity and is therefore used when it is found necessary to supplement the quota resources. The NAB was established in 1997 and has subsequently been renewed for periods of four or five years. The current NAB agreement was extended by five years in November 2016, i.e. from November 2017 to November 2022.

All drawings on NAB commitments require a prior decision by the participants and the IMF to *activate* the NAB agreement. The NAB was activated continuously in the period from April 2011 to February 2016, but was terminated following the doubling in early 2016, since the IMF's quota resources are assessed to be sufficient to meet any short-term borrowing

Development in Denmark's commitments to the IMF, 2008 and 2015-16

Chart 3



Source: IMF and Danmarks Nationalbank.

requirements. During the most recent period of activation, NAB resources were frequently used to fund IMF lending, meaning that Danmarks Nationalbank still has credit outstanding relating to loans under the NAB agreement.

In connection with the final approval of the 2010 quota review, it was decided to reduce the total NAB commitments from SDR 370 billion to SDR 181 billion. Danmarks Nationalbank's loan commitment under the NAB was reduced correspondingly and is now SDR 1.6 billion (kr. 15.4 billion).

Further bilateral loan agreements

Since 2009, Danmarks Nationalbank has also committed extraordinary loan resources to the IMF, thereby contributing to a "third line of defence" if the need arises to take substantial action to counter potential risks to the global financial system. The bilateral loan agreements with the IMF have been renewed from time to time, most recently in October 2016, when the IMF and Danmarks Nationalbank signed a bilateral loan agreement for 5.3 billion euro (kr. 39.4 billion). This agreement was a continuation of an existing agreement from 2012 for the same amount.

7 The IMF's Executive Board decided to establish the NAB in 1997 in response to risks of future financial crises. Denmark has participated in the borrowing arrangement from the outset.

Overall, the IMF had received commitments from 31 bilateral lenders totalling SDR 277 billion (kr. 2,620 billion) by December 2016. Drawing on these commitments is, however, conditional upon the NAB being activated and the remaining NAB resources falling below a certain threshold. For these reasons, the IMF has not drawn on extraordinary bilateral loan commitments since 2012.

Lending resources for low-income countries

Since the mid-1980s, the IMF has been able to offer its low-income members loans on more favourable terms. As of 2010, this has been effected through the Poverty Reduction and Growth Trust (PRGT), which is managed separately from the IMF's other resources.⁸ Like general IMF lending, the concessional lending under the PRGT is funded via resources borrowed from member countries. In addition, there was previously a regular need for separate funding of the PRGT's interest subsidies for low-income countries. These funds were sourced primarily from bilateral donors.⁹ As a result of various strategic measures, including changes to the PRGT, the IMF assesses that the subsidising part of the PRGT will be funded in the long term, so that no additional donations for interest subsidies will be required, subject to certain conditions. However, there will still be a need for a regular renewal of loan commitments to the PRGT.

Total lending resources under the PRGT amounted to SDR 11.9 billion at end-December 2016. In November 2016, Danmarks Nationalbank increased its loan commitment to the PRGT from SDR 200 million to SDR 500 million (from kr. 1.9 billion to kr. 4.7 billion). The increase came in response to the IMF's ambition to raise further funding for the PRGT. In this context, it should be emphasised that Danmarks National-

bank's loan commitments under the PRGT are not development aid and must therefore be repaid.

The SDR system

Quota subscriptions and loan resources make up most of Danmarks Nationalbank's financial accounts with the IMF. In addition, Danmarks Nationalbank has an exposure to the IMF in the form of the "SDR system", in which all current IMF members participate. Special Drawing Rights (SDRs) can be seen as a kind of artificial reserve currency that the IMF can allocate to its member countries as a means to supplement their existing foreign exchange reserves.¹⁰

However, SDR is neither a currency, nor a claim on the IMF. Instead, the SDR is a *potential claim* on the freely usable currency of IMF members' foreign exchange reserves, including Denmark's. This means that in practice the SDR system can be seen as a mutual overdraft facility, whereby countries with temporary balance of payments problems or weak reserves can exchange their holdings of SDRs for hard currency held by countries with strong balances of payments and foreign exchange reserves. The SDR system therefore has certain similarities with currency swap agreements between central banks, albeit with the notable differences that an exchange of SDRs does not require a reverse exchange at a specific time and that the holdings of SDRs automatically set a limit to how much hard currency a country can buy with its SDRs.

After the introduction of the SDR in 1969, aggregate holdings remained relatively small for a long time, but as part of the effort to counter the global financial crisis, the IMF members in 2009 adopted an extensive general allocation of SDRs, which increased

8 In 2010, the PRGT replaced the Poverty Reduction and Growth Facility (PRGF) existing at that time (see Jensen and Jørgensen (2009)).

9 Denmark has regularly contributed to the PRGT interest subsidies when requested to do so by the IMF. The most recent Danish contribution was made in connection with the IMF's 2012 decision to transfer a proportion of the windfall profits from the 2009-10 gold sales to its member countries. A prerequisite of this profit-sharing was that the member countries subsequently donated their shares of the profits to the PRGT, which Denmark did consequently. In the assessment of the IMF, the return on the PRGT funds will now be sufficient to subsidise future lending to the poorest countries. Therefore, future donations for PRGT interest subsidies are not deemed to be necessary under favourable conditions. However, this does not prevent regular renewal of loan commitments to the PRGT.

10 The value of the SDR is calculated on the basis of a weighted basket of five leading global currencies: the dollar, euro, pound sterling, yen – and from 1 October 2016 also the Chinese renminbi. The decision to include the renminbi was made in November 2015 during the most recent five-year review of the SDR. In connection with these reviews, the IMF's Executive Board decides which currencies to include in the SDR and with which weights. The reviews also include assessments of the financial instruments to be included in the calculation of the "SDR interest rate" (see IMF Financial Operations 2016).

the volume of outstanding SDRs by a factor of almost 10.¹¹ The members' SDR holdings increased considerably, and as a result the existing global foreign exchange reserves were strengthened. The system now totals SDR 204.1 billion, of which the total allocation to Denmark amounts to SDR 1,531.5 million.

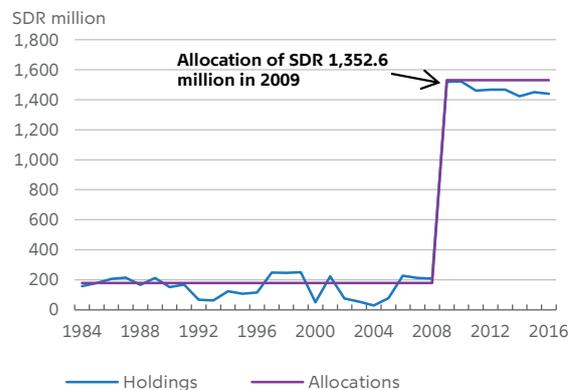
Denmark's SDR holdings are an asset made available to Danmarks Nationalbank. And since SDRs can be exchanged for hard currency, Danmarks Nationalbank's holdings of SDRs are also included in the foreign exchange reserve. At the same time, Denmark's participation in the SDR system means that other countries are entitled to exchange their SDRs for e.g. euro or dollars from Danmarks Nationalbank's foreign exchange reserve. Conversely, countries may also buy SDRs from Danmarks Nationalbank and pay in hard currency.¹²

All the current 189 IMF members participate in the SDR system. But since 1987 the system has functioned via voluntary trading arrangements with currently 32 member countries having made commitments to sell and buy SDRs within specific intervals around their total SDR allocations. On behalf of Denmark, Danmarks Nationalbank has made a commitment to hold 50-150 per cent of the SDRs allocated. Danmarks Nationalbank's current holdings of SDRs amounted to SDR 1,440.4 million, equivalent to kr. 13.6 billion, at end-December 2016. So at that time Danmarks Nationalbank had sold SDR 91 million, equivalent to kr. 0.9 billion, net. Historically, Danmarks Nationalbank's holdings of SDRs have been close to the cumulated allocation, cf. Chart 4. Following the 2009 allocation, the holdings have averaged 96 per cent of the cumulated allocation, and since 1984 the maximum share has been 140 per cent of the allocation.

So far, the voluntary trading arrangements have been fully sufficient to meet member countries' wishes to buy or sell SDRs. However, the system has a built-in security feature in the event that the capacity

Danmarks Nationalbank's holdings and allocation of SDRs

Chart 4



Note: Via the voluntary part of the SDR system, Danmarks Nationalbank has made a commitment to hold 50-150 per cent of the accumulated SDR allocation.
Source: IMF.

of the voluntary trading arrangements is insufficient. This compulsory part of the SDR system allows the IMF to impose an obligation on member states with strong balances of payments and reserves to buy SDRs from countries with weak external positions. In that connection, the IMF may ask countries to hold up to three times their SDR allocation, in Denmark's case up to SDR 4.6 billion (kr. 43.5 billion). But, as already mentioned, this has not been necessary, and Danmarks Nationalbank has never been anywhere near holding three times Denmark's SDR allocation, as the IMF may request under the compulsory part of the system.

The total commitments and their (potential) use

The IMF's maximum drawing rights at Danmarks Nationalbank via quotas, the voluntary borrowing arrangements and the SDR system constitute Danmarks Nationalbank's potential credit exposure to the IMF.¹³ At end-December 2016, these facilities totalled kr. 135.7 billion. In this connection it is worth

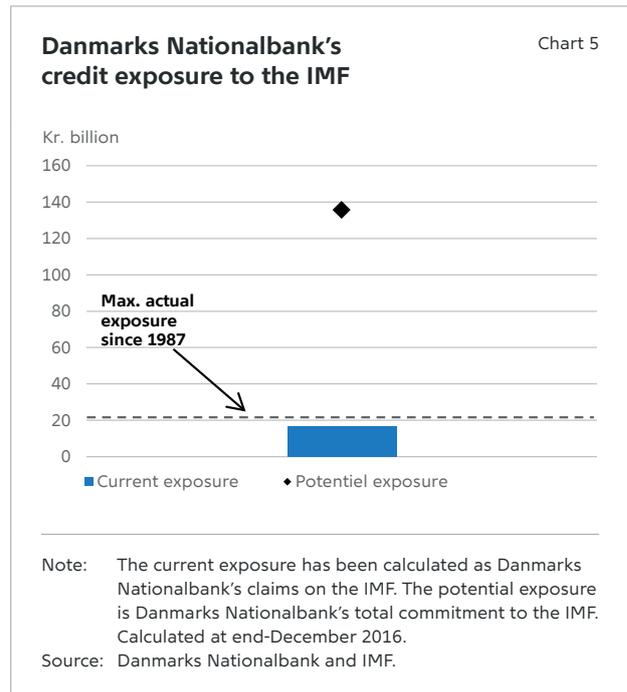
11 See IMF Financial Operations 2016 for a more detailed description of the SDR system.

12 The reasons why countries choose to buy SDRs could e.g. be that they are preparing repayments of IMF loans (which are settled in SDRs) or that they want to diversify their foreign exchange reserves.

13 In addition to credit risk, Danmarks Nationalbank's financial accounts with the IMF include interest rate and foreign exchange risk. See Jensen and Sørensen (2009) for a description.

noting that the IMF's actual drawings on Danmarks Nationalbank's commitments have been relatively limited over time, cf. Chart 5. When the IMF draws on Danish loan commitments, or Danmarks Nationalbank increases its holdings of SDRs, Danmarks Nationalbank obtains a corresponding claim on the IMF. Danmarks Nationalbank's maximum claim in this respect since 1987 has been kr. 21.6 billion, reached in January 2013. In December 2016, the claim on the IMF was kr. 16.7 billion, corresponding to approximately 12 per cent of the total commitments.

Given the above, the obvious question is why the total commitments to the IMF are so large when the current drawings are considerably lower. The answer is firstly that member countries' total commitments contribute to supporting the IMF's lending capacity, also in the event of stress scenarios. This implies that in normal situations the IMF's lending capacity will considerably exceed outstanding -loans and lending commitments. Secondly, a sufficiently well-funded IMF may in itself play an important role in terms of stabilising the global financial system, as strong faith in the IMF's crisis response capacity reduces the probability of extensive capital flight from vulnerable economies. In addition, it should be mentioned that there is sometimes a significant difference between the IMF's outstanding loans – funded by drawings on, inter alia, Denmark's commitments – and the total amount of approved lending arrangements. The reason for this is i.a. that loans are disbursed gradu-



ally and that many borrowers typically choose not to have the full loan amount disbursed.

Table 1 shows Danmarks Nationalbank's current and potential credit exposures to the IMF. The holdings of SDRs constitute by far the largest share of the current exposure. Since Denmark participates in the SDR system, the IMF can, as mentioned above,

Danmarks Nationalbank's credit exposure to the IMF Table 1

	Current exposure, kr. billion	Potential exposure, kr. billion	Current exposure relative to potential exposure, per cent
SDR system	13.6	43.5	31.4
Quota ¹	0.6	32.6	1.9
New Arrangements to Borrow, NAB	2.0	15.4	13.1
Bilateral loan	-	39.4	0.0
IMF's Poverty Reduction and Growth Trust, PRGT	0.4	4.7	7.5
Total claim on the IMF	16.7	135.7	12.3

Note: In the calculation of the credit exposure, Danmarks Nationalbank's SDR exchange rate at 30 December 2016 has been applied: kr. 947.60 per SDR 100. Calculated at end-December 2016.

Source: IMF.

¹ Here the current exposure is the reserve tranche position, while the potential exposure is Denmark's quota in the IMF.

in principle ask Danmarks Nationalbank to hold up to three times its cumulated SDR allocation, corresponding to kr. 43.5 billion. However, the current holdings of SDRs are close to Danmarks Nationalbank's allocation (December 2016). Adjusted for the holdings of SDRs, the credit exposure, comprising lending under quotas and the voluntary borrowing arrangements, makes up a considerably smaller part of the total claim on the IMF, standing at just kr. 3 billion at end-December 2016.

Besides affecting the credit exposure, the IMF's drawings on the quota, the SDR system or the voluntary borrowing arrangements also lead to changes in Danmarks Nationalbank's exchange rate and interest rate exposures.¹⁴

Box 2 describes how such drawings affect Danmarks Nationalbank's foreign exchange reserve and balance sheet.

Scenarios and risk management

The risk of losses on either the current or the potential exposure to the IMF is very low. Danmarks Nationalbank has a credit exposure to the IMF, not to the countries to which the IMF lends. Historically, no creditor has ever experienced losses on the IMF. Part of the explanation is that IMF loans are always granted subject to a number of conditions. This is the very essence of IMF lending arrangements, as the IMF thereby ensures that borrowers (i) implement the necessary reforms to bring their economies back on track and (ii) prudently use the loan disbursements for the right purposes. Given the built-in security measures in the borrowing programmes, the IMF disburses the loans in instalments and often not until the applicant has implemented a number of necessary measures. Furthermore, the IMF disburses

the loans under close and regular monitoring. If a deviation from the agreed terms and conditions of the borrowing programme is observed, the IMF may halt future disbursements.

To this the IMF's status as "preferred creditor" can be added. This status implies that borrowing countries give priority to repayments to the IMF over other creditors should they be unable to meet their debt servicing obligations in full (and the fact that other creditors accept this premise).¹⁵ In practice, this means that IMF loans are far better secured than direct loans from one country to another, but also better secured than equivalent loans under the euro area's European Stability Mechanism (ESM). Ultimately, the IMF also holds extensive reserves, supported by a considerable stock of gold, to cover any losses on loans granted. All in all, the creditworthiness of the IMF is assessed to be extremely high.¹⁶

The probability that the IMF will fully exploit the Danish commitments is extremely low. This would firstly require that the IMF's lending activity in reality increased so much that it would deplete most of the IMF's available resources. As at December 2016, the member countries' total resources committed to the IMF constituted approximately SDR 932 billion (kr. 8,834 billion), and the current loans (including loan commitments) totalled just under SDR 81 billion (kr. 767 billion).¹⁷ This means that the IMF currently has very solid capacity to provide assistance in connection with any extensive global stress scenarios. A potential strong increase in the IMF's lending would also entail approval of far more lending arrangements, as well as decisions to use resources under both the NAB and the bilateral loan agreements. It is important to underscore that

14 For further information, see Jensen and Sørensen (2009) and Mogensen (2003). For a comprehensive description of Danmarks Nationalbank's risk management, see Danmarks Nationalbank (2003).

15 Although the IMF's status as "preferred creditor" does not appear directly from legally binding agreements with debtors and other creditors, respectively, it is agreed by the Paris Club. The Paris Club is the forum where bilateral creditors conclude agreements on debt restructuring and rescheduling for debtor countries that are unable to service their debts.

16 In connection with the IMF's PRGT loans, for which the credit risk may be somewhat higher than for the IMF's ordinary loans, Danmarks Nationalbank's credit exposure is also guaranteed directly by the Danish government.

17 The current loans have been calculated as the sum of total credit outstanding and unused commitments under approved loan arrangements (less the precautionary lending facilities for Mexico, Poland, Colombia and Morocco).

IMF commitments and their impact on Danmarks Nationalbank's foreign exchange reserve and balance sheet

Box 2

In accordance with international conventions, total claims on the IMF are included in member countries' foreign exchange reserves. But in practice this part of Danmarks Nationalbank's foreign exchange reserve is to some extent illiquid and cannot immediately be used for intervention purchases in the foreign exchange market. An overview

of the foreign exchange reserve at end-December 2016 is provided below. At that time, the claim on the IMF amounted to 3.7 per cent of the total foreign exchange reserve. This is close to the average for the last 10 years, which has been 3.3 per cent.

Danmarks Nationalbank's foreign exchange reserve, end-2016

Kr. billion

Gold		17.5
Foreign assets	+	424.9
Claims on the International Monetary Fund, IMF	+	16.7
Foreign liabilities	-	3.0
Foreign exchange reserve	=	456.0

Source: Danmarks Nationalbank.

When the IMF draws on Danish loan commitments in connection with lending to member countries, this does not affect the size of the foreign exchange reserve, but only its composition. The reason is that in such cases the IMF will ask Danmarks Nationalbank for global reserve currencies, and in return Danmarks Nationalbank will acquire a claim on the IMF. In other words, the holdings of reserve currencies are reduced, but this reduction is offset by an equivalent increase in the claim on the IMF. Consequently, the size of the foreign exchange reserve remains unchanged. The same applies when the IMF asks Danmarks Nationalbank to purchase SDRs against reserve currencies so that the SDR holdings increase.

This also means that the total Danish commitments to the IMF cannot be seen from Danmarks Nationalbank's balance sheet or the statement of the foreign exchange reserve. They only appear when the IMF draws on the commitments. So the share of the loan commitment that has not been used constitutes a kind of conditional claim on the liquid part of the foreign exchange reserve.

Danmarks Nationalbank's financial accounts with the IMF appear in two places on Danmarks Nationalbank's balance sheet (see the excerpt below). Claims on the IMF are an asset for Danmarks Nationalbank and hence they are included in the total assets on the balance sheet (see e.g. Danmarks Nationalbank's Annual Report). As previously mentioned, the total claim on the IMF includes Danmarks Nationalbank's SDR holdings with a value of kr. 13.6 billion. Since the SDR has been created artificially, the IMF may in principle (cf. the IMF's Articles of Agreement) cancel the SDR allocation again at any time – but until now it has never done so. This means that the current SDR allocation with a value of kr. 14.5 billion appears on the liabilities side of the balance sheet – as "Counterpart of Special Drawing Rights allocated by the IMF". An increased SDR allocation from the IMF will increase the foreign exchange reserve correspondingly. At the same time, the new allocation will be included on the liabilities side of the balance sheet as it has not as such increased Danmarks Nationalbank's wealth. Therefore Danmarks Nationalbank's net wealth (net capital) remains unchanged.

Excerpt of Danmarks Nationalbank's balance sheet, end-2016

Assets	Kr. billion	Liabilities	Kr. billion
Claims on the IMF	16.7	Counterpart of Special Drawing Rights allocated by the IMF (SDR allocation)	14.5

Source: Danmarks Nationalbank.

such decisions would have to be made on the basis of broad support among the IMF members, where Denmark would also have a say. Moreover, this hypothetical scenario would require replacement of the voluntary SDR arrangements by the compulsory part of the system (which has never previously occurred, cf. above) and full utilisation thereof.

An extra security measure which should be mentioned is that under the rules for drawings on quotas, bilateral loans and the SDR system, respectively, the IMF does not draw on national commitments if the IMF finds that the country in question does not have the necessary capacity. In addition, Danmarks Nationalbank has the option to say no to drawings on the Danish commitments in situations where its liquidity is limited. Overall, the risk associated with Danmarks Nationalbank's lending and further commitments to the IMF is very limited.

The importance of having a strong IMF

The combined increased commitments to the IMF, including Denmark's, serve an important purpose. Bolstering the IMF's lending capacity means that in future it will also be able to provide financial assistance to individual member countries at risk of incurring – or having incurred – balance of payments problems. This is relevant not only to economic and financial stability in the countries in question, but also to the global financial system as a whole. A well-functioning IMF with sufficient funding can provide targeted and timely assistance with a view to preventing problems in individual countries from spreading to other countries. Given the considerable economic interdependence of countries, maintaining that capacity is essential.

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