

CURRENCY UNION TECHNICAL EXPERT GROUP (CUTEG)

DRAFT FOLLOW-UP PAPER (CUTEG) # 3

(1) Topic: **Treatment of national agencies in a centralized currency union**

(2) Issues – see CUTEG Issues Paper #3 and CUTEG Outcome Paper #3
(<http://www.imf.org/external/np/sta/bop/cuteg.htm>)

Background

1. In its meeting of June 2004, the CUTEG came to the provisional view that the currency union central bank (CUCB) should be treated in the balance of payments (BOP) as an institutional unit, non-resident of member countries of the currency union (CU) but a resident of the CU. This provisional view has evidently strong implications for the appropriate treatment of national agencies in a centralized CU. This paper examines the consequences, and investigates the various options for the presentation of national data in a centralized CU.

Current international standards for the statistical treatment of the issue

2. Following *BPM5* methodology, in a centralized CU, each national office is treated as a separate institutional unit from the CUCB and all assets and liabilities of the CU are allocated to the national agencies in proportion to the claims they have on the CUCB. In theory, there is a complete pass through of the CUCB in BOP/IIP statistics (see Issues Paper 3 for a comprehensive description of the current methodology). One reasoning behind this treatment is that “the national office acts as the central bank for that country” (*SNA93*, paragraph 14.34), which means that BOP statistics should identify for each country member of a CU a monetary authority distinct from other CU member countries.

3. It should be noted that this methodology was set up at a time when there was only centralized CUs in existence. For the first time, the *MFSM 2000* acknowledged the existence of a decentralized type of CU (the Eurosystem) and recommended that two different methodologies be applied, depending on the nature of the CU: implementation of the *SNA93/BPM5* methodology for the centralized CU, and imputation of assets and liabilities on a strict residence basis for all agencies part of a decentralized CU.

4. The *External Debt Guide* (paragraph 2.21) does not distinguish between the two models. It states that the CUCB should be considered as “an international organization, and thus a non-resident from the perspective of the national central bank (i.e. national office acting as central bank)”.

Concerns/shortcomings from the current treatment

5. The current methodology needs to be adapted. In the first place, there is an inconsistency between *BPM5*, the *MFSM2000*, and the *External Debt Guide*. Also, the

present *BPM5* methodology arguably is not consistent with the general definition of an institutional unit for statistical purpose (legal entity endowed with assets and incurring liabilities on their own behalf and being centre of decision-making: *1993 SNA*, paragraph 2.19). This presupposes that a CUCB is an international organization. Consequently, confirming the *External Debt Guide* recommendation, the *Annotated outline for the revision of the BPM5* (paragraph 4.50 and 4.51) proposes that, from the national perspective, the CUCB should always be considered as a non-resident institutional unit whatever the form of the CU.

6. In addition, the *BPM5* methodology can create bilateral asymmetries, because the partner countries to transactions involving a centralized CU are likely to allocate these transactions to notional countries representing regional central banks rather than apportioning the transactions to member countries of regional central banks.

7. Finally, during the June meeting, the discussion revealed that, in practice, the current *BPM5* methodology is not fully applied in the existing centralized CU (BCEAO, BEAC, ECCB). For example, in some instances, the CUCB is regarded as having its own assets and liabilities. Therefore, even in the centralized model of CU, there is no complete pass through of the CUCB assets and liabilities. In addition, the changes in reserve assets shown in the BOP of member countries of the BCEAO and the BEAC (assets in the “operation account” of the French Treasury in the Zone franc arrangement) are not apportioned to the claims that member governments have on the bank’s collective assets, but are the result of actual BOP transactions of the country¹.

Possible treatment of the issue

8. The CUTEAG has come to the provisional conclusion that, consistent with the recognition of institutional units, the CUCB should always be treated in the balance of payments as an institutional unit, non-resident of member countries of the CU but a resident of the CU (see Outcome paper 3 of the June 2004 meeting).

9. This methodology is de facto applied in the Eurosystem, as there are no national agencies and, in each country, monetary activities are carried out by central banks having their own assets and liabilities. However, the implications in BOP/IIP statistics of countries member of a centralized CU is that all the assets and liabilities of the CUCB would be held outside the member countries and no longer allocated to them. As a result, from the point of view of CU member countries, monetary activities carried out by the CUCB would be transactions with non-residents (within the CU aggregate).

¹ It should be noted that these reserve assets are legally owned by the CUCB (accounts of the BCEAO and the BEAC at the French Treasury). They are shown in the BOP/IIP of countries for statistical purpose only.

10. To examine the implications of this approach, a distinction is made between transactions of the CUCB with non residents of the CU, and transactions with residents of the CU.

a) Transactions with non residents of the CU

11. A CUCB can possibly engage in many transactions with non residents of the CU (security issues for example) including in reserves assets. Such transactions should be captured in the BOP/IIP of the CUCB. One consequence would be that CU member countries would record no transaction or position in reserve assets. This would represent a significant change from the current *BPM5* methodology where these transactions are reflected in the BOP/IIP of member countries.

b) Transactions with residents of the CU

12. Domestic monetary operations from the point of view of member countries would become transactions with a non-resident institution. The consequences for monetary statistics appear to be limited because the definition and measure of money supply would not be altered, and the banknotes in circulation in each country would still be considered as a domestic currency (see Outcome paper 12). More specifically, with regard to the 3 dimensions of monetary aggregates, the consequences would be as follow :

- financial assets components of credit aggregates : no change

- sectors that are credit holders : no change

- sectors that are debtors: the issuer of CU banknotes would shift from a resident to a non-resident institution. Although unusual, this situation already exists in countries where a foreign currency co-circulates with the national currency. The CUCB would be considered as a nonresident money issuer in the domestic economy (*MFSM2000*, paragraph 322).

13. With regard to BOP/IIP implications, all transactions of the CUCB with member countries would be affected as the national offices have few, if any, assets of their own and are only an administrative extension of the CUCB. These offices are resident in the economy and might function as agents (this needs to be confirmed by the regional central banks). If so, the recording of their activities would be subject to *BPM5* guidance for agents (such as paragraph 83). In this case, while transactions of the CUCB with non-residents of the CU would have to be shown in the BOP of the CUCB, how should monetary operations of the CUCB in a CU member country be presented the national BOP/IIP statistics of member countries of a centralized CU ? The possible solutions are examined below.

14. An alternative approach for centralized CU would be to adopt the solution recommended in the *MFSM2000*. However, such an approach would create a somewhat paradoxical situation, as the CUCB of a decentralized CU, which holds one fraction only of the assets and liabilities of the CU, would be treated as an independent institutional unit, while the CUCB of a centralized CU, which holds all the assets and liabilities, would

completely disappears from BOP statistics. It seems that, from a conceptual viewpoint, it would be more judicious to agree on a comparable treatment of CUCB, whatever the form of the CU.

Possible solutions

15. The attached case study examines two possible solutions for the treatment of national agencies in a centralized CU.

a) First option

16. All operations of the CUCB vis à vis a member country would be treated on a resident-non resident basis (option 1 : complete “pass through” of the national agencies) :

- this option generates large gross flows and positions, and a complicated set of intra-CU BOP/IIP;

- all the monetary transactions of a CUCB vis à vis each country are clearly identified;

- transactions are included in the balance of payments of each member country which are generally considered as of a domestic nature (holding of domestic banknotes by residents, transactions between the banking sector and the central bank, etc.). However, arguably that reflects the reality of the situation in that the claims and liabilities generated are on a non-resident entity.

b) Second option

17. A second option would consist in establishing in each country member of the CU, for statistical purpose, a notional unit in charge of carrying out domestic monetary activities. (see option 2: pass through of the CUCB for domestic operations). In this case, all assets and liabilities of the country’s residents with the CUCB would be recorded as claims/liabilities with the notional unit, with the difference the net claim on/liability to the CUCB. This case study shows that:

- Only one entry (“net claims and liabilities to the CUCB”) would summarize the transactions between a member country and the CUCB. This would significantly simplify the entries in the BOP/IIP

- the BOP/IIP of the CUCB would be limited to transactions in foreign exchanges of the CU, which are the counterpart entries to its net claims/liabilities vis-à-vis member countries;

18. It should be noted that this option would not bring a notable change from the present recording practices. Thus, there would remain a different treatment for a CUCB depending upon the type of system, although in this instance the CUCB would be an institutional unit with claims and liabilities recorded, including on nonresidents of the CU (and so it would

hold the reserve assets of the CU). But the claims and liabilities of residents would not be on the CUCB even though from a legal viewpoint this is where they fall.

19. Data based on the current recommendation of the *BPM5* could be presented as a supplementary information.

Points for discussion

1. *Do CUTEG members confirm the provisional view that the CUCB should be classified as an institutional unit in its own right, with its own assts and liabilities ? Thus,*

2. *Do CUTEG members agree that unlike the MFSM approach, the CUCB should be treated the same way regardless of type of system (centralized or decentralized) ?*

3. *Given answers 1 and 2, with regard to intra-CU transactions of the CUCB, do CUTEG members support the idea that all monetary transactions of the CUCB with residents of the CU should be classified as BOP transactions of member countries, or that a notional agency be created for statistical purpose that records only net transactions/positions of a CU member country with the CUCB ?*

4. *Do CUTEG members support the idea that data on the present BPM5 basis be shown as supplementary information ?*

CASE STUDY

I - BACKGROUND

We assume that 2 countries A and B decide to create a CU, by transferring all their assets and liabilities to a CUCB. Before the inception of the CU, the respective balance sheets of the national central banks were as follows :

NCB country A		NCB country B	
Assets	Liabilities	Assets	Liabilities
Foreign assets 500	Bank notes 1400	Foreign Assets. 200	Banknotes 600
Domestic assets 1100	Capital 200	Domestic Assets.500	Capital 100
of which <i>banks</i> 700		of which <i>banks</i> 300	
<i>Government</i> 400		<i>Government</i> 200	
Total 1600	Total 1600	Total 700	Total 700

After the creation of the CU, the balance sheet of the CUCB is as follows :

CUCB	
Assets	Liabilities
Foreign assets 700	Banknotes 2000
Domestic assets 1600	Capital 300
of which <i>banks</i> 1000	
<i>Governments</i> 600	
Total 2300	Total 2300

The CUCB is a nonresident of countries A and B and its operations are carried out in each country through a national agency. This national agency is not a legal entity and does not hold any asset or liability.

After the creation of the CUCB, the IIP of countries A and B vis à vis the CUCB would show the following entries :

	Country A	Country B
Assets		
Direct investment	200	100
Other investment		
Currency and deposits	1400	600
Liabilities		
Other investments		
Banking sector	700	300
Government	400	200
Net IIP	+500	+200

It should be noted that the net asset position of the countries A and B vis à vis the CUCB is equivalent to the amount of foreign exchanges assets which has been transferred to it. On the other hand, the net IIP of the CUCB is always 0, as the foreign exchanges assets it holds are the counterpart of its liabilities to member countries.

II TRANSACTIONS

During the time period, the following operations take place :

Country A

Deficit of the current account : -200

The CUCB increases its net assets on the banking sector by +100 and on the Government by +300

A bank in country A makes a loan of 60 to a resident of country B

Increase in banknotes held by residents of country A : +140

Country B

Surplus of the current account : +100

The CUCB increases its net assets on the banking sector by +50 and on the Government by +100.

The resident of country B uses the loan received from country A to finance imports.

Increase in banknotes held by residents of country B : +310

It should be noted that the changes in banknotes in circulation (+140 in country A and +310 in country B) are the exact counterpart of the transactions with the CUCB (credit to the domestic sector and changes in reserve assets).

III RECORDING OF BOP/IIP TRANSACTIONS

1st option : complete pass through of national agencies

As the CUCB is a non-resident of countries A and B, all the transactions with the CUCB have to be recorded in the BOP/IIP of each country :

Balance of payments :

	Country A		Country B		CUCB	
	Credit	Debit	Credit	Debit	Credit	Debit
Current Account		200	100			
Financial Account						
Other investment						
Banking sector	100	60	50			150
Government sector	300		100			400
Other sectors						
Loans			60			
Cur. and dep.		140		310	450	
Reserves					100	

IIP of country A vis à vis CUCB

	Beginning Period	Transactions	End period
Assets			
Direct investment	200	0	200
Other investment			
Currency and deposits	1400	140	1540
Liabilities			
Other investments			
Banking sector	700	100	800
Government	400	300	700
Net IIP	500	-260	240

2nd option : pass through of the CUCB for all transactions with the domestic sector

All transactions of the CUCB in a country are assumed to be carried out by a resident entity (notional monetary authority represented by the national agency). The outcome is a variation in the net claims/liabilities to the CUCB which are recorded in the BOP/IIP. By construction, the counterpart to changes in claims/liabilities to the CUCB is change in reserves assets of the CUCB.

Balance of payments :

	Country A		Country B		CUCB	
	Credit	Debit	Credit	Debit	Credit	Debit
Current Account		200	100			
Financial Account						
Other investment						
Monetary authorities (claims/liabilities to the CUCB)	260			160		100
Banking sector		60				
Government sector						
Other sectors						
Loans			60			
Cur. and dep.						
Reserves					100	

IIP country A vis à vis the CUCB

	Beginning Period	Transactions	End period
Assets			
Other investment			
Monetary authorities (net claims on the CUCB)	500	-260	240

It should be noted that a country can possibly be in a situation where it is in a net liability position vis à vis the CUCB, for example after incurring repeated deficits of its balance of current accounts.

3rd option : complete pass through of the CUCB for all operations

	Country A		Country B	
	Credit	Debit	Credit	Debit
Current Account		200	100	
Financial Account				
Other investment				
Banking sector		60		
Government sector				
Other sectors				
Loans			60	
Cur. and dep.				
Reserves	260			160

This option is given as a memorandum item. It is the implementation of the current *BPM5* methodology. In this case, the CUCB disappears from BOP/IIP statistics. This is not the option adopted by the CUTEG.