IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS

RESERVE ASSETS TECHNICAL EXPERT GROUP (RESTEG)

ISSUES PAPER (RESTEG) # 4

MARKETABILITY (LIQUIDITY)

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December 2005

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1. The term "liquidity" is central to the determination of the classification of an instrument as a reserve asset. For some instruments, such as securities, this term is synonymous with "marketability." *Balance of Payments Manual, fifth edition (BPM5)* provides little by way of description as to what is meant by liquidity or marketability, and it would seem appropriate in the new *Manual* to provide more detail.

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

2. *BPM5* describes in paragraph 431 the concept of "available for use," which is a key criterion for an asset to be classified as a reserve asset. In describing the availability for use of an asset it is stated that this "is partly dependent on any conditionality that affects the asset—including, as one main aspect, the liquidity or marketability of the asset." and "Owned assets (such as monetary gold, SDRs, and reserve positions in the Fund) that are immediately available can be viewed as assets in the most unconditional form. Foreign exchange holdings and other claims, in many instances, are equally available."

3. The *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template (Guidelines)* also makes clear in paragraph 65 that a key criterion for an asset to be classified in reserve asset is its "usability, "and that reserve assets are "first and foremost, liquid or marketable." Further the footnote of paragraph 65 (footnote 19) states that, "*Marketable* assets refer to those that can be bought, sold, and liquidated with minimum cost and time and for which there are ready and willing sellers and buyers." Also, if deposits are available on demand, demand deposits and term deposits that are redeemable on demand, this is considered consistent with the liquidity concept (paragraph 91).

4. In another context, the *Compilation Guide on Financial Soundness Indicators* (*FSI Guide*) in defining "liquidity" states that, "In terms of markets, *liquidity* generally refers to the ability to buy and sell assets quickly and in large volume without substantially affecting the asset's price. In terms of instruments, liquidity generally refers to those assets that can be converted into cash quickly without a significant loss in value." (Appendix VII: Glossary of terms).

II. Issues arising from the current treatment of marketability

5. *BPM5* is largely silent on the issues of liquidity and marketability, but says more on "availability for use" (paragraph 431), as noted above, the *Guidelines* provide some guidance on marketability that could be adopted by the new *Manual*.

6. Further, it is worth noting that market participants may interpret "marketability" different from "liquidity," in that the former implies the ability to buy and sell the instrument

with minimum time and cost, whereas the latter also implies the ability to buy and sell without unduly affecting the value of the security. The two definitions in 3 and 4 above implicitly make this distinction. However, a distinction between the cost of selling and the loss in value on sale is probably an artificial one in that reserve managers take both costs into account. Further, while the *Guidelines* speak of liquid or marketable (paragraph 65), this was presumably intended to permit coverage of both nontraded assets, such as demand deposits, which are liquid, and traded assets, such as securities. But again distinguishing between the cost of selling a security and any costs incurred in getting ready access to deposits could be viewed as artificial as both affect the value received from selling/liquidating an asset. So, the new guidance could instead focus on a single concept that encompasses both liquidity for nontraded assets and marketability for a traded instrument.

7. Finally, it is also worth noting that the key aspect is that an asset is readily available in the most unconditional form. So, for instance, the *Guidelines* makes clear that real estate is not to be included in reserve assets (paragraph 74). The guidance in both *BPM5* and the *Guidelines* looks at assets based solely on the liquidity or marketability of the instrument itself. The ability to use an asset as collateral to generate liquidity, e.g., as with repurchase agreements or a country's contribution to a regional international organization, is not considered in itself sufficient to make an instrument liquid.

III. Possible treatments

8. The starting point for any discussion of marketablity or liquidity is the wording in paragraph 65 of the *Guidelines.* In providing guidance on what is meant by liquidity or marketability the new *Manual* could draw on the *Guidelines*' text on marketability (in line with the footnote 19 of the *Guidelines*), and the definition of market liquidity in the *FSI Guide* to come up with a single criterion. This criterion would emphasize the ability to buy, sell and liquidate an asset for foreign currency (cash) with minimum cost and time. It could further elaborate on minimum cost to encompass penalties paid for ready availability of a time deposit, the costs of transacting in a security, and the ability to transact in an asset without significantly affecting it's value.

9. The guidance would continue to be based on the concept of the usability of the asset itself and the ability to raise funds by using it as collateral is not sufficient to make it a reserve asset.

IV. Points for discussion

(1) What are the group's views on the proposals set out in paragraphs 8 and 9?

(2) Do RESTEG members have additional ideas as to the definition/or examples of what constitutes marketability?

(3) Do RESTEG have any concerns about the application of the liquidity concept to nontraded assets such as deposits?

References

BPM5, paragraph 424, 431, 432

Guidelines, paragraphs 64, 74-76

Annotated Outline, paragraphs 5.56

Compilation Guide on Financial Soundness Indicators, Appendix VII