Exchange Rate Determination for ADF-XI
(Background Paper #9)

ADF-XI Replenishment Meeting
14 – 15 March 2007
Dar-es-salaam, Tanzania
1. **BACKGROUND**

1.1 Under previous ADF replenishments, state participants have denominated their subscriptions in SDRs, in a currency used for the valuation of the SDR or in the currency of the state participant if such currency is freely convertible. The exchange rate used in the determination of the currency amount has typically been an average rate based on a six-month period ending before the conclusion of the negotiations. However, if during a specified period a state participant has experienced a rate of inflation in excess of 10% per annum on average, as determined by the Fund, the subscription of that state participant shall be denominated in SDRs. The inflation test is intended to help minimize the loss in the value of replenishment resources, attributable to depreciation in the national currencies of state participants with high domestic inflation rates.

2. **BASIS FOR RECOMMENDATIONS**

2.1 To avoid protracted discussions regarding the selection of rates, it is important that the state participants agree early in the replenishment negotiations on the reference period to be used to determine the average rate to be used. In making this determination, we propose that the same criteria as those used for prior replenishments and also for IDA be used. These criteria are as follows:

1. **Sufficient lead time:** to facilitate the process of obtaining pledging authorisations, state participants should be allowed sufficient lead time to determine the national currency amounts required to meet a specific share or SDR replenishment objective.

2. **Future dates:** the exchange rate period chosen should avoid using known rates to the extent feasible.

3. **Minimize effect of short-term currency fluctuations:** the method for determining exchange rates should mitigate short-term currency fluctuations. As a rule of thumb, a six-month period is deemed to assure this purpose.
Decision(s) Required:
ADF-XI Exchange Rate Reference Period
Recommendations / Proposal:
Deputies:

- At the March 2007 meeting, agree on a future 6-month period over which the ADF XI exchange rates would be averaged. On the assumption that the negotiations are expected to be completed by 31 December 2007, we propose the use of the six-month period ending 30 September 2007.

- Also at the first meeting, agree that the period 2004-2006 would be used for purposes of the inflation rate test and that a 10% threshold should be used.

As additional background, we present as Annex 1 a summary of recent exchange rate averaging periods.
## ANNEX 1

### SUMMARY RECENT EXCHANGE RATE AVERAGING PERIODS

<table>
<thead>
<tr>
<th>Replenishment</th>
<th>Replenishment Period</th>
<th>Averaging Period</th>
<th>Inflation Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADF-V</td>
<td>1988 - 1990</td>
<td>Six Months ending 31 October, 1987</td>
<td></td>
</tr>
</tbody>
</table>