

**INFORMAL
SESSION TO
ENGAGE**

FO/DIS/23/23

February 24, 2023

To: Members of the Executive Board

From: The Secretary

Subject: **The Consolidated Medium-Term Income and Expenditure Framework**

Board Action: **Informal session to engage** Executive Directors

Additional Information: The attached paper provides background for informal session to engage on budget discussions scheduled for Thursday, March 2, 2023.

Publication: Not proposed, as this is a preliminary report.

Questions: Mr. Bradbury, FIN (ext. 39034)
Ms. Khaw, FIN (ext. 37820)
Mr. Nana, FIN (ext. 38849)
Mr. Fosu, OBP (ext. 37922)



February 23, 2023

THE CONSOLIDATED MEDIUM-TERM INCOME AND EXPENDITURE FRAMEWORK

EXECUTIVE SUMMARY

The medium-term income projections have been updated from the April 2022 outlook and the December 2022 review of the adequacy of precautionary balances. The revised projections maintain a positive forecast for net operational income over the medium term, with the main changes to the outlook stemming from higher lending and investment income projections.

Lending income has increased from earlier estimates in line with the higher projected credit path for credit outstanding under the updated desk survey scenario. Projected income from the Fixed-Income Subaccount and interest-free resources is expected to increase more sharply over the medium-term reflecting the upward shift in the projected path for the SDR interest rate from prior low levels. Reimbursements to the General Resources Account (GRA) are marginally higher and include the estimated costs for Resilience and Sustainability Facility (RSF) country operations and related Fund overhead costs, beginning in FY 2024. A modest pension-related (IAS 19) gain is estimated for FY 2023 based on the end-December 2022 remeasurement of the Fund's Plan, however the actual outcome for the year remains uncertain. Projections of the Fund's income are subject to larger than normal uncertainties related to the impact of inflation and geopolitical tensions on key assumptions.

The proposed medium-term budget seeks to align resources with institutional priorities and emerging needs, recognizing the need for difficult trade-offs. The budget builds on continued reprioritization to meet critical needs in traditional core areas, while allocating the second phase of the augmentation to support a greener, digital, and more inclusive global economy. The Fund will need to remain agile given the highly uncertain global outlook. Projected expenses are higher in SDR terms reflecting a strengthening of the U.S. dollar against the SDR and a higher Fund deflator.

Staff has also updated its analysis of the Fund's income position in an illustrative future low lending environment, according to two alternative scenarios for interest rates and payout from the Endowment Subaccount (EA). These scenarios yield income-expenditure positions that are marginally positive or negative depending on respective assumptions for interest rates and investment returns.

Updated projections point to a faster pace of reserve accumulation than was anticipated in the recent Review of the Adequacy of the Fund's Precautionary Balances.

Precautionary balances over the medium term are now expected to reach SDR 32.6 billion by FY 2028 under the desk survey, above the medium-term indicative target of SDR 25 billion. This reflects mainly a higher projected credit path for credit outstanding under the updated desk survey scenario and higher investment income expected over the medium term, offset partly by a higher projected expenditure path in SDR terms.

Approved By
Bernard Lauwers (FIN) and
Michele Shannon (OBP)

Prepared by the Finance Department (Diviesh Nana (lead), Emer Fleming, Karin Ginton, Vidhya Rustaman, Jesse Jinyong Yang, and Yang Jessie Yang, under the guidance of Jeannie Khaw and Simon Bradbury), and the Office of Budget and Planning (Benjamin Fosu and Maria Albino). Administrative assistance was provided by Amara Myaing and Mary Pandit (FIN).

CONTENTS

INTRODUCTION	4
CONSOLIDATED INCOME AND EXPENSES	4
A. Medium-Term Income	4
B. Medium-Term Expenditure	9
C. The Longer-Run Income-Expenditure Position in an Illustrative Low Lending Environment	9
PRECAUTIONARY BALANCES OUTLOOK	12
BOX	
1. Impact of Key Assumptions on the Income Position	7
FIGURES	
1. Key Medium-Term Income Projections (FY 2023–28), December 2022 vs. April 2022	5
2. Actual and Projected Operational Income and Expenses—FY 2013–33	5
3. Precautionary Balances Accumulation	13
TABLES	
1. Consolidated Income and Expenses, FY 2023–33 Desk Survey Scenario	10
2. Income Projections	14
ANNEXES	
I. Illustrative Low Lending Environment	15
II. Consolidated Income and Expenses, FY 2022–32	17

INTRODUCTION

1. This paper updates the April 2022 consolidated income and expenditure outlook.¹ It is timed to provide background information for the *Informal Board Session to Engage on the Preliminary Proposals for the FY 2024–FY 2026 Medium-Term Budget* scheduled for early March. In view of the timing, some elements of the estimates for FY 2023 and FY 2024 (including reimbursements, capital budget items expensed, and depreciation) will be updated separately in the upcoming paper for the annual income discussion in April.

2. The paper is organized as follows. The first section presents the updated outlook for the Fund’s consolidated income and expenditures through FY 2029, highlighting key changes since the last detailed income projections in April 2022, and outlining the impact of key assumptions (Box 1). The paper then briefly describes the medium-term expenditure outlook. The discussion concludes with an update of the longer-run income-expenditure position which, as in the past, features an illustration of the income position in a future low lending environment. The paper also updates the projected pace of accumulation of precautionary balances over the medium term.

CONSOLIDATED INCOME AND EXPENSES

A. Medium-Term Income

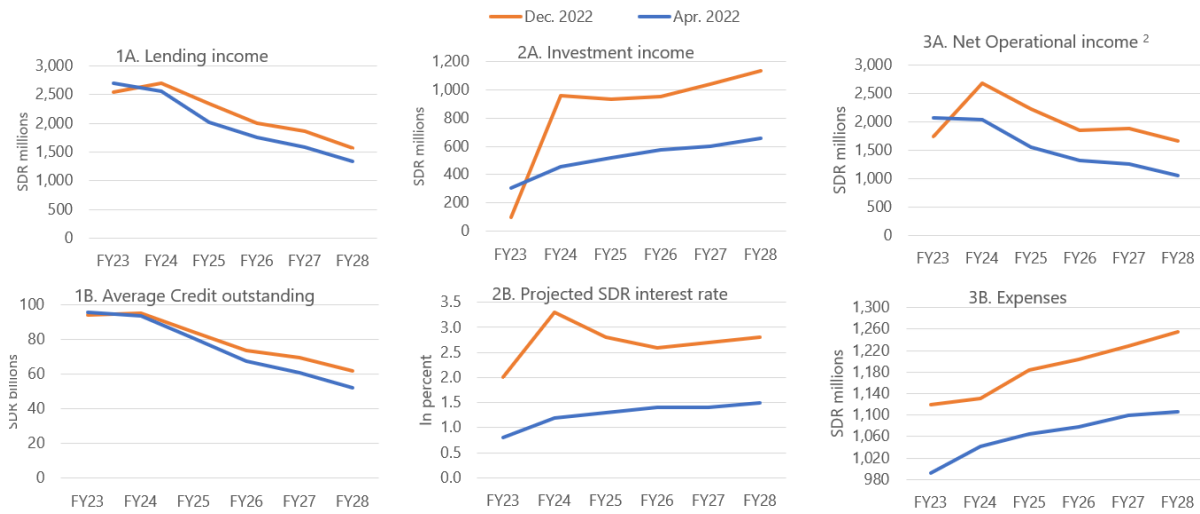
3. The updated projections of the medium-term income outlook are higher than projected last April, and the overall income position remains strong for the next few years (Figures 1 and 2). This can mostly be attributed to a higher projected path for credit outstanding which includes expected arrangements that were not anticipated in April 2022. Non-lending income is projected to be higher than the April 2022 estimate, mainly reflecting the higher investment income expected over the medium term. As a result, net operational income, before taking into account the pension-related (IAS 19) gain and retained endowment income, is projected to average about SDR 2.0 billion (US\$2.7 billion) annually during FY 2023–28, compared with an average of about SDR 1.5 billion (US\$2.2 billion) projected for the same period in April 2022 (Annex II).

4. Operational lending income is projected to be higher over the medium term than in April 2022.² Annual average credit outstanding is projected to increase by about SDR 4.8 billion per year over the period FY 2023–28, compared with an annual average April 2022 projection of SDR 75.1 billion, thus increasing income from the margin and surcharges over the medium term. The higher credit path mainly reflects arrangements approved since the April projections, and expected

¹ For April 2022, see *Review of the Fund’s Income Position for FY 2022 and FY 2023–2024* (EBS/22/26, 4/12/2022).

² Lending income comprises the margin for the rate of charge, service charges, commitment fees, and surcharges. The rate of charge on funds disbursed from the GRA comprises the weekly SDR interest rate plus a fixed margin that is set by the Executive Board every two years (currently 100 basis points). The GRA also pays interest (remuneration) to members on their creditor positions. Consequently, any changes in SDR interest rates do not impact the Fund’s lending income, as the increase (decrease) in the rate of charge is offset by a corresponding increase (decrease) in the rate remuneration.

**Figure 1. Key Medium-Term Income Projections (FY 2023–28),¹
December 2022 vs. April 2022**



Summary of
Medium-Term
Income and Expenditure
Projections
(In millions of SDRs)

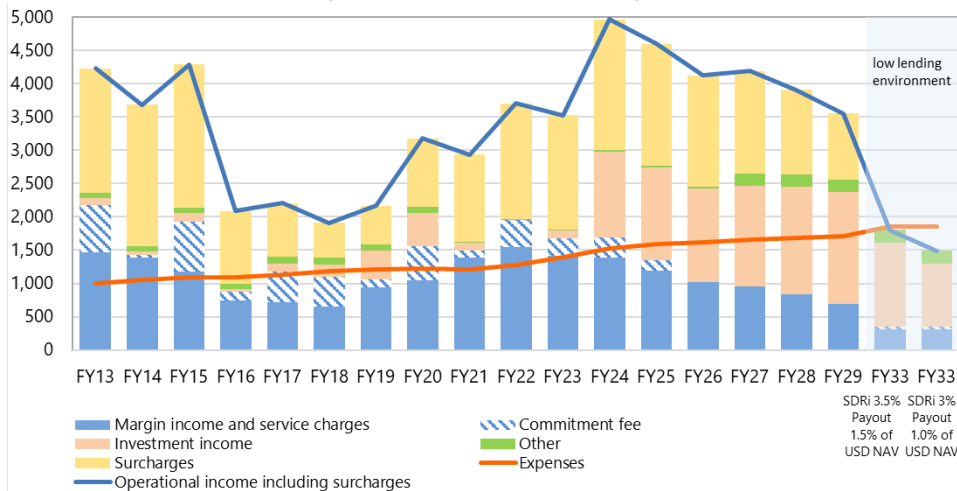
	FY23	FY24	FY25	FY26	FY27	FY28
Operational Income	2,751	3,804	3,403	3,054	3,105	2,918
Expenses ²	1,119	1,130	1,183	1,203	1,229	1,255
Net Operational Income ²	1,731	2,674	2,220	1,851	1,876	1,663
Retained Endowment Income	-275	242	304	315	354	364
Net income	1,456	2,916	2,524	2,166	2,230	2,027

Source: Finance Department.

¹ For the detailed income and expenditure projections see Table 1 (December 2022) and Annex II (April 2022).

² In FY 2023, net operational income includes the IAS 19 remeasurement gain and expenses include the periodic pension cost.

**Figure 2. Actual and Projected Operational Income and Expenses—FY 2013–33¹
(In millions of U.S. dollars)**



Source: Finance Department.

¹ Operational income and expenses of the GRA, excluding the pension-related (IAS 19) gains and losses.

additional demand for Fund lending under the current desk survey.^{3,4} Arrangements and outright purchases approved by the Executive Board since the beginning of the year, including certain arrangements previously projected under the April 2022 desk survey, are: an RFI purchase for Ukraine (SDR 1.0 billion); SBAs for Armenia (SDR 0.1 billion), Georgia (SDR 0.2 billion), and Serbia (SDR 1.9 billion); extended arrangements for Bangladesh (SDR 1.6 billion), Barbados (SDR 0.1 billion), Benin (SDR 0.3 billion), Egypt (SDR 2.4 billion), and Mauritania (SDR 0.04 billion); a PLL arrangement for North Macedonia (SDR 0.4 billion); FCL arrangements for Chile (SDR 14 billion) and Peru (SDR 4 billion); and an SLL arrangement for Chile (SDR 2.5 billion), which was subsequently cancelled.

5. Commitment fee income for FY 2023–25 is projected to be higher than the April 2022 estimate.⁵ Commitment fee income for the period is projected to be about SDR 158 million higher than the April estimate, reflecting mainly the new FCL arrangements for Chile and Peru.

6. Non-lending income is expected to be substantially higher over the medium term compared with earlier estimates, driven mainly by the sharp rise in the level of the projected SDR interest rate path.

- **Projected investment income from the Fixed-Income Subaccount (FI) has increased compared to April 2022, reflecting substantially higher interest rates in SDR markets.** SDR-weighted government bond yields have increased by about 200 basis points since April. The level of the projected path for the SDR interest rate has also increased by about 150 basis points (Figure 1). The sharp increase in interest rates has weighed down the FI's expected performance for FY 2023. However, higher levels of interest rates, and refinements to the investment strategy approved by the Board in January 2022 will improve the prospects of the FI achieving its long-term return objective of 50 basis points above the SDR interest rate on average, over time.⁶

³ The desk survey reflects desk assessments of the likelihood of a program request based on knowledge of member countries' economic outlook, financing needs, and the political landscape.

⁴ Projections under the desk survey scenario do not take into account the potential effects of an increase in access limits, currently scheduled to be discussed by the Executive Board on March 6 (forthcoming). Staff expects a modest increase in potential use of GRA resources under the revised policy, with the possibility of higher lending income in future lending projections.

⁵ Commitment fee income is recognized only at the expiration or cancellation of an arrangement. The commitment fees for the two-year Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL) arrangements are included in income at the end of the two-year period if no purchases have been made. Given that the projections are based on existing arrangements treated as precautionary only, no commitment fee income is projected beyond FY 2025.

⁶ In January 2022, the Executive Board modified the investment strategy of the Fixed-Income Subaccount that had been in place since 2015. The Board set the objective for the subaccount return at 50 bps over the 3-month SDR interest rate over time, established a maximum average duration of three years for the portfolio, raised the limit for Group 2 assets from 35 to 40 percent and modified the minimum credit rating for eligible assets to at least BBB- (S&P long-term rating scale) for corporate bonds and BBB+ for all other assets. See *Review of the Investment Account and Trust Assets Investment Strategy* (SM/21/206, 12/10/21).

Box 1. Impact of Key Assumptions on the Income Position

The projections for income and reserve accumulation in the desk survey scenario remain highly sensitive to a number of key underlying assumptions. Projections include lending arrangements beyond those approved through end-December 2022 but exclude any annual projections for pension related (IAS 19) gains and losses beyond the current year's estimate due to the unpredictability of underlying actuarial assumptions.

- As illustrated by the significant fluctuations in recent years, lending income is particularly sensitive to the impact of large new lending arrangements, as well as advance repurchases and changes in the timing of purchases under existing arrangements.
- Changes in actuarial assumptions that impact the annual pension expense under International Accounting Standard 19 (IAS 19), *Employee Benefits*, can be substantial and have a significant impact on overall Fund income.¹ However, what distinguishes the gains and losses from regular items of income and expenses is that they tend to offset each other, as evidenced over the years, although the timing and magnitude may vary.
- In the unlikely event of a provision for impairment losses on credit outstanding being required under International Financial Reporting Standard 9 (IFRS 9), *Financial Instruments*, income would be reduced.² Staff commenced the annual IFRS 9-related impairment assessments for FY 2023 in February with the process scheduled for conclusion by June 2023.
- Other key factors that affect the Fund's income position include movements in the SDR interest rate, the U.S. dollar/SDR exchange rate, and returns across asset classes in which the EA invested.

Table 2 sets out the sensitivity of the income projections to key assumptions.

¹ IAS 19 is the International Financial Reporting Standard that deals with accounting for pension and other employee benefits, including the impact of remeasurement gains and losses incurred during the year. The Fund's actuaries' projection for IAS 19 gains and losses for FY 2023 was based on end-October valuations and has been updated by staff using end-December 2022 asset values and discount rate. The projections will be updated in the April 2023 income paper.

² The Fund has never recorded a provision for impairment losses and cases where provisioning may need to be considered by the Fund are expected to remain very rare. Accordingly, given the current circumstances and future uncertainty surrounding any expected exceptional events, the projection assumptions do not incorporate any provision for impairment losses under IFRS 9.

- **The commencement of payouts from the Endowment Subaccount (EA) is now expected to be delayed further.** The sharp increase in U.S. inflation and the recent decline in financial markets have both been a major drag on the EA's performance versus its 3 percent U.S. dollar real return target. Furthermore, the elevated level of inflation continues to pose a significant challenge for the EA to meet its long-term real return target.⁷ The recent investment losses have been absorbed by the EA's cushion of retained investment income, which has now been eroded to very low levels. This cushion had been built up intentionally through delaying the commencement of EA payouts to provide protection to the real value of the EA. Initiation of the

⁷ The Board's review of the EA in 2018 initiated a gradual evolution of its investment strategy and established a framework for guiding future payouts of investment income. The refinements to the EA strategy approved in January 2022 seek to increase the likelihood that the EA will achieve its long-term target (e.g., decrease allocation to government bonds and TIPS and increase allocation to infrastructure equities and REITS) and simplify the EA structure to enable a more targeted use of active management.

EA payouts will be discussed in the forthcoming April income paper and the cushion of retained investment income will be reassessed, as a pre-requisite to commencing payouts. In the meantime, a further one-year delay in the EA payout to FY 2024 is assumed in staff's projections.

- **Reimbursements to the General Resources Account (GRA) are marginally higher**, and include the estimated costs for RSF country operations and related Fund overhead costs (e.g., space, equipment), beginning in FY 2024.
 - **Total costs of administering the RST will be drawn from the Reserve Account for the: a) budget receipt covering trust management (budgeted at US\$4½ million in FY 2024); and b) income reimbursement covering all other costs.** These reimbursements to the GRA will commence in FY 2024, reflecting estimated operational costs (i.e., country program design and review, policy discussions with authorities, program monitoring and periodic policy review beyond financial terms and safeguards) and overhead costs (such as additional office space requirements and other overhead needs). Estimates included in the original RST paper have been updated based on projections for the scale of RST operations in FY 2024 at about US\$8 million. The cost estimates are subject to considerable uncertainty, including on the number of countries that will seek RST support, and will be reviewed based on experience.
 - **In July 2021, the Board agreed to suspend the reimbursement of Poverty Reduction and Growth Trust (PRGT) administrative costs from FY 2022 through FY 2026.**⁸ This will lower the GRA's annual income and slow the pace of reserve accumulation in the GRA over the medium term by an equivalent amount.
- **Projected income from interest-free resources is higher reflecting recent interest rate developments.**⁹ The increase in the implicit returns on interest-free resources follows the upward shift in the projected path for the SDR interest rate, thereby increasing projected interest-free income through FY 2028 by about SDR 222 million compared with the April 2022 estimates.

7. The FY 2023 net income projection includes an estimate for pension-related gains based on the end-December 2022 asset valuations and discount rate. It points to pension-related gains of SDR 29 million comprising net periodic pension expense of SDR 70 million and a remeasurement gain amounting to SDR 99 million that reflects gains attributable to the discount rate trending higher since the start of the financial year, mostly offset by losses resulting from the

⁸ Annual reimbursement from the PRGT Reserve Account to the GRA was introduced in 2008. A temporary suspension of reimbursement, however, is one of the recognized contingency measures under the PRGT's three-pillar framework when self-sustained capacity falls short of the target envelope. The suspension will retain these resources in the PRGT Reserve Account, which provides security to lenders.

⁹ GRA interest-free resources comprise primarily unremunerated reserve tranche positions not represented by gold holdings and GRA net income not transferred to the IA. These resources generate implicit income for the Fund by reducing members' reserve tranche positions and the remuneration expense thereon or increasing interest income if reflected in SDR holdings of the GRA.

negative plan asset performance to end-December.¹⁰ However, the actual outcome for the year remains uncertain amid ongoing fluctuations in financial markets and their impact on the valuation of pension assets as well as the discount rate. Consistent with established practice, projections beyond the current financial year for these gains or losses are not made due to the unpredictability of the underlying actuarial assumptions.

B. Medium-Term Expenditure

8. The proposed FY 2024 budget of US\$1,411 million includes a 2 percent structural augmentation and a one-off US\$7 million allocation for overseas Annual Meeting travel. It seeks to align resources with institutional priorities and emerging needs.¹¹ The budget builds on continued reprioritization to meet critical needs in traditional core areas, while allocating the second phase of the augmentation to support a greener, digital, and more inclusive global economy. It also provides resources for work on debt and governance and operationalizes budget receipts arising from a management fee, as anticipated under the RST. With travel resuming and with full utilization of structural resources now projected, unwinding of exceptional one-off resourcing will need to continue during FY 2024. At the same time, the highly uncertain global outlook highlights the importance of the Fund to remain agile. Externally funded operations are expected to continue to recover as in-person capacity building picks up and will also increase reflecting the second of a three-year step increase approved in the FY 2023–25 budget to support the structural transformation agenda. Over the medium-term, expenses are projected to be higher in SDR terms reflecting a strengthening of the U.S. dollar against the SDR and a higher Fund deflator.

9. The proposed capital budget of US\$108 million including Cloud Capital Equivalent (CCE) has increased from US\$77.9 million in FY 2023. The increase is driven by the resumption of facilities-related investments after a period of stabilization that allowed for completion of ongoing projects and better assessment of hybrid workspace needs. This includes expenses related to field offices. A projected increase in cloud costs also contribute to the higher overall capital envelope relative to FY 2023. The envelope provides space to support hybrid work and staff growth, critical lifecycle investments, and priority projects related to security and ongoing modernization.

C. The Longer-Run Income-Expenditure Position in an Illustrative Low Lending Environment

10. Staff has updated its analysis of the Fund’s income position in an illustrative future low lending environment under two possible scenarios and the assumptions are discussed in Annex I. The illustrative low-lending environment is assumed to be reached in FY 2033 when

¹⁰ Remeasurement gains of SDR 1.1 billion from the 80 basis points increase in the discount rate since the beginning of the year, as rising corporate bond yields drove the discount rate to highs last seen more than a decade ago; offset by an estimated loss of about SDR 1 billion on plan assets portfolio performance during the year reflecting high inflation and ongoing geopolitical uncertainty.

¹¹ See *Preliminary Proposals for the FY 2024–FY 2026 Medium-Term Budget* (FO/Dis/23/18, 2/16/23).

Table 1. Consolidated Income and Expenses, FY 2023–33
Desk Survey Scenario

	FY23	FY24	FY25	FY26	FY27	FY28	FY29	Low-lending environment	
								Scenario A	Scenario B
								SDRi 3.5% P/out=1.5%	SDRi 3% P/out=1%
								FY33	FY33
	(in SDR millions)								
A. Operational Income	2,751	3,804	3,403	3,054	3,105	2,918	2,649	1,290	1,062
Lending income	2,552	2,703	2,351	2,002	1,856	1,574	1,254	247	247
Margin for the rate of charge	944	951	843	739	697	619	513	200	200
Service charge and other income	116	79	35	21	13	1	0	23	23
Commitment fees	197	219	123	0	0	0	0	24	24
Surcharges	1,295	1,454	1,350	1,242	1,146	954	741	0	0
Investment income	97	960	932	950	1,039	1,133	1,189	813	598
Fixed-Income Subaccount 1/	97	898	868	884	972	1,064	1,119	675	525
Endowment Subaccount pay-out 2/	0	62	64	66	67	69	70	138	73
Interest-free resources 3/	92	125	102	84	81	79	70	89	76
Reimbursements	10	16	18	18	129	132	136	141	141
SDR Department	10	10	10	10	11	11	11	12	12
PRG Trust 4/	0	0	0	0	110	113	116	120	120
RST 5/	0	6	8	8	8	8	9	9	9
B. Expenses 6/	1,119	1,130	1,183	1,203	1,229	1,255	1,276	1,325	1,325
Net administrative budget	975	1,045	1,098	1,122	1,150	1,176	1,199	1,249	1,249
Capital budget items expensed	15	22	22	22	22	23	23	24	24
Depreciation	59	63	63	59	57	56	54	52	52
Net periodic pension cost	70	0	0	0	0	0	0	0	0
C. Net Operational Income (Loss) Before Provisioning (A-B)	1,632	2,674	2,220	1,851	1,876	1,663	1,373	(35)	(263)
Provision for loan impairment losses	0	0	0	0	0	0	0	0	0
D. Net Operational Income (Loss)	1,632	2,674	2,220	1,851	1,876	1,663	1,373	(35)	(263)
E. Pension-related remeasurement gain	99	0	0	0	0	0	0	0	0
Net Operational Income (Loss) After Remeasurement (D+E)	1,731	2,674	2,220	1,851	1,876	1,663	1,373	(35)	(263)
Endowment Subaccount - Retained Income	(275)	242	304	315	354	364	373	82	147
Net Income (Loss)	1,456	2,916	2,524	2,166	2,230	2,027	1,747	47	(116)
	(in US\$ millions)								
F. Operational Income	3,657	5,136	4,594	4,123	4,192	3,911	3,549	1,803	1,487
Lending income	3,393	3,649	3,173	2,702	2,506	2,109	1,680	345	345
Investment income	129	1,296	1,259	1,283	1,403	1,519	1,594	1,138	839
Interest free resources	122	169	137	113	109	105	93	124	107
Reimbursements	13	22	25	25	174	178	182	196	196
G. Expenses	1,486	1,525	1,596	1,623	1,659	1,681	1,711	1,854	1,854
Net administrative budget	1,296	1,411	1,482	1,514	1,552	1,576	1,607	1,748	1,748
Capital budget items expensed	19	29	30	29	30	30	31	33	33
Depreciation	78	85	84	80	77	75	73	73	73
Net periodic pension cost	93	0	0	0	0	0	0	0	0
H. Net Operational Income (Loss) (F-G)	2,171	3,611	2,998	2,500	2,533	2,230	1,838	(51)	(367)
Memorandum Items:									
Fund credit (average stock, SDR billions)	94.4	95.1	84.3	73.9	69.7	61.9	51.3	20.0	20.0
SDR interest rate (in percent)	2.0	3.3	2.8	2.6	2.7	2.8	2.8	3.5	3.0
US\$/SDR exchange rate	1.33	1.35	1.35	1.35	1.35	1.34	1.34	1.40	1.40
Precautionary balances (end of period, SDR billions) 7/	22.5	25.0	27.3	29.1	31.0	32.6	34.0	15.0	15.0

Table 1. Consolidated Income and Expenses, FY 2023–33
Desk Survey Scenario (concluded)

¹ Includes refinements to the investment strategy of the FI which improved the prospects of achieving a 50-basis point margin on average over the SDR interest rate over the medium term. See *Review of the Investment Account and Trust Assets Investment Strategy* (SM/21/206, 12/10/21).

² The projections assume a 1 percent payout from the EA commencing in FY 2024. The illustrative scenarios for FY 2033 show a continued payout of 1 percent in a low investment return environment (Scenario B); and a higher payout of 1.5 percent in a high investment return environment (Scenario A).

³ Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to unremunerated reserve tranche positions not represented by gold holdings and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense or increase interest income if reflected in SDR holdings of the GRA, resulting in implicit income for the Fund.

⁴ A five-year suspension of the PRGT reimbursement of expenses for the FY 2022–26 was approved by the Board in July 2021.

⁵ Reimbursement of costs for RSF country operations and related Fund overhead costs (e.g., space; equipment). See *Proposal to Establish a Resilience and Sustainability Trust* (SM/22/63, 3/21/22). Cost estimates for RST reimbursement reflect initial estimates for the scale and unit costs of RST-supported operations.

⁶ Includes proposed adjustment for deflator in FY 2024 in January 2023 to 6.2 percent. See *The Fund's Budget Deflator* (FO/DIS/23/8, 1/18/23). Also includes budget augmentation that was approved in the context of the FY 2023–FY 2025 Medium-Term Budget and implemented through annual increases in the real net administrative budget averaging 2 percent each year during FY 2023 to FY 2025 (relative to FY 2022), returning to a flat real budget trajectory thereafter. See *The Budget Augmentation Framework* (EBAP/21/52, 11/12/21).

⁷ Precautionary balances are adjusted to exclude the annual IAS 19 gains and losses included in accounting income. See Box 2, *The Consolidated Medium-Term Income and Expenditure Framework* (FO/DIS/22/31, 2/22/22).

drawings under current and potential arrangements have been largely repurchased (Table 1). The negative performance under the low lending environment scenarios reflects mainly the large increase in operational expenses compared with the 2022 review mainly on account of higher operational costs in SDR terms on expectations of the USD strengthening against the SDR over the medium term, as well as a revision of the deflator in FY 2024, that combine to increase projected net administrative budget costs by about 15 percent in the long term. Operational income is marginally higher due mainly to the projected SDR interest rate range shifting higher, however payouts from the EA remain modest reflecting a payout ratio that is lower than was anticipated at the time of the 2008 NIM review.¹²

11. Investment and margin income would be expected to cover a large portion of expenses in the illustrative future low-lending environment but remain sensitive to several other key assumptions (Table 1 and Figure 2). While expenditures are assumed to be constant in real terms, the net income outlook remains sensitive to movements in the U.S. dollar/SDR exchange rate, which, based on current forward market rates, is assumed to weaken slightly. For example, if the U.S. dollar/SDR exchange rate remained broadly unchanged at current levels, a net operational loss of SDR 95 million (US\$127 million) would be recognized in FY 2033 under Scenario A, and a loss of SDR 319 million (US\$423 million) under Scenario B. The scenarios assume that none of the credit outstanding in a low-lending environment would be subject to surcharges, and assuming a margin

¹² See *Review of the Investment Account and Trust Assets Investment Strategy* (SM/21/206, 12/10/21).

of 100 basis points, lending income would, depending on the buoyancy of investment income, contribute about 19–23 percent of total income in these scenarios. As such, a change in the margin could have a significant impact on the net income position particularly if interest rates were to remain low. Lowering the margin by 20 basis points to 80 basis points would reduce the low-lending environment income assumed in FY 2033 by SDR 40 million (US\$56 million). The scenarios also assume reimbursement to the GRA for the expenses of operating the PRGT (which is assumed to resume in FY 2027), the SDR department, and the RST which combined is estimated at SDR 141 million in FY 2033.

12. The illustrative low lending scenario also features very conservative assumptions for precautionary balances and credit outstanding. In contrast, precautionary balances are expected to reach SDR 36.2 billion by FY 2032, more than double the ‘floor’ assumed in the illustrative low lending environment.¹³ Credit outstanding under the desk survey scenario is also projected to be higher over the medium term than under past baseline scenarios. Further, the 10-year moving average of actual annual credit outstanding from FY 2003 to FY 2022 ranges between SDR 45 billion and SDR 69 billion. Assuming higher precautionary balances of about SDR 20 billion (i.e., in excess of the ‘floor’) and higher credit outstanding of SDR 30 billion in the illustrative low lending environment, the net loss in the more conservative Scenario B is offset to yield a net gain of about SDR 14 million; under Scenario A these assumptions yield a net gain of SDR 292 million.

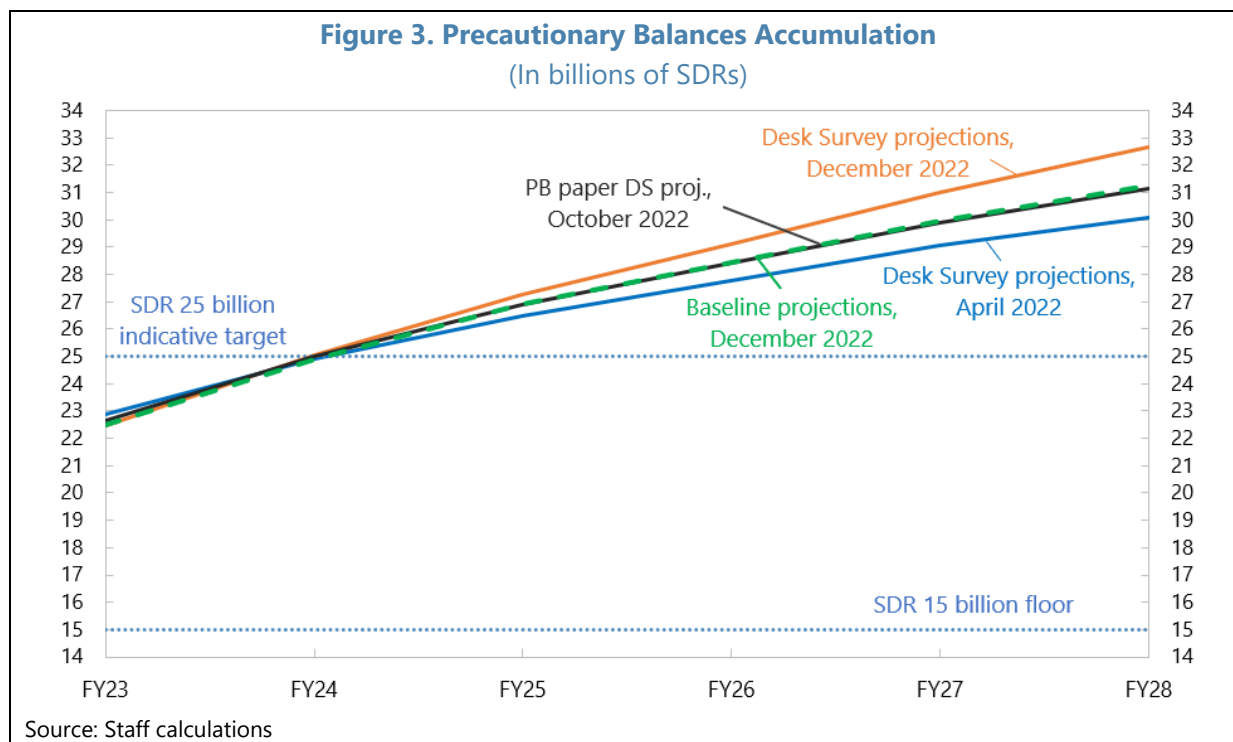
PRECAUTIONARY BALANCES OUTLOOK

13. Updated projections of the pace of reserve accumulation are higher over the medium term than expected in the December review of precautionary balances (Figure 3).¹⁴ This reflects mainly an upward shift of the SDR interest rate path from prior low levels, impacting positively investment income, and the potential demand for Fund lending under the current desk survey being higher than previously anticipated raising the path for credit outstanding and lending income, offset partly by a higher projected expenditure path in SDR terms due to the upward revision of the deflator in FY 2024 coupled with a projected strengthening of the U.S. dollar against the SDR over the medium term.

14. Against this backdrop, precautionary balances over the medium term are now expected to reach SDR 32.6 billion by FY 2028 under the desk survey, about SDR 1.5 billion higher than projected in December 2022. The indicative medium-term target is expected to be reached in late FY 2024 or early FY 2025 (Figure 3); as the projections for investment income and administrative expenses in SDR terms remain sensitive to changes in interest and exchange rates, respectively.

¹³ The low lending environment assumes that a portion of reserves is distributed to the membership and that only the floor level (SDR 15 billion) of precautionary balances is retained.


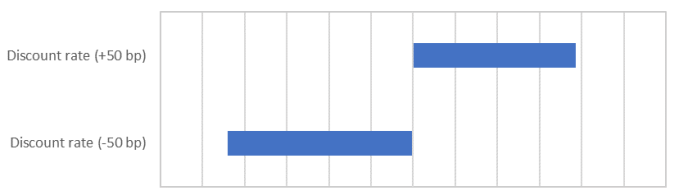

¹⁴ For a fuller discussion see *Review of the Adequacy of the Fund's Precautionary Balances (SM/22/260, 11/16/22)* and *The Chair's Summing Up—Review of the Adequacy of the Fund's Precautionary Balances - Executive Board Meeting 22/100, December 12, 2022 (SU/22/165, 12/14/22)*.



15. Under a baseline scenario for income projections that only includes scheduled disbursements for arrangements approved through end-December 2022 (Figure 3), the pace of accumulation of precautionary balances would be marginally lower but also reach the indicative target in FY 2025.

16. The projected pace of precautionary balances accumulation is sensitive to the underlying assumptions (Box 1). The approval of new financing beyond the desk survey would result in higher lending income and a faster accumulation of precautionary balances. Conversely, in the event of borrowing member countries making advance repurchases, the pace of accumulation of precautionary balances would be slower. Annual income projections continue to exclude any projections for pension related gains and losses beyond the current year due to the unpredictability of the underlying actuarial assumptions. Table 2 details the sensitivity of the projections to other key drivers of income.

Table 2. Income Projections

Key Parameters	Assumptions	Sensitivity Analysis (Scenario B)																
Average US\$/SDR exchange rate	Rising to 1.4 by FY 2033 from 1.33 in FY 2023	<p style="text-align: center;">Cumulative Impact on Precautionary Balances in FY29 - Changes in Key Assumptions for the Period FY24-29 (in millions of SDRs)</p>  <table border="1"> <caption>Cumulative Impact on Precautionary Balances in FY29</caption> <thead> <tr> <th>Assumption</th> <th>Impact (millions of SDRs)</th> </tr> </thead> <tbody> <tr> <td>Margin (+20 bp)</td> <td>~900</td> </tr> <tr> <td>SDRi (+50 bp)</td> <td>~900</td> </tr> <tr> <td>US\$/SDR exchange rate (10%)</td> <td>~600</td> </tr> <tr> <td>US\$/SDR exchange rate (-10%)</td> <td>~-700</td> </tr> <tr> <td>SDRi (-50 bp)</td> <td>~-800</td> </tr> <tr> <td>Margin (-20 bp)</td> <td>~-900</td> </tr> </tbody> </table>	Assumption	Impact (millions of SDRs)	Margin (+20 bp)	~900	SDRi (+50 bp)	~900	US\$/SDR exchange rate (10%)	~600	US\$/SDR exchange rate (-10%)	~-700	SDRi (-50 bp)	~-800	Margin (-20 bp)	~-900		
Assumption	Impact (millions of SDRs)																	
Margin (+20 bp)	~900																	
SDRi (+50 bp)	~900																	
US\$/SDR exchange rate (10%)	~600																	
US\$/SDR exchange rate (-10%)	~-700																	
SDRi (-50 bp)	~-800																	
Margin (-20 bp)	~-900																	
SDR interest rate	Rising to 3.0 percent by FY 2033 from 2.0 percent in FY 2023	<p style="text-align: center;">Sensitivity to Changes in the Discount Rate on Net Income¹ (in millions of SDRs)</p>  <table border="1"> <caption>Sensitivity to Changes in the Discount Rate on Net Income</caption> <thead> <tr> <th>Discount Rate Change</th> <th>Impact (millions of SDRs)</th> </tr> </thead> <tbody> <tr> <td>+50 bp</td> <td>~700</td> </tr> <tr> <td>-50 bp</td> <td>~-700</td> </tr> </tbody> </table>	Discount Rate Change	Impact (millions of SDRs)	+50 bp	~700	-50 bp	~-700										
Discount Rate Change	Impact (millions of SDRs)																	
+50 bp	~700																	
-50 bp	~-700																	
Margin for rate of charge (basis points)	100																	
Discount rate	FY 2023 projections based on 5.0 percent at end-December 2022.	<p>1/ Sensitivity of Plans's Defined Benefit Obligation to the discount rate as of April 30, 2022.</p> <p style="text-align: center;">Low-Lending Environment (FY2033) Net Operational Income after Changes in Key Assumptions (in millions of SDRs)</p>  <table border="1"> <caption>Net Operational Income after Changes in Key Assumptions (FY2033)</caption> <thead> <tr> <th>Assumption</th> <th>Net Operational Income (millions of SDRs)</th> </tr> </thead> <tbody> <tr> <td>Baseline</td> <td>-250</td> </tr> <tr> <td>SDRi (+50 bp)</td> <td>-200</td> </tr> <tr> <td>SDRi (-50 bp)</td> <td>-300</td> </tr> <tr> <td>Margin (+20 bp)</td> <td>-250</td> </tr> <tr> <td>Margin (-20 bp)</td> <td>-350</td> </tr> <tr> <td>US\$/SDR exchange rate (10%)</td> <td>-150</td> </tr> <tr> <td>US\$/SDR exchange rate (-10%)</td> <td>-350</td> </tr> </tbody> </table>	Assumption	Net Operational Income (millions of SDRs)	Baseline	-250	SDRi (+50 bp)	-200	SDRi (-50 bp)	-300	Margin (+20 bp)	-250	Margin (-20 bp)	-350	US\$/SDR exchange rate (10%)	-150	US\$/SDR exchange rate (-10%)	-350
Assumption	Net Operational Income (millions of SDRs)																	
Baseline	-250																	
SDRi (+50 bp)	-200																	
SDRi (-50 bp)	-300																	
Margin (+20 bp)	-250																	
Margin (-20 bp)	-350																	
US\$/SDR exchange rate (10%)	-150																	
US\$/SDR exchange rate (-10%)	-350																	

Annex I. Illustrative Low Lending Environment

1. In 2008, when the Executive Board endorsed the New Income Model (NIM), a long-term goal was to broaden income sources to provide sustainable financing for the institution.¹ In the current environment of relatively low interest rates, the Fund remains reliant on income from lending to cover the cost of the bulk of its activities. Against this background, the updated outlook of the illustrative future low-lending environment is intended as a cross-check on the consistency of the projected budgetary envelope with the Fund's income in the longer run, with lending income assumed to fall to lower levels.

2. The assumptions underlying the low-lending environment are very conservative especially in light of the current high lending environment. These are intended to illustrate a possible floor level of income providing an indication of the Fund's ability to generate positive net income even when credit is low. A conservative average credit level of SDR 20 billion is assumed. Commitments under arrangements treated as precautionary are also assumed to decline from current levels to SDR 10 billion. The scenarios assume precautionary balances at the current floor of SDR 15 billion. A return to a flat real budget trajectory after the budget augmentation is also assumed. The scenarios are purely illustrative and will be revisited in the upcoming review of the Fund's income in April.

3. Two possible scenarios for investment income are shown in the illustrative low-lending environment (Text Table and Table 1). Investment income would be in the form of

payouts from the EA and returns earned on the FI. In keeping with the recent *Review of the Investment Account and Trust Assets Investment Strategy*, Scenario B assumes a 50 basis point return over the SDR interest rate on the FI in the long run, and

	Scenario assumptions	
	A	B
Average stock of credit (SDR billions)	20	20
Stock of precautionary arrangements (SDR billions)	10	10
Precautionary balances (SDR billions)	15	15
SDR interest rate (percent)	3.5	3.0
US\$/SDR	1.40	1.40
Endowment payout assumptions	Revision of payout rate to 1.5% of US\$ NAV in FY 33, assuming that EA outperforms over the long term	Start in FY 24 at 1% of US\$ NAV, increasing by GED annually

Scenario A assumes a 100 basis point return over the SDR interest rate based on improved expectations. Under Scenario B, which illustrates a broad continuation of the desk survey scenario in Table 1, the payout from the EA continues at 1 percent of the U.S. dollar NAV and the SDR interest rate rises to 3 percent. This conservative payout and interest rate assumption is more closely aligned with the prevailing investment return outlook, particularly in the United States. These assumptions yield a negative income-expenditure position of about SDR 263 million (US\$367 million). Scenario A illustrates the potential impact of a higher investment return environment, with an SDR rate of 3.5 percent reflecting the buoyancy in the global interest rate environment and a 100 basis point

¹ See *Developing a New Income Model for the Fund-Proposed Decisions* (SM/08/80, 03/20/08; SM/08/80, Rev. 1, 04/02/08; SM/08/80 Rev. 1, Sup. 1, 04/08/08).

return over the SDR interest rate in the FI, and a higher payout from the endowment of 1.5 percent in FY 2033 that assumes portfolio performance exceeding expectations under existing or future investment strategies. Under these assumptions, the longer-term income-expenditure position would be less negative.

Box AI.1 reviews the income under Scenario B of the illustrative low-lending environment (Table 1 and Figure 2) based on the key assumptions.

Box AI.1. Key Assumptions for FY 2033—Illustrative Low-Lending Environment

- **Operational lending income** (US\$345 million or SDR 247 million by FY 2033)

Outstanding Fund credit is assumed to decline to an average level of about SDR 20 billion by FY 2033 in the low-lending environment, upon which a margin of 100 basis points would generate income of about SDR 200 million. Commitments under arrangements treated as precautionary are assumed to also decline to an average of SDR 10 billion, yielding some SDR 24 million in annual commitment fees. Average annual purchases of about SDR 4.5 billion from FY 2033 generate about SDR 23 million in annual service charges.

- **Investment income** (US\$839 million or SDR 598 million by FY 2033)

Currency amounts equivalent to net operational income are assumed to be transferred annually to the Fixed-Income Subaccount for investment in the subsequent year. Average investment returns in this portfolio are expected to exceed the SDR interest rate by 50 basis points on average over time. This would yield annual income of about SDR 525 million in the low-lending environment assuming an SDR interest rate of 3 percent and a precautionary balances floor of SDR 15 billion.

The refinements to the EA strategy approved in January 2022 are intended to bring projected returns closer to the target and simplify the EA structure to enable a more targeted use of active management.

- **Implicit income on interest-free resources** (US\$107 million or SDR 76 million by FY 2033)

The interest-free resources retained in the GRA are mainly attributable to the unremunerated reserve tranche positions not represented by gold holdings and GRA net income not transferred to the Investment Account. These resources reduce members' reserve tranche positions and the Fund's remuneration expense or increase interest income if reflected in SDR holdings of the GRA, resulting in an implicit income for the Fund.

- **Reimbursements** (US\$196 million or SDR 141 million in FY 2033)

Reimbursements from the SDR Department are based on April 2022 projections and are estimated at about SDR 10 million in FY 2023. Reimbursement of the GRA for the expenses of administering the PRGT is projected to resume in FY 2027 and reach SDR 120 million in FY 2033. Reimbursements also reflect the estimated costs for RSF country operations and related Fund overhead costs (e.g., space; equipment) commencing in FY 2024. Administrative costs and the associated reimbursements are impacted by the budget augmentation during FY 2023–25 before reversion to a flat real trajectory in FY 2026.

Annex II. Consolidated Income and Expenses, FY 2022–32

April 2022 Desk Survey Scenario									
	FY22	FY23	FY24	FY25	FY26	FY27	FY28	Low-lending environment	
								Scenario A	Scenario B
								SDRi 3% P/out=1.5%	SDRi 2% P/out=1%
	FY32	FY32							
(in SDR millions)									
A. Operational Income	2,570	3,056	3,082	2,609	2,395	2,355	2,160	1,126	891
Lending income	2,618	2,704	2,559	2,023	1,750	1,586	1,333	247	247
Margin for the rate of charge	904	959	936	806	677	609	521	200	200
Service charge and other income	199	118	72	17	10	0	0	23	23
Commitment fees	283	196	183	2	0	0	0	24	24
Surcharges	1,232	1,431	1,368	1,198	1,063	977	812	0	0
Investment income	(62)	305	457	518	573	600	654	640	449
Fixed-Income Subaccount 1/	(62)	240	391	451	505	531	584	525	375
Gold endowment pay-out 2/	0	65	66	67	68	69	70	115	74
Interest free resources 3/ 6/	6	38	57	59	62	61	64	125	81
SCA-1 and other	6	38	57	59	62	61	64	125	81
Reimbursements	8	9	9	9	10	108	109	114	114
SDR Department	8	9	9	9	10	10	10	10	10
PRG Trust 4/	0	0	0	0	0	98	99	104	104
RST	0	0	0	0	0	0	0	0	0
B. Expenses 5/	1,073	992	1,042	1,065	1,078	1,099	1,106	1,158	1,158
Net administrative budget	830	918	957	980	997	1,020	1,027	1,082	1,082
Capital budget items expensed	18	15	22	22	22	22	23	24	24
Depreciation	53	59	63	63	59	57	56	52	52
Net periodic pension cost (IAS 19)	172	0	0	0	0	0	0	0	0
C. Net Operational Income (Loss) Before Provisioning (A-B)	1,497	2,064	2,040	1,544	1,317	1,256	1,054	(32)	(267)
Provision for loan impairment losses	0	0	0	0	0	0	0	0	0
D. Net Operational Income (Loss)	1,497	2,064	2,040	1,544	1,317	1,256	1,054	(32)	(267)
E. Pension-related remeasurement gain (IAS 19)	512	0	0	0	0	0	0	0	0
Net Operational Income (Loss) After Pension-Related (IAS 19) Adjustment (D+E)	2,009	2,064	2,040	1,544	1,317	1,256	1,054	(32)	(267)
Endowment (Gold Profits) Subaccount - Retained Income	202	75	105	106	116	133	195	77	112
Net Income (Loss)	2,211	2,139	2,145	1,650	1,433	1,389	1,249	45	(155)
(in US\$ millions)									
F. Operational Income	3,651	4,309	4,378	3,756	3,472	3,438	3,197	1,746	1,383
Lending income (including Surcharges)	3,718	3,813	3,634	2,912	2,537	2,316	1,974	382	382
Investment income	(88)	430	650	746	832	876	967	992	697
Interest free resources	9	53	81	84	89	89	95	194	126
Reimbursements	12	13	13	14	14	157	161	178	178
G. Expenses	1,522	1,398	1,479	1,533	1,563	1,604	1,635	1,794	1,794
Net administrative budget	1,178	1,295	1,359	1,411	1,446	1,489	1,519	1,677	1,677
Capital budget items expensed	25	20	31	32	31	32	33	37	37
Depreciation	75	83	89	90	86	83	83	80	80
Net periodic pension cost	244	0	0	0	0	0	0	0	0
H. Net Operational Income (Loss) (F-G)	2,129	2,911	2,899	2,223	1,909	1,834	1,562	(48)	(411)
Memorandum Items:									
Fund credit (average stock, SDR billions)	90.4	95.9	93.6	80.6	67.7	60.9	52.1	20.0	20.0
SDR interest rate (in percent)	0.1	0.8	1.2	1.3	1.4	1.4	1.5	3.0	2.0
US\$/SDR exchange rate	1.42	1.41	1.42	1.44	1.45	1.46	1.48	1.55	1.55
Precautionary balances (end of period, SDR billions) 6/	20.9	22.9	24.9	26.5	27.8	29.0	30.1	15.0	15.0

¹ Includes recent refinements of the investment strategy of the IA-FI which improved the prospects of achieving a 50 basis point margin on average over the SDR interest rate over the medium term.

² The projections assume a 1 percent payout from the gold endowment commencing in FY 2023. The illustrative scenarios for FY 2032 show a continued payout of 1 percent in a low investment return environment (Scenario B); and a higher payout of 1.5 percent in a high investment return environment (Scenario A).

April 2022 Desk Survey Scenario (concluded)

³ Interest-free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to unremunerated reserve tranche positions not represented by gold holdings and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense or increase interest income if reflected in SDR holdings of the GRA, resulting in implicit income for the Fund.

⁴ Updated for a five-year suspension of the PRGT reimbursement of expenses for the FY 2022–26 approved by the Board in July 2021.

⁵ [The Budget Augmentation Framework](#) (11/12/21) proposed an augmentation to be implemented through annual increases in the real net administrative budget averaging 2 percent each year during FY 23 to FY 25 (relative to FY 22), returning to a flat real budget trajectory thereafter. The augmentation was approved in the context of the FY 2023–FY 2025 Medium-Term Budget.

⁶ Reflects a reduction in precautionary balances as a result of the full distribution of the SCA-1 (SDR 1,066 million) in the context of the clearance by Sudan of its overdue financial obligations to the Fund. Precautionary balances are also adjusted for a positive one-off permanent adjustment of SDR 205 million effective May 1, 2021 to reverse the impact of the cumulative IAS 19 gains and losses previously included in the Fund's precautionary balances under the accounting basis.