

**INFORMAL  
SESSION TO  
ENGAGE**

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February 19, 2021

To: Members of the Executive Board

From: The Secretary

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

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Questions: Mr. Bradbury, FIN (ext. 39034)  
Mr. Nana, FIN (ext. 38849)  
Mr. Balakrishnan, OBP (ext. 39526)





February 19, 2021

## THE CONSOLIDATED MEDIUM-TERM INCOME AND EXPENDITURE FRAMEWORK

### EXECUTIVE SUMMARY

The medium-term income projections have been updated from the April 2020 outlook and the revised projections indicate higher levels of net operational income over the coming years.

The updated lending projections, based on a *desk survey*, are significantly higher than the baseline projections in the April paper that took account of arrangements approved through end-March 2020 and estimates of potential emergency loan demand at the onset of the COVID-19 pandemic. Non-lending income is lower due largely to the downward revision of the projected path for the SDR interest rate and lower overall investment returns estimated on average over the medium term; offset partly by slightly higher payouts from the Endowment Subaccount (EA) over the medium term than projected in April. A large pension-related (IAS 19) gain is estimated for FY 2021 based on the end-December remeasurement of the Fund's Plan by the actuary. Consistent with established practice, projections beyond the current financial year for IAS 19 gains or losses are not made due to the unpredictability of the underlying actuarial assumptions. Projections of the Fund's income are subject to larger than normal uncertainties related to the impact of the COVID-19 pandemic on key assumptions.

The medium-term budget will propose a structural augmentation as part of a two-pronged strategy. A baseline budget meets crisis needs within a flat real envelope through reallocation of resources, including a crisis-related anticipated underspend on travel, savings from modernization projects, and use of carry forward of underspend from previous years. A structural augmentation would address longer-term priority needs. Expenses in SDR terms are lower due to a weaker path for the U.S. dollar against the SDR. Budget dynamics are consistent with the Fund's medium-term income position and with maintaining adequate precautionary balances.

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 the SDR interest rate and the payout from the EA. These scenarios yield income-expenditure positions that are positive or negative depending on assumptions for interest rates and investment returns.

A faster pace of reserve accumulation is now estimated with precautionary balances projected to reach SDR 28.5 billion in FY 2027, above the medium-term indicative target of SDR 25 billion that was raised from SDR 20 billion in October 2020. The sharp rise in precautionary balances over the medium term reflects mainly the impact of the higher path for credit outstanding under the desk survey scenario. Under a baseline scenario that includes only current arrangements, precautionary balances could peak at SDR 22.4 billion over the medium term.

This paper provides background information for the Executive Board's discussion of the budget and income and focuses on the medium-term outlook. The upcoming review of *The Fund's Income Position for FY 2021—Interim Update* paper presents a more detailed update of the Fund's income position for FY 2021 based on developments through the first eight months. The interim update paper also discusses some preliminary thoughts regarding the timing of initiating payouts from the Endowment Subaccount (EA) and on options for the reporting of pension-related gains and losses. An informal session to engage with the Executive Board on the interim update paper is tentatively scheduled for early March.

Approved By  
**Andrew Tweedie (FIN) and  
 Michele Shannon (OBP)**

Prepared by the Finance Department (Diviesh Nana (lead), Fiona Delaney, Emer Fleming, Martin Gororo, Vidhya Rustaman, Charles Xie, Jesse (Jinyong) Yang, and Yang (Jessie) Yang, under the guidance of Simon Bradbury and Maria Manno) and the Office of Budget and Planning (Anand Balakrishnan, Maria Albino, and Andrea Salerno).

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## INTRODUCTION

**1. This paper updates the April 2020 consolidated income and expenditure outlook.** As in the past, this paper provides background information for the Executive Board’s discussion of the budget and income.<sup>1</sup> The timing of the paper has been aligned with the *Informal Board Session to Engage on the Preliminary Proposals for the FY 2022–FY 2024 Medium-Term Budget* scheduled for late February (Annex II). In view of this timing, some elements of the estimates for FY 2021 and FY 2022 (including reimbursements, capital budget items expensed, and depreciation) will be updated separately in the upcoming papers for the annual income discussion in April.<sup>2</sup>

**2. The paper is organized as follows.** The first part of the paper presents the updated outlook for the Fund’s consolidated income and expenditures through FY 2027. It reviews the outlook for the Fund’s medium-term income from lending and non-lending sources, highlighting key changes since the last detailed income projections in April 2020, and outlines the impact of key assumptions that support the medium-term projections (Box 1). The paper then briefly describes the medium-term expenditure outlook. The discussion of consolidated income and expenditures concludes with an update of the longer-run income-expenditure position which, as in the past, provides an illustration of the income position in a future low lending environment. The paper also provides an update on the projected pace of accumulation of precautionary balances over the medium term.

## CONSOLIDATED INCOME AND EXPENSES

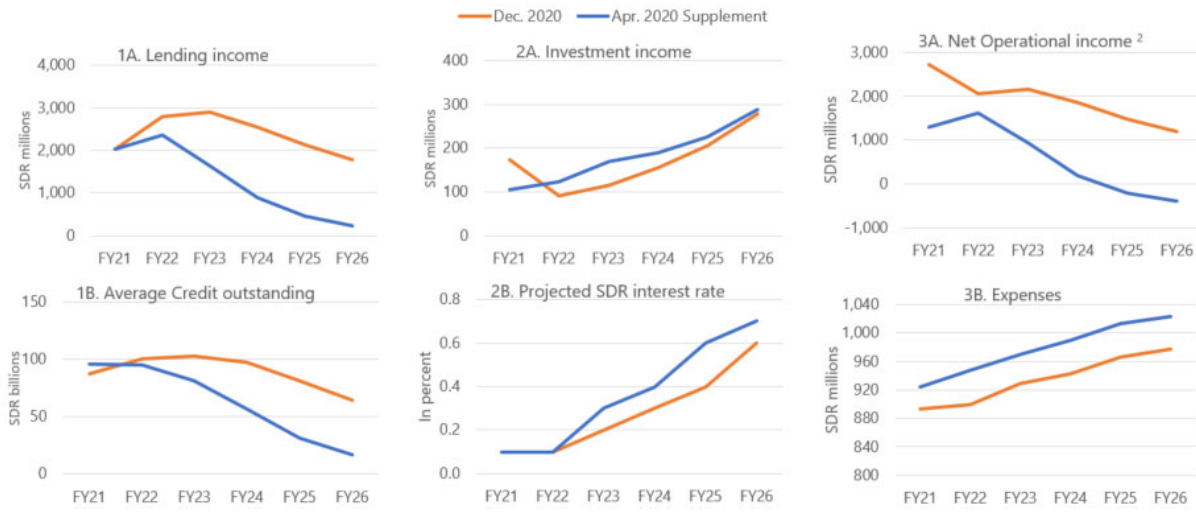
### A. Medium-Term Income

**3. The updated projections of the medium-term income outlook point to a significantly higher income position than projected last April (Figures 1 and 2).** This can be attributed mainly to a higher projected path for credit outstanding under the desk survey of potential demand for Fund lending, which reflects desk assessments of the likelihood of a program request based on knowledge of member countries’ economic outlook, financing needs, and the political landscape. By contrast, the baseline projections in the April paper took account of arrangements approved through end-March 2020 and estimates of potential emergency loan demand (mainly in the form of Rapid Financing Instruments) associated with the COVID-19 pandemic. Non-lending income is projected to be lower than the April 2020 estimate, as the effect of lower interest rates more than

<sup>1</sup> The upcoming review of *The Fund’s Income Position for FY 2021—Interim Update* paper (forthcoming) presents a more detailed update of the Fund’s income position for FY 2021 based on developments through the first eight months. The interim update paper also discusses some preliminary thoughts regarding the timing of initiating payouts from the Endowment Subaccount (EA) and on options for the reporting of pension-related gains and losses. An informal session to engage on the interim update paper is tentatively scheduled for early March.

<sup>2</sup> For April 2020, see *Review of the Fund’s Income Position for FY 2020 and FY 2021–2022* (EBS/20/58, 04/13/20) and *Review of the Fund’s Income Position for FY 2020 and FY 2021–2022—Supplementary Information* (EBS/20/58, Supplement 1, 04/21/20).

**Figure 1. Key Medium-Term Income Projections (FY 2021–26),<sup>1</sup>  
December 2020 vs. April 2020**



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

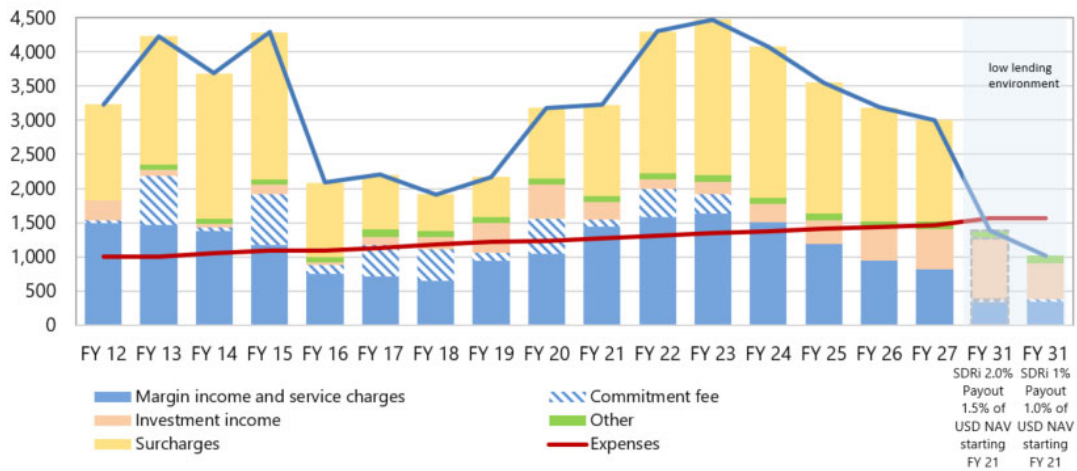
	FY21	FY22	FY23	FY24	FY25	FY26
Operational Income	2,273	2,968	3,088	2,792	2,435	2,169
Expenses	893	900	929	943	967	977
Net Operational Income <sup>2</sup>	2,716	2,068	2,159	1,849	1,468	1,192
Retained Endowment Income	506	122	123	117	105	91
Net income	3,222	2,190	2,282	1,966	1,573	1,283

Source: Finance Department.

<sup>1</sup> For the detailed income and expenditure projections see Table 1 (December 2020) and Table 3 (April 2020).

<sup>2</sup> In FY 2021, net operational income includes the IAS 19 gain.

**Figure 2. Actual and Projected Operational Income and Expenses—FY 2012–31<sup>1</sup>  
(In millions of U.S. dollars)**



Source: Finance Department.

<sup>1</sup> Operational income and expenses excluding the pension-related (IAS 19) gains and losses.

offsets the higher path for reserve accumulation 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 1.7 billion (US\$2.4 billion) annually during FY 2021–26, compared with an average of about SDR 0.6 billion (US\$0.8 billion) projected for the same period in April 2020 (Table 3).

**4. Operational lending income including surcharges is projected to be markedly higher over the medium term than in April 2020.**<sup>3</sup> Twenty-one RFIs (SDR 8.3 billion), two SBAs for Ukraine and Egypt (SDR 7.4 billion), one EFF arrangement for Ecuador (SDR 4.6 billion), together with three FCL arrangements for Chile, Colombia, and Peru (SDR 37.7 billion), and one PLL arrangement for Panama (SDR 1.9 billion) have been approved by the Executive Board since April 2020.<sup>4</sup> Combined with the potential new programs under the desk survey,<sup>5</sup> annual average credit outstanding is projected to increase by about SDR 26.3 billion per year over the period FY 2021–26, compared with the April 2020 projection, thus significantly increasing income from the margin and surcharges over the medium term.

**5. Commitment fee income is projected to be higher than the April 2020 estimate.**<sup>6</sup> Commitment fee income for the period FY 2021–23 is projected to be about SDR 223 million higher than was estimated in April 2020, reflecting mainly the new FCL arrangements for Chile, Colombia, and Peru, and the recognition of commitment fee income from Argentina’s cancellation of its stand-by arrangement.

**6. Non-lending income, which mainly comprises investment income, is expected to be lower over the medium term compared with earlier projections.**

- **Income from the Fixed-Income Subaccount (FI) is projected to be lower than previously projected.**<sup>7</sup> This is largely due to the downward revision in the projected path for the SDR interest rate during the forecast period (Figure 1) and lower overall returns on average over the medium term than previously estimated; offset partly by the higher net operational income

<sup>3</sup> Lending income comprises the margin for the rate of charge, service charges, commitment fees, and surcharges.

<sup>4</sup> In addition, augmentations totaling SDR 1.2 billion under existing arrangements for Angola, Armenia, Barbados, Georgia, and Honduras were approved during the period.

<sup>5</sup> The desk survey of potential demand for Fund lending that was also the source for the main scenario in the recent precautionary balances discussion (see *Review of the Adequacy of the Fund’s Precautionary Balances* (SM/20/159, 10/8/20)), has been updated.

<sup>6</sup> 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 2023.

<sup>7</sup> The Fixed-Income Subaccount has investments equivalent to the Fund’s general and special reserves except for amounts attributed to gold sales profits in the special reserve. In August 2015 the Executive Board modified the investment strategy of the Fixed-Income Subaccount that had been in place since 2006. The objective for the subaccount return is to exceed the SDR interest rate over time while minimizing the frequency and extent of negative returns over a three- to four-year horizon. See *Review of the Investment Strategy for Fixed-Income Subaccount of the Investment Account* (SM/15/210, 08/05/15).

### Box 1. Impact of Key Assumptions on Income Position

The projections for income and reserve accumulation in the desk survey scenario include arrangements beyond those approved through end-December 2020 and remain highly sensitive to a number of key underlying assumptions. They exclude any annual projections for pension related (i.e., 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.<sup>1</sup> 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.
- International Financial Reporting Standard 9 (IFRS 9), *Financial Instruments*, addresses, inter alia, accounting for impairment losses on credit outstanding to the Fund. Staff commenced the process of IFRS 9-related impairment assessments for FY 2021 in late January.<sup>2</sup>
- 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 is invested.

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

<sup>1</sup> IAS 19 is the International Financial Reporting Standard that deals with accounting for pension and other employee benefits, including the full impact of rereasurement gains and losses incurred during the year. As discussed in the *Review of the Fund's Income Position for FY 2020 and FY 2021–2022* (EBS/20/58, 04/13/20), the standard introduces an additional source of volatility in the Fund's income as any gains or losses arising from changes in actuarial assumptions are now recognized in the year incurred. This estimate for FY 2021 will be revised to include a full-year projection in the April 2021 income paper.

<sup>2</sup> IFRS 9, the new standard for financial instruments, has been implemented for the Fund's financial reporting effective FY 2019. Under the impairment requirements of IFRS 9 it is no longer necessary for a credit event to have occurred before credit losses are recognized; reporting entities are instead required to estimate an "expected loss" considering a broader range of relevant considerations, including forward-looking information. See *Provisioning for Impairment Losses in the Context of the Fund* (FO/Dis/20/37, 3/3/20) and *Provisioning for Impairment Losses in the Context of the Fund-Supplementary Information* (FO/Dis/20/37, Sup. 1).

outlook and the faster pace of reserve build-up expected over the medium term. As a consequence, estimated returns from the subaccount in FY 2021–26 are lower than prior estimates.

- **Implementation of the payout from the EA could commence in FY 2021, subject to a reassessment of the Fund's income outlook, the EA's performance, and market conditions at the time.**<sup>8,9</sup> The initial payout is expected to be limited to around 1 percent of NAV or about

<sup>8</sup> At the April 2018 review of the Fund's income position, the Board endorsed staff's proposal to delay initiating the payout for 3 years until FY 2021 to build a cushion in the EA (then increasing by the GED each year).

<sup>9</sup> See the discussion of the payout policy in March 2018 (*Review of the Investment Account* (SM/18/24, 02/02/18)) and the framework for guiding future payouts from the EA agreed by the Board in April 2018 (*Review of the Fund's Income Position FY 2018 and FY 2019–2020* (EBS/18/25, 04/05/18; and Cor. 1, 04/25/18)).

US\$85 million (SDR 60 million), increasing by the GED each year thereafter.<sup>10</sup> The revised initial payout amount results in slightly higher payouts over the medium term than projected in April. *The Fund's Income Position for FY 2021—Interim Update* (forthcoming) explores the merits of a further one-year delay in initiating the payout.

**7. The FY 2021 net income projection includes an estimate for the pension-related gain under International Accounting Standard (IAS) 19.** The year-to-date estimates through December 31, 2020 point to pension-related gains of SDR 1.3 billion that are largely attributable to strong plan asset performance, offset partly by a reduction in the discount rate since the start of the financial year.<sup>11</sup> No gains or losses are projected beyond the current year due to the unpredictability of the underlying actuarial assumptions.<sup>12</sup>

## B. Medium-Term Expenditure

**8. The FY 2022–24 medium-term budget will propose a structural augmentation.**<sup>13</sup> This is part of a two-pronged strategy that, first, sets out a “baseline” budget that meets crisis needs within a flat real envelope and, second, outlines how a structural augmentation can support the needed step-up in work to address longer term challenges related to climate change, digitalization, as well as fragility and exclusion that will shape the global economy in the period ahead. Further work is underway to define the scale of the proposed structural augmentation, which will be presented for a decision in April. Expense projections reflect the baseline budget, which addresses near-term priorities through reallocation of resources, including a crisis-related anticipated underspend on travel, savings from modernization projects, and use of carry forward of underspend from previous years.<sup>14</sup> The baseline budget is consistent with the Fund’s medium-term income position and with maintaining adequate precautionary balances. The *Preliminary Proposals for the FY 2022–FY 2024 Medium-Term Budget* paper also concludes that, given the relative scale of income to the Fund’s net administrative budget, with every 10 percent of the current budget base being equivalent to about 3 percent of current income, income-expenditure dynamics remain robust to an augmentation to the baseline budget.

<sup>10</sup> The constant real payout rule would be used to determine future payout amounts after the initial payout is determined. Under this rule, the payout amount for any given year would be calculated as the prior year’s payout increased by the deflator (GED).

<sup>11</sup> See *The Fund's Income Position for FY 2021—Interim Update* (forthcoming) and *Audited Financial Statements for the Financial Years ended April 30, 2020 and 2019* (EBAP/20/52, 7/7/20) for the sensitivity of the present value of the defined benefit obligation to changes in actuarial assumptions at April 30, 2020. A one percent increase (decrease) in the discount rate yields a decrease (increase) in the range of about 17 to 19 percent in the Fund’s defined benefit obligation.

<sup>12</sup> *The Fund's Income Position for FY 2021—Interim Update* (forthcoming) discusses options for the reporting of pension-related gains and losses under International Accounting Standard (IAS) 19.

<sup>13</sup> See *Preliminary Proposals for the FY 2022–FY 2024 Medium-Term Budget* (FO/Dis/21/24, 2/11/21).

<sup>14</sup> In nominal terms, the projections incorporate the use of the U.S. CPI as the GED, approved by the Board as part of the CCBR.

**Table 1. Consolidated Income and Expenses, FY 2021–31**  
**Desk Survey Scenario**

	FY21	FY22	FY23	FY24	FY25	FY26	FY27	Low-lending environment	
								Scenario A	Scenario B
								SDRI 2%	SDRI 1%
								P/out=1.5%	P/out=1%
	(in SDR millions)								
<b>A. Operational income</b>	<b>2,273</b>	<b>2,968</b>	<b>3,088</b>	<b>2,792</b>	<b>2,435</b>	<b>2,169</b>	<b>2,027</b>	<b>909</b>	<b>670</b>
Lending income	2,027	2,801	2,890	2,544	2,130	1,775	1,554	247	247
Margin for the rate of charge	873	1,007	1,030	974	811	644	552	200	200
Service charge	142	83	95	60	5	0	0	23	23
Commitment fees	70	282	196	0	0	0	0	24	24
Surcharges	942	1,429	1,569	1,510	1,314	1,131	1,002	0	0
Investment income	173	92	115	156	206	279	343	449	279
Fixed-income Subaccount 1/	113	32	53	94	142	214	277	348	209
Gold endowment pay-out 2/	60	60	62	62	64	65	66	101	70
Interest free resources 3/	7	8	15	23	29	43	57	137	68
SCA-1 and other	7	8	15	23	29	43	57	137	68
Reimbursements	66	67	68	69	70	72	73	76	76
SDR Department	3	3	3	3	3	3	3	3	3
PRG Trust 4/	63	64	65	66	67	69	70	73	73
<b>B. Expenses 5/</b>	<b>893</b>	<b>900</b>	<b>929</b>	<b>943</b>	<b>967</b>	<b>977</b>	<b>992</b>	<b>1,029</b>	<b>1,029</b>
Net administrative budget	835	837	859	867	893	903	919	960	960
Capital budget items expensed	9	9	9	10	10	10	9	11	11
Depreciation	49	54	61	66	64	64	64	58	58
<b>C. Net operational income (loss) (A-B)</b>	<b>1,380</b>	<b>2,068</b>	<b>2,159</b>	<b>1,849</b>	<b>1,468</b>	<b>1,192</b>	<b>1,035</b>	<b>(120)</b>	<b>(359)</b>
D. Pension and other benefits related (IAS 19) gain	1,336	0	0	0	0	0	0	0	0
<b>Net operational income (loss) after pension-related (IAS 19) adjustment (C-D)</b>	<b>2,716</b>	<b>2,068</b>	<b>2,159</b>	<b>1,849</b>	<b>1,468</b>	<b>1,192</b>	<b>1,035</b>	<b>(120)</b>	<b>(359)</b>
Endowment (Gold Profits) Subaccount - Retained Income	506	122	123	117	105	91	151	130	158
<b>Net income (loss)</b>	<b>3,222</b>	<b>2,190</b>	<b>2,282</b>	<b>1,966</b>	<b>1,573</b>	<b>1,283</b>	<b>1,187</b>	<b>10</b>	<b>(201)</b>
	(in US\$ millions)								
<b>E. Operational income</b>	<b>3,227</b>	<b>4,303</b>	<b>4,475</b>	<b>4,075</b>	<b>3,554</b>	<b>3,188</b>	<b>2,998</b>	<b>1,382</b>	<b>1,019</b>
Lending income (including Surcharges)	2,878	4,063	4,190	3,714	3,109	2,609	2,299	375	375
Investment income	245	133	165	228	300	410	507	683	425
Interest free resources	10	11	22	33	42	64	84	208	103
Reimbursements	94	96	98	100	103	105	108	116	116
<b>F. Expenses</b>	<b>1,269</b>	<b>1,305</b>	<b>1,346</b>	<b>1,377</b>	<b>1,410</b>	<b>1,436</b>	<b>1,469</b>	<b>1,564</b>	<b>1,564</b>
Net administrative budget	1,186	1,214	1,245	1,266	1,303	1,328	1,360	1,460	1,460
Capital budget items expensed	13	12	13	15	14	14	14	16	16
Depreciation	70	79	88	96	93	94	95	88	88
<b>G. Net operational income (loss) (E-F)</b>	<b>1,958</b>	<b>2,998</b>	<b>3,129</b>	<b>2,698</b>	<b>2,144</b>	<b>1,752</b>	<b>1,529</b>	<b>(182)</b>	<b>(545)</b>
<b>Memorandum Items:</b>									
Fund credit (average stock, SDR billions)	87.3	100.7	103.0	97.4	81.1	64.4	55.2	20.0	20.0
SDR interest rate (in percent)	0.1	0.1	0.2	0.3	0.4	0.6	0.8	2.0	1.0
US\$/SDR exchange rate	1.42	1.45	1.45	1.46	1.46	1.47	1.48	1.52	1.52
Precautionary balances (end of period, SDR billions) 6/	18.7	20.8	22.9	24.8	26.2	27.4	28.5	15.0	15.0

<sup>1</sup> The current medium-term projections are conservative and assume that a premium of 50 basis points over the SDR rate is attained in the longer run.

<sup>2</sup> The baseline projections assume a 1 percent payout from the gold endowment commencing in FY 2021. The illustrative scenarios for FY 2031 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).

<sup>3</sup> 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 the SCA-1, 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.

<sup>4</sup> These projections could be revised in light of on-going discussions on the review of concessional financing.

<sup>5</sup> The FY 22–24 budget will propose a structural augmentation as part of a two-pronged strategy as outlined in *Preliminary Proposals for the FY 2022–FY 2024 Medium-Term Budget* (FO/Dis/21/24, 2/11/21). Projections for the net administrative budget from FY 2022 onwards here show GED and a flat budget envelope, but do not yet reflect the proposed structural augmentation.

<sup>6</sup> Does not reflect the impact on income and an adjustment of precautionary balances of any distribution of the SCA-1 in the context of the ongoing discussions on Sudan's debt relief.

**9. The preliminary capital budget request for next year will be marginally less than the FY 2021 budget.** This reflects the continued uncertainties and disruption associated with the pandemic, which has led to delays and some deferral of activities, particularly on the facilities side. Lifecycle replacements, including standard audio-visual equipment replacements, the first phase of the HQ1 elevator refurbishment, and remediation of HQ1 air/humidity issues, make up the majority of facilities projects in FY 2022. Large modernization programs and pre-requisite projects are expected to continue to drive IT capital spending in FY 2022. The portfolio also comprises other critical systems development and upgrades, information security, and lifecycle replacements for IT infrastructure.

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

**10. The illustrative future low-lending environment is assumed to be reached in FY 2031 when drawings under current and potential arrangements have been largely repurchased (Annex I and Table 1).** The assumptions underlying the low-lending environment are very conservative especially in light of the current high lending environment and 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. As in April 2020, a conservative credit level assumption of SDR 20 billion is maintained in the illustrative low-lending environment (Text Table).

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.<sup>15</sup> Investment

income would be in the form of payouts from the Endowment Subaccount and returns earned on the Fixed-Income Subaccount.<sup>16</sup> Both scenarios assume a 50 basis point return over the SDR interest rate on the Fund's Fixed-Income

	Scenarios	
	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)	2.0	1.0
US\$/SDR	1.52	1.52
Endowment payout assumptions	Start in FY 21 at 1.5 % of US\$ NAV, increasing by GED annually	Start in FY 21 at 1% of US\$ NAV, increasing by GED annually

Subaccount in the long run and no increase in the current real expenditure envelope. The scenarios are purely illustrative and will be revisited in the upcoming review of the Fund's income in April.

**11. Scenario B illustrates a broad continuation of the baseline scenario in Table 1.** In particular, the payout from the endowment continues at 1 percent of the U.S. dollar NAV and the SDR interest rate rises to 1 percent. This conservative payout and interest rate assumption is more

<sup>15</sup> As part of the recent review by the Executive Board of the precautionary balances on October 30, 2020 the floor was left unchanged at SDR 15 billion (see *Review of the Adequacy of the Fund's Precautionary Balances* (SM/20/159, 10/8/20)).

<sup>16</sup> At the April 2018 review of the Fund's income position, the Board endorsed staff's proposal to delay initiating the payout for 3 years until FY 2021 (then increasing by the GED each year thereafter) to build a cushion in the EA.

closely aligned with the prevailing return outlook reflecting the continued low interest rate environment, particularly in the United States. These assumptions yield a negative income-expenditure position of about SDR 359 million (US\$545 million). Scenario A illustrates the potential impact of a higher investment return environment, with an SDR rate of 2 percent, and a higher payout from the endowment of 1.5 percent, which is within the range of prior expectations of prospective returns from the proposed investment strategy.<sup>17</sup> Under these assumptions, the longer-term income-expenditure position would be moderately negative. Operational income in the low lending environment is constrained by lower-than-expected non-lending income and reflects mainly the low interest rates expected to prevail in the long term. Non-lending income, which comprises mainly investment income is limited, both by the very low returns generated by the fixed-income securities in the FI as well as lower payouts from the EA reflecting a more modest outlook for investment returns from the portfolio (which comprises both equity and fixed-income securities).<sup>18</sup>

**12. 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 further. For example, if the U.S. dollar/SDR exchange rate remained broadly unchanged at current levels, under Scenario A a net operational loss of SDR 185 million (US\$263 million) would be recognized in FY 2031, and a loss of SDR 418 million (US\$592 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 of 100 basis points, lending income would, depending on the buoyancy of investment income, contribute about 27–37 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 2031 by SDR 40 million (US\$60 million). The scenarios also assume continued reimbursement of the GRA for the expenses of operating the PRG Trust and the SDR department (estimated at SDR 76 million in FY 2031).

**13. The illustrative low lending environment also makes very conservative assumptions for precautionary balances and credit outstanding.** In contrast, precautionary balances are expected to reach SDR 30 billion by FY 2030, double the ‘floor’ assumed in the illustrative low lending environment.<sup>19</sup> Credit outstanding under the desk survey scenario is also projected to be higher over the medium term than under past baseline scenarios. 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

<sup>17</sup> See the *Review of the Investment Account* (SM/18/24, 02/02/18).

<sup>18</sup> The forthcoming IA Review, advanced to March 2022, will consider possible modifications to the IA investment strategy and provide an opportunity to revisit the return outlook.

<sup>19</sup> The low lending environment assumes that a portion of reserves are distributed to the membership and that only the floor level (SDR 15 billion) of precautionary balances is retained.

the illustrative low lending environment, the net loss in the more conservative Scenario B is almost halved to about SDR 185 million; under Scenario A these assumptions yield a modest net gain of SDR 106 million in the low lending environment compared with the loss currently projected.

## PRECAUTIONARY BALANCES OUTLOOK

**14. Updated projections of the pace of reserve accumulation are significantly higher than those anticipated in April.**<sup>20</sup> This reflects mainly a higher path for credit outstanding, under the desk survey of potential demand for Fund lending, which reflects desk assessments of the likelihood of a program request based on knowledge of member countries' economic outlook, financing needs, and the political landscape.<sup>21</sup> Overall, income from the margin, surcharges, and service charges and the estimated pension-related (IAS 19) gain for FY 2021 are expected to increase the Fund's precautionary balances significantly compared to the previous projections, accelerating the pace of projected reserve accumulation over the medium term; offset partly by expectations of a more gradual rise in investment income fueled mainly by the downward shift in the SDR interest rate path weighing negatively on investment income return projections over the medium term.

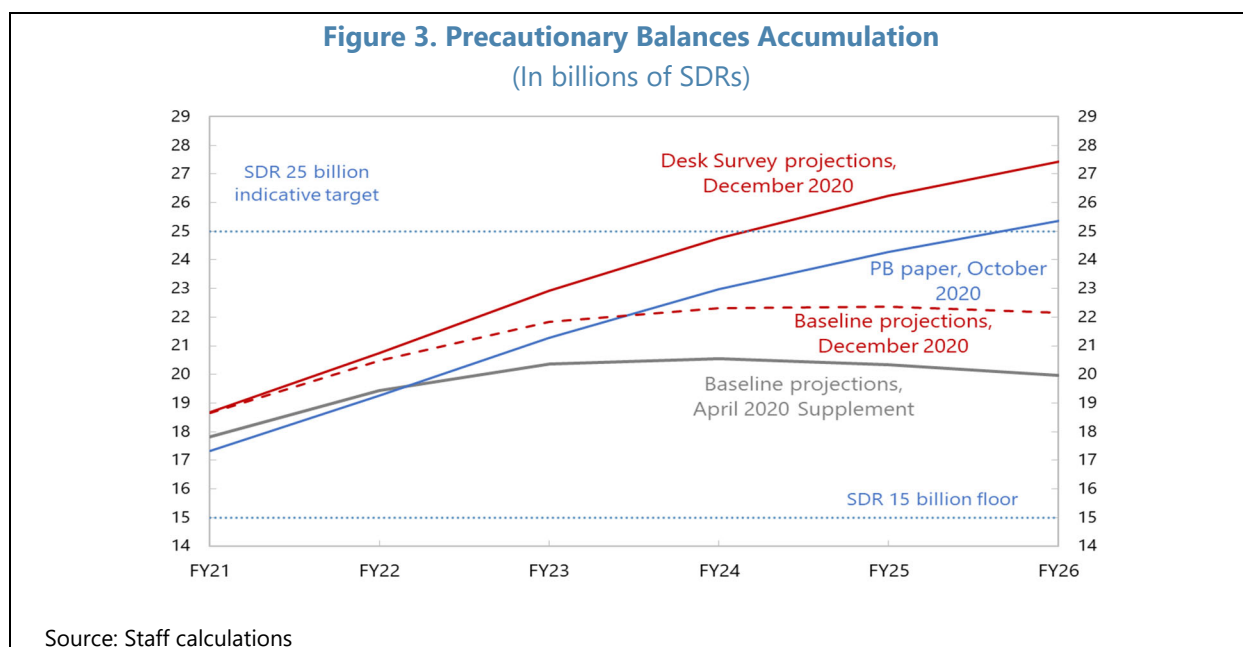
**15. Against this backdrop, precautionary balances over the medium term are now expected to reach SDR 27.4 billion by FY 2026 under the desk survey, about SDR 7.4 billion higher than under the April projection.**<sup>22</sup> The indicative medium-term target, which was raised from SDR 20 billion to SDR 25 billion during the review of the adequacy of precautionary balances in October, is expected to be reached in FY 2025, about one year earlier than was projected in October (Figure 3).

**16. The pace of accumulation of precautionary balances would be lower under a baseline scenario for income projections that only include scheduled disbursements for arrangements approved through end-December 2020 (Figure 3).** As a result, precautionary balances would peak at SDR 22.4 billion over the medium term, remaining below the recently revised indicative target of SDR 25 billion but higher than the previous target of SDR 20 billion. Conversely, approval of new financing beyond the desk survey would result in higher lending income and a faster accumulation of precautionary balances as described in *The Review of the Adequacy of the Fund's Precautionary Balances*.

<sup>20</sup> For a more detailed review of the outlook for precautionary balances, see *Review of the Adequacy of the Fund's Precautionary Balances* (SM/20/159, 10/8/20).

<sup>21</sup> By contrast, the baseline projections in the April paper took account of arrangements approved through end-March 2020 and estimates of potential emergency loan demand (mainly in the form of Rapid Financing Instruments) associated with the COVID-19 pandemic.

<sup>22</sup> Does not reflect the impact on income and an adjustment of precautionary balances of any distribution of the SCA-1 in the context of the ongoing discussions on Sudan's debt relief.



**17. Advance repurchases could lower the pace of accumulation of precautionary balances.**

Recently Bolivia and Morocco repurchased all or part of their outstanding credit earlier than scheduled and Greece has also indicated its intention to make repurchases ahead of schedule. The decision to make advance repurchases and their timing and magnitude depends on individual borrowing countries' circumstances, however, and no projections of further advance repurchases are included in the current medium-term outlook.

**18. As noted in Box 1, the projected pace of reserve accumulation is sensitive to the underlying assumptions.** The income projections for the desk survey scenario incorporate potential demand for Fund lending beyond the current arrangements; and exclude any annual projections for pension related (i.e., IAS 19) 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 some key drivers of income.

**Table 2. Income Projections**

Key Parameters	Baseline Assumptions	Sensitivity Analysis (Scenario B)
Average US\$/SDR exchange rate	Rising to 1.52 by FY 2031 from 1.42 in FY 2021	<p style="text-align: center;">Cumulative Impact on Precautionary Balances in FY27 - Changes in Key Assumptions for the Period FY22-27 (in millions of SDRs)</p>
SDR interest rate	Rising to 1.0 percent by FY 2031 from 0.1 percent in FY 2021	<p style="text-align: center;">Sensitivity to Changes in the Discount Rate on Net Income<sup>1</sup> (in millions of SDRs)</p>
Margin for rate of charge (basis points)	100	<p>1/ Sensitivity of Plans's Defined Benefit Obligation to the discount rate as of April 30, 2020.</p>
Discount rate	n/a	<p style="text-align: center;">Low-Lending Environment (FY2031) Net Operational Income after Changes in Key Assumptions (in millions of SDRs)</p>

**Table 3. Consolidated Income and Expenses, FY 2020–30**  
**April 2020 Baseline Scenario**

	FY20	FY21	FY22	FY23	FY24	FY25	FY26	Low-lending environment	
								Scenario A	Scenario B
								SDRi 2% P/out=1.5%	SDRi 1% P/out=1%
	FY30	FY30	FY30						
	(in SDR millions)								
<b>A. Operational income</b>	<b>2,251</b>	<b>2,220</b>	<b>2,571</b>	<b>1,907</b>	<b>1,182</b>	<b>796</b>	<b>638</b>	<b>883</b>	<b>648</b>
Lending income	1,889	2,039	2,369	1,643	890	453	225	247	247
Margin for the rate of charge	667	961	951	809	566	314	164	200	200
Service charge	97	125	13	5	1	0	0	23	23
Commitment fees	373	40	285	0	0	0	0	24	24
Surcharges	752	913	1,120	829	323	139	61	0	0
Investment income	253	105	124	170	190	226	289	449	269
Fixed-Income Subaccount 1/	253	51	69	114	133	168	230	348	209
Gold endowment pay-out 2/	0	54	55	56	57	58	59	101	60
Interest free resources 3/	44	7	8	23	30	43	49	110	55
SCA-1 and other	44	7	8	23	30	43	49	110	55
Reimbursements	65	69	70	71	72	74	75	77	77
SDR Department	3	3	3	3	3	3	3	3	3
PRG Trust	62	66	67	68	69	71	72	74	74
<b>B. Expenses</b>	<b>895</b>	<b>924</b>	<b>948</b>	<b>970</b>	<b>990</b>	<b>1,014</b>	<b>1,024</b>	<b>1,040</b>	<b>1,040</b>
Net administrative budget	832	866	885	900	914	940	950	971	971
Capital budget items expensed	18	9	9	9	10	10	10	11	11
Depreciation	45	49	54	61	66	64	64	58	58
<b>C. Net operational income (loss) (A-B)</b>	<b>1,356</b>	<b>1,296</b>	<b>1,623</b>	<b>937</b>	<b>192</b>	<b>-218</b>	<b>-386</b>	<b>-157</b>	<b>-392</b>
<b>D. Pension and other benefits related (IAS 19) loss</b>	<b>-2,375</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Net operational income (loss) after pension-related (IAS 19) adjustment (C-D)</b>	<b>-1,019</b>	<b>1,296</b>	<b>1,623</b>	<b>937</b>	<b>192</b>	<b>-218</b>	<b>-386</b>	<b>-157</b>	<b>-392</b>
Endowment (Gold Profits) Subaccount	-126	116	122	123	121	177	175	-155	-115
<b>Net income (loss)</b>	<b>-1,145</b>	<b>1,412</b>	<b>1,745</b>	<b>1,060</b>	<b>313</b>	<b>-41</b>	<b>-211</b>	<b>-312</b>	<b>-507</b>
	(in US\$ millions)								
<b>E. Operational income</b>	<b>3,106</b>	<b>3,040</b>	<b>3,546</b>	<b>2,630</b>	<b>1,644</b>	<b>1,107</b>	<b>892</b>	<b>1,324</b>	<b>971</b>
Lending income (including Surcharges)	2,607	2,793	3,269	2,267	1,238	630	314	370	370
Investment income	349	143	170	233	264	314	405	673	403
Interest free resources	61	10	11	32	41	60	68	166	83
Reimbursements	89	94	96	98	101	103	105	115	115
<b>F. Expenses</b>	<b>1,234</b>	<b>1,266</b>	<b>1,308</b>	<b>1,340</b>	<b>1,376</b>	<b>1,410</b>	<b>1,434</b>	<b>1,559</b>	<b>1,559</b>
Net administrative budget	1,148	1,186	1,221	1,243	1,271	1,307	1,330	1,457	1,457
Capital budget items expensed	24	13	12	13	14	14	14	16	16
Depreciation	62	67	75	84	91	89	90	86	86
<b>G. Net operational income (loss) (E-F)</b>	<b>1,872</b>	<b>1,774</b>	<b>2,238</b>	<b>1,290</b>	<b>268</b>	<b>-303</b>	<b>-542</b>	<b>-235</b>	<b>-588</b>
<b>Memorandum Items:</b>									
Fund credit (average stock, SDR billions)	66.7	96.1	95.1	80.9	56.6	31.4	16.4	20.0	20.0
SDR interest rate (in percent)	0.8	0.1	0.1	0.3	0.4	0.6	0.7	2.0	1.0
US\$/SDR exchange rate	1.38	1.37	1.38	1.38	1.39	1.39	1.40	1.50	1.50
Precautionary balances (end of period, SDR billions)	16.5	17.8	19.4	20.4	20.6	20.3	20.0	15.0	15.0

<sup>1</sup> The current medium-term projections are conservative and assume that a premium of 50 basis points over the SDR rate is attained in the longer run.

<sup>2</sup> The baseline projections assume a 1 percent payout from the Endowment Subaccount commencing in FY 2021. The illustrative scenarios for FY 2030 show a continued payout of 1 percent (Scenario B); and a higher payout of 1.5 percent in a higher investment return environment (Scenario A).

<sup>3</sup> 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 the SCA-1, 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.

## Annex I. Illustrative Low Lending Environment

**1. Staff has also updated its analysis of the Fund’s income position in an illustrative future low lending environment.** 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.<sup>1</sup> In the current environment of low interest rates, the Fund remains reliant on income from lending to cover 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 low levels.

### Box A1.1. Key Assumptions for FY 2031—Illustrative Low-Lending Environment

Summary of income under the illustrative low-lending environment (Table 1—Scenario B and Figure 2)

- **Operational lending income** (US\$375 million or SDR 247 million by FY 2031)

Outstanding Fund credit is assumed to decline to an average level of about SDR 20 billion by FY 2031 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 2031 generate about SDR 23 million in annual service charges (at 50 basis points).

- **Investment income** (US\$425 million or SDR 279 million by FY 2031)

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 in the longer run. This would yield annual income of about SDR 209 million in the low-lending environment (FY 2031) assuming an SDR interest rate of 1 percent and a precautionary balances floor of SDR 15 billion.

The implementation of the proposed investment strategy for the passively and actively managed portions of the endowment (initially SDR 4.4 billion, plus earnings during the interim period) was completed during FY 2017 and FY 2019, respectively. At the April 2018 review of the fund’s income position, the Board endorsed staff’s proposal to delay initiating the payout for 3 years until FY 2021 to build a cushion in the EA (then increasing by the GED each year).

- **Implicit income on interest free resources** (US\$103 million or SDR 68 million by FY 2031)

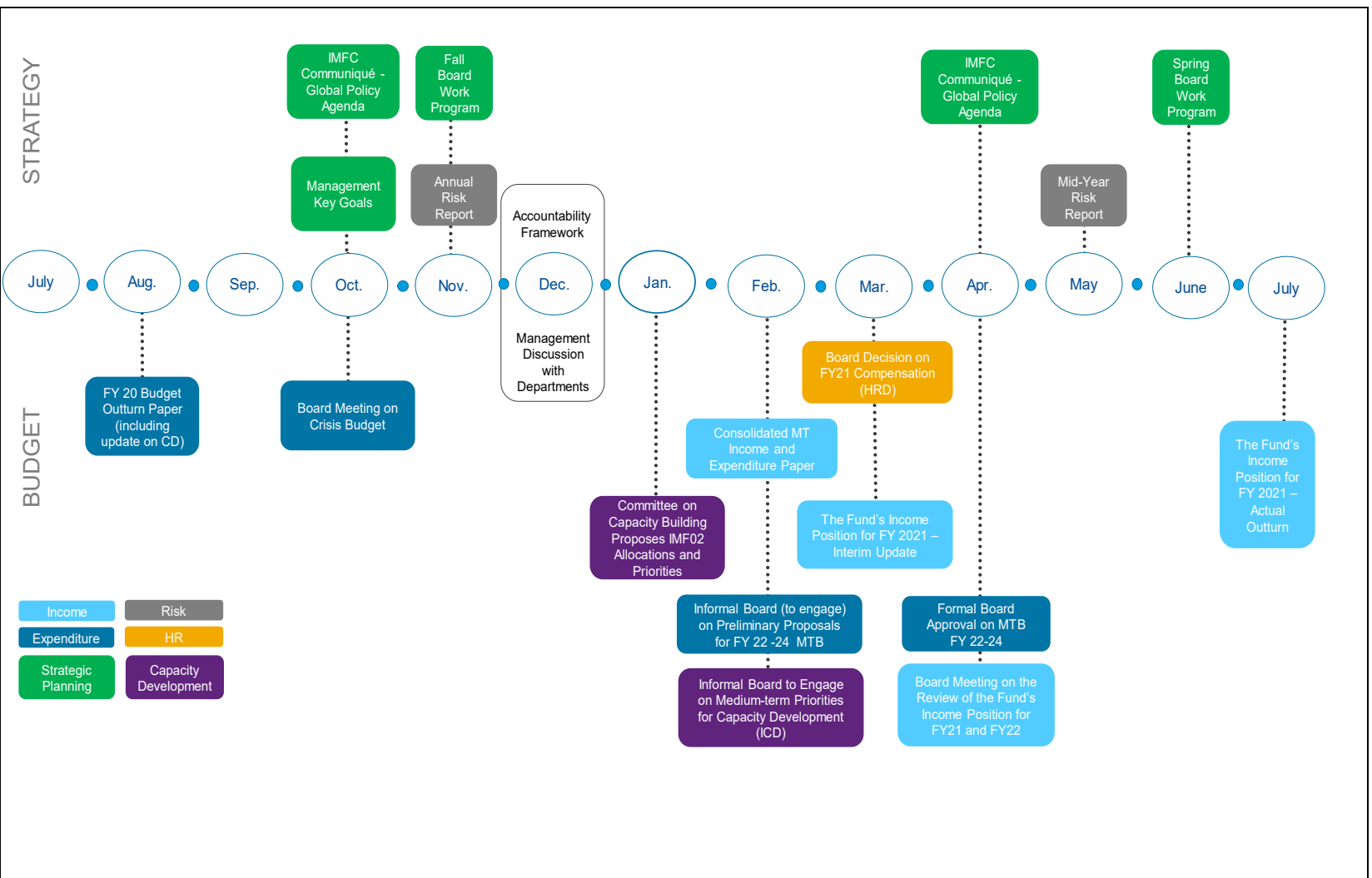
The interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA net income not transferred to the Investment Account. These resources reduce members’ reserve tranche positions and the Fund’s remuneration expense or increase interest income if they are reflected in SDR holdings of the GRA, resulting in implicit income for the Fund.

- **Reimbursements** (US\$116 million or SDR 76 million in FY 2031)

Reimbursements from the SDR Department are based on April 2020 projections, and are estimated at about SDR 3 million in FY 2021. Reimbursement of the GRA for the expenses of administering the PRGT is assumed to be SDR 63 million in FY 2021. Administrative costs and the associated reimbursements are assumed to be stable in real terms in the medium term.

<sup>1</sup> 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).

## Annex II. Strategic Planning Process Timeline, FY 2020-21<sup>1</sup>



<sup>1</sup> As of end-January 2021.