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CONFIDENTIAL

August 8, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Access Limits in 1985 - Preliminary Considerations - Financial Aspects

Attached for consideration by the Executive Directors is a paper on preliminary financial considerations on access to the Fund's resources in 1985. This paper, together with the papers on preliminary policy considerations (EBS/84/168, 8/8/84) and access limits for special facilities (EBS/84/169, 8/8/84), has been scheduled for discussion on Wednesday, September 5, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. T. Leddy, ext (5)8332.

Att: (1)

INTERNATIONAL MONETARY FUND

Access Limits in 1985--Preliminary Considerations--Financial Aspects

Prepared by the Treasurer's Department

(In consultation with other Departments)

Approved by W. O. Habermeier

August 8, 1984

I. Introduction

The decisions adopted by the Executive Board in January 1984 on the policy on enlarged access and access limits under the special facilities provide for review by the Board not later than December 31, 1984, in light of all relevant factors, including the magnitude of members' payments problems and developments in the Fund's liquidity. 1/ Companion papers on enlarged access and access under the special facilities discuss a number of considerations bearing on members' likely needs for credit from the Fund in 1985 and suggest that there are important reasons to maintain unchanged in 1985 the current limits on access to the Fund's resources. 2/ The current review of the Fund's liquidity and financing needs being circulated concurrently provides updated estimates of the Fund's liquidity through 1985, and, more tentatively, for 1986, on the assumption of unchanged policies on access to the Fund's resources. 3/ The present paper summarizes key aspects of the Fund's liquidity and financing needs as presented in the liquidity review; discusses in a preliminary way the financing of the enlarged access policy in 1985 under the provisions of Decision No. 7601-(84/3) relating to the use of ordinary and borrowed resources; reviews some factors relevant to medium-term assessment of the Fund's liquidity; and provides a summary and some preliminary conclusions.

II. Implications of Unchanged Access Limits for the Fund's Liquidity and Financing Needs

Since the time of the Interim Committee's discussion of access to the Fund's resources in September 1983, the Fund's liquidity has strengthened very substantially with implementation of the Eighth General Review of Quotas, implementation of the enlargement of the General Arrangements to Borrow, and conclusion of short-term borrowing

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1/ Decision Nos. 7599-(84/3), 7600-(84/3), 7601-(84/3) and 7602-(84/3).
2/ See "Access Limits for 1985--Preliminary Policy Considerations" (EBS/84/168, 8/8/84) and "Review of Access Limits for Special Facilities" (EBS/84/169, 8/8/84).
3/ EBS/84/171, 8/8/84.

arrangements totaling SDR 6 billion. More recently, the Fund's current liquidity has improved somewhat further, as a result of additions to the Fund's holdings of currencies included for transfers in the operational budget and as a result of some reduction in demands for use of the Fund's resources as compared with the experience of recent years and with earlier projections.

Table 1 below summarizes estimated commitments under arrangements, purchases under the special facilities and other factors affecting the Fund's liquidity (including modest provision for use of reserve tranche positions), to project developments in the Fund's liquidity over the period August 1984 to end-1986. In brief, it now appears likely that the Fund will have available uncommitted borrowed resources on the order of SDR 2 billion at the end of 1984, and that uncommitted ordinary resources (adjusted) will total about SDR 29 billion at that time. 1/ For 1985, a commitment gap is expected to emerge in the latter part of 1985 and to rise to around SDR 1.0 billion by the end of the year; preliminary indications are that further borrowing of up to SDR 1.7 billion could be required for 1986. It should be noted that the projections for commitments under arrangements in the remainder of 1984 and 1985 reflect some reductions from recent estimates due in part to the assignment of lower probabilities to some programs. If a few relatively large programs were actually concluded for the full amounts under consideration, commitments of borrowed resources could be in the ranges of SDR 1.6-2.5 billion in the latter part of 1984 and SDR 3-4 billion in 1985, with the lower ends of the ranges representing the more likely outcome on the basis of the probability factors provided by area departments.

The current projections for commitments under arrangements and purchases under the special facilities imply a net expansion of Fund credit outstanding of SDR 6.5 billion in 1984 and SDR 5.6 billion in 1985, in contrast to an average annual expansion of SDR 8.2 billion in 1982-83 and a high of SDR 10.6 billion in 1983. If the very preliminary projections for 1986 were to materialize, Fund credit outstanding would actually decline slightly in that year. While a decline in the rate of expansion of Fund credit might appear to be consistent with an improving trend in world economic conditions, any assumptions regarding the future world economic environment are subject to a high degree of uncertainty. The estimates for commitments for individual countries are also subject to greater uncertainty, and are therefore based on generally lower probability factors, the farther the estimates are extended into the future. Therefore, while it may be helpful to have some tentative view of prospective developments in 1986 in considering the access limits for 1985, it also may be questioned whether the reduction in the expansion of Fund credit implicit in the present estimates would be a realistic expectation, particularly if the recovery in the world economy were to falter or there were adverse developments in international capital markets.

1/ All references to uncommitted ordinary resources in this paper are on an adjusted basis.

Table 1. Estimates of the Fund's Liquidity, August 1984-1986 1/

(In billions of SDRs or percent)

	Aug.-Dec. 1984	1985	1986
1. Supply of uncommitted ordinary resources			
a. Available at beginning of period	32.1	29.0	27.0
b. Repurchases, net of repayments to lenders	-0.1	2.1	4.3
c. Total	32.0	31.1	31.3
2. Commitments under arrangements	3.5	5.1	3.2
a. Ordinary resources	1.9	2.1	1.5
b. Borrowed resources	1.6	3.0	1.7
3. Financing from ordinary resources			
a. Available uncommitted ordinary resources (line 1c)	32.0	31.1	31.3
b. Less: Commitments under arrangements (line 2a)	-1.9	-2.1	-1.5
c. Less: Purchases under special facilities	-0.6	-1.2	-1.2
d. Less: Reserve tranche purchases	-0.5	-0.8	-0.8
4. Balance of uncommitted ordinary resources at end-year	29.0	27.0	27.8

	End of period			
6. Memorandum items	July 1984	1984	1985	1986
a. Need for new borrowed resources to cover commitments (cumulative)	-3.6	-2.0	1.0	2.7
b. Liquid claims on the Fund	42.0	43.4	47.4	45.1
Reserve tranche positions	27.9	29.0	29.5	26.5
Loan claims	14.1	14.4	17.9	18.6
c. Liquidity ratio (percent)	77.1	66.8	57.0	61.6
d. Quota ratio (percent) 2/	38.5	37.0	36.5	36.3
e. Asset ratio (percent)				
(1) Excluding gold	103.6	91.0	76.4	82.7
(2) Including gold	112.1	99.3	84.0	90.7

1/ For definitions and detailed explanations, see EBS/84/171, 8/8/84.

2/ Calculations assume new borrowing is arranged as indicated in line 6a, i.e., in the amounts of SDR 1 billion in 1985 and SDR 1.7 billion in 1986.

Two further qualifications about the current projections should be noted. First, the projections include no arrangements with industrial countries and make only modest allowance for use of reserve tranche positions. Second, recent additions to the list of usable currencies have brought the number of currencies and the amounts available to very high levels. The currencies of nearly all industrial countries are included in the current totals of usable resources, and it is not envisaged that there will be substantial further additions in the foreseeable future. It would appear more likely that any substantial adjustments in the amount of the Fund's usable currency holdings would be in a downward direction.

Although these considerations suggest the possibility that the Fund's liquidity may not remain as strong as implied by the projections, and a need for additional borrowed resources is expected to arise during 1985 on the basis of present policy regarding the use of ordinary and borrowed resources, it would not appear that liquidity considerations would provide a compelling basis for reductions of the access limits in 1985.

III. Financing Enlarged Access in 1985

As noted, a commitment gap for borrowed resources is, in the absence of new borrowing arrangements, expected to arise in the latter part of 1985 and to increase to about SDR 1.0 billion by the end of the year, on the assumption that the policy on access and its financing would remain unchanged. On the basis of the same assumption about access policy and very tentative indications of demand for Fund credit, the borrowing requirement in 1986 could be on the order of a further SDR 1.7 billion.

The prospect of a commitment gap raises the following considerations.

1. The existence of a commitment gap represents a potential call on the Fund's ordinary resources in the event borrowing is not arranged, and the Fund should take decisions at an appropriate point on the financing of enlarged access--i.e., to arrange borrowings to avoid the emergence of a sizable commitment gap in accordance with the provisions of the existing policy, or to modify the policy regarding the use of ordinary and borrowed resources if that would appear to be a prudent course in the light of medium-run considerations. However, given the fact that a commitment gap is not expected to emerge until the latter part of 1985 and in light of the present liquidity situation, a decision on financing does not appear to be of great urgency at this time. It may be preferable to consider the question on the occasion of the next review of the Fund's liquidity in early 1985, which would permit the opportunity to take updated estimates of the Fund's liquidity and prospective demands for Fund resources into account.

2. New borrowing on the order of magnitude that now appears to be called for in 1985 and 1986 would be exceeded by repayments of earlier borrowings which will total SDR 3.3 billion in those two years, as may be seen from the schedule of repayments to lenders in Table 2. The quota ratio under the guidelines for borrowing that have been adopted by the Executive Board would decline slightly in each year after taking account of new borrowing of the order indicated above, and even somewhat greater borrowing requirements would not materially change the result.

3. The main possibilities for borrowing that could be considered in order to meet the prospective needs would include activation of the General Arrangements to Borrow (GAB) and the associated arrangement with Saudi Arabia; the establishment of new or expanded borrowing arrangements with selected members; the establishment of a broader central bank investment facility; and borrowing by the Fund from private markets.

The following points may be noted briefly about these possibilities. (i) The GAB and the associated arrangement with Saudi Arabia are already in existence and well defined as to terms and amounts of credit lines. Judgments would, however, be required about whether the conditions for activation of the GAB were present, and due regard would need to be given to potential calls on the GAB in connection with Fund transactions with GAB participants. (ii) Consultations would be required to determine the scope for further Fund borrowing from selected members in a relatively strong reserve position, possibly including some participants in current lending arrangements. As noted, the new borrowing requirements that now appear to be in prospect would be exceeded by repayment of the loan claims of present lenders as a group. (iii) Establishment of a broader central bank investment facility could offer the possibility of involving a wider range of countries that might be in a position to invest a portion of their reserves with the Fund. The possible outlines of such a facility, which could in some respects be similar to that recently offered by the IBRD, were described in a staff paper and discussed by the Executive Board in 1981, 1/ and the earlier soundings of potential interest in such a facility could be brought up to date. (iv) Questions relating to Fund borrowing in the private markets have been discussed in staff papers and by the Executive Board on a number of occasions, and these could also be brought up to date.

4. The question may also be raised whether the Fund could prudently use ordinary resources to cover the prospective commitment of borrowed resources in 1985. It would then also be necessary to consider whether such use should be regarded as temporary, pending subsequent borrowing, or as a permanent substitution of ordinary for borrowed resources in

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1/ See SM/81/109, Sup. 4 (11/9/81) and EBM/81/151 (12/7/81).

relation to commitments in 1985. 1/ The question of use of ordinary in place of borrowed resources would need to be considered, inter alia, on the basis of the prospects for the Fund's liquidity in the medium term. Several important elements of such an assessment are discussed in the following section.

IV. Medium-Term Prospects for the Fund's Liquidity

The Fund's liquidity would be expected to decline in 1985 whether projected commitments of borrowed resources were financed by new borrowing or not, by comparison with the position estimated for the end of 1984. However, the projected position at the end of 1985 would not be substantially different, whether borrowed or ordinary resources were used, and would be expected to be still reasonably comfortable in either case. At the same time, the uncertain nature of the projected commitments and the potential vulnerability of the Fund's holdings of usable resources to shifts in members' balance of payments and reserve positions have been mentioned and need to be borne in mind. In addition, a number of more general and longer-term considerations would suggest a very cautious approach to the question of possibly involving the use of ordinary in place of borrowed resources to cover commitments of borrowed resources. The following would appear to be the more important.

1. The scheduled flow of repurchases to the Fund begins to rise substantially in the near future, and this should be expected to be a source of strength for the Fund's liquidity over the next few years. At the same time, however, funds equivalent to a significant part of the inflow from these repurchases will be needed to repay the Fund's borrowings, including, in 1984 and again beginning toward the end of 1986, repayment of short-term borrowings. Table 2 provides data on projected repurchases and repayments and on the net impact of these flows on the Fund's ordinary resources.

While it may be reasonable to assume that the need for Fund credit by the non-oil developing countries might be expected to decline over the medium term, it may be questioned whether it could reasonably be anticipated that world economic and financial conditions would permit an orderly contraction of Fund credit outstanding near the magnitudes implicit in Column 3 of Table 2, which shows gross repurchases totaling nearly SDR 23 billion during the period 1986-88. The prospects for a

1/ It will be recalled that ordinary resources are being used to repay short-term borrowings totaling SDR 1.3 billion arranged in 1981 to finance the enlarged access policy, and this results, in effect, in a temporary substitution of ordinary for borrowed resources until the relevant repurchases are made. Further use of ordinary resources will be required to repay the recently concluded borrowings totaling SDR 6 billion, beginning toward the end of 1986, unless additional borrowing is arranged for this purpose.

reduction in Fund credit outstanding would depend crucially on developments in world trade and economic growth, continued progress on the part of debtor countries in achieving external adjustment, the management of the bulge in other debt service payments facing many countries in the middle 1980's and the willingness and ability of other sources of financing to compensate, if necessary, for a contraction of Fund credit.

Table 2. Projected Repurchases, Repayments to Lenders and Consequent Additions to Ordinary Resources

(In billions of SDRs)

Calendar year	Repurchases: Of purchases through 7/31/84 (1)	Repurchases: Of subsequent purchases through 12/31/85 (2)	Total (3)	Repayments to lenders (4)	Net impact on ordinary resources (5)
Aug.-Dec. 1984	1.2	--	1.2	-1.3	-0.1
1985	3.5	--	3.5	-1.4	2.1
1986	6.2	--	6.2	-1.9	4.3
1987	8.1	0.1	8.2	-5.9	2.3
1988	5.8	2.5	8.3	-4.6	3.7
1989	3.6	4.8	8.4	-2.6	5.8
1990	2.4	3.2	5.6	-1.9	3.7
1991	1.1	1.9	3.0	-0.8	2.2
Total	31.9	12.5	44.4	-20.4	24.0

Table 3 illustrates the sensitivity of the Fund's liquidity to alternative assumptions about the level of purchases during the period 1986-88, in the absence of further borrowing by the Fund. If, for example, it were assumed that purchases would be approximately equal, on average, to the net flow of ordinary resources shown in the last column of Table 2 (i.e., equivalent to about 45 percent of the gross flow of repurchases in 1986-88, or an annual average of SDR 3.4 billion), the Fund's holdings of uncommitted ordinary resources would remain stable at about SDR 27 billion, and the liquidity ratio would rise from about 57 percent at the end of 1985 to about 77 percent at the end of 1988 as a result of the repayment of borrowing by the Fund. If it were assumed, alternatively, that new purchases would amount to 80 percent of the gross flow of repurchases, implying a gradual reduction in Fund credit outstanding, the Fund's holdings of uncommitted ordinary resources would fall to about SDR 19 billion and the liquidity ratio would decline to around 45 percent at the end of the period. The Fund will need to repay some SDR 12.4 billion of existing borrowings during 1986-88, which represents about 55 percent of the gross reflow of funds from repurchases during these three years. Depending on circumstances in this period, including the possibility that there would be a need for further expansion of Fund credit outstanding, the Fund could face the need to arrange substantial new borrowing. It would be preferable to arrange such borrowing in advance so as to avoid any substantial deterioration of the Fund's holdings of ordinary resources.

Table 3. Development of the Fund's Liquidity on Alternative Assumptions About Purchases, 1986-88 1/

	Assumed average annual purchases, 1986-88		End of 1988	
	(SDR billions)	(Percent of gross repurchases in Table 3)	Holdings of uncommitted ordinary resources (SDR billions)	Liquidity ratio (Percent)
a.	3.4	45	27.0	77
b.	5.0	67	22.2	56
c.	6.0	80	19.2	45
d.	7.6	100	14.4	30
e.	9.1	120	9.9	19

1/ For the purposes of this illustration, the simplifying assumption is made that all commitments under arrangements would be matched by purchases under arrangements during the period, i.e., that there would be no change in the undrawn balance of commitments under arrangements over the period.

Of some help in mitigating the potential drain on the Fund's resources is the projected flow of repayments of Trust Fund loans, which will total SDR 1.9 billion (in excess of requirements for the SFF subsidy account) during the period 1985-88. Decisions have yet to be taken on the precise use that will be made of these resources. Nonetheless, they represent a Fund-related source of balance of payments financing for members and can in that sense be viewed as a supplement to the Fund's liquidity and ability to assist members in overcoming their balance of of payments difficulties.

2. Although considerable progress is being made in addressing the world debt situation and members' balance of payments problems, it is recognized that satisfactory resolution will require a medium-term effort. The Fund should continue to be in a position to play an active financial as well as catalytic role in dealing with the debt situation and other balance of payments problems over the next few years. While it may be hoped that with continued progress the need for Fund credit will decline, the Fund must nonetheless remain equipped to respond to the needs of a delicate and uncertain situation.

3. The Fund must also retain sufficient resources to give confidence to members not currently using Fund credit, including the larger industrial countries, that it would be in a position to respond to their requirements should the need arise. In particular, the Fund must assure at all times that it has the capacity to respond immediately to demands for encashment of reserve tranche positions and loan claims. These have tended to be rather firmly held in the aggregate. In part, this may be explained by the fact that over time only a relatively small proportion have generally been held by members in or facing balance of payments difficulties. In part, it may also be explained by other reasons, including the policies of some industrial members to keep net intervention in the exchange markets relatively low, resulting in less need to use reserves. However, shifts in the external positions and/or the exchange policies of a relatively few major creditors to the Fund could have a substantial impact on the Fund's liquidity, and this impact would be exacerbated to the extent such shifts were accompanied by encashment of reserve claims on the Fund. To illustrate, if currencies presently accounting for, say, 20 percent, of the Fund's usable currency holdings were now excluded from the operational budget and there were no offsetting increases, the Fund's liquidity ratio would decline from the present level of 77 percent to 67 percent. 1/ If this development were accompanied by use of, say, 20 percent of existing holdings of reserve tranche positions (by members whose currencies were not in the operational budget) and that use were financed from the Fund's ordinary resources, the liquidity ratio would fall to some 54 percent. While such shifts might reflect large-scale changes in members' external financial positions and are not regarded at present

1/ It is assumed for the purposes of this illustration that following such a change the adjustment factor for the Fund's holdings of currencies would be reduced from 0.25 to, say, 0.20.

as highly probable, they are not necessarily implausible and must enter as a possibility into assessments of the prospects for the Fund's liquidity. If such shifts were to occur, this would give rise to consideration of activating the GAB, as the GAB is an important backstop element to the Fund's liquidity in this respect.

4. The ninth review of quotas would not normally be expected to be completed until early 1988, and any increase in quotas that might be agreed in the course of that review could probably not be implemented until around the end of 1988, at best, or the first part of 1989; nor is it possible to predict the size of any quota increase that might be decided during the next review. It is prudent, therefore, to plan on the basis that present quotas will be in effect for at least three full years beyond 1985.

These factors suggest strongly that the Fund should regard very cautiously the emergence of any commitment gap and potential for use of ordinary resources in lieu of borrowed resources under the enlarged access policy, despite the apparent strength of the Fund's liquidity at present and in immediate prospect. Since a modest commitment gap is not now expected to begin to emerge until the latter part of next year, the question of financing the Fund's commitments of borrowed resources for 1985 could appropriately be addressed at the time of the next liquidity review in early 1985. If the current prospects for the Fund's liquidity and use of the Fund's resources were broadly confirmed in the review, a decision to substitute, temporarily or permanently, ordinary for borrowed resources in covering commitments of borrowed resources in 1985 might be considered. If, however, there were a significant deterioration in the position or prospects, the need for review could be accelerated, and the staff would expect that borrowing would need to be considered, including possibly through the GAB.

V. Summary and Conclusions

1. The Fund's liquidity and prospects have improved substantially since the issue of access in 1984 was considered by the Interim Committee, as a result of agreed increases in the Fund's resources and more recently reflecting additions to the Fund's stock of usable currencies and some slowdown in demands for the Fund's resources. Although the outlook is subject to some qualifications and risks, liquidity considerations would not appear to provide a compelling basis for a reduction of the access limits in 1985.

2. Under present policies on financing enlarged access, a commitment gap for borrowed resources is now expected to emerge in the latter part of 1985 and to reach about SDR 1 billion by the end of the year.

3. The emergence of a commitment gap will require decisions on its financing. Since a gap is not expected to emerge until the latter part of 1985, however, it may be preferable to consider this question on the

basis of updated estimates in the context of the review of the Fund's liquidity and financing needs in early 1985.

4. This question would need to be assessed in light not only of the current position but also the medium-term prospects for the Fund's liquidity, the main elements of which strongly suggest the need for great caution in considering the possibility of using ordinary in place of borrowed resources under the enlarged access policy.

5. If the current prospects were broadly confirmed, use of ordinary in lieu of borrowed resources for financing enlarged access in 1985 might be considered. If, however, there were a material deterioration in the position or prospects, the need for review could be accelerated, and the staff would expect that borrowing would need to be considered, including possibly through the GAB.