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EBS/84/235

CONFIDENTIAL

November 19, 1984

To: Members of the Executive Board
From: The Secretary
Subject: Mid-Year Review of the Fund's Income Position

Attached for consideration by the Executive Directors is a paper on the mid-year review of the Fund's income position for the financial year ending April 30, 1985.

This subject has been tentatively scheduled for discussion on Monday, December 10, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Wittich (ext. (5)8307) or Mr. Keuppens (ext. (5)7823).

Att: (1)

INTERNATIONAL MONETARY FUND

Mid-Year Review of the Fund's Income Position

Prepared by the Treasurer's Department

Approved by W.O. Habermeier

November 19, 1984

I. Introduction

Under Rule I-6(4) a mid-year review of the Fund's income position is required to be held shortly after October 31 of each year. This paper provides the basis for the mid-year review for the financial year ending April 30, 1985 (FY 1985). It presents the actual income and expense for the first half of the year and revised estimates for the year as a whole. The revised estimates of income and expense have been made in the light of the actual outcome for the first six months of FY 1985, the latest half-yearly review by the Executive Board of the Fund's liquidity and financing needs, updated for developments since that date, and developments in the SDR interest rate.

This paper is organized as follows: Section II summarizes actual income and expense for the first six months of FY 1985; Section III presents the revised estimates for the year as a whole, explains the differences between the revised and the earlier estimates, and discusses the effects on the Fund's income position of deviations from the revised estimates; Section IV considers alternative courses of action for the remainder of the year; and a summary and conclusions are set out in Section V.

The Fund's income position was reviewed last May and June 1984 and a substantial deficit (SDR 68 million) was projected for FY 1985 on the assumption of an unchanged rate of charge on the use of the Fund's ordinary resources. ^{1/} Following this review, the Executive Board took the following actions:

(i) net income of SDR 73 million for FY 1984 was placed to the Special Reserve;

(ii) SDR 22 million of net income in excess of the target amount for FY 1984 was deemed to be income for FY 1985 for the purpose of

^{1/} See "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84; EBS/84/91 Supplement 1, 5/21/84; EBS/84/91, Supplement 3, 6/22/84) and Executive Board Decision No. 7712-(84/85), adopted June 1, 1984; No. 7713-(84/85) as amended by No. 7740-(84/100) adopted June 27, 1984, and No. 7714-(84/85)S, adopted June 1, 1984.

determining the rate of charge for that year, in accordance with the provisions of Rule I-6(4)(d), and the target net income for FY 1985 accordingly set at SDR 10 million;

(iii) the rate of charge was increased from 6.6 percent to 7 percent per annum as from May 1, 1984; and

(iv) the SDR interest rate was continued at 100 percent of the combined market rate.

The Executive Board also reached the following understanding regarding the mid-term review of the Fund's income position:

"If at the time of the mid-term review the net income for FY 1985 is estimated to be substantially in excess of the target, Management would make its judgment in the light of this and other relevant factors on an appropriate reduction in the rate of charge for the balance of the year, and the Executive Board would consider the proposal." 1/

II. Outcome for the First Six Months of 1985

The outcome for the first six months of FY 1985 is a deficit of SDR 11 million, rather than a net income of about SDR 9 million that was implied by the estimates prepared at the time of the last review of the Fund's income position and the decisions taken in June 1984 (see Table 1 below). The main reasons for the shortfall below these earlier estimates are fourfold:

(i) the SDR interest rate for the first six months averaged 9.26 percent, as compared with a rate of 9.0 percent used in preparing the estimates at the beginning of the financial year. As was noted at the time, a deviation of one percentage point from the rate assumed would change net income by about SDR 162 million for the year as a whole; 2/ if the SDR interest rate had averaged 9 percent as projected, net income for the six months ending October 31, 1984 would have been in the order of SDR 7 million rather than the actual deficit of SDR 11 million;

(ii) the use of Fund resources was considerably below the level estimated at the beginning of the year, reflecting mainly delays in finalizing new arrangements and a consequential shortfall in purchases projected to be made under arrangements;

1/ See "Review of the Fund's Income Position for the Financial Years 1984 and 1985--Decisions and Understanding," (EBS/84/91 Supplement 2, 6/7/84).

2/ See "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84) p. 10.

Table 1. Estimated Income and Expense
For the Financial Year 1985

(In millions of SDRs)

	Actual Six Months October 31, 1984	Preliminary Estimates April 1984 <u>1/</u>	Revised Estimates
1. <u>Operational Income</u>			
a. Periodic charges:			
Regular facilities	677	1,497	1,382
SFF	450	776	865
Enlarged Access	<u>399</u>	<u>972</u>	<u>904</u>
Total charges	1,526	3,245	3,151
b. Interest on SDR holdings	277	459	479
c. Other income:			
Regular facilities	12	32	25
Enlarged Access	<u>7</u>	<u>24</u>	<u>19</u>
Total Other Income	19	56	44
Total Operational Income	1,822	3,760	3,674
2. <u>Operational Expense</u>			
a. Remuneration	902	1,877	1,736
b. Interest expense:			
SFF	441	758	846
Enlarged Access <u>2/</u>	<u>382</u>	<u>896</u>	<u>827</u>
Total Interest Expense	823	1,654	1,673
Total Operational Expense	1,725	3,531	3,409
3. Net operational income	97	229	265
4. Administrative expense	<u>108</u>	<u>211</u>	<u>231</u>
5. Net income (deficit)	(11)	18	34
Pro memoria			
Deemed income from 1984	11	22	22

1/ Estimates in "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84), adjusted for the increase in the rate of charge from 6.6 percent to 7 percent.

2/ Less net income from temporary investments held in the Borrowed Resources Suspense Account.

(iii) average holdings of SDRs in the first six months of FY 1985 were also higher than originally estimated, in part due to the delays in purchases but also because of larger inflows of SDRs than had been estimated earlier;

(iv) administrative expenditures expressed in terms of SDRs exceeded the estimated level. The SDR value of administrative expenses is subject to change because of changes in the SDR value of the currencies used in payment (mainly the U.S. dollar) over which the Fund has no control, and the increase reflects mainly an appreciation of the U.S. dollar in terms of the SDR by 5 percent from the beginning of FY 1985, when the estimates were made, to November 14, 1984. A further increase in expenses resulted from the general salary adjustment that was approved in July 1984.

III. Revised Estimates for FY 1985

1. Projected income and target income for FY 1985

Net income for the financial year 1985 as a whole is now estimated in the order of SDR 34 million. Taking into account income of SDR 22 million in excess of target for FY 1984 that was deemed to be income for FY 1985 for the purpose of determining the rate of charge, the target income agreed for the year is SDR 10 million, or SDR 5 million for the first six months of the year. 1/ As noted earlier, the actual income for the first half of FY 1985 was a deficit of SDR 11 million. Rule I-6(4)(b) prescribes that if actual income for the first six months of the financial year, on an annual basis, is below the target amount for the year by an amount equal to or greater than 2 percent of the Fund's reserves at the beginning of the financial year (i.e., actual income falls short of one-third of the target income, also on an annual basis), the Executive Board would need to consider how to deal with the situation in order to reach the net income target; failing an agreement by December 15, the rate of charge is to be increased as of November 1 to the level necessary to reach the target amount of net income for the year. Actual income in the first six months of FY 1985 is below the net income target by more than 2 percent of reserves as the deficit in that period exceeded SDR 6 million. 2/

1/ The target income is determined as 3 percent of reserves at the end of the preceding year minus any "deemed" income, i.e., SDR 32 million minus SDR 22 million.

2/ The deficit of SDR 6 million below which the safeguard mechanism of Rule I-6(4)(b) comes into operation is calculated as follows:

	<u>Full Year</u>	<u>Half Year</u>
Target income of 3 percent of reserves at the beginning of the year	32	16

Present circumstances regarding the outcome for the Fund's income position may be considered rather unusual in that a surplus is projected for the financial year as a whole though there is an actual deficit in the first half. There is therefore no need for the Executive Board to adopt a decision in terms of Rule I-6(4)(b), which calls for an increase in the rate of charge to the level necessary to achieve the target amount of income.

2. Assumptions and projections underlying the revised estimates

The marked differences between the projections prepared in April/May 1984, the actual outcome for the first half of the year, and the revised estimates reflect developments in the intervening period, mainly in market interest rates and in the use of Fund credit. The new assumptions on which the revised estimates for FY 1985 are based are quantified in Table 2, and the estimates of average daily balances and rates resulting from these assumptions are summarized in Appendix Table 1.

A reconciliation of the revised income estimates that result from these assumptions and projections with the estimates contained in the review of the Fund's income position prepared at the beginning of the financial year is shown in Appendix Table 2.

The main differences in assumptions can be summarized as follows:

(i) SDR interest rate - The SDR interest rate is projected to average 8.3 percent over the second half of the year, the level reached following the very sharp decline over the last four weeks 1/

2/ (Cont'd from p. 4)

Shortfall that would activate safeguard mechanism (2 percent of reserves at the beginning of the year)	<u>21</u>	<u>11</u>
Net income for the first half below which safeguard mechanism would be activated if there were no deemed income	...*	5
Less - Deemed income	<u>22</u>	<u>11</u>
Net income (deficit) for first half below which safeguard mechanism is activated	...*	(6)

*Safeguard mechanism applies only to results for the first half year.

1/ In order to avoid the need for forecasts of market and SDR interest rates, the income projections are based on the current SDR interest rate. As is customary, the SDR rate used for estimates over the second half of FY 1985 is the rate in effect when the calculations were made, rounded to the nearest one-tenth of 1 percent. The SDR rate was 8.34 percent for the week ended November 16, 1984. In the first six months, the SDR interest rate ranged from a high of 9.67 percent to a low of 8.78 percent.

Table 2. Assumptions on Which Estimates
for Financial Year 1985 are Based

(In millions of SDRs)

	Actual Six Months October 31, 1984	Preliminary Estimates April 1984 <u>1/</u>	Revised Estimates for the Year as a Whole
A. Ordinary Resources			
1. Purchases			
Unremunerated reserve tranche <u>2/</u>	191	500	400
Credit tranches	1,248	4,520	3,145
Compensatory financing and Buffer Stock	<u>757</u>	<u>1,780</u>	<u>1,500</u>
Total	2,196	6,800	5,045
2. Repurchases other than SFF and Enlarged Access	958	2,005	2,075
3. Average SDR holdings	5,924	5,100	5,430
B. Borrowed Resources			
1. SFF:			
Repayment of borrowing	288	675	675
Repurchases	250	640	640
2. Enlarged Access:			
Purchases	1,421	4,880	3,885
Repayment of borrowing	206	1,190	1,065
Repurchases	--	45	45
C. Interest Rates			
1. Average SDR interest rate (percent)	9.26	9.00	8.83
2. Average rate of remuneration (percent)	8.18	7.95	7.76
3. Average rate of charge (percent)	7.00	7.00	7.00
4. Average SFF interest rate (percent)	12.96	11.50	12.86
5. Average net cost of borrowing under enlarged access policy (percent)	10.79	10.44	10.85

1/ See "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84), p. 5.

2/ Only purchases in the unremunerated reserve tranche are taken into consideration. Purchases in the remunerated reserve tranche normally represent an exchange of a remunerated position between the purchasing member and the members whose currencies are sold by the Fund and have little effect on the Fund's income position.

7.34 percent, reflecting not only the decline in the SDR interest rate but also the increase in the remuneration coefficient that will become effective February 1, 1985 if the SDR interest rate remains at the present level. 1/

(ii) Estimated use of Fund resources - It is now estimated that purchases under stand-by and extended arrangements will amount to SDR 3.15 billion for FY 1985 (SDR 1.25 billion in the first six months), down from SDR 4.5 billion estimated at the beginning of the year. 2/ As a consequence, there will be shifts in the timing of some purchases which were originally expected to be made early in FY 1985 to later in the year or in some cases drawings will be shifted to FY 1986.

Compensatory financing and buffer stock purchases are also now projected lower at SDR 1,500 million (SDR 757 million in the first six months) instead of an estimated SDR 1,780 million in May 1984.

Purchases in the unremunerated reserve tranche are estimated to amount to SDR 400 million (instead of SDR 500 million). These purchases amounted to SDR 191 million in the first six months, and projections for the year have been reduced slightly from the original estimates in line with the reduced volume of drawings so far in FY 1985. It is also to be noted that as agreed by the Executive Board, repayments of short-term EAR borrowing will be made from ordinary resources; such repayments will amount to SDR 1,065 million in FY 1985.

As a consequence of these downward revisions in the use of Fund credit, average balances subject to charges in FY 1985 are now projected at SDR 19.75 billion as compared to SDR 21.38 billion estimated in May 1984. 3/

1/ Rule I-10 prescribes that during FY 1985-87, the remuneration coefficient shall be the higher of (i) 85 percent increased by 3.33 percentage points at the beginning of each of FY 1985, FY 1986, and FY 1987; and (ii) 85 percent increased or decreased on the first day of each quarter by 1 percentage point for each 1/6th of 1 percentage point that the SDR interest rate on the day before the beginning of the quarter is below or above the SDR interest rate in effect on April 30, 1984 (i.e., 8.91 percent), provided that the coefficient in no quarter shall be more than 2.5 percentage points above the amount of the coefficient determined under (i) for the financial year.

2/ The assumptions underlying the use of Fund credit are based on the latest review presented in "The Fund's Liquidity and Financing Needs" (EBS/84/171, 8/8/84), revised to take into account developments since August 1984.

3/ These projections of average balances assume overdue repurchases to be discharged promptly, and repurchases thereafter to be made when due. To the extent that this assumption is not met, income will be lower. See also "Overdue Financial Obligations to the Fund - Effect on Income and Treatment in Financial Statements" (EBS/84/231, 11/14/84), and also page 11 below.

(iii) Reduction in SDR holdings - The Fund's holdings of SDRs will be gradually reduced to a level of approximately SDR 4.2 billion by the end of the financial year so as to attain the target level of SDR 4.0 billion at end-May 1985 (as compared to a level of SDR 5.6 billion at mid-year). Due in part to the delays in purchases mentioned above and also owing to larger than expected inflows of SDRs, the gradual reduction in the Fund's holdings of SDRs will occur somewhat later than projected at the beginning of FY 1985, and it is now estimated that for the year as a whole, the Fund's holdings will average about SDR 5,430 million, or somewhat above the average of SDR 5,100 million projected earlier.

(iv) Administrative expenses - Administrative expenses are now estimated in the order of SDR 231 million, compared with an amount of SDR 211 million estimated at the beginning of the financial year. This new estimate takes into account not only the general salary adjustment agreed by the Executive Board in July, but also the strengthening of the U.S. dollar in terms of the SDR already mentioned, and an increase of SDR 6 million representing expenses in FY 1985 in connection with Fund computing services which will shortly be submitted to the Executive Board for its consideration and approval.

3. Effect of deviations from assumptions and projections

As discussed in earlier staff memoranda on the Fund's income position, the target amount of net income of 3 percent of the Fund's reserves is a very small proportion (less than 1 percent) of the Fund's operating income and expense. Net income is highly sensitive to relatively small changes in some variables from the level used in the projections, particularly to deviations--which must be expected to occur--of the market rates of interest from the projected level. An increase of 0.5 percentage point in the average SDR interest rate from the average level of 8.3 percent over the remaining six months of the financial year used in the estimates would lead to a decrease in net income of about SDR 36 million; and a decrease in the average SDR interest rate of the same order of magnitude would result in an increase in the remuneration coefficient and thus lead to an increase of a somewhat smaller amount (about SDR 28 million) to net income in the year. The net income effects resulting from changes that may occur in the use of the Fund's resources from assumed amounts are not of the same order of magnitude, but nevertheless would have a noticeable impact on net income. These effects are summarized in Table 3, and are shown in Appendix Table 3 for a wider range in the average SDR interest rate.

Table 3. Effect on Net Income for 1985 of Various Combinations
of Deviations from Projections Underlying the
Projection of Fund Income 1/

(In millions of SDRs)

Deviation	Effect on Estimated Net Income		
	At Projected SDR Interest Rate of 8.30 percent	Estimated SDR Rate November 1, 1984 - April 30, 1985	
		Increase in Average SDR Rate by One-Half Per- centage Point	Decrease in Average SDR Rate by One-Half Per- centage Point <u>2/</u>
Projected use of resources and average SDR holdings		-36	+28
Purchases in the unremunerated reserve tranche:			
a. Higher by SDR 100 million <u>3/</u>	-2	-37	+26
b. Lower by SDR 100 million <u>3/</u>	+2	-36	+31
Purchases financed with ordinary resources:			
a. Higher by SDR 500 million <u>4/</u>	+2	-36	+31
b. Lower by SDR 500 million <u>4/</u>	-2	-36	+26
EAR purchases:			
a. Higher by SDR 500 million <u>4/</u>	+3	-34	+31
b. Lower by SDR 500 million <u>4/</u>	-3	-39	+25
Average holdings of SDR higher or lower by SDR 250 million	+4 -4	-33 -40	+31 +25

1/ Based on actual results to October 31, 1984 and estimates to April 30, 1985.

2/ Implying an SDR interest rate of 7.80 percent. If this rate obtained on January 31, 1985 the remuneration coefficient would increase to 90.83 percent of the SDR interest rate from February 1, 1985.

3/ This implies that average use of the unremunerated reserve tranche during the second half of the year would increase or decrease by SDR 50 million.

4/ This implies that average balances subject to the charges levied on the use of ordinary resources during the second half of the year would increase or decrease by SDR 250 million.

IV. The Rate of Charge for the Remainder of FY 1985

Although the Fund experienced an excess of expenses over income in the first six months of the financial year, revised projections indicate net income substantially in excess of the target income of SDR 10 million that was agreed for the year as a whole. Estimated net income of SDR 34 million would thus exceed the agreed target by SDR 24 million. If all the assumptions and projections incorporated in these calculations turned out to be correct, the net income target of SDR 10 million that was established at the beginning of FY 1985 could be achieved with a rate of charge on the use of the Fund's ordinary resources of 6.76 percent for the remainder of the financial year, i.e., with a reduction of 0.24 percent from the present rate of charge of 7 percent.

As mentioned earlier, the Executive Board, in its discussion of the Fund's income position at the beginning of the 1985 financial year, reached an understanding that it will consider a proposal by Management if, in Management's judgment and in the light of estimated net income for FY 1985 and other relevant factors, an appropriate reduction could be made in the rate of charge for the balance of the year. An amount of SDR 24 million could be regarded as being in excess of the agreed target income of SDR 10 million by a substantial amount. The question that arises is whether it would be appropriate in present circumstances for Management to propose a reduction in the rate of charge for the remainder of this year.

As discussed above, the major factor which has a direct bearing on the Fund's income position during the remainder of the financial year is the level and change in the SDR interest rate. Market rates of interest, and the SDR interest rate, have shown a downward tendency in recent weeks. Consequently, it might well be regarded as appropriate that the Fund's rate of charge on the use of its ordinary resources should also decline with this recent general fall in interest rates.

In making projections of the Fund's net income position, the Fund staff does not make estimates of interest rates over the course of the year. It projects that the level of interest rates ruling at the time the staff paper on the Fund's income position is issued will continue at that level for the remainder of the period covered by the review. This is a highly restrictive assumption. If the SDR rate of interest over the next half year averaged 8.63 percent (rather than the projected 8.3 percent) the net income estimated for the last six months of this financial year would be reduced by SDR 24 million, and net income for FY 1985 as a whole would fall to SDR 10 million, i.e., to the net income target for the financial year. Furthermore, the projected surplus of SDR 34 million for FY 1985 would turn into a deficit that would exceed the level that would trigger the safeguard clause if the SDR interest rate averaged in excess of 8.91 percent for the remainder of the financial year. (It will be recalled that at the beginning of the financial year net

income projections were based on the assumption that the SDR interest rate would average 9 percent.)

Three further factors also need to be considered:

(i) if purchases again were to fall short of the newly projected levels, net income would be lower than anticipated because the reduction in earnings from the service charge would more than offset the saving of remuneration that would be paid in excess of charges on the use of Fund credit. As Executive Directors are aware, considerable delays can and do occur in the timing of the conclusion of members' arrangements with the Fund with consequential changes in the timing of purchases under those arrangements;

(ii) as explained in "Overdue Financial Obligations to the Fund - Effect on Income and Treatment in Financial Statements" (EBS/84/231), overdue obligations reduce the Fund's net income position. The implied loss of income resulting from overdue charges and overdue repurchases as a result of delays in members meeting their obligations are estimated to amount to SDR 3 million for FY 1985, based on the average outstanding total of overdue payments in the first six months of FY 1985.

The present projections of net income are based on the assumption that overdue charges and repurchases will be settled promptly, and that members now overdue in their payments in the Fund will hence meet all obligations as they fall due. However, it cannot be precluded that total overdue obligations will continue at the present level or rise over the remainder of FY 1985. In that event, net income will be lower than estimated because of the rising incidence of overdue obligations. Furthermore, proposals have been advanced for the consideration of the Executive Board that the total and duration of overdue payments be taken into account in determining the Fund's net income target and reserve growth. ^{1/} The existing amount of overdue obligations could be seen broadly to justify an increase in the rate of accumulation of reserves in present circumstances;

(iii) the Executive Board has frequently stressed the desirability of achieving a reasonable degree of stability in the rate of charge and avoiding, to the extent possible, overly sharp fluctuations in that rate. The cost of financing the use of Fund credit will rise relative to market interest rates at the beginning of the coming financial year because the agreed increase in the remuneration coefficient to 91.66 percent will enter into effect. It is, therefore, likely that the rate of charge will need to be increased from the present level of 7 percent unless the outstanding use of Fund credit contracted sharply, which is not projected, or the SDR interest rate continued to decline sharply and, on average over the year, would remain markedly below recent levels. It is, therefore, rather likely that a reduction now in the rate of charge would be followed by a reversal in half a year's time.

^{1/} See "Overdue Financial Obligations to the Fund - Effect on Income and Treatment in Financial Statements" (EBS/84/231, 11/14/84).

As noted earlier, the uncertainties surrounding the present net income projections are unusually great. In these circumstances, it is difficult to come to a judgment on the desirability of proposing a reduction in the rate of charge for the remainder of the financial year. Consequently, consideration may be given to a number of alternative courses of action, and the Executive Directors may wish to express their views on these alternatives:

(i) the rate of charge could immediately be reduced to 6.76 percent;

(ii) the rate of charge could be reduced retroactively at the time of the next income review, with effect from November 1, 1984, to the extent that realized net income for FY 1985 exceeded the target net income of SDR 10 million;

(iii) the amount of net income in excess of the target amount of income in FY 1985 could be deemed as income for FY 1986 in order to reduce or avoid an increase in the rate of charge that at that time might otherwise become necessary in order to achieve the target net income of 3 percent of reserves given the planned increase in the rate of remuneration;

(iv) the target amount of net income in FY 1985 could be increased in line with the proposals put forward for consideration in EBS/84/231.

V. Summary and Conclusions

1. During the first six months of FY 1985, the Fund experienced an actual net deficit of SDR 11 million. The actual deficit during the first six months of the financial year, on an annualized basis, is of an order of magnitude that requires the Executive Board to consider, under Rule I-6(4)(b), whether any action is necessary to deal with the matter. However, notwithstanding the deficit during the first six months, projected income for FY 1985 as a whole exceeds target income. There is, therefore, no need for the Executive Board to adopt a decision in terms of that Rule, which calls for an increase in the rate of charge necessary to achieve the target amount of net income.

2. For the year as a whole, the Fund is estimated to earn net income in the order of SDR 34 million, or SDR 24 million in excess of the net income target agreed at the beginning of FY 1985. The estimates are based on the same procedures as used in the past, in particular on projecting the present SDR rate of interest of 8.3 percent to remain in effect throughout the remaining six months of the financial year, as compared with an SDR interest rate of 9 percent assumed at the beginning of FY 1985.

3. The projected net income in excess of target would make it possible to reduce the rate of charge on the use of Fund resources to 6.76 percent and still achieve the target net income of SDR 10 million. A reduction in the rate of charge would be consistent with recent trends in market rates of interest. In this regard, it will be recalled that an understanding was reached in the Executive Board at the time of the last review of the Fund's income position that it will consider a proposal Management would make for an appropriate reduction in the rate of charge for the balance of the year if in its judgment net income at the mid-term review is estimated to be substantially in excess of the target and in the light of other relevant factors.

4. There are, however, a number of significant uncertainties surrounding the present estimate of net income for the remainder of the financial year. These include the sensitivity of the income estimate to changes in the underlying assumptions, in particular, to deviations in the estimated use of Fund resources and, perhaps most important, to the uncertain course of interest rates in the remainder of FY 1985. The adverse effect on the Fund's income of the persistence of overdue payments to the Fund and the effect on the rate of charge of the scheduled increase in the remuneration coefficient at the beginning of FY 1986 need also to be considered in terms of the desirability of maintaining stability in the rate of charge to the extent feasible.

5. In view of these uncertainties, it is difficult to come to a judgment on whether to propose at the present time a reduction in the rate of charge to 6.76 percent, which would allow achievement of the agreed net income target for FY 1985 if the level of income projected in accordance with past practices were in fact to be realized. The Executive Board may, of course, wish to consider a reduction of the rate of charge from 7 percent to 6.76 percent at the present time. However, in view of the uncertainties mentioned above, it may be preferable for the Executive Board to defer such a decision until the actual level of net income realized will have been determined at the end of the financial year, and at that time reduce the rate of charge retroactively, with effect from November 1, 1984, to the extent that realized income for FY 1985 exceeded the target income of SDR 10 million. Alternatively, the Executive Board could consider at the end of FY 1985 either deeming any FY 1985 income in excess of target as income in FY 1986 for the purpose of determining the target income and charges for that year, which could help avoid or reduce undesirable fluctuations in the rate of charge, or placing net income in excess of the target amount of income in FY 1985 to the Fund's reserves in line with the proposals put forward for consideration in EBS/84/231.

Table 1. Estimates of Average Daily Balances and Rates of Periodic Charges
SDR Interest, Remuneration, and Interest on Borrowing
Financial Year 1985

(In millions of SDRs)

	Actual Six Months October 31, 1984	1985 Preliminary Estimates ^{1/}	Revised Estimates for the Year as a Whole
A. Ordinary Resources			
1. Balances subject to periodic charges	19,253	21,380	19,750
Average rate of charge (percent)	7.00	7.00	7.00
2. Holdings of SDRs in the General Resources Account	5,924	5,100	5,430
Average rate of interest (percent)	9.26	9.00	8.83
3. Income-earning balances	25,177	26,480	25,180
Weighted average rate of revenue (percent)	7.53	7.39	7.39
4. Remunerated positions	21,861	23,610	22,370
Average rate of remuneration (percent)	8.18	7.95	7.76
5. Interest-costing balances	21,861	23,610	22,370
Weighted average rate of expense (percent)	8.18	7.95	7.76
6. Pro memoria			
Margin between rate of charge and the average rate of remuneration (excess of the rate of remuneration over the rate of charge) (percent)	1.18	0.95	0.76
B. Borrowed Resources			
1. Balances subject to periodic charges			
SFF	6,792	6,610	6,610
Enlarged Access	<u>7,215</u>	<u>9,140</u>	<u>8,180</u>
Total	14,007	15,750	14,790
Average rate of charge (percent)			
SFF	13.18	11.73	13.09
Enlarged Access	10.99	10.64	11.05
Combined	12.05	11.10	11.96
2. Borrowings			
SFF	6,767	6,590	6,580
Enlarged Access ^{2/}	<u>7,267</u>	<u>8,585</u>	<u>7,730</u>
Total	14,034	15,175	14,310
Average rate of interest (percent)			
SFF	12.96	11.50	12.86
Enlarged Access ^{3/}	10.79	10.44	10.85
Combined	11.84	10.90	11.77
Pro memoria			
Excess of average balances subject to periodic charges over average borrowings ^{4/}			
SFF	25	20	30
Enlarged Access	<u>171</u>	<u>555</u>	<u>560</u>
Total	196	575	590

^{1/} See "Review of the Fund's Income Position for the Financial Years 1984 and 1985" (EBS/84/91, 4/24/84).

^{2/} Balances held in the Borrowed Resources Suspense Account averaged SDR 223 million during the six month period ended October 31, 1984 and are estimated to average SDR 110 million during financial year 1985.

^{3/} Net cost of borrowing after deducting net income from investments.

^{4/} Average borrowings after deducting balances held in the Borrowed Resources Suspense Account.

Table 2. Effects on Net Income for 1985
of Differences between Original Estimates and Revised Estimates

(In millions of SDRs)

	Original Estimates April 1984	Revised Estimates	Difference	Explanation of Difference between Original and Revised Estimates					Other
				Less than Estimated Use of Resources	Lower than		Higher than Estimated SDR Holdings		
					Estimated SDR Interest Rate	Average Rate of Remun- eration			
1. <u>Operational income</u>									
a. Periodic charges	1,497	1,382	-115	-115	--	--	--	--	
b. Interest on SDR holdings	459	479	+20	--	-9	--	+29	--	
c. Charges from borrowed resources net of interest expense	94	96	+2	--	--	--	--	+2	
d. Service charges	<u>56</u>	<u>44</u>	<u>-12</u>	<u>-12</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	
Total	2,106	2,001	-105	-127	-9	--	+29	+2	
2. <u>Operational expense</u>									
Remuneration	1,877	1,736	-141	-98	--	-43	--	--	
3. Net operational income	229	265	+36	-29	-9	+43	+29	+2	
4. Administrative expense	<u>211</u>	<u>231</u>	<u>+20</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>+20</u>	
5. Net income	18	34	+16	-29	-9	+43	+29	-18	

Table 3. Effect on Income of Variances from the
Assumption on the Fund's Income Position and the Rate of Charge
Financial Year 1985

(In millions of SDRs)

Remuneration Coefficient February 1 - April 30, 1985	Average SDR Rate of Interest for the Second Half of FY 1985 (in percent)									
	8.00	8.10	8.20	8.30	8.40	8.50	8.60	8.70	8.80	8.90
	90.46	89.86	89.26	88.66	88.33	88.33	88.33	88.33	88.33	88.33
Purchases in the unremunerated reserve tranche and in the credit tranches during the second half of 1985 (including special facilities)										
1. As projected in Table 2										
Net income <u>2/</u>	49	44	39	34	28	20	12	6	-2	-10
Rate of charge (percent) <u>3/</u>	6.61	6.66	6.71	6.76	6.82	6.90	6.98	7.04	7.12	7.20
2. Purchases in the unremunerated reserve tranche, higher by SDR 100 million										
Net income <u>2/</u>	47	42	37	33	26	18	10	4	-4	-12
Rate of charge (percent) <u>3/</u>	6.64	6.69	6.74	6.78	6.85	6.93	7.01	7.07	7.15	7.23
3. Purchases in the unremunerated reserve tranche, lower by SDR 100 million										
Net income <u>2/</u>	51	46	41	36	30	22	14	8	--	-8
Rate of charge (percent) <u>3/</u>	6.59	6.64	6.69	6.74	6.80	6.88	6.96	7.02	7.10	7.18
4. Credit tranche purchases, higher by SDR 500 million										
Net income <u>2/</u>	51	46	41	36	30	22	14	8	--	-8
Rate of charge (percent) <u>3/</u>	6.59	6.64	6.69	6.74	6.80	6.88	6.96	7.02	7.10	7.18
5. Credit tranche purchases, lower by SDR 500 million										
Net income <u>2/</u>	47	42	37	32	26	18	10	4	-4	-12
Rate of charge (percent) <u>3/</u>	6.64	6.69	6.74	6.79	6.85	6.93	7.01	7.07	7.15	7.23

1/ Assumes SDR rate of interest on average during the period November 1, 1984 to April 30, 1985.

2/ Net income for the year at the present rate of charge of 7.00 percent.

3/ Rate of charge in second half of year necessary to produce the annual target income of SDR 10 million (to which is added SDR 22 million of deemed income).