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EBS/83/36

CONFIDENTIAL

February 16, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Malaysia - Use of Fund Resources - Buffer Stock Financing Facility - Compulsory Contributions to the Buffer Stock of the Sixth International Tin Agreement

Attached for consideration by the Executive Directors is a paper on a request from Malaysia for a purchase of SDR 45.2 million in connection with Malaysia's contributions to the buffer stock of the sixth international tin agreement. A draft decision appears on page 7.

It is proposed to bring this subject, together with Malaysia's request for a purchase in connection with its contributions to the international natural rubber agreement (EBS/83/37, 2/16/83), to the agenda for discussion on Friday, March 11, 1983.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

MALAYSIA

Use of Fund Resources--Buffer Stock Financing Facility--
Compulsory Contributions to the Buffer Stock of the
Sixth International Tin Agreement

Prepared by the Research Department and the Asian Department

(In consultation with the Exchange and Trade Relations,
Legal, and Treasurer's Departments)

Approved by Wm. C. Hood and Tun Thin

February 15, 1983

The Managing Director has been informed that the Malaysian authorities are requesting a purchase of the equivalent of SDR 45.2 million in connection with the obligation of Malaysia to make its compulsory contributions in full to the buffer stock of the Sixth International Tin Agreement (ITA). The request is made in accordance with the provisions of paragraph (1) of Decision No. 2772-(69/47), June 25, 1969, as amended by Decision No. 4913-(75/207), December 24, 1975, and of Decision No. 7247-(82/147), November 12, 1982. The request is made within the time limits prescribed in paragraph 2 of Decision No. 7247-(82/147). The purchase relates to the entire amount required to be contributed by Malaysia under Article 22 of the Agreement and the decision taken by the International Tin Council (ITC) on July 1, 1982.

Malaysia already has an amount of SDR 58.5 million (or 15.4 per cent of quota) outstanding under the buffer stock financing facility, in respect of a purchase made in June 1982 for its final contribution to the buffer stock of the Fifth ITA which ended on June 30, 1982. The Malaysian authorities informed the ITC on July 19, 1982 that they elected to make Malaysia's full compulsory contributions to the buffer stock of the Sixth ITA by transfer of assets from the buffer stock of the Fifth ITA, with effect from July 1, 1982. In this situation, an expectation of repurchase thereby arises, and approval of the present request is therefore subject to Malaysia's repurchase of the amount transferred from the Fifth to the Sixth ITA, which is the same as the amount of the purchase requested. The Malaysian authorities have been requested to make the expected repurchase, and their request includes a statement that they will do so on the same date as the proposed purchase.

The proposed purchase is equivalent to 11.9 per cent of Malaysia's quota in the Fund, and after the repurchase mentioned above, if it is approved together with a request for a purchase of SDR 67.8 million in connection with contributions by Malaysia to the International Natural Rubber Agreement (INRA), which is expected to be considered at the same time, Malaysia's purchases under the buffer stock financing facility will amount to 33.3 per cent of quota, and the Fund's holdings of Malaysian currency will be raised to 152.6 per cent of quota.

This paper is presented in four sections and an Annex: (1) Malaysia's balance of payments position and cooperation with the Fund; (2) the buffer stock contribution; (3) repurchase; and (4) staff appraisal and proposed decision. The Annex summarizes Malaysia's relations with the Fund.

1. Balance of payments position and cooperation with the Fund

a. Balance of payments position

The current account deficit rose from SDR 0.2 billion (1 per cent of GNP) in 1980 to SDR 1.9 billion (9.5 per cent of GNP) in 1981, largely because of a deterioration in the external terms of trade by 17 per cent and a decline in export volumes by 4 per cent. Despite a sharp increase in net capital inflows, representing mainly Eurodollar loans to the Government, the balance of payments recorded an overall deficit of SDR 375 million following sizable surpluses in each of the preceding two years (Table 1). Gross international reserves declined to the equivalent of 4.3 months of imports by the end of 1981. The authorities made use of Fund resources in the amount of SDR 189.8 million (50 per cent of quota) under the compensatory financing facility.

Based on the latest official estimates, the trade balance deteriorated further in 1982 and the current account deficit rose sharply to SDR 3.4 billion, equivalent to about 15 per cent of GNP (Table 1). The growth of exports remained sluggish owing to continued stagnant world market conditions for most of Malaysia's exports. Import growth was contained at 13 per cent on account of the slowdown of economic activity. The widening of the deficit on the services account reflected primarily increased interest payments on foreign debt. Net capital inflows rose sharply to SDR 3.7 billion, with most of the increase attributable to government borrowing abroad. The overall balance of payments deficit of SDR 234 million was financed partly from gross international reserves, which declined to the equivalent of SDR 3.7 billion or 3.9 months of imports by the end of November 1982. Malaysia made use of Fund resources in the amount of SDR 58.5 million (15.4 per cent of quota) under the buffer stock financing facility in connection with its contribution to the buffer stock of the Fifth International Tin Agreement.

For 1983 the staff projects a moderate increase in export growth in response to the anticipated recovery in world market conditions for Malaysia's major export commodities. The growth of imports is expected to slow down to a rate slightly below that of nominal GDP because of a drawdown of inventories. The current account deficit of the balance of payments is likely to be about the same as in 1982. Assuming slightly larger net capital inflows than in the previous year, the overall balance of payments deficit in 1983 is expected to be smaller than in 1982.

Table 1. Malaysia: Summary Balance of Payments

(In millions of SDRs)

	1979	1980	1981	1982 Estimate
A. Current account	793	-184	-1,945	-3,361
Trade balance	2,282	1,685	-40	-953
Exports	(8,315)	(9,899)	(9,905)	(10,274)
Imports	(-6,033)	(-8,214)	(-9,945)	(-11,227)
Services (net)	-1,448	-1,826	-1,865	-2,368
Transfers (net)	-41	-43	-40	-40
B. Capital account	375	1,142	2,172	3,678
Official long-term	247	109	1,020	1,972
Private long-term	532	702	1,119	1,335
Private short-term	-404	331	33	371
C. Errors and omissions (net)	-548	-604	-628	-551
D. SDR allocation	26	26	26	--
E. Overall balance (A through D)	646	380	-375	-234
F. Change in net international reserves (-increase)	-646	-380	375	234
Of which:				
Use of Fund credit	--	--	190	59
Memorandum items:				
Current account balance as a per cent of GNP	5.4	-1.1	-9.5	-15.0
Overall balance as a per cent of GNP	4.4	2.2	-1.8	-1.0
Gross international reserves	3,046	3,521	3,516	3,687 1/
(In terms of months of imports)	(6.1)	(5.1)	(4.3)	(3.9)

Sources: Data provided by the Malaysian authorities; staff estimates; and IMF *International Financial Statistics*.

1/ As of November 30, 1982.

b. Cooperation with the Fund

The request for the proposed purchase may be met where the Fund is satisfied that the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for the member's balance of payments difficulties. The staff believes that this requirement is met in the present case. The Malaysian authorities have regularly held Article IV consultations with the Fund. In the 1982 Article IV consultation discussions at EBM/82/87 on June 23, 1982, it was noted that the authorities should adopt a less expansionary fiscal stance, particularly in view of the projected further widening of the current account deficit. Effective July 1982, the authorities took measures to reduce the level of public expenditure and have planned to limit the growth of their expenditure to only 1 per cent in the 1983 budget. The new budget also introduced several measures to increase revenue in order to reduce the fiscal gap, including doubling of the rates of taxes on the sales of goods and services. The present request by Malaysia for a purchase under the buffer stock financing decision includes a statement that Malaysia will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

2. The buffer stock contribution

Since February 1982, the tin market, like that for most metals during the current world recession, has been very weak. Buffer stock support operations by the International Tin Council (ITC) have been continuously necessary, and stringent export controls, which were introduced in April 1982 and intensified in July, have so far been extended through March 1983. The price has been prevented from falling below the floor of the ITA, but remains at or close to it.

At its first session in July 1982, the Council of the Sixth ITA, which had come into force provisionally on July 1, decided to call up the full amounts of members' compulsory contributions to the buffer stock. As provided in Article 22(5) of the Agreement, the ITC resolution of July 1 allows members, if they so elect, to make their contributions by transfer from the buffer stock account held under the Fifth ITA, rather than in cash.

Malaysia's contribution, as a share of the total amount to be contributed by producing member countries, is based on its recent share of world tin production. Malaysia's total contribution amounts to 4,015 tons of tin, of which the initial contribution of 2,042 tons of tin became due on July 1, 1982, and the balance of 1,973 tons of tin became due on August 2, 1982. The value of the contribution is determined as the equivalent in pounds sterling of 4,015 tons of tin, valued at the floor price in effect on July 1, 1982, when the contributions were called up. The floor price on July 1 was $M29.15 per kilo, so that Malaysia's contribution of M$117 million, when converted to sterling at the $M/£ rate on July 1, amounts to £28.4 million. On July 19, 1982, the Malaysian authorities informed the ITC that they elected to make Malaysia's total contribution of 4,015 tons of tin to the buffer stock of the Sixth ITA by transfer from the buffer stock of the Fifth ITA, with effect from July 1, 1982.

This transfer by Malaysia of assets from the Fifth ITA to the Sixth ITA is equivalent to a distribution of that amount by the ITC to Malaysia. Under paragraph 1(b) of Executive Board Decision No. 5703-(78/39), as amended, and paragraph 3 of Executive Board Decision No. 5127-(76/91) relating to the Fifth ITA, that distribution gives rise to an expectation to repurchase an equivalent amount out of the purchase of SDR 58.5 million made by Malaysia in connection with its final contribution to the Fifth ITA buffer stock. For the purpose of valuation, July 1, 1982 is taken to be the date of transfer and payment, and accordingly, the sterling amount (£28.4 million), converted to SDRs at the rate in effect on July 1, 1982 is SDR 45.2 million. The staff has been able to clarify Malaysia's election to make its contribution to the Sixth ITA only very recently, and has now requested the Malaysian authorities to make the expected repurchase. The request for the purchase accordingly includes a statement that the repurchase will be made on the same date as the proposed purchase.

By Decision No. 7247-(82/147), the Fund stands ready to assist in financing the full amount of eligible members' compulsory contributions to the buffer stock of the Sixth ITA, subject to the limit of 50 per cent of their quotas in the Fund on their outstanding purchases under the buffer stock financing facility. The amount of the proposed purchase, SDR 45.2 million, is equivalent to 11.9 per cent of Malaysia's quota. Malaysia's purchases currently outstanding under the facility amount to SDR 58.5 million, equivalent to 15.4 per cent of quota, in respect of the purchase made in June 1982 relating to the member's final contribution to the buffer stock of the Fifth ITA. After the repurchase of SDR 45.2 million out of that purchase, and the purchase of SDR 45.2 million now requested, the amount outstanding in respect of tin would remain unchanged at SDR 58.5 million or 15.4 per cent of quota. With a purchase of SDR 67.8 million in respect of contributions to the buffer stock of the International Natural Rubber Agreement, the request for which is expected to be considered concurrently with this request, Malaysia's purchases outstanding under the buffer stock financing facility would be raised to SDR 126.3 million or 33.3 per cent of quota.

3. Repurchase requirements

Malaysia will be required to repurchase the proposed purchase in equal quarterly installments during the period beginning three years and ending five years after the date of purchase. 1/ Malaysia will also be expected to make repurchases at an earlier date in accordance with the relevant provisions of the Fund Articles and decisions relating to repurchase in the light of improvement in a member's balance of payments and reserve position. 2/ Moreover, in accordance with paragraph 3(b) of Decision No. 7247-(82/147), Malaysia will be expected to make repurchases at an earlier date (i) when and to the extent that the ITC makes refunds to Malaysia, and (ii) if the Sixth ITA terminates without being replaced by a new ITA providing for a buffer stock, when transfers in liquidation are made to Malaysia.

1/ Article V, Section 7(c), and Decision No. 5703-(78/39) as amended by Decision No. 6862-(81/81).

2/ Article V, Section 7(b) and Decision No. 6172-(79/101).

4. Staff appraisal and proposed decision

Malaysia is requesting a purchase equivalent to SDR 45.2 million, in order to finance its contributions in full to the buffer stock of the Sixth ITA called up by the ITC on July 1, 1982. On July 19, 1982, Malaysia elected to make its total contribution with effect from July 1, 1982 by transfer of part of its share of its assets of the buffer stock of the Fifth ITA. The proposed purchase is equivalent to 11.9 per cent of Malaysia's quota in the Fund, and is contingent upon a completion of a repurchase of the same amount in respect of part of a purchase made by Malaysia in June 1982 in connection with its final contribution to the buffer stock of the Fifth ITA. The repurchase in respect of the amount transferred from the Fifth ITA to the Sixth ITA is the same as the amount of the purchase now requested. Malaysia has been requested to make the expected repurchase, and the request for the purchase includes a statement that it will do so on the same day as the proposed purchase. After that repurchase, if both the current requests relating to Malaysia's contributions to the buffer stock of the 1980 International Natural Rubber Agreement (INRA), and the Sixth ITA are approved, Malaysia's purchases outstanding under the buffer stock financing facility will amount to 33.3 per cent of quota.

Malaysia's overall balance of payments is estimated to have recorded a deficit of SDR 234 million in 1982, and gross international reserves at the end of November were equivalent to 3.9 months of imports, compared with 4.3 months imports at the end of 1981. For 1983, although the current account deficit may remain about the same, the overall deficit is expected to be smaller than in 1982 on the assumption that net capital inflows will be slightly larger. The staff considers that Malaysia's balance of payments need justifies the proposed purchase.

The amount of the proposed purchase is equivalent to the full amounts of the initial and subsequent compulsory contributions called up from Malaysia by the ITC on July 1, 1982 under the provisions of Article 22 of the Sixth ITA. If the purchase is approved, repurchases in respect of it will be required and expected, as appropriate, in accordance with paragraph 3 of Decision No. 7247-(82/147), adopted November 12, 1982. Both the proposed purchase and the timing of the request are in accordance with the provisions of paragraph 2 of Decision No. 7247-(82/147). The request includes a statement that Malaysia will cooperate with the Fund in efforts to find, where required, appropriate solutions for its balance of payments difficulties.

The staff believes that the request meets all the requirements set forth in Decision No. 2772-(69/47), Buffer Stock Financing Facility: The Problem of Stabilization of Prices of Primary Products, as amended by Decision No. 4913-(75/207), and Decision No. 7247-(82/147) on Buffer Stock Financing Facility: Sixth International Tin Agreement.

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund has received a request by the Government of Malaysia for a purchase of SDR 45.2 million under the decision on Buffer Stock Financing Facility: The Problem of Stabilization of Prices of Primary Products, Decision No. 2772-(69/47), June 25, 1969, as amended by Decision No. 4913-(75/207), December 24, 1975, and the Decision on Buffer Stock Financing Facility: Sixth International Tin Agreement, Decision No. 7247-(82/147), November 12, 1982.

2. The Fund determines that this purchase would be consistent with the decisions referred to in (1) above, notes the representations of Malaysia, and approves the purchase in accordance with the request.

Malaysia's Relations with the Fund
(As of January 31, 1983)

Status:	Article VIII.
Date of membership:	March 7, 1958.
Quota:	SDR 379.5 million.
Fund holdings of ringgit:	SDR 511.2 million (equivalent to 134.7 per cent of quota).
Use of Fund resources:	In September 1981, Malaysia purchased the equivalent of SDR 189.8 million or 50 per cent of quota under the compensatory financing facility. In June 1982, Malaysia purchased the equivalent of SDR 58.5 million or 15.4 per cent of quota under the buffer stock financing facility.
SDR position:	SDR 118.1 million, or 84.9 per cent of net cumulative allocation of SDR 139.05 million.
Gold distribution:	159,165.213 fine ounces (four distributions).
Direct distribution of profits from gold sales (July 1, 1976 to July 31, 1980):	US$29.56 million.
Exchange system:	The ringgit is pegged to an undisclosed composite of currencies of Malaysia's major trading partners, and the weighting reflects the importance of currencies used in settlement as well as trade shares. Margins of 2.25 per cent are maintained, but occasionally and for relatively short periods, the rate has been allowed to exceed margins. The representative exchange rate of the ringgit under Rule O-2 is the mid-point between the buying and selling rates for the U.S. dollar quoted at noon on the Kuala Lumpur foreign exchange market; the mid-point at end-January 1982 was M$2.2740 per US$1.

Exchange practices under Article VIII:	Payments and transfers for current international transactions are free of restrictions except to Israel and South Africa. Capital transactions above certain limits require prior approval; approvals are freely given except for investments by Malaysian residents in Israel and South Africa.
Last Article IV consultation:	The Executive Board discussed the staff report on June 2, 1982. Staff discussions were held during April 15-26, 1982 (SM/82/106; SM/82/112).
Technical assistance:	The Fund has provided technical assistance to Malaysia through its Asian Department, Bureau of Statistics, Central Banking Department, and Fiscal Affairs Department.