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INFORMATION

November 8, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Buffer Stock Financing Facility - Report on the 1979 International Natural Rubber Agreement

Attached for the information of the Executive Directors is the annual report on the operations of the 1979 International Natural Rubber Agreement under the buffer stock financing facility.

If Executive Directors have technical or factual questions relating to this paper, they should contact Mr. Kaibni (ext. (5)7721).

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

Buffer Stock Financing Facility--Report on the 1979 International Natural Rubber Agreement

Prepared by the Research Department

(In consultation with other departments)

Approved by Wm. C. Hood

November 7, 1983

This paper reviews developments in connection with the 1979 International Natural Rubber Agreement (INRA). It is being circulated for the information of Executive Directors in accordance with paragraph 5 of Executive Board Decision No. 7246-(82/147), adopted November 12, 1982, dealing with Fund financing of members' contributions to the acquisition costs of the buffer stock established under the International Natural Rubber Agreement (INRA). 1/ The paper is presented in three sections and two annexes. The sections deal with: (1) market developments and intervention operations under the Agreement; (2) use of Fund resources by members of the INRA under the buffer stock financing facility; and (3) conclusions. Annex I contains a brief description of participation in the Agreement and Annex II contains the text of Executive Board Decision No. 7246-(82/147).

1. Market developments and intervention operations under the Agreement

a. Market developments and outlook

Since the industrial countries account for about 75 percent of total world natural rubber consumption, there is a strong relationship between the fluctuation of economic activity in these countries and world natural rubber consumption and trade. The overall growth rate of real GNP in the industrial countries declined from 4 percent per annum in the period 1976-79 to only 1.25 percent per annum in 1980 and 1981, and in 1982, real GNP in these countries actually fell by 0.3 percent. However, due to the sharp rise in oil prices in 1979 and 1980 and the associated rise in the price of synthetic rubber, the natural rubber market remained buoyant until the third quarter of 1980. Thereafter, as the effects of the deepening recession became more widespread, the rubber market weakened rapidly and rubber prices declined sharply during 1981 and remained depressed until the end of 1982 (Chart 1).

1/ A description of the operational features of the Agreement is contained in SM/82/91 (9/22/82) entitled "Possible Fund Financing of Natural Rubber Buffer Stocks Established Under the 1979 International Rubber Agreement." The full text of the Agreement is attached as an annex to that staff memorandum.

The attenuation of inflationary trends, a decline in interest rates, and increasing consumer confidence set the stage for the upturn in economic activity in the industrial countries which began in the United States during the first quarter of 1983. After increasing by 2.1 percent in the first quarter of 1983, the aggregate index of U.S. industrial output increased by 4.2 percent in the second quarter. Passenger car production, a leading outlet for natural rubber, increased by 25 percent in the United States between the fourth quarter of 1982 and the first quarter of 1983 and by a further 18 percent in the second quarter of 1983. The aggregate index of industrial output in the industrial countries increased at an average rate of 2 percent during the first two quarters of 1983. The increase in demand for natural rubber due to the upturn in economic activity and heavy buying by centrally planned economies coincided with a seasonal decline in supplies due to the onset of winter in the producing countries. As a result, natural rubber prices recovered by 37 percent between December 1982 and September 1983. Provided the recovery in economic activity in the industrial countries is sustained and becomes more widespread, the market for natural rubber can be expected to improve further during the final quarter of 1983 and beyond.

From 1979 to 1982 world natural rubber consumption is estimated to have declined by 7 percent, while world rubber production declined by only 2 percent (Table 1). As a result, global year-end stocks are estimated to have increased by about 20 percent. The ratio of year-end stocks to annual consumption increased from 0.40 in 1979 to 0.51 in 1982; excluding stocks held by the INRA, the stock/consumption ratio increased from 0.40 to 0.44 during the same period. Purchases by the buffer stock of the INRA, which stood at 260,000 tons, accounted for more than 85 percent of the estimated increase in world stocks of 305,000 tons from 1979 to 1982. Total world exports of natural rubber declined by 8 percent from 3.325 million tons in 1979 to 3.060 million tons in 1982. Aggregate earnings from natural rubber exports of the four principal natural rubber exporting countries--Malaysia, Indonesia, Thailand, and Sri Lanka 1/--declined by 28 percent from SDR 2.8 billion in 1979 to SDR 2.1 billion in 1982.

b. Intervention operations under the Agreement

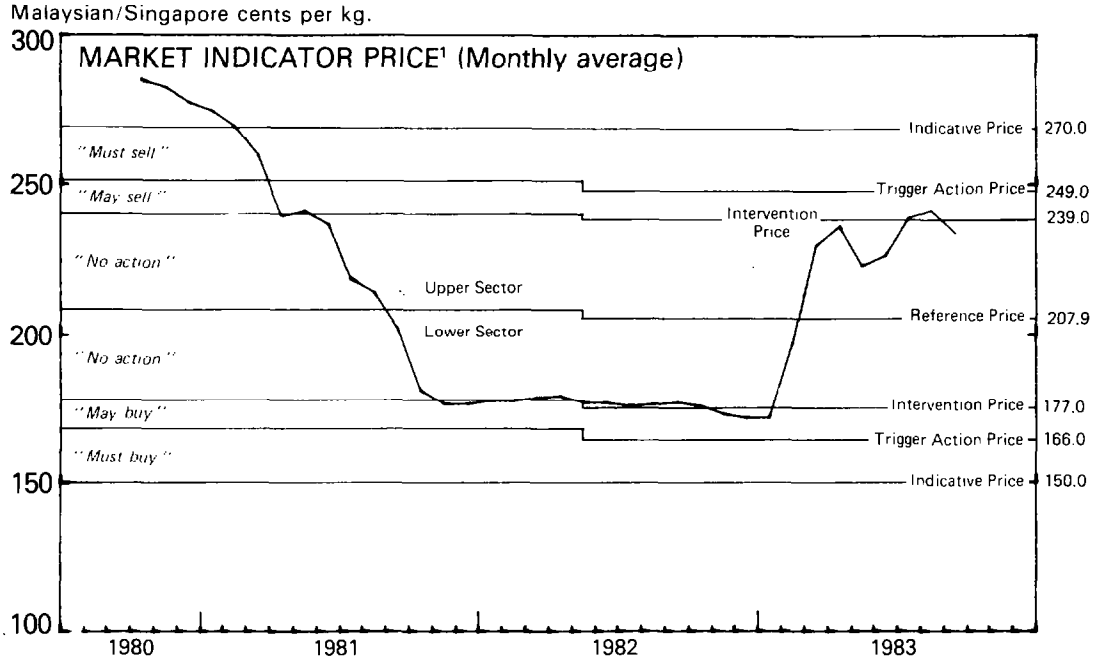
When the International Natural Rubber Agreement entered into force in late October 1980, the monthly average of the daily market indicator price (MIP) 2/ was above the intervention range of the Agreement, but by October 1981 it had breached the lower intervention price of 179 Malaysian/Singapore cents per kilogram and entered the "may buy" sector of the range (Chart 1). Buffer stock purchases to defend the lower trigger action

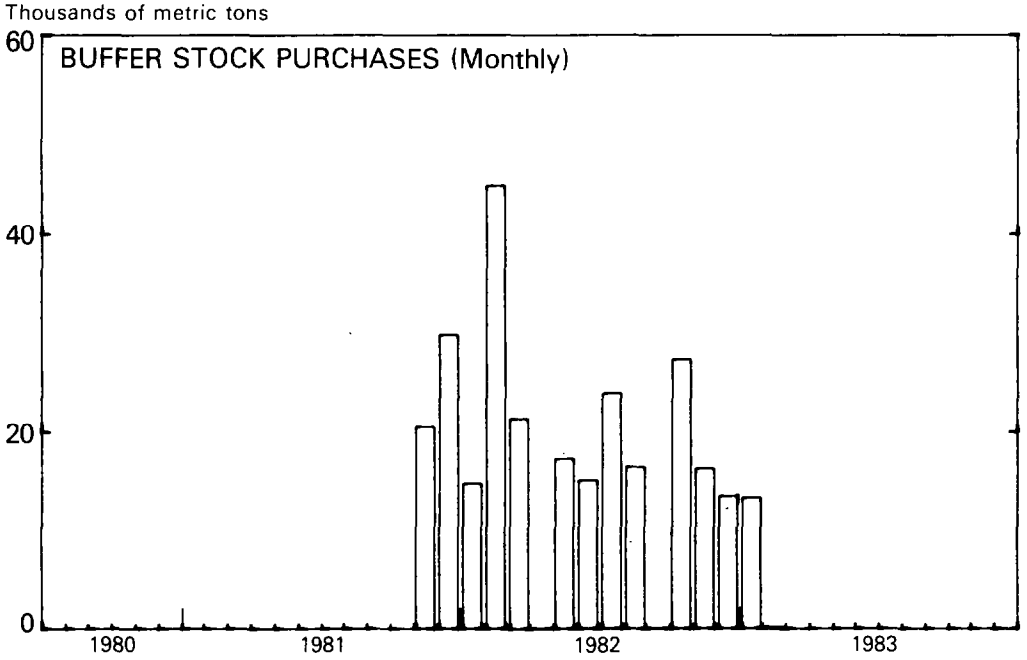
1/ Together, these four countries account for more than 90 percent of total world exports of natural rubber.

2/ The MIP is defined in the Agreement as the average official price for RSS 1, RSS 3, and TSR 20 quality rubber on the Kuala Lumpur, London, New York, and Singapore markets, expressed in equally weighted Malaysian and Singapore cents per kilogram.

CHART 1

INTERNATIONAL NATURAL RUBBER AGREEMENT (INRA) MARKET INDICATOR PRICE IN RELATION TO PRICE BANDS AND BUFFER STOCK PURCHASES





Source: International Natural Rubber Organization.

[1]The market indicator price is the composite weighted average of official prices for RSS 1, RSS 3, and TSR 20 quality rubber on the Kuala Lumpur, London, New York and Singapore markets, expressed in equally weighted Malaysian and Singapore cents per kilogram.

Table 1. Summary of World Natural Rubber Position, Calendar Years 1979-1982

(In thousands of metric tons)

	1979	1980	1981	1982 1/
1. Opening commercial stocks	1,555	1,545	1,630	1,620
2. Production	3,860	3,845	3,690	3,780
3. Current supply ((1)+(2))	5,415	5,390	5,320	5,400
4. Consumption	3,870	3,760	3,650	3,600
5. Closing commercial stocks ((3)-(4))	1,545	1,630	1,620	1,590
6. INRO buffer stock net purchases				
(a) During the year	--	--	50	210
(b) Cumulative	--	--	50	260
7. Total year-end stocks ((5)+(6b))	1,545	1,630	1,670	1,850

Source: International Rubber Study Group; Rubber Statistical Bulletin; and Fund staff estimates.

1/ Estimated.

price of 168 cents per kilogram commenced in November 1981, and by April 1982, total buffer stock purchases amounted to 131,000 tons. 1/ During the second year of operation (November 1981-October 1982), total buffer stock purchases amounted to 224,000 tons. The buffer stock manager intervened in the market during each month of this year except for the months of April and September, when the MIP was either above or very close to the upper boundary of the "may buy" sector of the intervention range. As the recovery of economic activity in the industrial countries, which was expected to start in the second half of 1982, did not materialize until the first quarter of 1983, the rubber market remained weak through the end of 1982. Consequently, during the first three months of the Agreement's third year (November 1982-October 1983), the buffer stock manager had to purchase an additional amount of 49,000 tons of rubber. By the end of January 1983, when the last purchase was made, total buffer stock purchases amounted to 270,000 tons; this is only about one half of the maximum capacity of 550,000 tons provided for in the Agreement.

If the recovery in economic activity in the industrial countries becomes more widespread, there is a strong likelihood that world natural rubber consumption will exceed world production in 1984 and 1985. However, because of the strong possibility of buffer stock sales, any further increases in natural rubber prices are likely to be quite moderate.

Exporting and importing members of the Agreement are committed to share equally in the total costs of acquiring and operating the international natural rubber buffer stock. The Executive Director of the International Natural Rubber Organization has made four call-ups of contributions to the Buffer Stock Account and the aggregate amount called up amounts to M$689.5 million. 2/ Of this amount, a total of M$674.6 million has been paid up, while arrears by importing and exporting members amount to M$11.2 million and M$4.0 million, respectively. On June 30, 1983, funds held in the Buffer Stock Account amounted to about M$149 million.

2. Use of Fund resources under the buffer stock financing facility

Executive Board Decision No. 7246-(82/147), adopted November 12, 1982, authorizes the provision of Fund assistance to eligible members of the INRA for the financing of members' direct compulsory contributions to the acquisition costs of the buffer stock established under the Agreement. As in the case of any use of Fund resources, a member must have a balance of payments need to draw. The member must also represent that it will cooperate with the Fund to find, where required, appropriate solutions for its balance of payments difficulties. Outstanding drawings

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1/ On May 6, 1982, in accordance with Article 32 of the Agreement, the INRC revised the reference price and the upper and lower intervention and trigger action prices downward by 1 percent.

2/ Approximately SDR 279 million at the September 1983 M$/SDR rate of exchange.

under the buffer stock financing facility in respect of all buffer stock arrangements for which the Fund makes financial assistance available are subject to a limit of 50 percent of quota; the drawings are additional to members' access to the reserve tranche, the credit tranches, the compensatory financing facility, and the compensatory financing of fluctuations in the cost of cereal imports. Members are obligated to repurchase within three to five years after a drawing and are expected to do so earlier if the International Natural Rubber Council (INRC) makes refunds to members.

Since Executive Board Decision No. 7246-(82/147) was adopted, the Fund has provided financial assistance amounting to SDR 131.6 million to five members (Indonesia, Sri Lanka, Malaysia, Thailand, and Ivory Coast) in connection with their direct compulsory contributions toward the acquisition costs of the buffer stock established under the Agreement (Table 2). 1/ Fund assistance enabled these five members to finance the

Table 2. Purchases by Fund Members in Connection with Their Contributions to the Buffer Stock of the INRA

Member	Date of Purchase	Amount of Purchase		Total Outstanding Purchases Under Buffer Stock Financing Facility (Percent of Quota)
		SDR Millions	Percent of Quota	
Indonesia (EBS/82/235)	1/7/83	37.4	5.2	9.0
Sri Lanka (EBS/83/2)	1/26/83	5.8	3.2	3.2
Malaysia (EBS/83/37)	3/11/83	67.8	17.9	33.3
Thailand (EBS/83/39)	3/21/83	19.6	7.2	21.5
Ivory Coast (EBS/83/186)	9/19/83	1.0	0.9	0.9
Total		131.6		

1/ Nigeria and Papua New Guinea are the only exporting members of the Agreement that have not requested purchases from the Fund under the buffer stock financing facility. The aggregate amount of these two members' contributions is SDR 1.5 million.

entire amount of their shares of the four call-ups made by the Executive Director of the International Natural Rubber Organization, and total Fund assistance to these members amounted to 99 percent of the total amount called up from all exporting members of the Agreement. Indonesia, Malaysia, and Thailand also made purchases on account of their contributions to the buffer stock of the International Tin Agreement, but none of the purchases caused the outstanding purchases to reach the access limit of 50 percent of quota.

In view of the favorable market outlook for natural rubber and the likelihood of buffer stock sales, there is a strong possibility that the five Fund members that have received financial assistance under the buffer stock financing facility will be expected to make repurchases in advance of the normal schedule.

3. Conclusions

The viability of the 1979 International Natural Rubber Agreement was severely tested by the most prolonged recession in post-war history. When the Agreement came into effect in October 1980, market prices were above the ceiling price of the intervention range of the Agreement, but as the world recession deepened and became more widespread, the rubber market weakened rapidly. Purchases by the buffer stock manager commenced in November 1981 and continued until January 1983. These purchases, which amounted to about half the stocking capacity provided under the Agreement, arrested the decline in prices and succeeded in stabilizing them within the Agreement's intervention range. With a rise in the demand for natural rubber stemming from the recovery in economic activity in the industrial countries, the price of natural rubber improved significantly during the first ten months of 1983. Further price increases are likely to occur as the recovery in world economic activity gathers momentum, but the extent of the rise in prices would be expected to be moderated by sales from the buffer stock.

The buffer stock purchases were financed by four call-ups of contributions from both the exporting and importing members of the Agreement. The Fund has provided financial assistance for a total amount of SDR 131.6 million to five members (Indonesia, Sri Lanka, Malaysia, Thailand, and Ivory Coast), in respect of the entire amount of their compulsory contributions. To the extent that buffer stock sales are likely to take place and that these sales will be followed by distributions of cash to members, the five members concerned will be expected to make repurchases in respect of their outstanding drawings in advance of the normal schedule.

Participation in the 1979 International Natural Rubber Agreement

In July 1982 Switzerland acceded to the Agreement and in November 1982 Turkey notified the Secretary-General of the United Nations that it had decided to withdraw from the Agreement. In accordance with Article 64 of the Agreement, Turkey will cease to be a member of the Agreement from November 1983. The present membership of the Agreement is as follows:

a. Exporting members: Indonesia, Ivory Coast, Malaysia, Nigeria, Papua New Guinea, Sri Lanka, and Thailand.

b. Importing members: Australia, Brazil, Canada, China, Czechoslovakia, 1/ the European Economic Community, Finland, France, the Federal Republic of Germany, Iraq, Ireland, Italy, Japan, Mexico, the Netherlands, Norway, Peru, Sweden, Switzerland, 1/ Turkey, the U.S.S.R., 1/ the United Kingdom, and the United States.

Unless the INRC decides to extend the Agreement (for a maximum period of two years), the current INRA will terminate in October 1985. Negotiations for a new Agreement to replace the present Agreement are expected to commence during the second half of 1984.

1/ Not a Fund member.

INTERNATIONAL MONETARY FUND

Buffer Stock Financing Facility: International Natural Rubber Agreement, 1979

Executive Board Decision No. 7246-(82/147)

November 12, 1982

1. The Fund, having considered the text of the International Natural Rubber Agreement as established by the United Nations Conference on Natural Rubber on October 6, 1979, finds that the terms of this Agreement relating to the international natural rubber buffer stock established under the Agreement are consistent with the principles referred to in Executive Board Decision No. 2772-(69/47), adopted June 25, 1969, as amended.

2. In view of paragraph 1 above, the Fund will meet, subject to the provisions of Executive Board Decision No. 2772-(69/47), as amended, a member's request for a purchase in connection with the financing by the member of its direct compulsory contribution to the acquisition costs of the buffer stock established under the International Natural Rubber Agreement, if its request is received in the Fund not later than six months after the date of the contribution or, in respect of contributions made before the date of this decision, not later than 90 days after the date of this decision.

3. A member that has outstanding purchases under this decision

(a) shall make repurchases in respect of these purchases in accordance with paragraph 1(a) of Decision No. 5703-(78/39), adopted March 22, 1978, as amended, and

(b) will be expected to repurchase at an earlier date than would be required under (a) above,

(i) when, and to the extent that, the International Natural Rubber Council refunds net contributions in excess of those required to support buffer stock operations, and

(ii) if the current Agreement terminates without being replaced by a new Agreement providing for a buffer stock, when transfers in liquidation are made to the member. Any transfer of natural rubber from the buffer stock to the member will be treated as a distribution in currency, valued at the lowest current price for each type or grade so transferred during the 30 market days preceding the termination of the Agreement.

4. If the current Agreement is to be replaced by a new Agreement providing for a buffer stock,

(a) a transfer of all or part of a member's share under the existing Agreement to the buffer stock account of the new Agreement will not be treated as a distribution in currency for the purpose of repurchase, if within 180 days of the termination of the current Agreement the Fund finds the terms of the new Agreement to be consistent with the principles referred to in Executive Board Decision No. 2772-(69/47), as amended;

(b) members that do not participate in the new Agreement will be expected to repurchase in accordance with paragraph 3(b)(ii) above.

5. The staff will keep the Executive Board informed on the operation of the buffer stock and other developments in connection with the International Natural Rubber Agreement by reports that will be made at least once a year, and the Fund may make such review of this decision as is appropriate in the light of these reports.