

EBS/83/248

CONFIDENTIAL

November 21, 1983

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

The attached paper reviewing the Fund's income position has been scheduled for discussion on Wednesday, December 14, 1983.

Att: (1)

INTERNATIONAL MONETARY FUND

Review of the Fund's Income Position

Prepared by the Treasurer's Department

Approved by W. O. Habermeier

November 21, 1983

I. Introduction

Rule I-6(4)(b) provides that a mid-year review of the Fund's income position shall be held shortly after October 31 of each year. 1/ The purpose of this paper is to provide the basis of the mid-year review of the Fund's income position as required by that Rule. It presents the actual results for the first half of financial year 1984, and revised estimates of income and expense for the year as a whole made in the light of the results for the first half year, the recent review of the Fund's liquidity position and on the assumption that substantially all of the increased quotas under the Eighth Review will be in effect (paid) by end-1983.

The Fund's income position was reviewed in May 1983 in the light of the actual net income for 1983 and estimates of income and expense were presented for 1984. 2/ At that time, net income for 1983 (SDR 65 million) was placed to the Special Reserve. The rate of charge was left unchanged at 6.6 percent per annum, the SDR interest rate was maintained at 100 percent of the combined market interest rate, the rate of remuneration was continued at 85 percent of the SDR interest rate, and the target amount of net income for 1984 was maintained unchanged at the equivalent of 3 percent of reserves on May 1, 1983.

Estimates of net income for 1984, based on assumptions at that time, were for net income of about SDR 93 million if the quota increases under the Eighth General Review of Quotas were in place by end-December 1983 and SDR 63 million if the increases were delayed until the end of the current financial year. The target amount of net income for 1984 (3 percent of reserves on May 1, 1983) was SDR 30 million.

1/ The text of Rule I-6(4) is reproduced in the Appendix.

2/ See "Review of the Fund's Income Position for Financial Years 1983 and 1984 (EBS/83/75, 4/18/83). See also minutes of Executive Board Meeting 83/70 (5/16/83).

II. Results for the first six months of 1984

For the first half of 1984, ended October 31, 1983, the Fund's net income amounted to SDR 24 million (see Table 1). Consequently, the safeguard mechanism in Rule I-6(4)(b) is not brought into effect. For that provision to have been applicable net income for the first six months of 1984 would have to have been SDR 5 million or less. 1/

Net income for the first half of the year is broadly in line with estimates for the year as a whole. During the first half year the effects of a marginally higher than assumed average SDR interest rate and rate of remuneration were more than offset by (i) a relatively low volume of purchases in the unremunerated reserve tranche (see Table 2); (ii) delays of some relatively large purchases by some members; and (iii) relatively large amounts of early repurchases and reversals of overcompensation of drawings under the compensatory financing facility by some members.

III. Revised Estimates for 1984

It is now estimated that net income for 1984 will be in the order of SDR 52 million, or approximately SDR 40 million lower than was estimated at the beginning of the financial year. The main reasons for the revisions are (i) an increase in administrative expenses; (ii) an increase in the SDR rate and rate of remuneration; and (iii) a level of drawings below the level that was earlier estimated. The revised data on which the estimates of net income has been made for the financial year 1984 are presented in Table 2; supporting data are provided in Table 3.

1/ Rule I-6(4)(b) provides that if, at the time of the mid-year review of the Fund's income position, the actual net income for the first six months of the financial year, on an annual basis, is below the target amount of net income by an amount equal to or greater than 2 percent of the Fund's reserves at the beginning of the financial year, the Executive Board shall consider an increase in the rate of charge as from November 1 so as to bring the Fund's income for the year as a whole into line with the target amount of net income. The figure of SDR 5 million is derived as follows:

	<u>Full Year</u>	<u>Half Year</u>
Target income of 3 percent of reserves at the beginning of the year	30	15
2 per cent of reserves at the beginning of the year	<u>20</u>	<u>10</u>
Income level for first half to trigger safeguard	<u>10</u>	<u>5</u>

Table 1. Estimated Income and Expense
For the Financial Year 1984

(In millions of SDRs)

	Actual Six Months October 31, 1983	Preliminary Estimates April 1983 <u>1/</u>	Revised Estimates <u>2/</u>
1. <u>Operational Income</u>			
a. <u>Periodic charges</u>			
Regular facilities	532	1,297	1,154
SFF	371	728	776
Enlarged Access	<u>177</u>	<u>559</u>	<u>507</u>
Total charges	1,080	2,584	2,437
b. Interest on SDR holdings	138	341	342
c. <u>Other income</u>			
Regular facilities	14	46	36
SFF	4	6	6
Enlarged Access	<u>9</u>	<u>30</u>	<u>28</u>
Total	1,245	3,007	2,849
2. <u>Operational Expense</u>			
a. Remuneration	567	1,454	1,327
b. <u>Interest expense</u>			
GAB	16	16	16
SFF	364	714	762
Enlarged Access <u>3/</u>	<u>174</u>	<u>548</u>	<u>497</u>
Total	1,121	2,732	2,602
3. Net operational income	124	275	247
4. Administrative expense	<u>100</u>	<u>182</u>	<u>195</u>
5. Net income	24	93	52
Pro memoria <u>4/</u>			
SFF	11	20	20
Enlarged Access	12	41	38

1/ See EBS/83/75 (4/18/83).

2/ Assumes quota increases in effect by end-1983.

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

4/ Net income including "other income" from the service charge of 0.5 per-cent.

Table 2. Assumptions on Which Estimates
for Financial Year 1984 are Based

(In millions of SDRs)

	Actual Six Months October 31, 1983	Preliminary Estimates April 1983 <u>1/</u>	Revised Estimates <u>2/</u>
A. Ordinary Resources			
1. Purchases			
Unremunerated reserve tranche <u>3/</u>	61	1,750	1,750
Credit tranches	1,805	7,100	5,435
Compensatory financing and Buffer Stock	<u>1,016</u>	<u>2,000</u>	<u>1,815</u>
Total	2,882	10,850	9,000
2. Scheduled repurchases other than SFF and Enlarged Access	1,074	1,265	1,765
3. Average SDR holdings	3,173	4,000	3,945
B. Borrowed Resources			
1. SFF:			
Purchases	754	1,200	1,120
Repurchases	62	200	200
Average balances	6,440	6,970	6,680
2. Enlarged Access:			
Purchases	1,750	6,100	5,570
Repurchases	--	--	--
Average balances	3,296	5,280	4,795
C. Interest Rates			
1. Average SDR interest rate (percent)	8.66	8.52	8.66
2. Average rate of remuneration (percent)	7.36	7.24	7.36
3. Average SFF interest rate (percent)	11.22	10.25	11.41
4. Average net cost of borrowing under enlarged access policy (percent)	10.47	10.34	10.37

1/ See EBS/83/75 (4/18/83).

2/ Assumes quota increases in effect by end-December 1983.

3/ Only those purchases in the unremunerated reserve tranche are taken into consideration. Purchases in the remunerated reserve tranche represent an exchange of a remunerated position between the purchasing member and the members whose currencies are sold by the Fund and have no effect on the Fund's income position. If SDRs were used by the Fund to finance such use there would be a net loss of income because the rate of remuneration is lower than the SDR rate of interest.

(i) Administrative expenses have been revised upward from SDR 182 million to SDR 195 million, an increase of SDR 13 million, reflecting the budget increase for the May 1983 salary adjustments, the shift into 1984 of some building costs originally estimated to fall in 1983 and the effects that changes in the US\$/SDR rate have on these expenses.

(ii) The SDR interest rate and the rate of remuneration are now assumed to remain unchanged from their average level of the first half of the year, i.e., at 8.66 percent and 7.36 percent, respectively, compared with rates of 8.52 percent and 7.24 percent estimated at the beginning of the year. The slight increase in the SDR rate and the rate of remuneration from the levels at the beginning of the year translate into a reduction of estimated net income for the whole year in the order of SDR 18 million, if interest rates remain unchanged at these levels for the balance of the year. ^{1/} (It is noteworthy that a change in the average SDR interest rate over the remainder of the year by 0.5 percentage point will change the outcome for net income by SDR 32 million for that period.)

(iii) On the assumption that the quota increases will have been paid by the end of 1983, it is estimated that use of the Fund's resources in 1984 will be below the level assumed at the beginning of the financial year by approximately SDR 2 billion on average. This will result in a reduction in estimated income from service charges of SDR 12 million and of approximately SDR 1 million in the margin of income over the costs of borrowing; the estimated reduction in income from periodic charges will be partly offset by an improvement in income from interest on SDR holdings and a net reduction of remuneration expense of SDR 4 million. The negative margin between the weighted average rates of income and expense is estimated to widen from the earlier estimate of 0.26 percentage point to 0.31 percentage point (Table 3).

(iv) As noted earlier, the estimates of net income for the remainder of the year are based on the assumption that substantially all of the quota increases authorized under the Eighth Review will be in effect by end-1983, and that access to the Fund's resources is not made contingent on the availability of resources. For example, if 10 percent of the total amount of quota increases would be delayed until the end of the financial year, the expected income would be lower by about SDR 3 million, reflecting a fall in earnings on lower SDR holdings and a partially offsetting decrease in remuneration expense.

^{1/} Based on the present assumptions, all other things being equal, an increase of the rate of remuneration say from January 1, 1984 to 90 percent of the SDR interest rate would result in an estimated deficit in 1984 of about SDR 15 million, or about SDR 50 million if the two rates were to be equalized.

Table 3. Estimates of Average Daily Balances
and Rates of SDR Interest, Remuneration, and Interest
(excluding SFF and Enlarged Access)
Financial Year 1984

(In millions of SDRs)

	Actual Six Months October 31, 1983	Preliminary Estimates April 1983 <u>1/</u>	Revised Estimates <u>2/</u>
1. Balances subject to periodic charges	15,990	19,645	17,485
Average rate of charge	6.6	6.6	6.6
2. Holdings of SDRs in the General Resources Account	3,173	4,000	3,945
Average rate of interest	8.66	8.52	8.66
3. Income-earning balances	19,163	23,645	21,430
Weighted average rate of income	6.94	6.92	6.98
4. Remunerated positions	15,318	20,085	18,030
Average rate of remuneration	7.36	7.24	7.36
5. Borrowings under the GAB <u>3/</u>	775	390	390
Average rate of interest	4.00	4.00	4.00
6. Interest-costing balances	16,093	20,475	18,420
Weighted average rate of expense	7.20	7.18	7.29
7. Net income-earning balances	3,070	3,170	3,010
Margin between weighted average rates of income and expense	-0.26	-0.26	-0.31
8. Pro memoria			
Margin between rate of charge and the average rate of remuneration	-0.76	-0.64	-0.76
Margin between average SDR rate and average rate of remuneration	1.30	1.28	1.30

1/ See EBS/83/75 (4/18/83).

2/ Assumes quota increases in effect by end-December 1983.

3/ Holdings subject to charges and amounts of borrowing under the SFF and EAR are excluded from this table because the rates of interest and of charges for the SFF and EAR are determined only at the end of six month periods ending June 30 and December 31. The rate of charge on supplementary financing provides the Fund with a basic constant margin of net income equal to 0.20 percentage point over the rate of interest, which progresses to 0.325 percentage point 3-1/2 years after the date of purchase. The rate of charge under the policy of enlarged access provides the Fund with a constant margin of net income equal to 0.20 percentage point over the average cost of borrowing.

IV. Summary and Conclusions

For the first six months of financial year 1984, net income of SDR 24 million was realized. The revised estimates for 1984 as a whole show a decline in net income from SDR 93 million estimated at the beginning of the financial year to SDR 52 million if virtually all the quota increases come into effect at the end of 1983.

The fall in estimated net income is due in part to a reduction in the use of the Fund's resources, leading to lower than estimated income from periodic and service charges which is not offset by a reduction in remuneration expense, and in part to the slight rise in the SDR interest rate and the rate of remuneration; administrative expenses were also higher than estimated at the beginning of the year. The actual results for 1984 will depend importantly on (i) the extent to which interest rates will diverge from the average level of the first half of the financial year; (ii) the timing of consents to and the payments for the quota increases; and (iii) the level of members' use of the Fund's resources.

It is the view of the staff that there is no need at this time to change the rate of charge on the use of ordinary resources. A further review of the Fund's income position (including estimates for 1985) will be made shortly after April 30, 1984 as provided by Rule I-6(4)(a) and (c). A review could be made earlier should the Executive Board consider an increase in the rate of remuneration in the course of this financial year.

Rule I-6(4) as amended on June 9, 1982

(4) The rate of charge on holdings acquired as a result of a purchase (i) in the credit tranches, or (ii) under the Extended Fund Facility (Executive Board Decision No. 4377-(74/114), as amended), or (iii) under the Facility for the Compensatory Financing of Export Fluctuations (Executive Board Decision No. 4912-(75/207), as amended), or (iv) under the Facility for the Problem of Stabilization of Prices of Primary Products (Executive Board Decision No. 2772-(69/47), as amended), or (v) under the Facility for Compensatory Financing of Fluctuations in the Cost of Cereal Imports (Executive Board Decision No. 6860-(81/81)), shall be determined in accordance with (a), (b), and (c), below.

- (a) The rate of charge shall be determined at the beginning of each financial year on the basis of the estimated income and expense of the Fund during the year and the target amount of net income for the year. The latter shall be three per cent of the Fund's reserves at the beginning of the year or such other percentage as the Executive Board may determine particularly in the light of the results in the previous financial year.
- (b) A mid-year review of the Fund's income position shall be held shortly after October 31 of each year. If actual net 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, two per cent of the Fund's reserves at the beginning of the financial year, the Executive Board will consider how to deal with the situation. If on December 15 no agreement has been reached as a result of this consideration, the rate determined under (a) at the beginning of the year shall be increased as of November 1 to the level necessary to reach the target amount of net income for the year.
- (c) A review of the Fund's income position shall be held shortly after the end of each financial year. If the net income for the year just ended is in excess of the target amount for the year, the Executive Board will consider whether the whole or a part of the excess should be used to reduce the rate of charge, or increase the rate of remuneration to not more than the rate of interest on the SDR, retroactively for the year just ended, or both, or to place all or part of the excess to reserve.

- (d) If the Fund's net income for a financial year is in excess of the target amount for that year, the Executive Board may for the purposes of the determinations and estimates referred to in (a) and (b) above in respect of the immediately subsequent financial year, decide to deem any part of the excess over the target amount that has been placed to reserve as income for that subsequent financial year.