FOR AGENDA

EBS/82/183

CONFIDENTIAL

October 8, 1982

To: Members of the Executive Board

From: The Acting Secretary

Subject: Australia - Use of Fund Resources - Buffer Stock Financing Facility - Special Stocks Under the International Sugar Agreement

Attached for consideration by the Executive Directors is a paper on a request expected to be received from Australia for a purchase equivalent to SDR 32.463 million under the buffer stock financing facility. A draft decision appears on page 9.

It is proposed to bring this subject to the agenda for discussion on Friday, November 5, 1982.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

AUSTRALIA

Use of Fund Resources--Buffer Stock Financing Facility--
Special Stocks Under the International Sugar Agreement

Prepared by the Research and European Departments

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

Approved by Wm. C. Hood and L.A. Whittome

October 6, 1982

The Managing Director has been informed that the Australian authorities will shortly request a purchase of SDR 32.463 million, or 2.7 per cent of quota, in connection with the obligation of Australia to constitute special stocks of sugar under the 1977 International Sugar Agreement (ISA). The expected request is to be made in accordance with the provisions of paragraph 1 of Decision No. 2772-(69/47), adopted June 25, 1969, as amended by Decision No. 4913-(75/207), adopted December 24, 1975. The proposed purchase relates to the minimum level of stocks that Australia, as an exporting member of the ISA, was obligated to accumulate in the 12 months ended June 1982. 1/ The required level of stocks was accumulated in two installments in February and June 1982. The special stocks have been valued for the purpose of a Fund purchase in accordance with the provisions of Decision No. 5597-(77/171), adopted December 16, 1977.

Australia has no purchases currently outstanding under the buffer stock financing facility. If approved, the purchase would raise the Fund's holdings of the member's currency from 100 per cent to 102.7 per cent of quota.

This paper, which is being circulated in advance of the formal request from Australia, is presented in four sections and an annex. The sections deal with: (1) balance of payments position, (2) recent market developments and the performance of Australia under the 1977 International Sugar Agreement, (3) the amount of purchase and repurchase expectations, and (4) staff appraisal and proposed decision. The annex summarizes the member's relations with the Fund.

1/ Australia is under obligation to accumulate the maximum level of stocks set under the ISA by December 31, 1983.

1. Balance of payments position

At present, the interpretation of recent developments in, and the short-term outlook for, Australia's balance of payments and reserve position is not entirely straightforward, in view of the large swings that have been taking place in the member's external transactions. An appraisal is required, however, inasmuch as the use of Fund resources under the buffer stock financing facility, like all other uses, is subject to the requirement of need because of the member's balance of payments or reserve position. 1/ It should be noted that the member's balance of payments and reserve position are separate criteria,each of which could be the basis for need to use the Fund's resources, with the former referring to the sum of transactions and the latter to a stock position.

Judgments about what constitutes a weak reserve position in this context are made on a case-by-case basis, taking into account a wide variety of factors, including inter alia the volume of foreign trade, past behavior of reserves, prospective developments, the traditional level of reserves, and seasonal factors. The SDR value of Australia's international reserves (including gold valued at SDR 35 an ounce) covered slightly less than two months' merchandise imports at the beginning of 1981/82 (fiscal year ended June 30), and in the following nine months declined to less than one month of imports. Thereafter, reserves rose sharply and by the end of the fiscal year exceeded two months' imports. Some decline again occurred in the next two months, becoming more pronounced in August; part of this loss can apparently be ascribed to the beginning of the seasonal turnaround in capital flows. When these facts are judged against the background of Australia's own previous experience since 1977 and the experience of other members, especially the group of small industrial countries, it is by no means self-evident that Australia's reserve position would generally be regarded as a weak one. Australia, however, unlike most other small industrial countries, is a primary commodity exporter and therefore subject to large swings in the terms of trade. Partly for this reason, the Australian authorities have recently considered it advisable to make provision for bolstering reserves by arranging substantial overseas loans.

As for Australia's balance of payments, the current account deficit has increased sharply in the last two years, from less than 2 per cent of GDP in 1979/80 to 6 per cent of GDP in 1981/82. In this period, the trade account moved from a surplus of about SDR 2.4 billion in 1979/80 to a deficit of over SDR 3.3 billion in 1981/82, and the deficit on invisibles account continued to widen. In 1981/82, export receipts rose little, reflecting in part weak world demand and lower prices for some commodities. The rapid growth in domestic demand for both consumer and investment goods led to a sharp rise in imports. In the first eight months of 1981/82, capital inflows fell short of covering the current account deficit, but

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1/ The third criterion stated in the Articles--need because of developments in reserves--is not applicable in the case of Australia, as it refers primarily to an impending discharge of liabilities.

Table 1. Australia: Balance of Payments, 1978/79-1982/83 1/

(In millions of SDRs)

	1978/79	1979/80	1980/81	1981/82	1982/83 2/
A. Current account	-3,374	-1,836	-4,833	-8,824	-9,400
Trade account	517	2,439	-343	-3,327	-3,000
Exports, f.o.b.	12,477	16,470	17,403	18,590	20,000
Imports, f.o.b.	-11,961	-14,032	-17,745	-21,817	-23,020
Invisibles, net	-3,890	-4,274	-4,490	-5,597	-6,400
B. Capital account	3,264	1,569	5,896	10,146	...
Government capital, net	1,203	-71	-64	268	...
Private capital and balancing item, net	2,061	1,640	5,959	9,878	...
C. Overall balance (A+B)	-110	-267	1,063	1,322	...
D. Monetary movements (increase in assets -)					
Gross international reserves	158	317	-1,151	-1,303	...
Use of Fund credit	--	-123	-123	--	32 3/
Other (incl. valuation adjustment)	-48	73	211	-19	...
Memorandum items:					
Current account balance (in per cent of GDP)	-3.7	-1.8	-4.0	-6.0	-6.0
Overall balance (in per cent of GDP)	-0.1	-0.3	0.9	0.9	...
Gross international reserves 4/ (in millions of SDRs)	1,962	1,645	2,796	4,099	3,584 5/
Gross international reserves 4/ (in months of imports)	2.0	1.4	1.9	2.3	1.9 5/

Sources: Information provided by the Australian authorities; and staff estimates.

1/ Financial years ended June 30; detail may not add because of rounding.
2/ Projection.
3/ Comprises proposed purchase under the BSFF.
4/ Gold valued at SDR 35 per fine ounce; end of period.
5/ End-August 1982.

extremely large capital inflows in the last quarter of 1981/82, which were partly seasonal, produced an overall surplus for the year as a whole. In spite of this outcome, the exchange rate of the Australian dollar depreciated by over 7 per cent in effective trade-weighted terms, and by over 14 per cent in terms of the U.S. dollar, between end-1981 and early September 1982. In late July 1982, the rate against the U.S. dollar went below parity for the first time.

The current account deficit for 1982/83 is projected at about SDR 9.4 billion, or again equivalent to about 6 per cent of GDP. Exports are forecast to increase by about 8 per cent, and import growth seems likely to decelerate markedly, in part because of a slowdown that is expected for private investment, including resource-related investment. However, the invisibles deficit is likely to continue to grow as investment income due abroad increases. Developments in the capital account will clearly be decisive in the overall outcome of the balance of payments in 1982/83, and considerable uncertainty now surrounds prospects for the capital account. It is difficult, in particular, to judge precisely how much of the heavy capital inflow in the last months of 1981/82 was of a short-term nature. Moreover, private long-term capital inflows may well moderate in 1982/83 as a result of revised investment plans following the recent fall in commodity prices, which is leading to a postponement of some major investment projects in the resources sector. Thus far in 1982/83, overseas loans contracted by the Government amount to SDR 600 million, and the Government is likely to undertake further borrowing.

The significant reserve losses in July and August 1982 do provide evidence of a payments deficit during the most recent period. As this period is rather short, the evidence could be either confirmed or contradicted by any later information that became available by the time that Australia's request is considered by the Executive Board. If Australia would be found at that time to have incurred a deficit that has not yet been overcome, that deficit would be within the period during which a member may make a purchase under the Decision (No. 5597-(77/171), adopted December 16, 1977) on the application of the Buffer Stock Financing Facility to the International Sugar Agreement. That decision provides that "a member may make a purchase under this decision if its request is received in the Fund not later than six months after (i) the end of the period in which the member has to fulfill its obligation to establish a special stock ...." As mentioned above, Australia was obligated to accumulate the first year's installment of special stocks in the 12 months ended June 1982, and is obligated to complete its accumulation of the maximum level of special stocks set under the ISA by the end of 1983. The present request is to be considered by the Board well within the time limit. The balance of payments difficulties being experienced by Australia at the time of Board consideration of the request would therefore be a basis for finding whether the requirement of need is met.

2. Recent market developments and the performance of Australia under the 1977 International Sugar Agreement (ISA)

There has been no change in the status of the ISA since the recent assessment contained in the staff paper on the Dominican Republic's request for a buffer stock purchase (EBS/82/114, 6/29/82). The free market price of sugar recovered by 14 per cent in July reflecting an increase in demand emanating mainly from China and Japan. But with the announcements of higher than previously estimated crops in Brazil, Cuba and India, the overall production surplus in 1981/82 was revised upward again to nearly 8 million tons. The world output in 1981/82 is now estimated at a record level of 99 million tons, while world consumption is estimated to be around 91 million tons. Reflecting the anticipated increase in supplies, the price of sugar fell again in August to 6.8 cents per pound, to about the same level as the average price in June 1982 (Table 2).

Australia is one of the major sugar-producing countries in the world and became a leading exporter in 1981. The volume of exports in 1981, at slightly less than 3 million metric tons, was 24 per cent larger than the year before. The imposition of export quotas under the ISA in May 1981 did not affect Australia as much as some other exporters because it already had contracts which were not subject to the quota restraint under the ISA.

Based on export performance during the last three years, Australia's basic export tonnage (BET) for 1982 has been set at 3.3 million tons, 28 per cent higher than that for 1981; its export quota currently in effect is 2.83 million tons, or 85 per cent of its BET, and is expected to be met in full. Owing to the steep fall in prices (Table 2), the value of Australia's sugar exports is expected to drop sharply. Australia has accumulated the minimum amount of special stocks (152,363 tons) which it was obligated to accumulate by June 30, 1982 under the ISA. These were accumulated in February and June, as evidenced by certificates of existence supplied by the authorities to the International Sugar Organization. Verification of the special stocks by an on-site inspection was conducted in May 1982 and the next inspection is scheduled for May 1983.

3. The amount of purchase and repurchase expectations

a. The amount of purchase

Under the terms of the ISA, Australia is obligated to constitute an amount equivalent to 380,908 tons in special stocks of sugar during a period ending December 1983. The minimum quantity to be constituted during the first year (12 months ended June 1982) is equivalent to 152,363 tons, and this quantity was accumulated by Australia in two installments: 100,000 tons in February 1982 and 52,363 tons in June 1982. The proposed purchase relates to these special stocks which have already been accumulated.

Table 2. Sugar Prices on the Free Market

		In U.S. Cents Per Pound		In SDRs Per Metric Ton	
		U.S. Cents	Percentage Change 1/	SDRs	Percentage Change
1976		11.56	-43.8	220.68	-40.9
1977		8.11	-29.8	153.22	-30.6
1978		7.82	-3.6	137.79	-10.1
1979		9.66	23.5	164.91	19.7
1980		28.67	196.8	485.68	194.5
1981		16.89	-41.1	315.70	-35.0
1981	I	24.56	-31.2	435.63	-28.8
	II	16.43	-33.1	306.44	-29.7
	III	14.25	-13.3	277.12	-9.6
	IV	12.31	-13.5	233.69	-15.7
1982	Jan.	12.90	-0.6	246.60	0.3
	Feb.	13.08	1.4	254.54	0.3
	Mar.	11.26	-13.9	220.96	-13.2
	Apr.	9.58	-14.9	189.41	-14.3
	May	8.11	-15.3	157.57	-16.8
	June	6.84	-15.7	136.83	-13.2
	July	7.80	14.0	157.55	15.1
	Aug.	6.77	-13.2	137.36	-12.8

1/ From previous period.

Valuation of the stocks for the purpose of determining the amount of the purchase has been made in accordance with paragraphs 3, 4, and 5 of Decision No. 5597-(77/171), adopted December 16, 1977, and the procedures set out in SM/78/229. Since the market price of sugar during February 1982 was above the floor price of the Agreement (13 cents per pound), the stocks constituted in February have been valued at the floor price; stocks constituted in June have been valued at the average market prices for June because the market price in June was below the floor price of the Agreement. Valued in this way, the stocks amount to SDR 32.463 million, which is the amount expected to be requested (Table 3).

The Australian authorities have stated that there are no outstanding loans in foreign exchange for which the special stocks held under the terms of the Agreement have been used as collateral. They have also stated that they will promptly inform the Fund of any such loans that may be obtained in future while any part of the proposed purchase remains outstanding.

Table 3. Valuation of Special Stocks of Sugar

Month of Stock Accumulation	Amount of Stocks Constituted (MT)	Price of Sugar			Value of Stocks (SDR Millions)
		U.S.¢/lb.	SDR/$ Rate	SDR/MT	
February	100,000	13.00	0.88270	252.984	25.298
June	52,363	6.84	0.90736	136.826	7.165
Total	152,363				32.463

b. Repurchase expectations

As provided in paragraph 6 of Decision No. 5597-(77/171) and in procedures set out in SM/78/229, a member with purchases outstanding under the Decision will be required to repurchase pursuant to Article V, Section 7(c) within three to five years after the date of the purchase in accordance with Decision No. 5703-(78/39), as amended by Decision No. 6862-(81/81). Moreover, paragraph 6 of Decision No. 5597-(77/171) reads in part:

> The member will be expected to make repurchase at an earlier date

(i) when, and to the extent that, stocks are released from the control of the International Sugar Organization, 1/ and

(ii) when the member obtains a loan in foreign exchange for which the special stock is used as collateral, to the extent that the amount of this loan, together with the amount of purchases outstanding exceeds the amount that the member may purchase in accordance with paragraphs 4 and 5 above.

In accordance with the procedures outlined in Section 5 of SM/78/229, Australia would be expected to repurchase from the Fund in the first event within 90 days from the date on which stocks are released from the control of the International Sugar Organization, or in the second event within a few days after the Fund has been informed of the loan for which the special stocks have been used as collateral.

4. Staff appraisal and proposed decision

Australia is expected to request a purchase of SDR 32.463 million, equivalent to 2.7 per cent of its quota in the Fund, under the buffer stock financing facility in connection with special stocks constituted under the terms of the 1977 International Sugar Agreement.

Australia's current account deficit increased sharply in fiscal 1981/82 to SDR 8.8 billion, but the overall balance of payments was in surplus as a result of extraordinarily large capital inflows in the final months of the year. Reserves (with gold valued at SDR 35 per ounce) for most of the fiscal year accounted for the equivalent of a month's merchandise imports. The outlook for 1982/83 indicates a current account deficit of about SDR 9.4 billion (6 per cent of GDP), but the overall outcome of the balance of payments will critically depend on developments in the capital account. Developments in the first two months of 1982/83 (July-August) provide evidence of a payments deficit being substantiated by a significant loss of reserves. In order to bolster reserves, the authorities have arranged substantial foreign borrowings. The staff believes that the proposed purchase will be justified by a balance of payments need if, at the time of Board consideration of the request, the deficit incurred during July-August has not subsequently been reversed.

Australia has constituted its minimum stocking obligation amounting to 152,363 tons of sugar for 1981/82 under the terms of the 1977 International Sugar Agreement. The proposed purchase in respect of the special

1/ This would normally occur when the price exceeds the trigger point specified in Article 44 of the Agreement, but could also occur if and when the Agreement is terminated.

stocks of sugar, calculated in accordance with Executive Board Decision No. 5597-(77/171) and the procedures set out in SM/78/229, is SDR 32.463 million.

There are no outstanding loans in foreign exchange for which the special stocks have been used as collateral, and the Australian authorities have indicated that they will inform the Fund of any such loans that may be obtained while the proposed purchase remains outstanding. The forthcoming request will include a statement that Australia will cooperate with the Fund in efforts to find, where required, appropriate solutions for its balance of payments difficulties; it will also include appropriate representation by Australia that it will make early repurchases of outstanding amounts of the proposed purchase in accordance with paragraph 6 of Executive Board Decision No. 5597-(77/171) as outlined in Section 3 of this paper.

The staff believes that the expected request for a purchase of the equivalent of SDR 32.463 million will meet all the requirements of Executive Board Decision No. 2772-(69/47), as amended, on the Problem of Stabilization of Prices of Primary Products, and Executive Board Decision No. 5597(77/171) on Fund Financing of Special Stocks under the 1977 International Sugar Agreement. Accordingly, the following draft decision is proposed for adoption by the Executive Board after a duly authenticated request for a purchase of the above-mentioned amount has been received:

1. The Fund has received a request by the Government of Australia for a purchase of the equivalent of SDR 32.463 million under the decision on Buffer Stock Financing Facility: The Problem of Stabilization of Prices of Primary Products (Decision No. 2772-(69/47), adopted June 25, 1969, as amended by Decision No. 4913-(75/207), adopted December 24, 1975), and the decision on Buffer Stock Financing Facility: 1977 International Sugar Agreement, Decision No. 5597-(77/171), adopted December 16, 1977).

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

Fund Relations with Australia 1/

Quota:	SDR 1,185 million.
Fund holdings of Australian dollars:	SDR 1,185 million, or 100.0 per cent of quota.
SDR position:	
Net cumulative allocation:	SDR 470.5 million, or 100.0 per cent of allocation.
Holdings:	SDR 7.6 million, or 1.7 per cent of allocation.
Exchange system:	The authorities of Australia do not maintain margins in respect of exchange restrictions. The exchange rate of the Australian dollar is determined by reference to a trade-weighted basket of currencies. In practice, a mid-rate for the Australian dollar in terms of the U.S. dollar (the intervention currency) is announced each day by the Reserve Bank. On August 11, 1982 the authorities set a middle rate for the U.S. dollar of \$A 1 = US\$0.9778. Exchange rates for other currencies are not officially posted. There are no taxes or subsidies on purchases on sales of foreign exchange.
Exchange practices subject to Article VIII:	None.
Last consultation:	March 1981.

1/ As of July 31, 1982.