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EBAP/09/63

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April 9, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **The Consolidated Medium-Term Income and Expenditure Framework**

The attached paper on the consolidated medium-term income and expenditure framework provides background to the paper on the proposed FY2010–FY2012 medium-term administrative, restructuring, and capital budgets (EBAP/09/51, 3/26/09), which is tentatively scheduled for discussion on **Wednesday, April 15, 2009.** The paper also provides background material for the discussion on the review of the Fund's income position for FY2009 and FY 2010, which is tentatively scheduled for discussion on **Wednesday, April 29, 2009.**

Questions may be referred to Ms. Reynolds, OBP (ext. 38795) on expenditure issues and Mr. Kwabe, FIN (ext. 37828) on income issues.

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The Consolidated Medium-Term Income and Expenditure Framework

Prepared by the Finance Department and the Office of Budget and Planning

Approved by Andrew Tweedie and Siddharth Tiwari

April 9, 2009

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I. Background and Strategic Considerations

1. **This paper updates the Fund's consolidated income and expenditure outlook through FY 15**. It incorporates and extends the income projections in the forthcoming paper on the *Review of the Fund's Income Position for FY 2009 and 2010* and budget projections in "The FY2010–FY2012 Medium-Term Administrative, Restructuring and Capital Budgets" (EBAP/09/51).

2. **Events have moved rapidly since April 2008 when the Executive Board last considered the consolidated income and expenditure situation and agreed on the new sustainable income model for the Fund**. The front-loaded restructuring plan aimed at cutting structural spending by $100 million is being implemented on schedule. At the same time, an extraordinary global financial shock has unfolded, leading to a sharp increase in demand for Fund advice and lending across the globe. It has also been accompanied by a significantly larger demand for Fund credit and a projected rise in lending income. However, these developments have not altered the imperative of timely implementation of the new income model to reduce the Fund's reliance on temporary lending income and generate the earnings needed to close the remainder of the $400 million structural financing gap on a sustainable basis.

3. **In addressing the global financial crisis, management is committed to providing for all reasonable funding needs, while adhering to the medium-term budget (MTB)**. The proposed MTB for FY 10–12 would meet demands by redeploying personnel resources within and across departments, by carrying forward the FY 09 spending under run, and by allocating half of the planned contingency reserves in FY 10 and FY 11. In this way, continued heavy demands in the months ahead are expected to be financed within the real FY 09–11 MTB envelope approved last year.

4. **However, in the face of a longer and deeper crisis, redeployment and the contingency would not be adequate. In addition, the cost of any new responsibilities arising in the context of a reformed global financial architecture would need to be addressed—and the budget consequences assessed if and when details become available**. On the basis of current information and assumptions, a supplementary budget allocation would likely be needed if the costs of meeting the crisis were to exceed the $32 million estimate for FY 10–11. A temporary increase in administrative resources could, if needed, be financed through the use of a small proportion of the higher lending income, which is also temporary. With this strategy, the Fund would maintain its commitment to the agreed structural steady state budget, while leaving open the possibility of additional longer-term financing for new mandates.

II. Consolidated Income and Expenses

5. **The framework presented in April 2008 combined the reduced expense path of the proposed FY 09–11 MTB and the new income model, in which a sharp decline in lending income was gradually offset by a rise in investment income** (Figure 1). While sensitive to key assumptions, including those for gold prices, investment returns and pay-out ratios from the endowment created by gold sales, the baseline projections pointed to the attainment of a sustainable balanced net income position within five years.

Figure 1. Income Model and Medium-Term Budget, April 2008
(in millions of U.S. dollars)

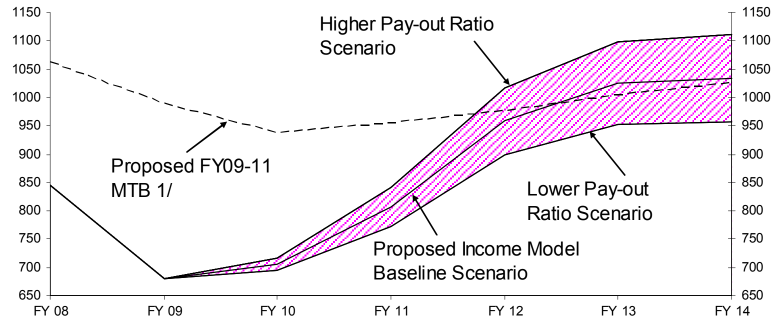
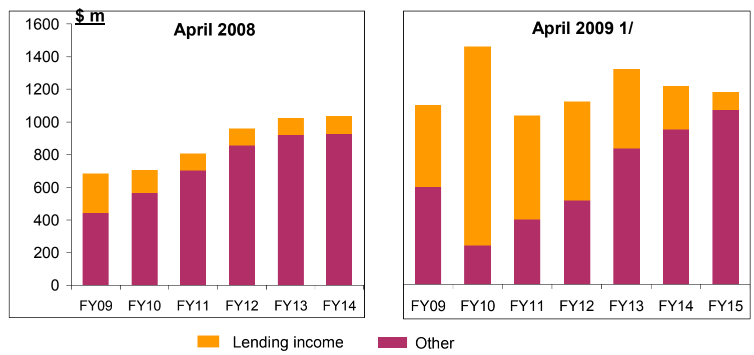


Figure 2a. Operational Income



1/ Excludes surcharge income from FY 11 onwards.

Figure 2b. Surcharge Income Placed to Reserves

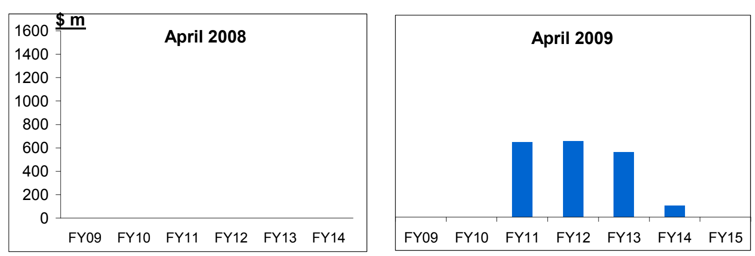
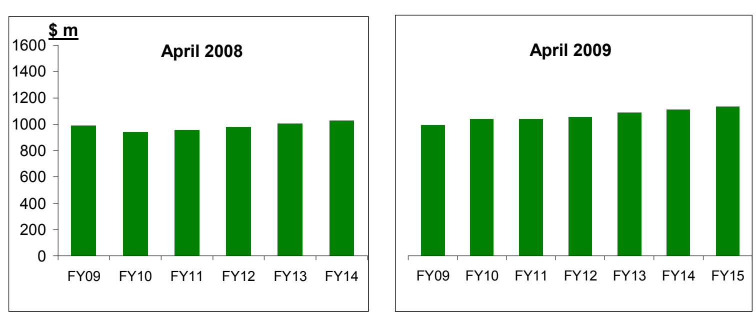


Figure 2c. Administrative Expenses



6. **Updated baseline projections show a moderate improvement in the medium term outlook** (Figures 2a–c and Table 1). The sharp rise in lending in the second half of FY 09 has significantly changed the immediate outlook for income. Over the longer term and with full implementation of the income model, the level of income drops back as lending income diminishes, but remains somewhat higher than envisaged previously. With the path of expenses essentially unchanged from the earlier framework, a modest surplus is projected over the medium term.

Table 1. Consolidated Income and Expenses, FY 09–15
Baseline Scenario

(In millions of U.S. dollars)

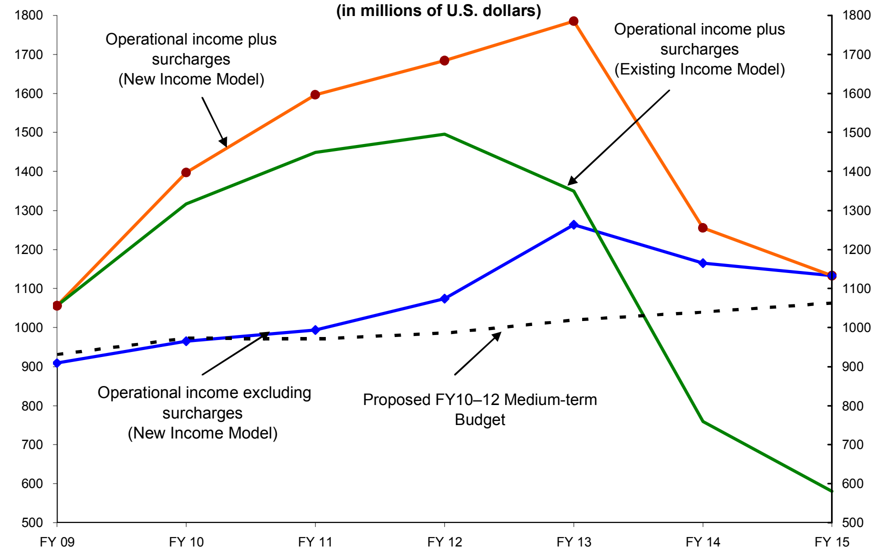
	Estimated	MTB Timeframe			Projected		
	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
A. Operational income 1/	1,056	1,397	994	1,075	1,263	1,164	1,130
1. Lending income 2/	482	1,168	613	582	463	254	105
2. Investment income 3/	535	125	238	304	564	648	729
Reserves	535	125	238	304	367	439	516
Gold endowment pay-out	0	0	0	0	196	208	213
3. Interest free resources 4/	33	21	59	107	153	179	214
SCA-1 and other	33	19	38	50	56	62	73
Gold book value	0	2	21	56	96	117	141
4. Reimbursements 5/	6	83	83	83	83	83	83
B. Administrative expenses	931	973	971	986	1,019	1,040	1,063
1. Net administrative expenditures 6/	818	905	918	932	961	979	1,003
2. Capital budget items expensed	17	17	11	10	14	15	15
3. Depreciation expense	36	39	42	44	44	46	45
4. Restructuring expenses 7/	60	12	0	0	0	0	0
C. Balance (A-B) 8/	124	424	23	89	244	124	67
Memorandum items:							
Operational income from new income model 9/	0	78	146	184	424	459	488
Profits from gold sales 1/	0	1,079	2,158	2,158	1,079	0	0
Surcharges 2/	147	432	602	610	522	90	0
U.S. dollar/SDR exchange rate 10/	1.55	1.50	1.50	1.50	1.50	1.50	1.50
SDR interest rate 11/	1.81	0.90	1.60	2.10	2.50	2.90	3.50
Fund credit (average stock, SDR billions)	12.5	32.4	39.4	38.3	30.4	16.4	6.5
Precautionary balances (end of period, SDR billions)	7.1	7.4	7.8	8.3	8.8	8.9	9.0
Capital expenditures (budget definition) 12/	52	52	43	48	49	52	53
Capital-related expenses 13/	53	56	53	54	58	61	60

Sources: Finance Department and Office of Budget and Planning.
Note: Figures may not add to totals due to rounding.
1/ Gold sales are assumed to be phased over 3 years from FY 10 third quarter, at an average price of $810 per ounce.
2/ Lending income includes surcharges in FY 09 and FY 10. Surcharges are assumed to be placed directly to reserves when net operational income from other sources is positive (FY 11–15).
3/ Incorporates the effect of a broader investment mandate from FY 11 and a 3 percent pay-out from the endowment.
4/ Incorporates the reduction in remuneration expenses from SCA-1 resources and from retaining proceeds equal to the book value of gold in the GRA.
5/ Reimbursement of the GRA for the administrative expenses of the PRGF-ESF Trust is assumed from FY 10.
6/ Net expenditures are estimated to exceed net budgets in FY 10–11 as a result of additional crisis-related expenditures that will be financed by carry forward of unspent administrative resources from FY 09—which in turn is reflected in the net expenditures estimate shown for that year. For FY 12–15, net administrative expenditures are equal to the net administrative budget.
7/ FY 08 included a restructuring provision of SDR 68 million ($111 million), see *The Fund's Income Position—Actual Outcome* (EBS/08/95, 8/12/08). No change has been made to the original estimate of restructuring costs as reported in the Consolidated Medium-Term Income and Budget Framework paper (EB/CB/08/6) dated December 29, 2008. These figures will be updated in the actual outcome paper on the Fund's income position for FY 09.
8/ Corresponds to net operational income in Table II.1, Annex II, with a deduction for restructuring expenses.
9/ Increase in operational income from broadening investments, the endowment funded by profits from gold sales, the remuneration reduction from the book value portion of gold sales, and reimbursement for PRGF-ESF Trust expenses.
10/ The US$/SDR exchange rate is assumed to be unchanged from recent levels.
11/ The SDR interest rate is assumed to decline in FY 10 and then rise in the medium term to 3.5 percent by FY 15, which reflects the historical average level of the SDR interest rate in the past 15 years.
12/ Estimated capital expenditures against capital budget appropriations in the concurrent and two preceding years.
13/ The sum of capital budget items expensed and depreciation expenses.

7. **Underlying expenditure consolidation remains on track**. Expenditure projections—which are unchanged from before—are based on the proposed FY 10–12 MTB (Annex I) and the assumption of zero real budget growth in outer years.

8. **Temporary income from lending should not mask the imperative of implementing the new income model**. In a baseline scenario—based on current arrangements[1]—lending income is projected to be significantly higher in the near term, with second round effects in terms of higher investment income from reserves in the outer years. At the same time, earnings from the endowment are projected (using the average gold price over the last two years of $810 per ounce) to be broadly unchanged. Accordingly, structural income would be moderately higher than envisaged in April 2008 under full implementation of the new income model, and the Fund would rely on lending income to finance less than 10 percent of the administrative budget, compared with more than 50 percent before the implementation of the new income model. Temporary surcharge income, which is excluded from operational income from FY 11, would considerably augment the medium-term operational surplus and allow a more rapid build-up of the Fund's reserves.[2] However, the new income model remains critical to this objective and to achieving a sustainable medium-term income position (Figure 3).

Figure 3. Baseline Scenario: Projected Income and Expenses
(in millions of U.S. dollars)



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[1] Including all financial arrangements approved as of end-March 2009 and the prospective Flexible Credit Line arrangement with Mexico. Annexes I and II, respectively, provide more detail on the assumptions behind the expenditure and income projections.

[2] Level-based surcharges, at 200 basis points, apply on Fund credit outstanding above 300 percent of a member's quota. In the past, except for periods when the Fund has experienced operational income shortfalls, surcharges have been placed directly to the Fund's reserves to help build up precautionary balances and mitigate credit risks. Under the recently approved reforms, time-based surcharges of 100 basis points will now apply on credit outstanding above 300 percent of quota and remaining outstanding for more than 36 months.

Table 2. Consolidated Income and Expenses, FY 09-15

High Lending Scenario

(In millions of U.S. dollars)

	Estimated	MTB Timeframe			Projected		
	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
A. Operational income 1/	1,058	2,068	1,522	1,708	1,911	1,738	1,585
1. Lending income 2/	484	1,837	1,115	1,144	980	629	289
2. Investment income 3/	535	125	256	360	678	831	989
Reserves	535	125	256	360	481	623	777
Gold endowment pay-out	0	0	0	0	196	208	213
3. Interest free resources 4/	34	24	68	122	171	195	224
SCA-1 and other	34	22	47	65	75	78	83
Gold book value	0	2	21	56	96	117	141
4. Reimbursements 5/	6	83	83	83	83	83	83
B. Administrative expenses	931	973	971	986	1,019	1,040	1,063
1. Net administrative expenditures 6/	818	905	918	932	961	979	1,003
2. Capital budget items expensed	17	17	11	10	14	15	15
3. Depreciation expense	36	39	42	44	44	46	45
4. Restructuring expenses 7/	60	12	0	0	0	0	0
C. Balance (A-B) 8/	127	1,095	551	722	892	698	522
Memorandum items:							
Operational income from new income model 9/	0	78	152	196	444	485	518
Profits from gold sales 1/	0	1,079	2,158	2,158	1,079	0	0
Surcharges 2/	147	690	1,219	1,415	1,318	600	127
U.S. dollar/SDR exchange rate 10/	1.55	1.50	1.50	1.50	1.50	1.50	1.50
SDR interest rate 11/	1.81	0.90	1.60	2.10	2.50	2.90	3.50
Fund credit (average stock, SDR billions)	12.5	47.9	68.3	73.5	64.8	41.5	18.8
Precautionary balances (end of period, SDR billions)	7.1	7.8	9.0	10.4	11.9	12.8	13.2
Capital expenditures (budget definition) 12/	52	52	43	48	49	52	53
Capital-related expenses 13/	53	56	53	54	58	61	60

Sources: Finance Department and Office of Budget and Planning.
Note: Figures may not add to totals due to rounding.
1/ Gold sales are assumed to be phased over 3 years from FY 10 third quarter, at an average price of $810 per ounce.
2/ Incorporates the effect of assumed higher lending taking account of current staff assessment of arrangements in the pipeline based on discussions with members, that implies a peak of Fund credit at SDR 74 billion in FY 12. Lending income includes surcharges for FY 09 and FY 10.
3/ Incorporates the effect of a broader investment mandate from FY 11 and a 3 percent pay-out from the endowment.
4/ Incorporates the reduction in remuneration expenses from SCA-1 resources and from retaining proceeds equal to the book value of gold in the GRA.
5/ Reimbursement of the GRA for the administrative expenses of the PRGF-ESF Trust is assumed from FY 10.
6/ Net expenditures are estimated to exceed net budgets in FY 10–11 as a result of additional crisis-related expenditures that will be financed by carry forward of unspent administrative resources from FY 09—which in turn is reflected in the net expenditures estimate shown for that year. For FY 12–15, net administrative expenditures are equal to the net administrative budget.
7/ FY08 included a restructuring provision of SDR 68 million ($111 million), see *The Fund's Income Position—Actual Outcome* (EBS/08/45, 8/12/08). No change has been made to the original estimate of restructuring costs as reported in the Consolidated Medium-Term Income and Budget Framework paper (EB/CB/08/6) dated December 29, 2008. These figures will be updated in the actual outcome paper on the Fund's income position for FY 09.
8/ Corresponds to net operational income in Table II.4, Annex II, with a deduction for restructuring expenses.
9/ Increase in operational income from broadening investments, the endowment funded by profits from gold sales, the remuneration reduction from the book value portion of gold sales, and reimbursement for PRGF-ESF Trust expenses.
10/ The US$/SDR exchange rate is assumed to be unchanged from recent levels.
11/ The SDR interest rate is assumed to decline in FY 10 and then rise in the medium term to 3.5 percent by FY 15, which reflects the historical average level of the SDR interest rate in the past 15 years.
12/ Estimated capital expenditures against capital budget appropriations in the concurrent and two preceding years.
13/ The sum of capital budget items expensed and depreciation expense.

9. **The baseline scenario is subject to several uncertainties for both expenditures and income**:

- Spending could be higher than under the MTB if the global crisis is deeper or more prolonged or if the Fund is given new mandates. Additional crisis demands would likely necessitate a supplementary appropriation, but would not adversely impact the Fund's overall balance because, as shown in Figure 3, temporary spending would be more than covered by temporary income.

- Alternative income paths would result from different assumptions on gold payout ratios and lending levels as discussed in Box 1 and Table 2, and Annex II.[3] The baseline still assumes a 3 percent payout ratio, which may be challenging given recent developments in global financial markets. Higher lending would increase the scope to build precautionary balances in the short term. Also, these projections do not take account of possible options to use additional resources from the agreed gold sales to increase the Fund's concessional lending capacity, which will be discussed in a separate paper.

Box 1: Lending Sensitivity Analysis

Given the uncertainties over potential significant demand for Fund financing as a result of the global financial crisis, the Fund's near-term income is also more than unusually uncertain. The impact of higher lending on Fund income is sensitive to a number of key parameters unique to each arrangement, i.e., the amount of access as a percent of quota, the phasing of disbursements and the size of the initial disbursement. However, the potential income effect of higher lending can be illustrated by assuming a drawing arrangement with access of 800 percent of quota. On this basis, additional lending of SDR 25 billion would yield additional annual average income of about SDR 335 million (see Table).[1,2] In the case of a precautionary Flexible Credit Line (FCL) or high access 24-month precautionary arrangement that is not drawn, the additional average annual income on the same basis (SDR 25 billion; 800 percent of quota) would be about SDR 65 million for the FCL and SDR 32 million for a precautionary arrangement.

	Total	Average per year
	(in SDR millions)	
Margin for the rate of charge	1,032	147
Service charges	125	18
Surcharges		
Level-based	1,007	144
Time-based	186	27
Total average annual income [1]		**335**

[1] Average over a seven-year period

[1] This assumes a 24-month arrangement, with seven equal quarterly disbursements following an initial disbursement of one-third of the total access; repayments start after 3 ¼ years and amounts are assumed to be fully repaid seven years after approval of the arrangement (obligations basis; earlier repayments would reduce the increase in income). On this basis, credit under the arrangement would peak at about SDR 25 billion after two years, with an average credit outstanding of about SDR 15 billion during the seven year cycle. The margin on the rate of charge is assumed to be 100 basis points and surcharges are based on the new charges and maturities framework recently approved.
[2] Does not include the incremental effects on expenditures.

[3] The endowment funded by gold sales is assumed to generate returns (payouts) that contribute to the Fund's operational income, while also preserving the real value of the endowment.

10. **Some alternative scenarios would lead to different policy options**. A high lending scenario presented in Table 2 illustrates staff's assessment of possible new arrangements in the pipeline, implying peak Fund credit of SDR 74 billion in FY 12 (nearly double that assumed in the baseline scenario). In this case, further reserve accumulation would be warranted in the short term, to mitigate heightened credit risks. In the longer-term, once lending had declined, a significant surplus would remain and the Board could consider the introduction of a dividend policy so that income in excess of operating requirements and reserve accumulation could be returned to the membership (perhaps combined with future reductions in the charges on Fund lending). Financing options for any new responsibilities or mandates that are not offset by shedding low priority outputs would also need to be considered.

III. Conclusion

11. **The global financial crisis will have a significant transitory impact on the Fund's medium-term finances and underscores the case for the new income model and a clear anchor for expenditures**. While potential expenditure pressures from the crisis could be financed by the expected much stronger income from lending in the near term, eventually such income will dissipate. Near-term surpluses provide an opportunity to considerably bolster the Fund's reserve position. A broader income base will be required to support the Fund's operational expenditures once the transitory effects of the crisis have passed.

ANNEX I: EXPENDITURE PROJECTIONS, FY 09–FY 15

1. **Detailed information on the proposed medium-term budget underlying the expense projections used in this paper are provided in "The FY2010–2012 Medium-Term Administrative, Restructuring, and Capital Budgets," (EBAP/09/51)**. This annex describes the salient features of EBAP/09/51 necessary to reconcile the administrative expenditures presented there with the concept of administrative expenses used here.

2. **The proposed net administrative envelopes for FY 10 and FY 11 are unchanged from those agreed in the FY 09–11 MTB, in real terms**. For FY 12–15, it is proposed that the envelope be held constant in real terms relative to FY 11, which represents the Fund's new structural steady state. The nominal budget envelopes are also unchanged for FY 10–11, reflecting the 4 percent global external deflator (Table 1). Details on the rolling forward process and deflator assumptions are presented in Section III.A. of EBAP/09/51.

3. **Net expenditures are expected to be temporarily in excess of the net budget figures by $23–25 million in both FY 10 and FY 11 because of increased work on the global crisis**. As described in Section III.C. of EBAP/09/51, these additional expenditures can be accommodated within the proposed net envelopes by carrying forward some of the administrative underrun on the FY 09 net administrative budget and by allocating half of the planned contingency reserves in FY 10 and FY 11.

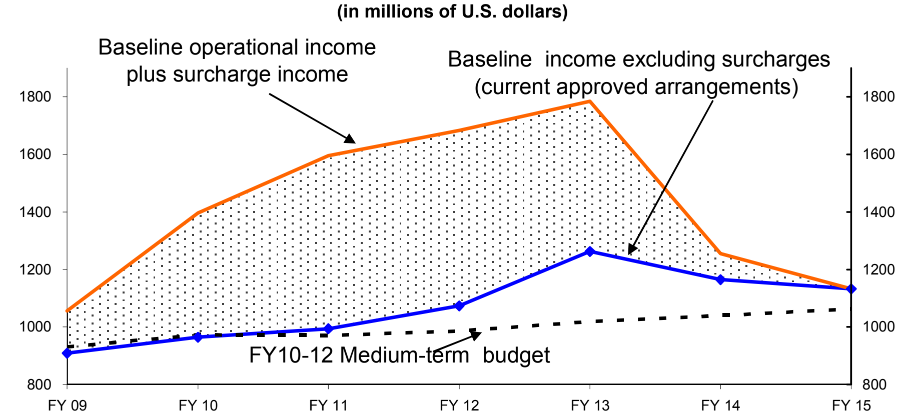
4. **The concept of administrative expenses**, as shown in Figures 1, 2c and 3 (and as used in the Fund's financial statements), is derived by adding restructuring expenditures, capital budget items expensed and depreciation expenses to the administrative expenditures figures. This reconciliation is shown in Section B of Tables 1 and 2.

ANNEX II: UPDATED INCOME PROJECTIONS, FY 09–FY 15

1. **Under updated projections, the Fund's steady state income after full implementation of the new income model would be slightly above that envisaged in April and in the December update.**[1] This primarily reflects higher lending income from the recent significant demand for Fund credit. Projected income from the endowment is broadly unchanged, while income from accumulated reserves could be higher by FY 15 than envisaged earlier. (See Box II.1 for assumptions underlying the projections.)

2. **The revised baseline, consistent with the staff's projection for FY 09 and FY 10, takes into account projected income from lending under Fund arrangements approved to date** (see Figure II.1).[2] Assuming all purchases are made under these arrangements, Fund credit outstanding would peak at just over SDR 39 billion in FY 11 (Table II.1). Thereafter, credit outstanding is assumed to decline to just over SDR 6 billion by FY 15, in line with the earlier steady state baseline projections.[3] Lending income also follows a similar path.

Figure II.1 Projected Income and Expenses
(in millions of U.S. dollars)



3. **The temporary increase in lending income would help to build up the Fund's precautionary balances**. The Fund would not incur large losses in the near term as envisaged when the Board approved the income model. In keeping with the medium term budget strategy underpinning the new income model, and to safeguard the Fund's balance sheet in the face of increased credit risks, this temporary increase in lending income would contribute to precautionary balances. When the Board reviewed the adequacy of precautionary balances in December 2008, Directors noted that once the Fund returns to a positive net income position, surcharge income should again be placed directly to

[1] See *Consolidated Medium Term Income and Expenditure Framework* (EB/CB/08/6, 12/29/2008).

[2] All financial arrangements approved as of end-March 2009 and the prospective Flexible Credit Line arrangement with Mexico.

[3] The income projections reflect the recent decision to end the policy of expectations-based repurchases. It is now assumed that all repurchases are made on an obligations basis, which may overstate lending income to the extent that members choose to repay the Fund early.

Box II.1. Income Projections—FY 09–15

Key Parameters	Value	Remarks
US$/SDR exchange rate	1.50, except for FY 2009 (1.55)	Assumed unchanged from recent level. A 10 percent rise (fall) in the US$/SDR exchange rate would raise (lower) annual income in FY 15 by US$100 million.
SDR interest rate	Rising to 3.5% by FY 15 from 0.9% in FY 10	A 50 basis point higher (lower) average SDR interest rate would raise (reduce) annual income in FY 15 by US$105 million.
Gold price (US$/oz.) Gold sales are assumed to be phased equally over 3 years from FY 10 (Q3) to FY 13 (Q2).	810	The assumed price is the current two-year average of US$810 per ounce. A US$100 per ounce higher (lower) average gold price would raise (reduce) annual income in FY 15 by US$48 million.
Margin for rate of charge (basis points)	100	Assumed unchanged from current level. A 25 basis point higher (lower) margin would raise (reduce) income in FY 15 by US$57 million.

Operational lending income (US$105 million or SDR 70 million by FY 15 in baseline scenario, Table II.1)

Fund credit is assumed to decline back to an average level of about SDR 6 billion in FY 15, upon which a margin of 100 basis points generates income of about SDR 65 million in FY 15. Average annual disbursements of about SDR 1 billion from FY 12, with service charges of 50 basis points, generate SDR 5 million in annual income.

Investment income (US$729 million or SDR 486 million by FY 15 in baseline scenario, Table II.1)

Returns on Investment Account (IA) assets of SDR 6 billion are assumed to exceed the SDR interest rate by an average of 50 basis points. A broadening of the investment mandate is assumed to take effect in FY 11, allowing average investment returns to exceed the SDR interest rate by 100 basis points, and lifting average annual income on reserves to over SDR 300 million by FY 15. This assumes that after an initial build up of reserves back to SDR 6.0 billion to recoup losses absorbed during FY 06–08, on an annual basis the net operational income, plus surcharges income, is transferred to the IA for investment in the subsequent year.

At an average price of US$810 per ounce, proceeds from the sale of 403.3 metric tons (12.966 million ounces) of gold are US$10.5 billion, with profits of US$6.5 billion (SDR 4.3 billion). Income from the endowment is assumed to be reinvested until the gold sales are substantially completed in FY 13. In the baseline scenario (Table II.1), the endowment funded by gold profits is assumed to generate an average real return of 3 percent, and a 3 percent pay-out ratio providing income of SDR 142 million in FY 15.

Interest free resources (US$214 million or SDR 142 million by FY 15 in baseline scenario, Table II.1)

Gold sales during FY 10–13 increase GRA currency holdings by the book value of gold (SDR 2,685 million), reducing reserve tranche positions and thereby cutting remuneration expenses by SDR 94 million at an SDR interest rate of 3.5 percent.

Reimbursements (US$83 million or SDR 55 million in FY 10 in baseline scenario, Table II.1)

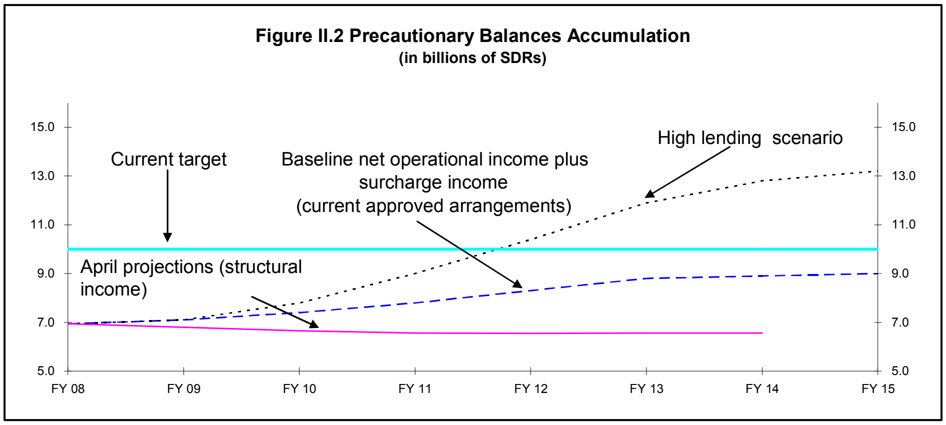
Reimbursements currently received from the SDR Department and the MDRI-I Trust are projected at SDR 4 million in FY 10. Reimbursement for the expenses of administering the PRGF-ESF Trust is assumed to resume in FY 10, with these expenses currently projected to be SDR 51 million. During FY 10–15, these administrative costs and the associated reimbursements are assumed to be stable in nominal terms.

Table II.1. Medium-Term Income and Expenditures, FY 09–15: Baseline Scenario

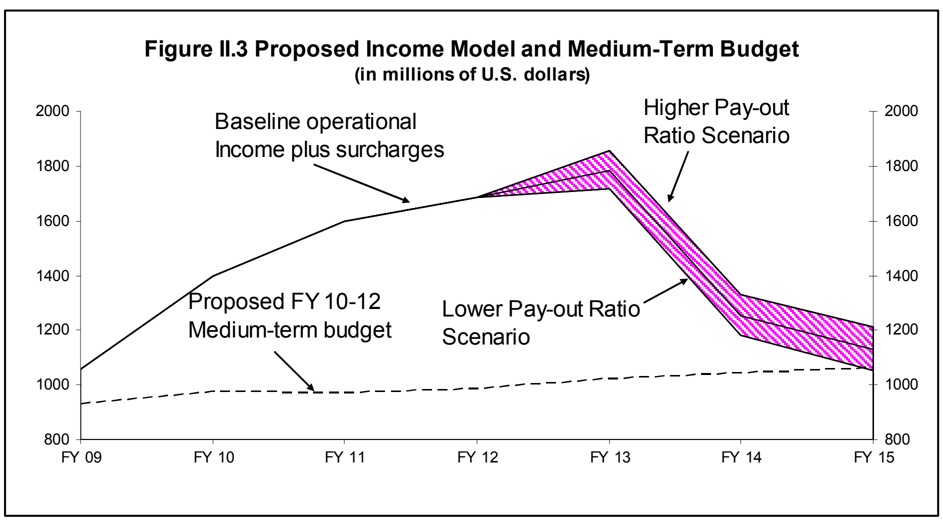
		Projected					
	FY09	FY10	FY11	FY12	FY13	FY14	FY15
	(In SDR millions)						
A. Operational income 1/	**683**	**931**	**662**	**717**	**842**	**776**	**753**
Lending income	312	779	409	388	309	169	70
Margin for the rate of charge	125	324	394	383	304	164	65
Service charge	92	167	15	5	5	5	5
Investment income	345	83	159	202	376	432	486
Reserves	345	83	159	202	245	293	344
Gold endowment pay-out (3 percent)	0	0	0	0	131	139	142
Interest free resources 2/	22	14	39	72	102	119	142
SCA-1 and other	22	13	25	34	38	42	48
Gold book value	0	1	14	38	64	78	94
Reimbursements 3/	4	55	55	55	55	55	55
MDRI-I Trust and SDR Department	4	4	4	4	4	4	4
PRGF-ESF Trust	0	51	51	51	51	51	51
B. Expenses	**562**	**641**	**647**	**657**	**679**	**693**	**709**
Net administrative expenditures 3/	528	603	612	621	641	653	669
Capital budget items expensed	11	11	7	7	9	10	10
Depreciation	23	26	28	29	29	31	30
C. Net operational income (A-B)	**121**	**290**	**15**	**60**	**162**	**82**	**45**
Gold profits	0	719	1439	1439	719	0	0
Surcharges 4/	0	0	401	407	348	60	0
Restructuring charge and rule of 50	-39	-8	0	0	0	0	0
IAS 19 timing adjustment	72	0	0	0	0	0	0
Retained endowment income 5/	0	9	72	148	87	93	95
Net income 6/	**154**	**1010**	**1928**	**2054**	**1317**	**235**	**140**
	(In US$ millions)						
D. Operational income 1/	**1056**	**1397**	**994**	**1075**	**1263**	**1164**	**1130**
Lending income	482	1168	613	582	463	254	105
Investment income	535	125	238	304	564	648	729
Interest free resources 2/	33	22	59	107	153	179	214
Reimbursements	6	83	83	83	83	83	83
E. Expenses	**871**	**961**	**971**	**986**	**1019**	**1040**	**1063**
Net administrative expenditures 3/	818	905	918	932	961	979	1003
Capital budget items expensed	17	17	11	10	14	15	15
Depreciation	36	39	42	44	44	46	45
F. Net operational income (D-E)	**185**	**436**	**23**	**89**	**244**	**124**	**67**
Net income 6/	**236**	**1517**	**2891**	**3078**	**1976**	**352**	**210**
Memorandum Items:							
Fund credit (average stock, SDR billions)	12.5	32.4	39.4	38.3	30.4	16.4	6.5
SDR interest rate (in percent)	1.81	0.90	1.60	2.10	2.50	2.90	3.50
US$/SDR exchange rate	1.55	1.50	1.50	1.50	1.50	1.50	1.50
New income measures (US$ millions) 7/	0	78	146	184	424	459	488

1/ Excludes profits from gold sales and income retained to preserve the real value of the endowment. Lending income includes surcharges in FY 09 and FY 10.
2/ Interest free resources reduce the Fund's remuneration expenses as they reflect Fund credit and SDR holdings on which the Fund has no corresponding remunerated reserve tranche positions. SCA-1 contributions are currently the main source of these resources. Gold sales would increase these resources because proceeds equal to the book value of gold would be retained in the GRA, reducing reserve tranche positions.
3/ Net expenditures are estimated to exceed net budgets in FY 10–11 as a result of additional crisis-related expenditures that will be financed by carry forward of unspent administrative resources from FY 09—which in turn is reflected in the net expenditures estimate shown for that year. For FY 12–15, net administrative expenditures are equal to the net administrative budget.
4/ Surcharges assumed to be placed to reserves from FY 11 when net operational income, excluding surcharges, is positive.
5/ Estimate of gold endowment income retained in the Investment Account to preserve the real value of the endowment.
6/ Net income on the basis presented in the Fund's annual financial statements.
7/ The effect on operational income of broadening investments, creating an endowment funded by profits from gold sales, the reduction in remuneration from proceeds equal to the book value of gold, and reimbursement of PRGF-ESF Trust expenses.

reserves to help accelerate the pace of reserve accumulation.[4] For presentational purposes, it is assumed in this paper that surcharge income is transferred to reserves beginning in FY 11.[5] Similarly, and to underscore the need to insulate the Fund's budget from fluctuations in lending income, the medium-term income projections in this paper now exclude surcharge income from the definition of operational income. The revised projections point to a reversal of the recent decline in precautionary balances, which rise in the baseline scenario from the current level of just under SDR 7 billion to almost SDR 9 billion in FY 15 (Figure II.2).



4. **Gold endowment payout**. In the revised projections, a 3 percent payout ratio from the endowment funded by gold sales would yield broadly the same income as envisaged in April 2008 (see Figure II.3). Income projections are sensitive to the assumptions on returns as discussed further below. Reflecting the delay in their approval, gold sales are now assumed to start in the second half of FY 10 and the projections are based on a gold price of $810 per ounce (the average price in the two years to March 2009) compared with $850 per ounce in the April 2008



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[4] See *The Acting Chairman's Summing Up: The Review of the Role and Adequacy of Precautionary Balances* (BUFF/08/175, 12/11/08).

[5] It may be possible to return to this practice in FY 10 if there is a return to positive net operational income, before taking account of surcharges (see Review of the Fund's Income Position for FY 09 and FY 10—forthcoming).

Table II.2. Medium-Term Income and Expenditures, FY 09–15: Lower Pay-out Scenario

		Projected					
	FY09	FY10	FY11	FY12	FY13	FY14	FY15
	(In SDR millions)						
A. Operational income 1/	**683**	**931**	**662**	**716**	**797**	**726**	**700**
Lending income	312	779	409	388	309	169	70
Margin for the rate of charge	125	324	394	383	304	164	65
Service charge	92	167	15	5	5	5	5
Investment income	345	83	159	202	331	383	433
Reserves	345	83	159	202	245	291	340
Gold endowment pay-out (2 percent)	0	0	0	0	86	92	94
Interest free resources 2/	22	14	39	72	101	119	142
SCA-1 and other	22	13	25	34	37	41	48
Gold book value	0	1	14	38	64	78	94
Reimbursements 3/	4	55	55	55	55	55	55
MDRI-I Trust and SDR Department	4	4	4	4	4	4	4
PRGF-ESF Trust	0	51	51	51	51	51	51
B. Expenses	**562**	**641**	**647**	**657**	**679**	**693**	**709**
Net administrative expenditures 3/	528	603	612	621	641	653	669
Capital budget items expensed	11	11	7	7	9	10	10
Depreciation	23	26	28	29	29	31	30
C. Net operational income (A-B)	**121**	**290**	**15**	**59**	**117**	**33**	**-9**
Gold profits	0	719	1439	1439	719	0	0
Surcharges 4/	0	0	401	407	348	60	0
Restructuring charge and rule of 50	-39	-8	0	0	0	0	0
IAS 19 timing adjustment	72	0	0	0	0	0	0
Retained endowment income 5/	0	7	58	118	86	92	94
Net income 6/	**154**	**1008**	**1913**	**2022**	**1271**	**184**	**85**
	(In US$ millions)						
D. Operational income 1/	**1056**	**1397**	**994**	**1075**	**1195**	**1089**	**1050**
Lending income	482	1168	613	582	463	254	105
Investment income	535	125	238	304	497	574	650
Interest free resources 2/	33	22	59	107	152	178	212
Reimbursements	6	83	83	83	83	83	83
E. Expenses	**871**	**961**	**971**	**986**	**1019**	**1040**	**1063**
Net administrative expenditures 3/	818	905	918	932	961	979	1003
Capital budget items expensed	17	17	11	10	14	15	15
Depreciation	36	39	42	44	44	46	45
F. Net operational income (D-E)	**185**	**436**	**23**	**89**	**176**	**49**	**-13**
Net income 6/	**236**	**1512**	**2869**	**3033**	**1906**	**276**	**128**
Memorandum Items:							
Fund credit (average stock, SDR billions)	12.5	32.4	39.4	38.3	30.4	16.4	6.5
SDR interest rate (in percent)	1.81	0.90	1.60	2.10	2.50	2.90	3.50
US$/SDR exchange rate	1.55	1.50	1.50	1.50	1.50	1.50	1.50
New income measures (US$ millions) 7/	0	78	146	184	357	387	415

1/ Excludes profits from gold sales and income retained to preserve the real value of the endowment. Lending income includes surcharges in FY 09 and FY 10.
2/ Interest free resources reduce the Fund's remuneration expenses as they reflect Fund credit and SDR holdings on which the Fund has no corresponding remunerated reserve tranche positions. SCA-1 contributions are currently the main source of these resources. Gold sales would increase these resources because proceeds equal to the book value of gold would be retained in the GRA, reducing reserve tranche positions.
3/ Net expenditures are estimated to exceed net budgets in FY 10–11 as a result of additional crisis-related expenditures that will be financed by carry forward of unspent administrative resources from FY 09—which in turn is reflected in the net expenditures estimate shown for that year. For FY 12–15, net administrative expenditures are equal to the net administrative budget.
4/ Surcharges assumed to be placed to reserves from FY 11 when net operational income, excluding surcharges, is positive.
5/ Estimate of gold endowment income retained in the Investment Account to preserve the real value of the endowment.
6/ Net income on the basis presented in the Fund's annual financial statements.
7/ The effect on operational income of broadening investments, creating an endowment funded by profits from gold sales, the reduction in remuneration from proceeds equal to the book value of gold, and reimbursement of PRGF-ESF Trust expenses.

paper.[6] The modest negative impact of these changes is partially offset in the revised projection by the retention of investment earnings from gold profits in the endowment, with payouts to the GRA commencing only when gold sales are substantially completed. The nominal payout ratio of 3 percent in the baseline would, over the long term, enable the real value of the endowment to be preserved if, as the Crockett Committee had assumed, the endowment can through diversification achieve an average real return of 3 percent. With a payout ratio of 2 percent, the steady state income level would be just in balance with the projected path of expenses, while a payout ratio of 4 percent would provide a further buffer (see Figure II.3 and Tables II.2 and II.3).

5. **Higher Fund lending would both necessitate and facilitate further accumulation of precautionary balances**. An alternative scenario, which takes account of the staff's current assessment of the possible new arrangements in the pipeline, implies a peak in Fund credit of close to SDR 74 billion in FY 12. Surcharge income would rise sharply and the Fund's net operating balance would become strongly positive (Table II.4 and Figure II.2). In these circumstances, and assuming that repurchases are made on an obligations basis rather than being brought forward in response to time-based surcharges, the current target level of reserves could be attained as early as in FY 12, and precautionary balances would reach close to SDR 13 billion in FY 15.

6. **The accumulation of reserves in this alternative scenario would also raise the Fund's sustainable income**. In this scenario, credit outstanding would be declining in FY 15 but still be well above the level assumed in the April 2008 framework, at an average of SDR 19 billion. However, after adjusting for this temporary income, the sustainable level of income, including income from reserves, would still be in excess of the path of expenses. Consideration would then need to be given to different options. As discussed in the recent paper on financial risks and precautionary balances,[7] if the Board considered that reserves were more than adequate in relation to credit risks, the excess reserves could be returned to the membership through the introduction of a dividend policy and/or consideration could be given to future reductions in the charges on Fund lending.

7. **The above projections are based on full implementation of the new income model**. In both the baseline and the high lending scenarios, the combined effect of all measures in the new income model provides income that would cover close to half of the Fund's projected expenses in FY 15. Moreover, in the intervening years, by meeting a growing share of the Fund's expenses, the new income model facilitates the accumulation of precautionary balances to address credit risks and also provide an important source of income to the Fund.

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[6] Since reimbursement of the GRA for the costs of administering the PRGF-ESF Trust is to commence only in the financial year in which the Board approves gold sales, the start of reimbursement is also delayed to FY 10.

[7] Review of the Role and Adequacy of the Fund's Precautionary Balances (EBS/08/110, 9/24/08 and Supplement 1, 12/3/08).

Table II.3. Medium-Term Income and Expenditures, FY 09–15: Higher Pay-out Scenario

		Projected					
	FY09	FY10	FY11	FY12	FY13	FY14	FY15
	(In SDR millions)						
A. Operational income 1/	**683**	**931**	**662**	**716**	**888**	**827**	**808**
Lending income	312	779	409	388	309	169	70
Margin for the rate of charge	125	324	394	383	304	164	65
Service charge	92	167	15	5	5	5	5
Investment income	345	83	159	202	421	482	540
Reserves	345	83	159	202	245	295	349
Gold endowment pay-out (4 percent)	0	0	0	0	177	187	191
Interest free resources 2/	22	14	39	71	103	120	143
SCA-1 and other	22	13	25	34	38	42	49
Gold book value	0	1	14	38	64	78	94
Reimbursements 3/	4	55	55	55	55	55	55
MDRI-I Trust and SDR Department	4	4	4	4	4	4	4
PRGF-ESF Trust	0	51	51	51	51	51	51
B. Expenses	**562**	**641**	**647**	**657**	**679**	**693**	**709**
Net administrative expenditures 3/	528	603	612	621	641	653	669
Capital budget items expensed	11	11	7	7	9	10	10
Depreciation	23	26	28	29	29	31	30
C. Net operational income (A-B)	**121**	**290**	**15**	**59**	**208**	**133**	**99**
Gold profits	0	719	1439	1439	719	0	0
Surcharges 4/	0	0	401	407	348	60	0
Restructuring charge and rule of 50	-39	-8	0	0	0	0	0
IAS 19 timing adjustment	72	0	0	0	0	0	0
Retained endowment income 5/	0	11	87	179	88	94	95
Net income 6/	**154**	**1012**	**1942**	**2083**	**1364**	**286**	**195**
	(In US$ millions)						
D. Operational income 1/	**1056**	**1397**	**994**	**1075**	**1332**	**1240**	**1212**
Lending income	482	1168	613	582	463	254	105
Investment income	535	125	238	304	632	723	809
Interest free resources 2/	33	22	59	107	154	180	215
Reimbursements	6	83	83	83	83	83	83
E. Expenses	**871**	**961**	**971**	**986**	**1019**	**1040**	**1063**
Net administrative expenditures 3/	818	905	918	932	961	979	1003
Capital budget items expensed	17	17	11	10	14	15	15
Depreciation	36	39	42	44	44	46	45
F. Net operational income (D-E)	**185**	**436**	**23**	**89**	**313**	**200**	**149**
Net income 6/	**236**	**1520**	**2913**	**3124**	**2046**	**430**	**293**
Memorandum Items:							
Fund credit (average stock, SDR billions)	12.5	32.4	39.4	38.3	30.4	16.4	6.5
SDR interest rate (in percent)	1.81	0.90	1.60	2.10	2.50	2.90	3.50
US$/SDR exchange rate	1.55	1.50	1.50	1.50	1.50	1.50	1.50
New income measures (US$ millions) 7/	0	78	146	184	492	532	563

1/ Excludes profits from gold sales and income retained to preserve the real value of the endowment. Lending income includes surcharges in FY 09 and FY 10.
2/ Interest free resources reduce the Fund's remuneration expenses as they reflect Fund credit and SDR holdings on which the Fund has no corresponding remunerated reserve tranche positions. SCA-1 contributions are currently the main source of these resources. Gold sales would increase these resources because proceeds equal to the book value of gold would be retained in the GRA, reducing reserve tranche positions.
3/ Net expenditures are estimated to exceed net budgets in FY 10–11 as a result of additional crisis-related expenditures that will be financed by carry forward of unspent administrative resources from FY 09—which in turn is reflected in the net expenditures estimate shown for that year. For FY 12–15, net administrative expenditures are equal to the net administrative budget.
4/ Surcharges assumed to be placed to reserves from FY 11 when net operational income, excluding surcharges, is positive.
5/ Estimate of gold endowment income retained in the Investment Account to preserve the real value of the endowment.
6/ Net income on the basis presented in the Fund's annual financial statements.
7/ The effect on operational income of broadening investments, creating an endowment funded by profits from gold sales, the reduction in remuneration from proceeds equal to the book value of gold, and reimbursement of PRGF-ESF Trust expenses.

Table II.4. Medium-Term Income and Expenditures, FY 09–15: High Lending Scenario

	Projected						
	FY09	FY10	FY11	FY12	FY13	FY14	FY15
	(In SDR millions)						
A. Operational income 1/	**683**	**1379**	**1015**	**1139**	**1274**	**1159**	**1057**
Lending income	312	1225	743	763	653	420	193
Margin for the rate of charge	125	479	683	735	648	415	188
Service charge	92	286	60	27	5	5	5
Investment income	345	83	171	240	452	554	660
Reserves	345	83	171	240	321	415	518
Gold endowment pay-out (3 percent)	0	0	0	0	131	139	142
Interest free resources 2/	22	16	46	81	114	130	149
SCA-1 and other	22	15	31	44	50	52	55
Gold book value	0	1	14	38	64	78	94
Reimbursements 3/	4	55	55	55	55	55	55
MDRI-I Trust and SDR Department	4	4	4	4	4	4	4
PRGF-ESF Trust	0	51	51	51	51	51	51
B. Expenses	**562**	**641**	**647**	**657**	**679**	**693**	**709**
Net administrative expenditures 3/	528	603	612	621	641	653	669
Capital budget items expensed	11	11	7	7	9	10	10
Depreciation	23	26	28	29	29	31	30
C. Net operational income (A-B)	**121**	**738**	**367**	**482**	**595**	**465**	**348**
Gold profits	0	719	1439	1439	719	0	0
Surcharges 4/	0	0	813	944	879	400	85
Restructuring charge and rule of 50	-39	-8	0	0	0	0	0
IAS 19 timing adjustment	72	0	0	0	0	0	0
Retained endowment income 5/	0	9	72	148	87	93	95
Net income 6/	**154**	**1458**	**2691**	**3012**	**2281**	**958**	**527**
	(In US$ millions)						
D. Operational income 1/	**1058**	**2068**	**1522**	**1708**	**1911**	**1738**	**1585**
Lending income	484	1837	1115	1144	980	629	289
Investment income	535	125	256	360	678	831	989
Interest free resources 2/	34	25	68	122	171	195	224
Reimbursements	6	83	83	83	83	83	83
E. Expenses	**871**	**961**	**971**	**986**	**1019**	**1040**	**1063**
Net administrative expenditures 3/	818	905	918	932	961	979	1003
Capital budget items expensed	17	17	11	10	14	15	15
Depreciation	36	39	42	44	44	46	45
F. Net operational income (D-E)	**187**	**1107**	**551**	**722**	**892**	**698**	**522**
Net income 6/	**238**	**2189**	**4037**	**4518**	**3421**	**1437**	**791**
Memorandum Items:							
Fund credit (average stock, SDR billions)	12.5	47.9	68.3	73.5	64.8	41.5	18.8
SDR interest rate (in percent)	1.81	0.90	1.60	2.10	2.50	2.90	3.50
US$/SDR exchange rate	1.55	1.50	1.50	1.50	1.50	1.50	1.50
New income measures (US$ millions) 7/	0	78	152	196	444	485	518

1/ Incorporates the effect of assumed higher lending taking account of current staff assessment of arrangements in the pipeline based on discussions with members, that implies a peak of Fund credit at SDR 74 billion in FY 12.
2/ Interest free resources reduce the Fund's remuneration expenses as they reflect Fund credit and SDR holdings on which the Fund has no corresponding remunerated reserve tranche positions. SCA-1 contributions are currently the main source of these resources. Gold sales would increase these resources because proceeds equal to the book value of gold would be retained in the GRA, reducing reserve tranche positions.
3/ Net expenditures are estimated to exceed net budgets in FY 10–11 as a result of additional crisis-related expenditures that will be financed by carry forward of unspent administrative resources from FY 09—which in turn is reflected in the net expenditures estimate shown for that year. For FY 12–15, net administrative expenditures are equal to the net administrative budget.
4/ Surcharges could be placed directly to reserves sooner than FY 11 in a high lending scenario.
5/ Estimate of gold endowment income retained in the Investment Account to preserve the real value of the endowment.
6/ Net income on the basis presented in the Fund's annual financial statements.
7/ The effect on operational income of broadening investments, creating an endowment funded by profits from gold sales, the reduction in remuneration from proceeds equal to the book value of gold, and reimbursement of PRGF-ESF Trust expenses.