FOR AGENDA

EB/CQuota/10/2
Correction 1

April 2, 2010

To: Members of the Committee of the Whole on Review of Quotas

From: The Secretary

Subject: **Fourteenth General Review of Quotas—The Size of the Fund—Initial Considerations**

The attached corrections to EB/CQuota/10/2 (3/15/10) have been provided by the staff:

Typographical Errors

Page 31, line 1: for "In addition, and as in EBS/09/7, current accounts are assumed to improve by half, reducing financing needs through adjustment. The Fund is assumed to cover only 60 percent of the total financing needs, with official financing from other sources making up the difference."
read "The Fund is assumed to cover the remaining financing need."

Page 32, line 3: "the emerging market scenarios and" removed

Questions may be referred to Mr. van Selm, SPR (ext. 38505)

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

Other Distribution:
Department Heads

in response to the perceived negative signal that rapid declines in reserves may send.[31] The Fund is assumed to cover the remaining financing need.

Results. The estimated call on Fund resources is substantial. The "sudden stop" scenario generates a need of SDR 266 billion (stemming from 39 countries), rising to SDR 430 billion (45 countries) in the broader-based crisis case that also entails deposit outflows. In the sudden stop scenario the median use of Fund resources equals 7.6 percent of GDP and 610 percent of quota, with about 30 percent of countries using more than either 10 percent of GDP or 1000 percent of quota. Median access is notably higher in the deposit outflow case, at 10.2 percent of GDP or 850 percent of quota, with half of countries using more than 10 percent of GDP and 30 percent using more than 1000 percent of quota. About half of total demand stems from emerging Europe, with the largest five cases (from Eastern Europe and Asia) also accounting for half of total commitments.

Emerging market scenario analysis

Financing needs and buffers	SDR bns	US$ bns
Net financing requirements	439	680
Use of international reserves	172	267
"Sudden stop" financing gap	**266**	**413**
Deposit outflows	228	354
Additional use of reserves	64	100
"Deposit outflow" financing gap	**430**	**667**

Methodology and results for advanced economies

Scenarios. The shock applied aims to reflect a systemic banking crisis, with a widespread retreat from risky assets, including—in a second scenario—difficulties in the funding of government debt by non-residents in fiscally vulnerable economies. Countries in the sample are those rated highly vulnerable in the fall 2009 vulnerability exercise for advanced economies (VEA), and those with large financial sectors relative to their size.[32] Shocks are applied to the stock of bank and government debt held by non-residents. VEA simulations using models of shock transmission through bank lending channels suggest that stress in some of the economies considered could spread widely, with strong impacts on other countries in the vulnerable group. The Fund is assumed to provide support in meeting the

[31] These assumptions are identical to those in EBS/09/07 except in two respects: firstly, drawdowns of other foreign assets are not considered here given the difficulty of assessing how drawdowns by one country would translate into lower inflows elsewhere (leaving global gross financing needs unchanged) and data limitations, and secondly the 25 percent maximum decline in reserves was not previously applied.

[32] The latter are drawn from the forthcoming Board paper 'Cross-Cutting Themes in Surveillance of Economies with Large Financial Sectors'.

external financing needs of banks, and budget support to compensate for a lack of external funding at reasonable interest rates.

Adjustment and share of Fund financing. As in EBS/09/7, the current account is assumed to adjust by 50 percent. However, this adjustment is only considered to alleviate financing pressure if a bank financing gap opens up (as described below). The Fund is assumed to contribute 60 percent of total official financing to cover the remaining gap, with foreign currency liquidity swap lines with major central banks and other bilateral support supplying the remainder.

Banking crisis. Rollover rates of gross short-term bank external liabilities of 85 percent are applied as a reasonable tail risk scenario. While relevant benchmarks are scarce, the decline in gross short-term bank external liabilities between the second and fourth quarters of 2008 averaged 18 percent in dollar terms for the countries considered in this sample. Banks are assumed to use liquid assets (cash and government securities) to cope with the shock, and the financing gaps are calculated as the shortfall between estimated liquid assets after the shock and a minimum liquid asset level. This minimum is set equal to 3 percent of liabilities (they did not fall below this level in any of the countries in the sample during 2008).

Government external debt. In the context of the banking crisis, a second scenario assumes a 5 percent reduction in the stock of external debt of the government reflecting lower demand by non-residents. This draws on the experience of "failed" auctions in some countries at the height of the crisis. While government debt of advanced economies held by non-residents is often domestic currency denominated, a reduction in such holdings still represents a capital outflow.

Results. Applying the banking crisis scenario to end-2008 gross short-term external liabilities generates a gross funding shortfall of SDR 968 billion.[33] After running down buffers and considering adjustment, the Fund would cover approximately SDR 112 billion. An additional SDR 58 billion in financing needs is generated by government debt shock, of which the Fund is assumed to cover about SDR 32 billion.[34] The total call on Fund resources would be of approximately SDR 145 billion, of which SDR 110 billion would stem roughly evenly from three countries.

Advanced economy scenario analysis

Financing needs and buffers	SDR bns	US$ bns
Bank funding shock	968	1,501
Use of liquid assets	747	1,158
Current account adjustment	35	54
"Bank shock" financing gap	**186**	**289**
Of which: Fund financing	112	173
Govt. external debt shock	58	90
Total financing gap	**244**	**379**
Of which: Fund financing	147	228

[33] Data is from Bankscope, for 2008.

[34] Data is for the second quarter of 2009, from the JEDH database.