FOR AGENDA

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SM/88/277

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December 20, 1988

To: Members of the Executive Board

From: The Acting Secretary

Subject: Compensatory Financing Facility Purchases Under the Compensatory and Contingency Financing Facility - Use of Revised Projections

Attached for consideration by the Executive Directors are proposed guidelines for updating projections in cases when there had been major changes between the time the staff report on a request for a compensatory financing purchase under the compensatory and contingency financing facility was issued, and the time the request is considered by the Board.

It is proposed that the attached paper be brought to the agenda on the next occasion on which the Board considers a request for a drawing under the compensatory element of the compensatory and contingency financing facility.

Mr. Pownall (ext. 7727) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

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INTERNATIONAL MONETARY FUND

Compensatory Financing Purchases Under the Compensatory and Contingency Financing Facility: Use of Revised Projections

Prepared by the Research Department

(In consultation with the Exchange and Trade Relations and Legal Departments)

Approved by Jacob A. Frenkel

December 20, 1988

At the Executive Board Meeting 88/168 (11/18/88), Executive Directors considered the Article IV consultation with Trinidad and Tobago and the request for a purchase under the compensatory financing facility. The staff representative pointed out that the shortfall underlying the proposed CF purchase was based on oil price projections prevailing at the time the paper was being prepared. Although current projections would result in a smaller shortfall, it was not proposed to change the shortfall calculation. This procedure was in line with past practice. In the past, changes in projections between the time of issuance of a CF paper and its consideration by the Board have been relatively infrequent and the practice has been to proceed on the basis of the projections underlying the original shortfall calculation.

While proposing to continue with established practice, the staff has been conscious of the fact that revisions to forecasts will now occur more frequently than in the past. The operational features of the contingency element of the CCFF will require that projections are updated more frequently, particularly for key variables such as petroleum prices. Indeed, to ensure that departing missions receive revised projections on a regular basis that take account of recent developments, procedures have been established to update projections for key variables such as oil prices, interest rates, and commodity prices on a monthly basis. These more frequent revisions may result in an increase in the occurrence of cases where the export shortfall based on the new projections would differ from that originally calculated.

Although this more frequent updating is likely to lead to an increase in the number of CF requests that would be affected by revised projections, the staff believes that there are two strong reasons for proceeding along established lines. First, the analysis presented in the staff paper is based on estimates existing at the time that the paper is being prepared and Directors have three to four weeks to consider the analysis. If the Board is to be given additional time to review the case based on the new projections, longer delays may occur. Secondly, given the volatility of some commodity prices, an updated projection will still be subject to a significant margin of error and may be only slightly more realistic than the original forecasts. It might also be noted that in the past in most cases where the revised projections would have resulted in a reduction in the shortfall, the reduction would not have affected the size of the purchase as there was already a considerable cushion between the original shortfall and the proposed purchase. Revisions to projections that would have raised the size of the shortfall have similarly not been a problem as most requests were already constrained by quota limits. In this connection, it should also be noted that the limit on export growth in the post-shortfall period will also act as a constraint on the size of a purchase where revised projections would result in an increase in exports in the post-shortfall period.

Despite the foregoing, it is clearly essential to ensure that revised projections do not invalidate the test of cooperation. In the past, where a CF request has been accompanied by a stand-by arrangement, the test of cooperation has hinged on whether the program is considered to remain viable. In the case of a CF request without an accompanying arrangement, the judgment has depended on whether existing policies continue to provide "reasonable assurance" that the member's balance of payments difficulties were being corrected.

To enable Executive Directors to make such a determination, it is proposed that at the time of a Board meeting to consider a purchase under the compensatory element of the CCFF, the staff would bring to the attention of Directors any changes in relevant assumptions with respect to prices, etc. In addition, the staff would provide the Board with a judgment as to whether the changed situation invalidates the policy basis for the drawing (i.e., whether or not, if no stand-by is in effect, the "reasonable assurance" that policies corrective of the underlying payments problem will be adopted still exists). If the staff judges that the "reasonable assurance" criterion has not been invalidated (and the Board accepts the staff's judgment), it is proposed that the request for a compensatory drawing would be dealt with on the basis of the data and projections in the original staff paper.