THE CONSOLIDATED MEDIUM-TERM INCOME AND EXPENDITURE FRAMEWORK

April 30, 2013

EXECUTIVE SUMMARY

The medium-term projections of Fund income and precautionary balances accumulation have been updated since the April 2012 projections. The overall income outlook remains positive with continued high lending income expected in the medium-term. The projections indicate a downward shift in the income path primarily due to lower non-lending income as a result of the low global interest rates and the agreement to phase in investments under the new gold-sales funded endowment. The updated expenditure path has not changed significantly. The projections also illustrate a broad balance between income and expenditures when lending returns to pre-crisis levels.

The accumulation of precautionary balances remains strong in the medium-term. The indicative medium-term target of SDR 20 billion is now expected to be reached by FY18–FY19.

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INTRODUCTION

1. **This paper updates the consolidated income and expenditure outlook from April 2012 and the projected accumulation of precautionary balances over the medium-term.[1]** The paper incorporates and extends the income and budget projections in the companion papers.[2]

2. **The projections continue to point to a strong net income position over the medium-term.** Lending income (including surcharges) is broadly in-line with that projected in April 2012. However, non-lending income is projected to be lower reflecting a slower recovery in interest rates and, thus, returns on investments and interest-free resources, and the agreement to phase in investments under the new gold-sales funded endowment (see Figure 1).[3] The updated expenditure path has also changed only slightly compared to the April 2012 projections. The illustrative steady state, with low lending income, remains broadly balanced. The accumulation of precautionary balances remains strong, with the indicative medium-term target of SDR 20 billion now expected to be attained by FY18–FY19.

CONSOLIDATED INCOME AND EXPENSES

A. Medium-term income

3. **Lending income.** Projected lending income is expected to remain high in the medium-term. The updated projections take account of non-precautionary arrangements approved through mid-March 2013. Average credit is now projected to peak at about SDR 91.9 billion in FY13 (see Table 1) or some SDR 9 billion lower than projected last April, due to the rephasing of drawings under existing arrangements and the expiration of arrangements with undrawn balances. However, the resulting decline in income from the margin, the service charge, and surcharges is offset in FY15 by an increase in projected income from commitment fees following the renewal of two arrangements under the Flexible Credit Line (FCL) and a new arrangement under the Precautionary and Liquidity Line.[4]

4. **Non-lending income.[5]** Over the medium-term, investment income and implicit returns on the Fund's interest-free resources are now projected to be lower than previously estimated.

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[1] See The Consolidated Medium-Term Income and Expenditure Framework (4/12/12).

[2] See Review of the Fund's Income Position for FY 2013 and FY 2014 (4/30/13) and FY2014—FY2016 Medium-Term Budget (3/29/13).

[3] See [Press Release No. 13/37] on the new rules and regulations of the Investment Account.

[4] Commitment fee income is only recognized at the expiration or cancellation of an arrangement. The fees for the two-year FCL and PLL arrangements are included in income at the end of the two-year period.

[5] Non-lending income comprises investment income, the implicit returns on the Fund's interest-free resources, and reimbursements from the SDR Department, PRGT Trust, MDRI-I Trust, and PCDR Trust (see Box 1).

- **Gold endowment.** The projections reflect the recently endorsed three-year funding period for the gold endowment, which is now assumed to start in mid-FY14 with the expectation that the endowment will be fully invested by FY18.[6] During the funding period, gold profits pending their investment according to the strategic allocation for the endowment shall be invested in short-term deposits broadly earning the SDR interest rate.

- **Reserves portfolio (Fixed Income subaccount)**. Projected earnings from the reserves portfolio are lower than earlier projected due to the constrained interest rate environment. The projections continue to assume that the premium over the SDR rate on this portfolio rises gradually over the medium-term to 100 basis points following a broadening of the investment mandate. However, to more closely align the projections to the current low yields in the markets of the SDR basket, the projections have been revised downwards from a historical premium of 50 basis points to 7 basis points in FY 14 rising to 100 basis points in FY 17. These assumptions will need to be revisited in light of future Board discussions on the investment mandate for this portfolio.

- **Interest-free resources**. The implicit returns on interest-free resources have been impacted downwards by the low global interest rates.

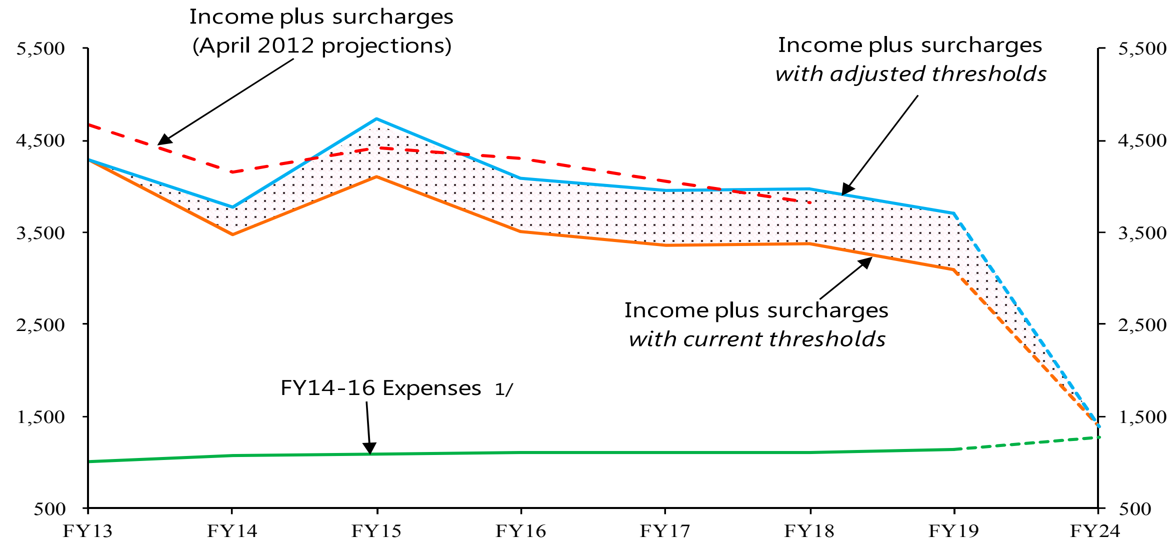
5. Income projections remain highly uncertain and sensitive to key assumptions. Major factors that affect the Fund's income position include the level of global interest rates, the timing of purchases and repurchases under existing arrangements, possible new arrangements, and the U.S. dollar/SDR exchange rate (Box 1 provides further details).[7] Projections are also sensitive to whether and how the thresholds for the application of surcharges are adjusted when the 14th General Quota Review comes into effect. A specific proposal concerning surcharges will be presented for Executive Board consideration in due course. For purely illustrative purposes, two scenarios are presented (Tables 2 and 3). The first assumes that the current surcharge thresholds remain unchanged as a percent of quota implying that surcharge income would decline for a given level of credit outstanding. The second assumes that the surcharge thresholds are adjusted in percent of quota to maintain their SDR value on average when the quota increases under the 14th General Quota Review come into effect, thereby offsetting the effect of the quota increase.[8] This adjustment to the thresholds would require a Board decision. The scenarios assume no advance repurchases are made.

[6] Under the recently approved rules and regulations for the endowment, in case of exceptional market conditions the Managing Director may decide to suspend phasing or extend the phase-in period by up to one year. It is expected that the Executive Board will consider the pay-out policy for the endowment toward the end of the phase-in period. See Press Release No. 13/37 on the new rules and regulations of the Investment Account.

[7] The projections assume full drawings under existing arrangements which tends to overstate the income projections. However, consistent with past practice, the projections only take account of currently approved arrangements, and not possible arrangements, thus lowering projected income effects.

[8] This scenario assumes that thresholds for the application of commitment fees are adjusted. Without this adjustment, commitment fee income is about nine percent or SDR 41 million lower over the projection period.

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



1/ Includes the proposed FY14-16 net administrative budget, depreciation, and capital budget items expensed.

B. Medium-term expenditures

6. The medium-term budget and expense projections assume that the net administrative budget remains unchanged in real terms from FY13 at a level of $1.01 billion in FY14 and FY15.[9] Assumptions regarding the path for phasing out of crisis-related expenditure are subject to change. In particular, the level of crisis-related spending and its phasing out will be reassessed when the FY15–17 Medium Term Budget (MTB) is formulated. Until then, as a technical assumption, crisis-related spending has been left unchanged from the path assumed last April.[10] The nominal expense path has changed only slightly compared with projections in April 2012, reflecting a slightly

[9] The figures are in FY14 dollars. About $6 million additional is included in the projected expenditures when the Annual Meetings are scheduled to be held abroad, in FY16 and in FY19.

[10] Expenditures associated with the global financial crisis are projected to remain stable at $53 million until FY15. In FY16, crisis-related spending declines by 25 percent (to $40 million), and by 50 percent (to $20 million) in FY17, phasing out altogether by FY18.

higher projected Global External Deflator (GED) for the medium term.[11] From FY17 onwards, the GED is assumed to revert to its longer term average of 2.7 percent.[12]

7. **These projections are subject to some uncertainty**. Crisis-related spending is expected to unwind as the crisis abates. However, some of the spending that is currently classified as crisis-related might turn out to be structural in nature. Moreover, new demands could arise as the Fund continues to respond to its members' needs in the context of still evolving repercussions of the global crisis.

Table 1. Consolidated Income and Expenses, FY2013–24
(in millions of U.S. dollars, unless otherwise stated)

	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19	FY 24
Based on current surcharge thresholds 2/								
I. Operational income	2,391	1,568	2,069	1,549	1,608	1,926	2,025	1,394
II. Administrative expenses	1,005	1,071	1,090	1,103	1,108	1,108	1,136	1,282
Of which: Net administrative budget	950	1,007	1,023	1,032	1,032	1,037	1,073	1,217
III. Net operational income (I-II)	1,386	497	979	446	500	818	889	112
Memorandum items:								
Surcharges	1,887	1,914	2,037	1,965	1,754	1,447	1,065	0
Fund credit (average stock, SDR billions)	91.9	88.2	78.9	71.2	64.8	57.0	47.8	10.0
US$/SDR exchange rate	1.52	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Precautionary balances (end of period, SDR billions) 3/	11.5	13.2	15.2	16.8	18.3	19.8	21.1	10.0
Based on adjusted surcharge thresholds 4/								
I. Operational income	2,391	1,568	2,132	1,564	1,640	1,983	2,115	1,394
II. Administrative expenses	1,005	1,071	1,090	1,103	1,108	1,108	1,136	1,282
Of which: Net administrative budget	950	1,007	1,023	1,032	1,032	1,037	1,073	1,217
III. Net operational income (I-II)	1,386	497	1,042	461	532	875	979	112
Memorandum items:								
Surcharges	1,887	2,202	2,592	2,522	2,318	1,992	1,597	0
Fund credit (average stock, SDR billions)	91.9	88.2	78.9	71.2	64.8	57.0	47.8	10.0
US$/SDR exchange rate	1.52	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Precautionary balances (end of period, SDR billions) 3/	11.5	13.3	15.8	17.8	19.7	21.6	23.3	10.0

[1] The illustrative steady state is assumed to be attained in FY24 when drawings under the current arrangements are largely repurchased.
[2] This scenario assumes that the existing surcharge thresholds will remain unchanged as a percent of quota following the implementation of the 14th General Review of Quotas.
[3] Annual net operational income and surcharges add to the level of precautionary balances each year.
[4] This scenario assumes that the surcharge thresholds are adjusted to maintain their SDR value following the implementation of the 14th General Review of Quotas. Adjusting the thresholds would require a Board decision.

[11] The GED is made up of a personnel component (based on the structure salary increase approved by the Board) and a non-personnel component (based on the projected US CPI reported in the WEO). For FY 15 and 16, both components are merely placeholders, and the resulting nominal budget envelopes are updated when actual salary increases and updated CPI projections become available. The GED in FY13 reflected an unchanged salary structure, and thus was unusually low.

[12] The longer-term average was calculated as a five-year backward looking average of the GED. This is also broadly consistent with a ten-year backward looking average of what a GED would have been under current policy.

8. Capital expenditures are projected to increase significantly mainly due to the planned HQ1 renovation. However, the increase in capital expenses reflected in the Fund's income statement is projected to be only moderate, as the major building renovations are depreciated over the remaining useful life of the buildings.

C. The long-run income-expenditure position

9. The steady state outlook has not changed significantly. In 2008 when the Board endorsed the new income model, the envisaged steady state assumed a long-term strategy of broadened income sources to provide sustainable financing for the institution.[13] The net income-expense position was finely balanced at that time. While the medium-term outlook has changed owing to the crisis and the current high demand for Fund credit, resulting in high lending income, the projected steady state has not changed significantly.

10. The illustrative steady state is assumed to be in FY24 when drawings under current arrangements have been largely repurchased. In this post-crisis environment, credit outstanding is assumed to stabilize at SDR 10 billion and lending would therefore contribute only modestly to total income. Investment income, including the assumed payout from the gold endowment, would cover about two-thirds of expenses, which in the long term are assumed to remain constant in real terms. Commitments under contingent lending facilities are assumed to also decline from current levels (see Box 1). The level of precautionary balances in the steady state is assumed conservatively at the floor of SDR 10 billion that the Board endorsed in the last review of the adequacy of precautionary balances in March 2012. On this basis, the steady state under current projections yields a positive income-expenditure position, as envisaged under the new income model.

PRECAUTIONARY BALANCES OUTLOOK

11. Precautionary balances are projected to reach about SDR 11.5 billion at end-FY13. Net income for FY13, including surcharges, is projected at about SDR 2.0 billion. When placed to reserves, this income would increase precautionary balances by about one-fifth, bringing them above the agreed floor of SDR 10 billion.

12. The updated projections continue to show a strong pace of reserve accumulation in the medium-term. In the scenario in which the current surcharge thresholds remain unchanged following the effectiveness of the 14th General Review of Quotas, precautionary balances increase by about SDR 1.7 billion per annum over the next five years allowing precautionary balances to reach the current medium-term target of SDR 20 billion by end-FY19, one year later than estimated in April 2012. In the scenario where surcharge thresholds are adjusted to maintain their SDR value on average following the effectiveness of the 14th General Review of Quotas, the pace of accumulation would be broadly in line

[13] See Press Release No. 08/74 on the Fund's New Income and Expenditure Framework.

with that projected in April 2012, at about SDR 2 billion per annum, and precautionary balances would reach the current target of SDR 20 billion by end-FY18, (Figure 2).

Figure 2. Precautionary Balances Accumulation
(in billions of SDRs)

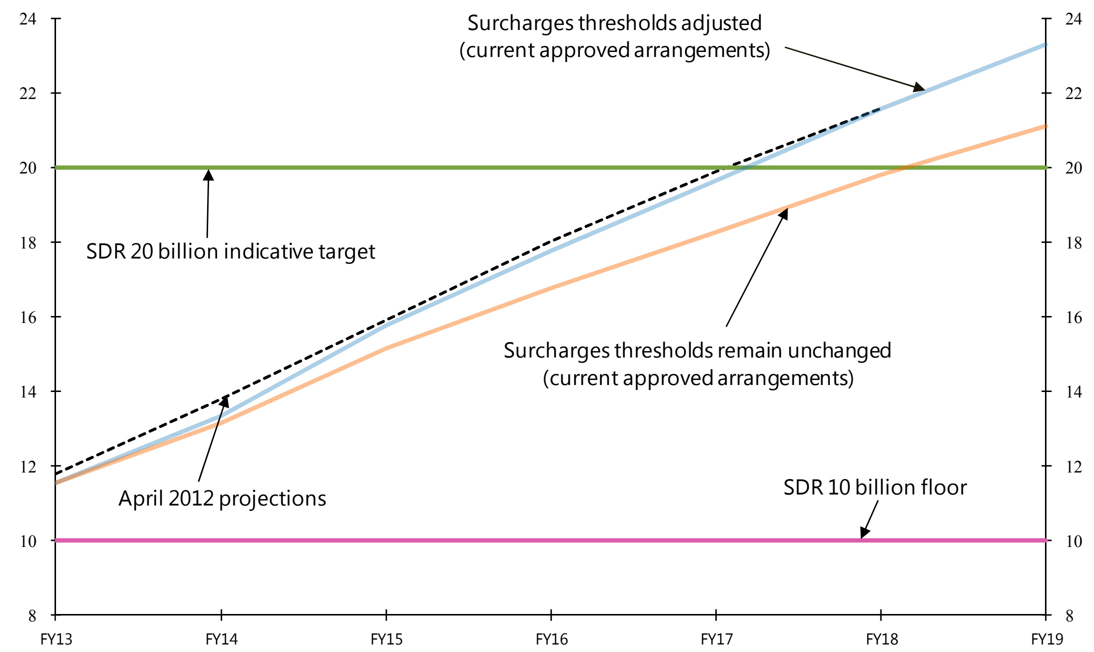


Table 2. Consolidated Income and Expenses, FY2013–24: Based on Current Surcharge Thresholds[1]

	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY24
				(in SDR millions)				
A. Operational income 2/	**1,573**	**1,046**	**1,379**	**1,032**	**1,072**	**1,284**	**1,351**	**930**
Lending income	1,457	968	1,238	743	648	570	478	136
Margin for the rate of charge	919	882	789	712	648	570	478	100
Service charge	57	67	36	31	0	0	0	12
Commitment fees	481	19	413	0	0	0	0	24
Investment income	58	18	74	200	312	573	706	560
Reserves	58	18	74	200	312	427	557	396
Gold endowment pay-out	0	0	0	0	0	146	149	164
Interest free resources 3/	5	5	11	33	54	81	106	163
Reimbursements 4/	53	55	56	56	58	60	61	71
MDRI-I, PCDR Trusts, and SDR Department	1	1	1	1	1	1	1	2
PRG Trust	52	54	55	55	57	59	60	69
B. Expenses	**661**	**713**	**726**	**735**	**738**	**739**	**757**	**855**
Net administrative budget	625	671	682	688	688	692	715	812
Capital budget items expensed	6	9	9	9	9	6	6	6
Depreciation	30	33	35	38	41	41	36	37
C. Net operational income (A-B)	**912**	**333**	**653**	**297**	**334**	**545**	**594**	**75**
Surcharges	1,242	1,276	1,358	1,310	1,169	965	710	0
IAS 19 timing adjustment	-147	0	0	0	0	0	0	0
Retained gold endowment income 5/	6	14	58	144	217	97	99	110
Net income	**2,013**	**1,623**	**2,069**	**1,751**	**1,720**	**1,607**	**1,403**	**185**
				(in US$ millions)				
D. Operational income 2/	**2,391**	**1,568**	**2,069**	**1,549**	**1,608**	**1,926**	**2,025**	**1,394**
Lending income	2,214	1,452	1,857	1,114	972	855	717	204
Investment income	89	26	111	301	468	860	1,058	840
Interest free resources	7	8	17	49	81	121	158	245
Reimbursements	81	82	84	85	87	90	92	105
E. Expenses	**1,005**	**1,071**	**1,090**	**1,103**	**1,108**	**1,108**	**1,136**	**1,282**
Net administrative budget	950	1,007	1,023	1,032	1,032	1,037	1,073	1,217
Capital budget items expensed	9	14	14	14	14	9	9	9
Depreciation	46	50	53	57	62	62	54	56
F. Net operational income (D-E)	**1,386**	**497**	**979**	**446**	**500**	**818**	**889**	**112**
Memorandum Items:								
Fund credit (average stock, SDR billions)	91.9	88.2	78.9	71.2	64.8	57.0	47.8	10.0
SDR interest rate (in percent)	0.1	0.1	0.2	0.6	1.0	1.5	2.0	3.5
US$/SDR exchange rate	1.52	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Surcharges (US$ millions)	1,887	1,914	2,037	1,965	1,754	1,447	1,065	0
New income measures (US$ millions) 6/	83	85	117	170	242	495	533	556
Precautionary balances (end of period, SDR billions)	11.5	13.2	15.2	16.8	18.3	19.8	21.1	10.0

[1] Surcharges and commitment fees are projected on the assumption that the existing thresholds for their application are not adjusted following the implementation of the 14th General Review of Quotas which is assumed to be effective from the second half of FY 14.

[2] Excludes surcharges. The pay-out from the endowment funded by gold profits is assumed to begin in FY18, when the endowment is fully in place.

[3] Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.

[4] Reimbursement of the GRA for the costs of administering the PRG Trust is assumed to resume in FY13.

[5] For the period to FY17 all the investment income from the gold endowment is retained in the IA. From FY18, the endowment is assumed to make an annual payout to the GRA and a portion of the income retained to preserve the real value of the endowment.

[6] 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 PRGT expenses.

Table 3. Consolidated Income and Expenses, FY2013–24: Based on Adjusted Surcharge Thresholds[1]

	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY24
				(in SDR millions)				
A. Operational income 2/	**1,573**	**1,046**	**1,422**	**1,042**	**1,093**	**1,322**	**1,410**	**930**
Lending income	1,457	968	1,279	743	648	570	478	136
Margin for the rate of charge	919	882	789	712	648	570	478	100
Service charge	57	67	36	31	0	0	0	12
Commitment fees	481	19	454	0	0	0	0	24
Investment income	58	18	75	209	331	608	761	560
Reserves	58	18	75	209	331	462	612	396
Gold endowment pay-out	0	0	0	0	0	146	149	164
Interest free resources 3/	5	5	12	34	56	84	110	163
Reimbursements 4/	53	55	56	56	58	60	61	71
MDRI-I, PCDR Trusts, and SDR Department	1	1	1	1	1	1	1	2
PRG Trust	52	54	55	55	57	59	60	69
B. Expenses	**661**	**713**	**726**	**735**	**738**	**739**	**757**	**855**
Net administrative budget	625	671	682	688	688	692	715	812
Capital budget items expensed	6	9	9	9	9	6	6	6
Depreciation	30	33	35	38	41	41	36	37
C. Net operational income (A-B)	**912**	**333**	**696**	**307**	**355**	**583**	**653**	**75**
Surcharges	1,242	1,468	1,728	1,681	1,545	1,328	1,064	0
IAS 19 timing adjustment	-147	0	0	0	0	0	0	0
Retained gold endowment income 5/	6	14	58	144	217	97	99	110
Net income	**2,013**	**1,815**	**2,482**	**2,132**	**2,117**	**2,008**	**1,816**	**185**
				(in US$ millions)				
D. Operational income 2/	**2,391**	**1,568**	**2,132**	**1,564**	**1,640**	**1,983**	**2,115**	**1,394**
Lending income	2,214	1,452	1,918	1,114	972	855	717	204
Investment income	89	26	112	314	497	912	1,141	840
Interest free resources	7	8	18	51	84	126	165	245
Reimbursements	81	82	84	85	87	90	92	105
E. Expenses	**1,005**	**1,071**	**1,090**	**1,103**	**1,108**	**1,108**	**1,136**	**1,282**
Net administrative budget	950	1,007	1,023	1,032	1,032	1,037	1,073	1,217
Capital budget items expensed	9	14	14	14	14	9	9	9
Depreciation	46	50	53	57	62	62	54	56
F. Net operational income (D-E)	**1,386**	**497**	**1,042**	**461**	**532**	**875**	**979**	**112**
Memorandum Items:								
Fund credit (average stock, SDR billions)	91.9	88.2	78.9	71.2	64.8	57.0	47.8	10.0
SDR interest rate (in percent)	0.1	0.1	0.2	0.6	1.0	1.5	2.0	3.5
US$/SDR exchange rate	1.52	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Surcharges (US$ millions)	1,887	2,202	2,592	2,522	2,318	1,992	1,597	0
New income measures (US$ millions) 6/	83	85	117	173	250	506	547	556
Precautionary balances (end of period, SDR billions)	11.5	13.3	15.8	17.8	19.7	21.6	23.3	10.0

[1] Surcharges and commitment fees are projected on the assumption that the existing thresholds for their application are halved following the implementation of the 14th General Review of Quotas which is assumed to be effective from the second half of FY14. Adjusting the thresholds would require a Board decision.
[2] Excludes surcharges. The pay-out from the endowment funded by gold profits is assumed to begin in FY18, when the endowment is fully in place.
[3] Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.
[4] Reimbursement of the GRA for the costs of administering the PRG Trust is assumed to resume in FY13.
[5] For the period to FY17 all the investment income from the gold endowment is retained in the IA. From FY18, the endowment is assumed to make an annual payout to the GRA and a portion of the income retained to preserve the real value of the endowment.
[6] 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 PRGT expenses.

Box 1. Income Projections

Key Parameters	Key Parameters	Key Parameters
US$/SDR exchange rate	1.50	Assumed unchanged from recent levels. A 10 percent rise (fall) in the US$/SDR exchange rate would raise (lower) annual income in FY19 by US$222 million.
SDR interest rate	Rising to 3.5% by FY23 from 0.1% in FY13	A 10 basis point higher (lower) average SDR interest rate would raise (reduce) annual income in FY19 by US$41 million.
Margin for rate of charge (basis points)	100	Assume unchanged from current level. A 50 basis point higher (lower) margin effective from FY15 would increase (reduce) income in FY15 and FY16 by US$592 million and US$544 million, respectively. A 50 basis point higher (lower) margin from effective FY15 would increase (lower) precautionary balances in the period to end-FY18 by some SDR 1.4 billion.

Operational lending income (US$204 million or SDR 136 million by FY24)

Fund credit is assumed to decline back to an average steady state level of about SDR 10 billion by FY24, upon which a margin of 100 basis points would generate income of about SDR 100 million. Commitments under contingent lending facilities are assumed to also decline to an average of SDR 10 billion in the steady state, yielding some SDR 24 million in annual commitment fees. Average annual disbursements of about SDR 2.5 billion from FY23 generate about SDR 12 million in annual service charges (at 50 basis points).

Investment income (US$840 million or SDR 560 million by FY24)

Net operational income, plus surcharges, are assumed to be transferred annually to the IA for investment in the subsequent year. Average investment returns in this portfolio are expected to exceed the SDR interest rate by 100 basis points by FY17, resulting in an annual income of about SDR 400 million in the steady state (FY24) when precautionary balances are assumed to be at the floor of SDR 10 billion.

The updated projections assume that implementation of the proposed investment strategy for the endowment (SDR 4.4 billion, equivalent to an average gold price of US$850 per ounce, plus earnings during the interim period) will be phased-in gradually, starting in FY14 with annual pay-outs of 3 percent beginning in FY18. The Board adopted two related decisions, in February and September 2012, to transfer SDR 0.7 billion and SDR 1.75 billion, respectively, attributable to windfall gold sales profit to help finance concessional lending to low-income countries. The first transfer of SDR 0.7 billion was made in October 2012 and the second transfer is assumed to take place in the second-half of FY14.

Interest free resources (US$245 million or SDR 163 million by FY24)

The interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.

Reimbursements (US$82 million or SDR 53 million in FY13)

Reimbursements from the SDR Department, MDRI-I Trust, and PCDR Trust, are projected at about SDR 1 million in FY13. Reimbursement of the GRA for the expenses of administering the PRGT is assumed to resume in FY13 at SDR 52 million. Administrative costs and the associated reimbursements are assumed to be stable in real terms in the medium term.