



IMF POLICY PAPER

POVERTY REDUCTION AND GROWTH TRUST—REVIEW OF INTEREST RATE STRUCTURE

June 2019

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 24, 2019 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on May 2, 2019, for the Executive Board's consideration on May 24, 2019.

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IMF Executive Board Modifies PRGT Interest Rate Mechanism and Approves Zero Rates on All Low-Income Country Lending Facilities Through end-June 2021

On May 24, 2019, the Executive Board of the International Monetary Fund (IMF) reviewed the interest rates applicable to concessional credit provided under the PRGT. They considered a proposal to modify the mechanism for setting PRGT interest rates, which would unify the interest rates applicable to loans under the Extended Credit Facility (ECF) and the Standby Credit Facility (SCF), while preserving the zero-interest rate on credit outstanding under the Rapid Credit Facility (RCF). The proposed change modestly increases the overall degree of concessionality of PRGT financing while producing moderate additional subsidy costs, which can be financed within the PRGT's self-sustaining financing envelope in the context of the full LIC facilities reform package also considered on May 24, 2019.

Since the adoption of the PRGT interest rate mechanism in 2009, no interest has been charged on outstanding PRGT credit. During the period 2010–16, the Board waived any interest on PRGT loans. For the period 2017–18, the application of the mechanism resulted in zero rates on credit under the PRGT facilities on the basis of the prevailing low global interest rates. In addition, in 2015 the Executive Board decided that no interest would be charged on loans under the Rapid Credit Facility (RCF).

Executive Board Assessment¹

Executive Directors welcomed the opportunity to review the interest rates charged on credits extended from the Poverty Reduction and Growth Trust (PRGT). They agreed to align the mechanism for determining interest rates to be charged on credit provided under the Stand-by Credit Facility (SCF) with the interest rate mechanism applicable to credit provided under the Extended Credit Facility (ECF), while keeping the latter unchanged. They noted that this change is consistent with the package of reforms adopted in the parallel Review of Facilities for Low-Income Countries.

Directors noted that the change in the interest rate mechanism applicable to SCF credit would simplify the structure of interest rates on concessional lending, making it more like the structure

¹ An explanation of any qualifiers used in summings up can be found here:
<http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

of interest rates charged on non-concessional loans, financed through the General Resources Account (GRA). Directors agreed that the proposed changes are consistent with preserving the fundamental logic of the PRGT interest rate mechanism, while modestly increasing the overall degree of concessionality of PRGT financing. They noted that the additional subsidy costs can be financed within the PRGT's self-sustaining financing envelope in the context of the full reform package, as discussed in the Review of the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Countries.

Based on the revised interest rate mechanism and the most recent 12-month average SDR rate, Directors supported staff's proposal to set interest rates on all ECF and SCF credit at zero until June 2021 in the context of a persistently low global interest rate environment. The interest rate on credit provided under the Rapid Credit Facility (RCF) was set at zero on a permanent basis in 2015. Directors also supported the staff's proposal to waive interest rate charges on the outstanding legacy credit under the Exogenous Shocks Facility (ESF) until November 2020, by which time all the credit previously extended under the ESF is scheduled to be fully repaid, or until the time of the next review.

The next review of the PRGT interest rate mechanism is scheduled to take place no later than June 2021.



May 2, 2019

POVERTY REDUCTION AND GROWTH TRUST—REVIEW OF INTEREST RATE STRUCTURE

EXECUTIVE SUMMARY

This paper reviews the Poverty Reduction and Growth Trust (PRGT) interest rate structure for the period July 2019–June 2021. Applying the PRGT’s existing interest rate setting mechanism, as modified in 2016, would result in a zero rate for the Extended Credit Facility (ECF), a rate of 0.25 percent for the Standby Credit Facility (SCF), and a zero rate for the Rapid Credit Facility (RCF).

Since the interest rate mechanism was first established in 2009, no interest has been charged on PRGT credit. The Executive Board granted interest waivers on all outstanding concessional credit during 2010–16 when low-income countries (LICs) faced considerable headwinds from the global economic environment. The interest rate mechanism has been in operation since then, resulting in zero rates on credit under all three PRGT facilities for the period 2017–18 on the basis of the prevailing low global interest rates. Charges on outstanding legacy balances under the former Exogenous Shocks Facility (ESF) were waived for the same period. In December 2018, the Executive Board approved a postponement of the next interest rate review to no later than June 30, 2019, while keeping interest rates unchanged in the interim, to provide time to assess the interest rate mechanism in light of the findings of the LIC Facilities Review.

In line with the package of reforms proposed in the parallel Review of LIC Facilities, this paper proposes to align interest rates on the SCF with those on the ECF. This revision of the interest rate mechanism would modestly increase the degree of concessionality of PRGT financing, while incurring moderate subsidy costs, which can be financed within the PRGT’s self-sustained financing envelope in the context of the full reform package.

Based on the average SDR rate over the most recently observed 12-month period, the proposed revised interest rate mechanism would result in zero interest rates on both ECF and SCF credit for the period July 2019–June 2021. Interest on RCF credit would remain permanently at zero, as decided in 2015. In addition, staff proposes to waive interest rate charges on legacy balances under the ESF until all outstanding credit is fully repaid or until the time of the next review, which should take place no later than June 2021.

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Glossary

ECF	Extended Credit Facility
EFF	Extended Fund Facility
ENDA	Emergency Natural Disaster Assistance
EPCA	Emergency Post-Conflict Assistance
ESF	Exogenous Shocks Facility
ESF-HAC	Exogenous Shocks Facility—High-Access Component
ESF-RAC	Exogenous Shocks Facility—Rapid-Access Component
IMF	International Monetary Fund
LICs	Low-Income Countries
PRGT	Poverty Reduction and Growth Trust
RCF	Rapid Credit Facility
SBA	Stand-by Arrangement
SCF	Standby Credit Facility
SDR	Special Drawing Rights
WEO	World Economic Outlook

INTRODUCTION

1. **This paper reviews the interest rates charged on borrowing from the PRGT.** The background section describes the PRGT interest rate mechanism and its application to date. The following section discusses the implications of the existing interest rate mechanism in the current economic environment. The third section describes a modification of the mechanism to align interest rates between the ECF and SCF as discussed in the parallel Review of LIC Facilities. It also recommends an extension of the waiver of charges on outstanding legacy balances under the ESF and analyzes the financial implications for the PRGT. The final section sets out the proposed interest rate structure for the period July 2019–June 2021.

BACKGROUND

2. **The PRGT interest rate mechanism was adopted in 2009 as part of a comprehensive reform of the IMF’s concessional facilities.** Prior to the reforms, the Fund’s concessional lending was traditionally extended at a uniform rate of 0.5 percent. The objective of the 2009 reforms was to increase the flexibility of IMF support to LICs and better tailor assistance to countries’ diverse needs given their heightened exposure to global volatility.¹ The interest rate structure and adjustment mechanism aimed to balance the following objectives: (i) increase concessionality of PRGT financing, especially in the context of low global interest rates at the time; (ii) preserve the Trust’s scarce resources; (iii) avoid permanently zero interest rates; (iv) tailor financial terms to LICs’ needs and capacity; and (v) limit fluctuations in concessionality of PRGT instruments and subsidy costs.

3. **The mechanism differentiates interest rates across PRGT facilities and links them to global interest rates (Table 1).** As conceived in 2009, interest rates on PRGT credit provided under different facilities are set for the upcoming two years in the context of biennial reviews; their level is linked to the average SDR interest rate over the most recently observed 12-month period; and the rate charged on SCF loans was set at 25 basis points above that for the ECF, as SCF users were expected to have somewhat higher capacity to service debt than ECF users, and reflecting also differences in the duration of their balance of payments financing and adjustment needs.

4. **Since its introduction in 2009, the application of the PRGT interest rate mechanism was deferred several times, through end-December 2016.** Upon adoption of the PRGT interest rate mechanism in 2009, the Board also endorsed temporary relief, through end-December 2011, of interest payments on all outstanding concessional loans, including the subsidized ENDA/EPCA and ESF loans. Subsequently, the Board decided to extend the waiver on interest payments on two occasions through end-2014.² In the 2014 Review, Directors approved a further extension of the temporary interest rate waiver through end-December 2016.

¹ See [A New Architecture of Facilities for Low-Income Countries and Reform of the Fund’s Concessional Financing Framework—Supplementary Information](#), July 20, 2009.

² See [Poverty Reduction and Growth Trust—Review of Interest Rate Structure](#) (November 23, 2011), [Poverty Reduction and Growth Trust Interest Rate Mechanism—Extension of Temporary Interest Rate Waiver](#) (December 14, 2012), and “Poverty Reduction and Growth Trust Interest Rate Mechanism—Extension of Temporary Interest Rate Waiver,” [Press Release No. 12/505](#), December 21, 2012.

Table 1. Evolution of Interest Rate Mechanism for the Fund's Concessional Facilities ^{1/}
(In percent)

A. January 2010 - July 2015 ^{2/ 3/ 4/}			
SDR rate thresholds	ECF	RCF	SCF
SDR rate < 2	0.00	0.00	0.25
2 ≤ SDR rate ≤ 5	0.25	0.25	0.50
SDR rate > 5	0.50	0.50	0.75
B. July 2015 - December 2016 ^{3/ 4/}			
SDR rate thresholds	ECF	RCF	SCF
SDR rate < 2	0.00	0.00	0.25
2 ≤ SDR rate ≤ 5	0.25	0.00	0.50
SDR rate > 5	0.50	0.00	0.75
C. December 2016 - June 2019 ^{5/}			
SDR rate thresholds	ECF	RCF	SCF
SDR rate ≤ 0.75	0.00	0.00	0.00
0.75 < SDR rate < 2	0.00	0.00	0.25
2 ≤ SDR rate ≤ 5	0.25	0.00	0.50
SDR rate > 5	0.50	0.00	0.75

1/ This is based on the average SDR rate over the most recently observed 12-month period.

2/ An Interest Rate Mechanism for the Fund's Concessional Facilities was approved by the Executive Board in July 2009; It was in effect for January 7, 2010-July 2015.

3/ A temporary waiver of interest payment for PRGT-eligible members on all outstanding concessional loans was approved by the Executive Board in July 2009, became effective on January 7, 2010 and further extended in December 2011, December 2012, and December 2014 until end-December 2016, after which the mechanism would apply.

4/ The interest rate charge on RCF lending was set permanently to zero as of July 2015.

5/ In December 2016, IMF Executive Board approved a new Interest Rate Mechanism and set zero rates on all low-income country lending facilities through end-2018, which was subsequently extended to end-June 2019.

5. **In July 2015, the PRGT interest rate mechanism was modified to enhance support for PRGT-eligible countries in fragile situations or hit by natural disasters.** As part of the Fund's response to the UN-sponsored dialogue on policies to promote financing of the 2030 Development Agenda, the Board approved an increase in concessionality of fast-disbursing support under the RCF by setting the interest rate levied on RCF financing permanently at zero, while preserving the PRGT interest rate mechanism for the SCF and ECF.³

³ See [Financing for Development—Enhancing the Safety Net for Developing Countries](#) (June 11, 2015) and "IMF Executive Board Adopts Decisions to Enhance the Financial Safety Net for Developing Countries," [Press Release No. 15/324](#), July 8, 2015. "

6. **In October 2016, the PRGT interest rate mechanism was amended to accommodate periods of very low interest rates worldwide.** Specifically, a new threshold was proposed whereby both the ECF and the SCF rate would be set at zero when the average SDR rate over the most recently observed 12-month period was less than or equal to 0.75 percent (Table 1). This proposal in effect kept all PRGT interest rates under the mechanism at zero percent through December 2018, while incurring only modest subsidy costs for the PRGT. In addition, the interest rate charges on outstanding legacy balances under the ESF—which are not included under the PRGT interest rate mechanism—were waived until December 2018. At the same time, most Directors expressed the view that the merits and implications of unifying the interest rate structure for the ECF and SCF should be examined as one element of the forthcoming review of the LIC Facilities.⁴

7. **At the first stage of the LIC Facilities Review in July 2018, many Directors supported the option of aligning the SCF interest rate with that of the ECF.**⁵ One motivation for the proposal was that the concessionality of the SCF remained lower than originally envisaged (as a result of the low interest environment). Moreover, earlier concerns about possible overuse of SCF arrangements had not materialized. One implication of such an interest rate alignment would be that the first adjustment in the interest rate on the SCF would not occur until the average SDR rate exceeds 2 percent, as is presently the case for the ECF. The staff paper noted that this would entail modest subsidy costs that should be examined in detail in conjunction with other reforms at the second stage of the LIC Facilities Review.

8. **On December 4, 2018, the Executive Board approved on a lapse-of-time basis the postponement of the deadline for the next interest rate review to no later than June 30, 2019.** The postponement provides an opportunity to assess the PRGT interest rate mechanism in light of the findings of the parallel LIC Facilities Review. The Board also decided that the existing zero percent interest rates under the ECF and SCF continue to be applied to outstanding balances of PRGT loans

Table 2. Interest Savings from Temporary Interest Waivers, January 2010–June 2019^{1/}
(In thousands of SDRs)

Country	Facility			Total
	SCF ^{2/}	ESF	ENDA/EPCA	
Bangladesh	-	-	806	806
Cameroon	-	1,692	-	1,692
Comoros	-	16	-	16
Congo, Dem. Rep.	-	2,043	-	2,043
Dominica	-	60	12	71
Ethiopia	-	3,457	-	3,457
Guinea-Bissau	-	-	5	5
Kenya	-	2,446	-	2,446
Kyrgyz Republic	-	579	-	579
Malawi	-	582	-	582
Maldives	-	39	0	39
Mozambique	754	2,095	-	2,849
Rwanda	924	-	-	924
Samoa	-	111	-	111
Senegal	-	2,226	-	2,226
Solomon Islands	187	-	-	187
Sri Lanka	-	-	7	7
St. Lucia	-	126	-	126
St. Vincent & Grenadines	-	67	-	67
Tanzania	1,046	4,009	-	5,055
Total	2,911	19,548	829	23,288

Source: Finance Department.

^{1/} Based on monthly average credit outstanding until end-March 2019 and projections of repayments from existing disbursements thereafter.

^{2/} Total savings include interest rate waivers during 2010-16 and the modification of the interest rate setting mechanism that resulted in a zero rate on SCF during 2017-June 2019.

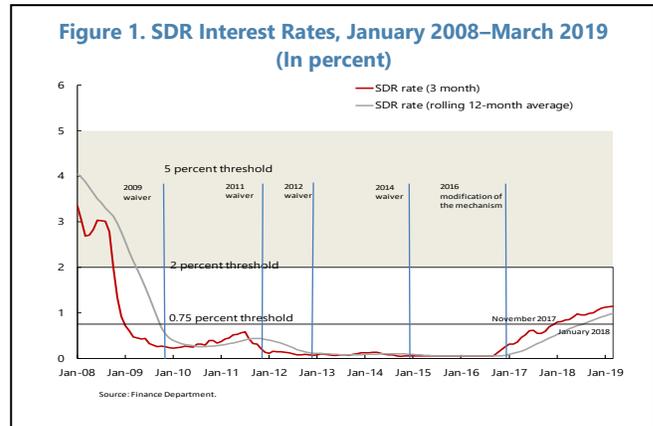
⁴ See "IMF Executive Board Modifies PRGT Interest Rate Mechanism and Approves Zero Rates on All Low-Income Country Lending Facilities through end-2018," [Press Release No. 16/448](#), October 6, 2016.

⁵ See [2018 Review of Facilities for Low-Income Countries](#), August 1, 2018.

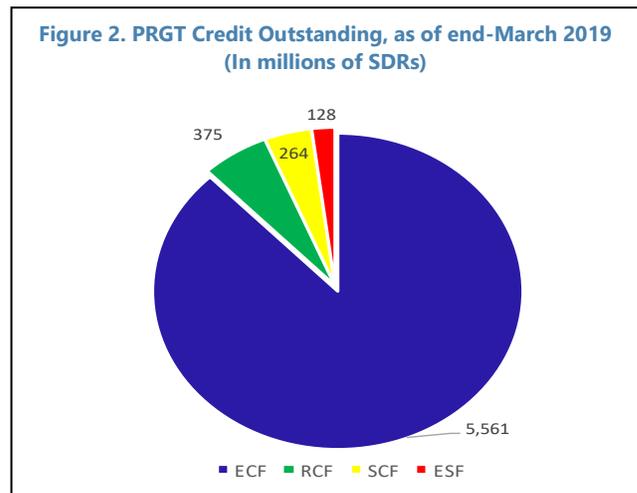
through June 30, 2019.⁶ Similarly, the waiver of interest rate charges on outstanding legacy balances under the ESF was extended by six months. The exceptional ESF interest rate waiver in place since January 2010 and the 2016 modification of the interest rate mechanism benefiting the SCF borrowers have provided savings to 20 member countries, estimated at SDR 23.3 million (Table 2).⁷

PRGT INTEREST RATES IN THE CURRENT ECONOMIC CONTEXT

9. **Reflecting recent trends in global interest rates, the SDR interest rate has increased to just over 1 percent, which is still low by historical standards** (Figure 1). The SDR rate declined from 0.23 percent at the time of the first interest rate waiver in January 2010 to 0.05 percent in September 2014 and remained at this level until September 2016. Since then, the SDR rate has steadily increased to reach 1.14 percent by end-March 2019.



10. **Applying the current PRGT interest rate mechanism would result in differential rates on SCF and ECF credit for the coming two years.** With the 12-month average SDR rate having risen above the 0.75 percent threshold, an interest rate of 0.25 percent would apply to outstanding credit under the SCF (SDR 264 million as of end-March 2019).⁸ For most PRGT borrowers an interest rate of zero would still apply (Figure 2), including outstanding credit under the ECF, which account for the bulk of PRGT lending, as well as credit under the RCF.



11. **Given low global interest rates, the degree of concessionality of PRGT loans remains lower than envisaged when the interest rate**

⁶ See [Decision No. 16060 \(16/91\)](#), adopted on October 3, 2016. and [Poverty Reduction and Growth Trust—Review of Interest Rate Structure—Postponement](#), November 27, 2018.

⁷ All but one of these countries are currently PRGT eligible. In addition, Sri Lanka had outstanding purchases under ENDA when the interest waiver became effective and these were fully repurchased before Sri Lanka’s graduation from PRGT-eligibility on April 10, 2010.

⁸ For SCF arrangements treated as precautionary, no interest is charged. An availability fee of 0.15 percent applies at the end of each six-month period on available but undrawn credit.

mechanism was established in 2009. The average grant element in PRGT loans is currently estimated to be below 30 percent, compared with a traditional benchmark of 35 percent.⁹

12. **At the same time, the global economic outlook for LICs has not substantively improved since the previous review, while downside risks remain significant.** Global growth is expected to slow to 3.3 percent in 2019, and many low-income countries continue to face substantial risks, including from volatile external conditions, a sharp tightening of external financing conditions, climate change and potent natural disasters, trade tensions, and subdued outlook for commodity prices. At the same time, public debt stocks have increased rapidly in this group during a period of low interest rates.¹⁰

PROPOSED MODIFICATIONS

13. **The reform package described in the parallel LIC Facilities Review includes a modification of the interest rate mechanism to align the SCF rate structure with that of the ECF (Table 3).** The change would make the SCF more concessional by (i) setting the SCF rate at zero when the SDR rate is below 2 percent and (ii) reducing the SCF rate by 0.25 percent when it is above 2 percent (See Table 1C to compare with the current mechanism).

SDR rate ^{1/}	ECF/SCF	RCF ^{2/}
SDR rate < 2	0.00	0.00
2 ≤ SDR rate ≤ 5	0.25	0.00
SDR rate > 5	0.50	0.00

1/ Average SDR interest rate over the most recently observed 12-month period.
2/ Rate set permanently to zero as of July 2015.

14. **The proposed modification would preserve the fundamental logic of the PRGT interest rate mechanism while making it more concessional.** The lower rate structure would bring the expected average concessionalism of the SCF closer to what was envisaged in the 2009 reforms, which did not anticipate the prolonged period of very low global rates. At the same time, the SCF's somewhat shorter maturity and period before repayments are required to begin would preserve an element of tailoring PRGT financing terms to the diverse economic needs of eligible members.¹¹ The modified rate structure would have greater similarity to the (unsubsidized) financing terms in the GRA in the sense that SBA and EFF loans carry the same basic rate of charge but have different repayment periods. Finally, the proposed modification of the mechanism preserves the link to world interest rates, allowing for non-zero rates and limiting fluctuations in the concessionalism of PRGT loans and subsidy costs.

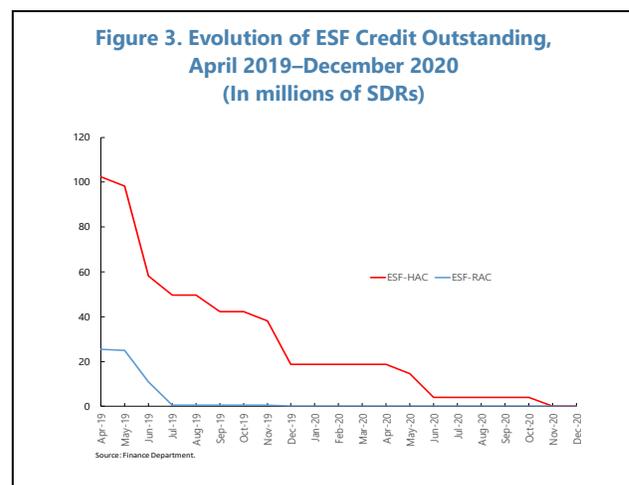
⁹ See [2018 Review of Facilities for Low-Income Countries](#), August 1, 2018. Since October 11, 2013, a unified discount rate of 5 percent is used to calculate the grant element of individual loans.

¹⁰ See [World Economic Outlook](#) (IMF, April 2019).

¹¹ Countries only qualify for the SCF if their balance of payments problems can be resolved in normally two years, whereas countries qualifying for the ECF and RCF may face protracted balance of payments problems.

15. **The modifications proposed above entail moderate subsidy costs, but can be financed with the resources of the self-sustained PRGT as part of the reform package proposed in the LIC Facilities Review.**¹² The costs are relatively modest (SDR 1.8 million) for the existing stock of outstanding SCF credit. Taking a longer view, and assuming a somewhat higher usage of SCF arrangements after the reforms proposed in the LIC Facilities Review, staff estimates that the alignment of the SCF and ECF rates would in the steady state cost about SDR 4.9 million annually and lower the PRGT's self-sustained capacity by about SDR 0.03 billion. As shown in the parallel papers, these subsidy costs, together with the net costs of the access increase and other reforms, can be accommodated under the self-sustained PRGT while maintaining the self-sustained lending capacity target of SDR 1¼ billion. Risks are evenly balanced over the coming decade though the longer-term outlook is subject to greater uncertainty.¹³

16. **In addition, there is a case for waiving the interest rate on legacy ESF credit until all outstanding balances are fully repaid or until the time of the next review.** As of end-March 2019, outstanding loans under the ESF amounted to SDR 127.8 million, of which SDR 102.4 million are under the ESF-HAC and SDR 25.4 million under the ESF-RAC (Figure 3). The rate on outstanding ESF loans would be 0.25 percent upon expiration of the interest rate waiver at end-June 2019. These facilities were broadly superseded by the RCF (in the case of the ESF-RAC) and the SCF (in the case of the ESF-HAC), respectively, under the 2009 LIC reforms. Continuing to waive the interest rate for outstanding ESF credit would align the charges with the PRGT rates applicable over the coming two years.¹⁴



PRGT INTEREST RATES FOR JULY 2019–JUNE 2021

17. **With the proposed modification of the interest rate mechanism and waiver of charges of ESF legacy credit, no interest would be charged on PRGT credit until June 2021.** With the 12-month average SDR rate currently below the 2 percent threshold, the interest rate on SCF and ECF credit would be zero for the period July 2019–June 2021. As decided by the Executive Board in 2015, the RCF interest rate would remain permanently at zero. Staff also recommends waiving

¹² See [2018-19 Review of Facilities for Low-Income Countries-Reform Proposals and Review of the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Countries](#), (May 6, 2019).

¹³ See [Review of the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Countries](#), (May 6, 2019).

¹⁴ All outstanding ESF balances are expected to be repaid by November 2020.

charges on outstanding balances under legacy ESF credit until all outstanding balances are fully repaid by November 2020 or until the time of the next review.

18. **Consistent with Section II, Paragraph 4(b) of the PRGT Instrument, the next review of the PRGT interest rate structure would be completed by June 30, 2021.**

Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

Poverty Reduction and Growth Trust—Review of Interest Rate Structure

1. In accordance with Section II, paragraph 4(b) of the Instrument to Establish the Poverty Reduction and Growth Trust (the "PRGT Instrument"), annexed to Decision No. 8759-(87/176) ESAF, adopted December 18, 1987, as amended, the Fund, as Trustee of the Poverty Reduction and Growth Trust (the "Trustee"), has reviewed the interest rates for loans under the Extended Credit Facility ("ECF") and the Standby Credit Facility ("SCF").
2. Section II, paragraphs 4(a)-(c) shall be amended to read as follows:
 - (a) Effective July 1, 2019, and subject to the provisions of Section IV, paragraph 5, interest on the outstanding balance of Trust loans shall be charged at the rate of zero percent per annum on loans under the ECF, the SCF, the ESF, and the RCF.
 - (b) The interest rates for loans outstanding under the ECF and the SCF as specified under paragraph (a) shall be subject to periodic reviews to take account of developments in world interest rates, with such first review to be completed by June 30, 2021, and subsequent reviews every two years thereafter. In the context of such reviews, and subject to the provisions of Section IV, paragraph 5, the interest rate on the outstanding balances of loans under the ECF and SCF shall normally be determined by the Trustee as follows:
 - (i) If the SDR interest rate (average rate over the most recently observed 12-month period) is less than 2 percent, the interest rate shall be established or maintained, as the case may be, at zero percent per annum for ECF and SCF loans;
 - (ii) If the SDR interest rate (average rate over the most recently observed 12-month period) is between 2 percent and 5 percent, the interest rate shall be established or maintained, as the case may be, at 0.25 percent per annum for ECF and SCF loans;

- (iii) If the SDR interest rate (average rate over the most recently observed 12-month period) is greater than 5 percent, the interest rate shall be established or maintained, as the case may be, at 0.5 percent per annum for ECF and SCF loans.
- (c) Notwithstanding the provisions of paragraph (a) or any interest rate determined in terms of the provisions of paragraph (b), interest at a rate equal to the SDR interest rate shall be charged on the amounts of any overdue interest on or overdue repayments of Trust loans.