oping countries of the Middle East and Europe saw a smaller decline in inflows, while flows to the Western Hemisphere, Africa, and the countries in transition actually increased. In the first quarter of 1998, net capital inflows to emerging market countries remained close to their already reduced levels of late 1997.

The sharp declines in private capital flows to emerging market economies in Asia, although cushioned to some extent by an increase in official financing flows, required substantial adjustments in these countries’ external positions. For the Asian developing countries, taken together, the current account deficit narrowed by almost $30 billion in 1997. And by early 1998, the countries most affected by the crisis—Indonesia, Korea, and Thailand—were each running current account sur-

pluses. In 1997 as a whole, a widening of current account deficits among a number of Latin American countries, reflecting the increase in foreign direct investment in the region, was the main counterpart to the narrowing of deficits in the Asian emerging markets (Table 3). In late 1997 and early 1998, however, a number of advanced economies—most notably the United States—and the oil-exporting countries began to show signs of deteriorating current account balances.

Consumer price inflation declined further in each of the main country groups in 1997 (see Figure 2). The decline was helped by the weakness of primary commodity prices, including those for oil. In early 1998, oil prices fell further; indeed, by April 1998, in SDR terms, oil prices were about 31 percent lower than a year earlier, while non-oil commodity prices had fallen by 20 percent over the same period. To some extent, the declines reflected the reduced demand for commodities in the countries embroiled in the Asian crisis; the sharp depreciation of these countries’ currencies may also have led to reductions in the foreign currency prices of their commodity exports.

The redirection of financial flows toward the mature markets following the onset of the crisis, together with prospects for lower inflation, contributed to significant declines in medium- and long-term interest rates in the industrial countries in late 1997 and early 1998—in some cases to 50-year lows. This easing of financial conditions, particularly in North America and in western Europe, contributed, in turn, to further gains in equity markets, with many indices reaching new peaks. These developments helped support the growth of domestic demand in industrial countries at the same time that net exports began to be adversely affected by the Asian crisis.

In foreign exchange markets, after considerable initial strengthening during 1997/98, the yen experienced strong selling pressures for most of the period, reflecting market concerns about progress in Japan’s economic recovery. After falling to ¥127 per dollar at the end of April 1997, the yen rebounded sharply in May and early June to reach a high of ¥110. With the recov-
ery losing momentum by midyear and with concerns about the domestic financial sector, the yen subsequently weakened anew; by the end of April 1998, it had depreciated to ¥132 per dollar. Although the deutsche mark depreciated further against the dollar during 1997 and in early 1998, the depreciation in nominal effective terms was moderate. The pound sterling rose steeply in 1997 and in early 1998, owing mainly to short-term cyclical factors.

**Advanced Economies**

Cyclical divergences remained sizable among the advanced economies in 1997. Economic activity was strong in the United States and the United Kingdom, with both economies operating close to capacity and unemployment rates at their lowest in many years. The major economies of continental Europe saw a strengthening of growth in the second half of 1997 and in early 1998, but significant margins of slack remained in most of these countries. The Japanese economy faltered after the first quarter of 1997, then slipped into recession in the fourth quarter of the year, with output contracting in the first quarter of 1998 by 5.3 percent at an annual rate. The impact of the Asian crisis on the advanced economies varied depending on two main factors. The first was the importance of trade and financial links with the crisis economies; these links were generally closest in the Asia-Pacific region. The second was the economy’s starting position. The dampening effects of the crisis had a relatively large adverse impact on Japan, where activity and confidence were already weak; by contrast, these effects most likely helped contain inflationary pressures in countries facing the risk of overheating.

After a strengthening of growth in 1996 following four years of weak recovery, self-sustaining growth seemed to be taking hold in Japan in the early part of 1997. But activity declined sharply in the second quarter and picked up only weakly during the remainder of the year. The loss of growth before the middle of the year was attributable primarily to domestic factors, including an increase in the consumption tax in April 1997, cuts in public spending, and financial sector fragility. In the latter part of the year, concerns about the Asian crisis and about the domestic financial sector, together with a renewed softening of equity prices, contributed to continued weakness in domestic spending. For the year as a whole, GDP grew by ¾ of 1 percent. The Japanese authorities responded to these developments by announcing a large fiscal stimulus package in April 1998 and by taking steps to address banking problems, including making public money available to strengthen deposit insurance and boost bank capital. Nevertheless, uncertainties remained about how the banking sector measures would be implemented. In July 1998, the Japanese authorities announced a series of further banking sector initiatives in a Comprehensive Plan for Financial Revitalization, including a “bridge bank” facility intended to facilitate the resolution of failed institutions and measures to strengthen bank supervision and increase transparency.

In the other advanced economies in the Asia-Pacific region, cyclical positions were generally stronger than in Japan when the Asian crisis erupted. In Australia,
rency unit (ecu) that implied a depreciation of 12½ percent; at the same time, the Irish pound was revalued by 3 percent in terms of its central parity.

**Developing Countries**

A number of developing countries experienced contagion in their financial markets from the Asian crisis during 1997, and many others began to feel other economic effects from the crisis around the turn of the year, including generally higher risk premiums on foreign credits. These influences aggravated a number of other problems limiting growth, such as loss of competitiveness, lower commodity prices, and domestic and external imbalances. In the developing countries as a group, economic growth slowed to 5¼ percent in 1997 from about 6½ percent in 1996. The slowdown was significant in Asia, but most marked in Africa (Figure 3). In the developing countries of the Western Hemisphere, in contrast, growth in 1997 was actually stronger than in the previous two years but weakened in the first quarter of 1998. The slower growth was the result of spillovers from the Asian crisis and policy measures to reduce vulnerability to adverse shifts in investor sentiment and to widening current account deficits.

In the Asian region, financial markets in China remained relatively immune to the contagion effects of the crisis, reflecting the country’s appropriate macroeconomic policies undertaken since 1993, the fact that its capital inflows consisted mainly of direct investment with limited vehicles for financial speculation, and its large foreign exchange reserves. While China’s real exchange rate appreciated somewhat as a result of the currency depreciations of its Asian trading partners, its trade position remained strong and the current account continued in surplus. The authorities remained committed to not devaluing the renminbi, a policy critical to restoring stability in the region. Also, inflation remained low following the sharp drop in 1997. In India, output growth declined to about 6 percent in 1997 from about 7½ percent in 1996. The rupee weakened against the dollar in late 1997, partly because of spillovers from the regional crisis, but its exchange value was little changed on a real multilateral basis. In Pakistan, the government adopted a program to strengthen macroeconomic policies and implemented structural reforms following the widening of macroeconomic imbalances and the threat of a foreign exchange crisis in late 1996 and early 1997.

In Latin America, consumer price inflation declined in Brazil to 4½ percent in 1997, while output growth at 3 percent remained much the same as in the previous year. In response to spillovers from Asia, the authorities tightened monetary and fiscal policies significantly in October and November 1997, and thereby restored confidence and halted the drain of foreign exchange reserves. In Argentina, output grew by a robust 8½ percent, while prices remained broadly stable; as in Brazil, financial market pressures emerged in October, with a significant stock market correction and widening spreads on sovereign debt. In Mexico, the Asian crisis led to a marked increase in exchange market and interest rate volatility. A substantial temporary increase in interest rates helped stabilize the exchange rate, but the peso fell against the dollar in February 1998. In Chile, the peso came under pressure in December but stabilized by late January after moderate foreign exchange market intervention and a sizable increase in interest rates.

For the Middle East and Europe region, the direct spillovers from the Asian crisis were limited, with temporary declines in equity prices in some countries and a widening of interest spreads on internationally traded debt. In the Islamic Republic of Iran, real GDP growth slowed to 3¼ percent in 1997 from 4½ percent in 1996, reflecting stagnant non-oil exports, cutbacks in government capital expenditure associated with a decline in oil revenue, and delays in structural reforms. In Turkey, growth continued close to 7 percent in 1997, while in Egypt successful efforts at macroeconomic stabilization and structural reform in recent years helped growth pick up to 5 percent. Jordan continued to reap the benefits of successful implementation of stabilization and reform policies, with continued robust growth in output, further declines in inflation, and a narrowing current account deficit.

Economic growth in Africa in 1997 was just 3¼ percent. The disappointing outcome mainly reflected the impact on a number of countries of poor weather, declines in commodity prices, and, in a few cases,
Figure 4

Initiative for Heavily Indebted Poor Countries

First Stage

- Paris Club provides flow rescheduling on Naples terms, that is, rescheduling of debt service on eligible debt falling due during the three-year consolidation period (up to 67 percent reduction on eligible maturities on a net present value basis).
- Other bilateral and commercial creditors provide at least comparable treatment.
- Multilateral institutions continue to provide adjustment support in the framework of World Bank- and IMF-supported adjustment programs.
- Country establishes first three-year track record of good performance (performance prior to the start of the HIPC Initiative can be taken into account).

Decision Point

Exit

- Paris Club stock-of-debt operation (on Naples terms) judged not sufficient for the country’s overall debt to become sustainable by the completion point—country requests additional support under the HIPC Initiative and IMF and World Bank Boards determine eligibility.

Eligible

- Paris Club stock-of-debt operation under Naples terms (up to 67 percent present value reduction of eligible debt) and comparable treatment by other bilateral and commercial creditors judged adequate for the country to reach sustainability by the completion point—country not eligible for HIPC Initiative.

Borderline

- For borderline cases, where there is doubt about whether sustainability would be achieved by the completion point under a Naples terms stock-of-debt operation, the country would receive further flow reschedulings under Naples terms.
- If the outcome at the completion point is better than or as projected, the country would receive a stock-of-debt operation on Naples terms from Paris Club creditors and comparable treatment from other bilateral and commercial creditors.

Second Stage

- Paris Club goes beyond Naples terms to provide more concessional debt reduction of up to 80 percent in present value terms.
- Other bilateral and commercial creditors provide at least comparable treatment.
- Donors and multilateral institutions provide enhanced support through interim measures.
- Country establishes a second track record of good performance under IMF- and Bank-supported programs.

Completion Point

- All creditors take coordinated action to provide sufficient assistance to reduce the country’s debt to a sustainable level.
- Paris Club provides deeper stock-of-debt reduction of up to 80 percent in present value terms on eligible debt.
- Other bilateral and commercial creditors provide at least comparable treatment on stock of debt.
- Multilateral institutions take action to reduce the net present value of their claims, taking into account the assistance provided by nonmultilateral creditors and their own preferred creditor status.

Borderline

- If the outcome at the completion point is worse than projected, the country could receive additional support under the HIPC Initiative, so as to be able to exit from unsustainable debt.
Member countries’ demand for IMF technical assistance and training remained strong in 1997/98. Technical assistance continued to focus on the monetary and fiscal aspects of macroeconomic management, but also addressed statistics, financial law, IMF financial organization and operations, and information technology (Figure 5). A large number of departments in the IMF provided assistance, and the Technical Assistance Committee—composed of senior staff from each of the IMF’s functional, area, and support departments—advised IMF management on priorities and policies and coordinated assistance activities among IMF departments. In the field, assistance was delivered by IMF staff and the assignment of short- and long-term advisors.

At headquarters and abroad, training courses and seminars on a variety of topics were given by the IMF Institute and other departments providing technical assistance and training. In 1997/98, the Institute’s program at headquarters included basic, intermediate, and advanced courses on financial programming and policies, shorter courses on such specialized topics as exchange rate policies and monetary and inflation targeting, and a high-level seminar on trade reform and regional integration in Africa. In addition, other functional departments—including Fiscal Affairs, Monetary and Exchange Affairs, Policy Development and Review, and Statistics—conducted seminars and courses in their areas of expertise in collaboration with the Institute. The Institute’s overseas training program continued to focus on issues related to the formulation and implementation of economic adjustment programs.

Technical assistance has been described as forming the third leg of the IMF stool—the other two legs...
to a large short-term financing need resulting from a sudden and disruptive loss of market confidence. SRF drawings are made within the context of a Stand-By or Extended Arrangement but are not subject to a specific quota limit. Repurchases (i.e., repayments) under the SRF are expected within 1–1½ years of each purchase, although the Board may extend this period by up to one year at which point the member is obligated to repurchase.

Members’ Use of IMF Resources and Credit Outstanding

In 1997/98, members’ purchases from the GRA, excluding reserve tranche purchases,18 amounted to SDR 19.0 billion, nearly four times the 1996/97 level of SDR 4.9 billion (Table 12; see also Appendix II, Table II.7). These purchases consisted of SDR 16.1 billion under Stand-By Arrangements (compared with SDR 1.8 billion in 1996/97) and SDR 2.8 billion under Extended Arrangements (SDR 2.8 billion in 1996/97). During 1997/98, there were also purchases of SDR 30 million under the policy on emergency postconflict assistance; no purchases were made under the Compensatory and Contingency Financing Facility (CCFF) (SDR 0.3 billion in 1996/97).

The largest users of IMF resources in 1997/98 were Asian members. Korea drew SDR 11.2 billion, including SDR 7.1 billion under the SRF; Indonesia SDR 2.2 billion; and Thailand SDR 2.0 billion. Russia was the next largest user, drawing a total of SDR 1.5 billion. Other members making significant purchases were the Philippines (SDR 0.8 billion), Algeria (SDR 0.3 billion), Argentina (SDR 0.2 billion), Bulgaria (SDR 0.2 billion), and Ukraine (SDR 0.2 billion). By region, purchases by Asian countries amounted to SDR 16.2 billion and purchases by European countries (including the Baltic States, Russia, and other countries of the former Soviet Union) amounted to SDR 2.0 billion. Purchases by Latin American, Middle Eastern, and African countries combined totaled SDR 0.7 billion.

Repurchases in the GRA during 1997/98 totaled SDR 3.8 billion, compared with SDR 6.7 billion in the previous financial year (Figure 7; see also Appendix II, Table II.8). The largest repurchases were made by Argentina (SDR 0.5 billion); India, Mexico, and Russia (roughly SDR 0.4 billion each); and Algeria, South Africa, and Venezuela (roughly SDR 0.3 billion each). Actual repurchases in 1997/98 were higher than the scheduled level of SDR 3.5 billion, owing to a repurchase by Algeria as a result of CCFF overcompensation (SDR 0.2 billion) and a voluntary advance repurchase by Hungary (SDR 0.1 billion). Given the sharp rise in the use of IMF resources in the recent past and the revolving nature and medium-term maturity of IMF financial assistance, scheduled repurchases are likely to

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18 Reserve tranche purchases totaling SDR 1.1 billion were made by Indonesia (SDR 288 million), Korea (SDR 444 million), and Thailand (SDR 317 million) in 1997/98, whereas there were no reserve tranche purchases in 1996/97. Reserve tranche purchases represent members’ use of their own IMF-related assets and not use of IMF credit.
The enlarged and extended ESAF Trust, which became effective on February 23, 1994, has a target for total loan resources of SDR 10.1 billion. Financing toward this goal has been provided by a broad cross-section of the IMF’s membership. Total effective commitments by lenders to the ESAF Trust amounted to SDR 9.7 billion as of April 30, 1998. The commitment period for ESAF Trust loans to eligible members runs through December 31, 2000, with disbursements to be made through the end of 2003.

Contributions to the Subsidy Account enable loans from the ESAF Trust to be provided at a highly concessional rate of interest (currently 0.5 percent a year). The total value of bilateral subsidy contributions is estimated at SDR 3.7 billion. In addition, the Board transferred SDR 0.4 billion from the SDA to the Subsidy Account in early 1994. This contribution by the IMF, including the interest it will earn, is valued at SDR 0.6 billion.

The availability of resources in the Subsidy Account, net of subsidies already paid, rose from SDR 1,562 million as of April 30, 1997, to SDR 1,629 million as of April 30, 1998. The ESAF Trust made interest payments of SDR 172 million to lenders in 1997/98, of which SDR 23 million was financed by payments of interest by borrowers from the Trust and the balance of SDR 149 million was drawn from the resources of the Subsidy Account.

Details of SAF and ESAF arrangements, and of borrowing agreements and subsidy contributions for the ESAF Trust, are provided in Appendix II (Tables II.1, II.5, and II.10).

**ESAF-HIPC Trust**

The ESAF-HIPC Trust was established in February 1997 to make grants or loans, or both, to eligible members that qualify for assistance under the Initiative for Heavily Indebted Poor Countries (HIPC) and to subsidize the interest rate on interim ESAF operations to ESAF-eligible members (see Chapter IX). Contributions to the Trust have been received from six countries. To proceed quickly with the implementation of the HIPC Initiative, the Board amended the ESAF Trust Instrument to permit the transfer of up to SDR 250 million from the Reserve Account of the ESAF Trust to the SDA for financing special ESAF operations, provided other resources are not available. All creditors to the Loan Account of the ESAF Trust consented to such a transfer. In addition, to augment the resources available in the ESAF-HIPC Trust, the Board decided to forgo the reimbursement to the GRA of the costs of administering the ESAF Trust in 1997/98 and to transfer SDR 40.7 million from the ESAF Trust Reserve Account to the ESAF-HIPC Trust. The Board also decided that no reimbursement would be made to the GRA in 1998/99 and authorized quarterly transfers totaling an estimated SDR 45 million from the ESAF Trust Reserve Account to the ESAF-HIPC Trust.

In April 1998, Uganda reached its completion point under the HIPC Initiative and SDR 51.5 million was disbursed in the form of a grant, which is being held in an administered account to be used to service a part of Uganda’s debt to the IMF under a schedule agreed with the Ugandan authorities.23 Resources available to the ESAF-HIPC Trust from bilateral contributions (including accrued interest) amounted to SDR 3.6 million at the end of April 1998.

**IMF Income, Charges, and Burden Sharing**

At the beginning of each financial year, the IMF sets the rate of charge on the use of its resources as a proportion of the weekly SDR interest rate to achieve a target amount of net income to add to its reserves. This method of setting the rate of charge has been in use for a number of years. By ensuring that its operational income closely reflects its operational costs, which depend largely on the SDR interest rate, the IMF tries to minimize the possible need for a discrete increase in the rate of charge during the financial year.

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23 On April 7, 1998, the IMF established the “Umbrella Account for HIPC Operations” to receive and administer resources on behalf of eligible member countries that qualify for assistance under the terms of the ESAF-HIPC Trust. Within the umbrella account, the IMF will establish an individual subaccount for each member receiving resources from the ESAF-HIPC Trust. These resources were used to meet part of the member’s debt-service payments on existing debt to the IMF.
In April 1997, the proportion of the rate of charge to the SDR interest rate for 1997/98 was set at 109.6 percent to achieve a net income target of SDR 99 million—or 5 percent of the IMF’s reserves at the beginning of the financial year—with the proviso that any income in excess of the target (excluding operational income generated from the use of credit under the SRF, discussed below) be used to reduce retroactively the proportion of the rate of charge for the year. Following a review of the IMF’s income position at midyear, the proportion of the rate of charge to the SDR interest rate was reduced retroactively to 107.0 percent for 1997/98, and SDR 31 million was returned to members that had paid charges through the third quarter of the financial year. Furthermore, at the end of the financial year, after actual income exceeding the target of SDR 22 million had been returned to members that paid charges during the year, the proportion of the rate of charge to the SDR interest rate was reduced retroactively to 105.6 percent for 1997/98. The average rate of charge on the use of IMF resources in 1997/98 was 4.41 percent, before adjustments for burden sharing, which are discussed below (Appendix II, Table II.14).

As described above, in December 1997, the IMF established the Supplemental Reserve Facility. The IMF levies a surcharge, in addition to the regular rate of charge, on the use of credit under the SRF. During the first year from the date of approval of financing under this facility, the surcharge is set at 300 basis points above the basic rate of charge; it increases by an additional 50 basis points at the end of the first year, and every six months thereafter, until the surcharge reaches 500 basis points. Net operational income generated from the use of credit under the SRF during 1997/98, after meeting the expenses of administering the ESAF Trust, amounted to SDR 65 million, which was placed to the General Reserve.

The IMF pays remuneration to a member on the amount by which its norm for remuneration exceeds the IMF’s holdings of its currency, excluding holdings that reflect the member’s use of IMF credit. The norm for remuneration is calculated as the sum of 75 percent of the member’s quota on April 1, 1978, plus any increases in quota consented to and paid after that date. For members joining the IMF after April 1, 1978, the norm is calculated as the sum of (1) a percentage of the member’s quota equal to the weighted average of the norms of all existing members relative to quota on the date of the member’s admission, and (2) any increases in the member’s quota consented to and paid after that date. The rate of remuneration, before the adjustments under the burden-sharing mechanisms discussed below, is set at 100 percent of the SDR interest rate, which averaged 4.18 percent in 1997/98.

The IMF continues to have measures in place to strengthen its financial position, in view of the existence of overdue financial obligations. First, a target amount of net income is determined each year to be added to IMF reserves, which provide protection against administrative deficits and losses of a capital nature. Second, debtor and creditor members share equally—through adjustments to the rate of charge and the rate of remuneration—the financial costs to the IMF of deferred overdue charges and of the allocation to the first Special Contingent Account (SCA-1), which, for 1997/98, was set at 5 percent of reserves at the beginning of the year (SDR 99 million). These adjustments, however, cannot reduce the rate of remuneration to less than 85 percent of the SDR interest rate. The SCA-1 was established as a precautionary measure to protect the IMF against the risks associated with overdue obligations; as of April 30, 1998, SCA-1 balances amounted to SDR 884 million. These burden-sharing procedures have been extended by the Board through 1998/99.

As part of the strengthened cooperative strategy to resolve the problem of protracted overdue financial
Note: Organization as of April 30, 1998. Parentheses indicate number of budgeted regular staff.

The Institute supports the Joint Vienna Institute, a training center in Vienna, Austria.

Beginning in May 1998, the IMF-Singapore Regional Training Institute, a new regional training center, was established and will receive support from the IMF Institute.
for facility improvements, new technology, and data-processing equipment. The 1998/99 Administrative Budget includes an increase of 32.5 positions in the authorized staffing level to meet the very heavy workload associated with the financial crisis in Asia that was not anticipated in the previous medium-term plan, for a number of other priority work activities, and to increase the number of participants in the IMF’s Economist Program. The increase in authorized staffing will allow the IMF to attend to priority work activities, to reduce the very high level of uncompensated overtime being worked by many staff, and to reduce accumulated leave balances. To resume the medium-term strategy of budgetary consolidation in the staffing area, the additional positions authorized to carry out the work on the Asian crisis will be eliminated once the crisis has abated and work returns to more normal levels. The one-time increase in the intake of economists into the Economist Program is meant to expand the IMF’s flexibility over the medium term and rebuild the economist ranks. Notwithstanding the increase in authorized staffing, the 1998/99 budget maintains the existing policy of budgetary consolidation by keeping administrative expenses relatively flat in real terms, compared with the 1997/98 budget. The Administrative Budget in nominal and real terms is shown in Figure 11. The Capital Budget represents a continuation of plans for completing major building projects, replacing older facilities and electronic data-processing equipment, and other medium-term programs.

**Building Projects**

The addition to the headquarters building (Phase III) is essentially completed, and in March 1998 staff began to move out of leased space and to occupy the building. The PEPCO building (Phase IV) adjacent to headquarters will be ready for occupancy after the current tenant has vacated and the building has been renovated. When the Phase IV project has been completed, staff will be housed in two immediately adjacent buildings owned by the IMF, overall occupancy costs will be reduced, and the IMF’s long-term space and budget strategies will have been realized.
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