INTERNATIONAL MONETARY FUND

The Consolidated Medium-Term Income and Expenditure Framework

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I. INTRODUCTION

1. **This paper updates the consolidated income and expenditure outlook and the projected accumulation of precautionary balances over the medium-term**. The paper incorporates and extends the income and budget projections in the companion papers; these projections are also in line with those discussed in the recent paper on the review of precautionary balances.[1]

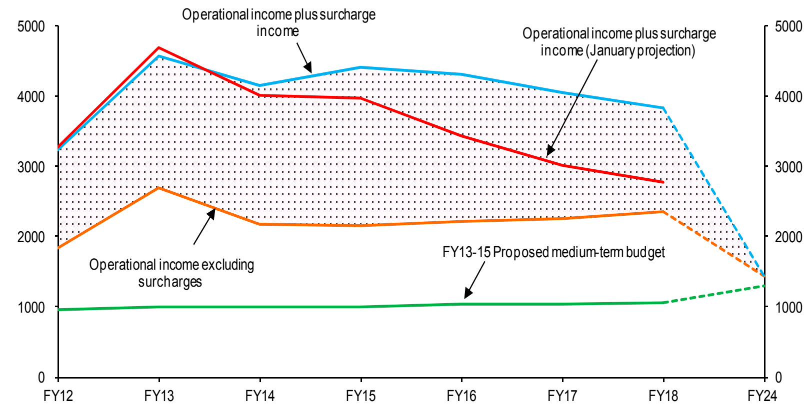
II. CONSOLIDATED INCOME AND EXPENSES

2. **Updated projections point to sustained high lending income in the medium-term**.[2] The world economy faces significant risks and the Fund is heavily engaged to support member countries' needs. Fund credit outstanding is currently at historic levels. While total lending income, including surcharges, is high, the Fund's non-lending income is constrained by the low global interest rate environment.

3. **The proposed FY 13–15 medium-term administrative budget is built on zero real growth compared to the FY 12 budget.** This unchanged envelope implies spending needs to be reprioritized to accommodate additional crisis and other demands—including a larger contingency to deal with the unusual degree of uncertainty associated with current global conditions.

4. **The medium-term income outlook is higher relative to the January projections** (Figure 1 and Table 1). Credit outstanding is now projected to peak at an average of just over SDR 100 billion in FY 13, slightly below the earlier expected peak of SDR 103 billion, but to remain higher in the outer years reflecting the longer average maturity of this credit.[3] As a result, total

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



[1] *Review of the Fund's Income Position for FY 2012 and FY 2013-14* (4/12/12) and *FY2013-FY2015 Medium-Term Budget* (3/30/12).

[2] Annexes I and II provide details on underlying assumptions for the projections. The projections assume full drawings under approved arrangements through end-March.

[3] This reflects a new extended arrangement approved in mid-March and a cancellation of a stand-by arrangement. Overall access to Fund resources increased by SDR 15 billion.

lending and surcharge income is also projected to be higher over the medium-term relative to the January outlook. The expense path is slightly lower than estimated in January reflecting a decrease in the deflator over the medium term relative to the January assumptions.

Table 1. Consolidated Income and Expenses, FY 2012–24
(in millions of U.S. dollars, unless otherwise stated)

	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 24
A. Operational income	1,852	2,773	2,176	2,141	2,209	2,244	2,347	1,416
B. Administrative expenses	1,025	1,059	1,062	1,070	1,105	1,121	1,133	1,392
Of which: Net administrative budget	968	997	997	1,002	1,032	1,043	1,060	1,326
C. Net operational income (A-B)	827	1,714	1,114	1,071	1,104	1,123	1,214	24
Memorandum items:								
Surcharges	1,421	1,885	1,969	2,269	2,090	1,804	1,472	0
SDR interest rate (percent)	0.3	0.3	0.4	0.9	1.4	1.9	2.4	3.5
Fund credit (average stock, SDR billions)	80.5	100.6	97.1	86.2	76.6	65.6	54.8	10.0
Precautionary balances (end of period, SDR billions) 1/	9.5	11.8	13.8	15.9	18.0	19.9	21.6	10.0

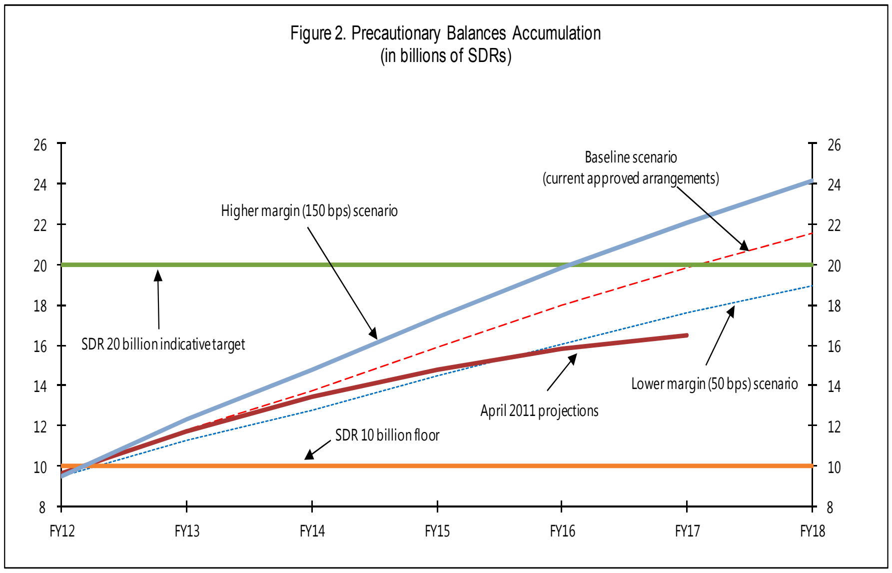
5. **Illustrative estimates of the long-run income-expenditure position in a post-crisis environment remain broadly balanced**. The gold endowment is expected to become fully operational in FY 14, and this together with a return of interest rates to more normal long-term levels would reduce the Fund's reliance on lending income in line with the new income model. In the illustrative long-run steady state, now assumed to be reached in FY 24 when drawings under current arrangements have been repurchased, investment income would cover almost two-thirds of the Fund's annual expenses allowing a balanced income-expenditure position in a low credit environment.[4]

III. Precautionary Balances Outlook

6. **Precautionary balances are projected to reach SDR 9.5 billion at end-FY 12**. Net income for FY 12, including surcharges, is projected at about SDR 1.5 billion, which when placed to reserves will represent an increase of about 18 percent relative to precautionary balances at the beginning of the financial year. The above balance will also bring the Fund close to the agreed floor of SDR 10 billion for precautionary balances.[5]

[4] Investment income in the long-run would comprise income from the gold endowment and the non-gold Investment Account portfolio funded by transfers of currencies from the GRA in amounts equivalent to reserves not attributable to gold profits from the recent limited gold sales.

[5] *Review of the Adequacy of the Fund's Precautionary Balances* (8/25/10).



7. **The pace of reserve accumulation is projected to accelerate significantly in the medium-term**. The indicative medium-term target of SDR 20 billion that was endorsed at the April review of precautionary balances could be reached in just over five years, during FY 18 (see Figure 2). The accelerated pace reflects the historically high levels of Fund credit, much of which is subject to surcharges in addition to the margin on the rate of charge. The baseline projection assumes a margin on the rate of charge of 100 basis points (the current level). Figure 2 illustrates the projected precautionary balances path under alternate scenarios with the margin at 150 and 50 basis points. Increasing the margin to 150 basis points beginning in FY 13 would add some SDR 2 billion to precautionary balances over the period to end-FY 18. A decrease in the margin to 50 basis points over the same period would lower precautionary balances by about SDR 2 billion by end-FY 18.

Annex I. Expenditure Projections, FY 2012–18

1. Detailed information on the proposed medium-term budget and expense projections for FY 13–15 are provided in *FY2013-FY2015 Medium-Term Budget* (3/30/12); these projections are used in this paper. This annex briefly describes the main assumptions.

2. Projections assume that the net administrative budget remains unchanged in real terms at a level of $985 million (in FY 12 dollars) in FY 13–15.[1] This includes expenditures associated with the global financial crisis that are projected to remain stable at $53 million until FY 15. Thereafter, crisis-related spending is projected to decline by 25 percent (to $39 million) in FY 16, and by 50 percent (to $20 million) in FY 17, phasing out altogether by FY 18.

3. The expense path is slightly lower than estimated in January. This reduction reflects the impact of the Executive Board's decision not to change the staff salary structure in the context of the 2012 Compensation Review (the earlier assumption held the structure increase at its 2011 level of 1.5 percent). This effect was only partly offset by an upward adjustment in the projected non-personnel component of the Fund's Global External Deflator (GED) for FY 13–15.[2] The GED is projected to be 0.6 percent in FY 13-14, and 0.5 percent in FY 15. Thereafter, the GED is projected to revert back to the historical norm of about 3.8 percent.[3]

4. These projections, in both real and nominal terms, are subject to considerable uncertainty. The increased crisis-related spending will unwind as the crisis abates. However, new demands could arise as the Fund needs to continue to respond to its members' needs in the context of still evolving developments in the global crisis. Also, in the long-term, possible new responsibilities for the Fund could result in additional structural demands, which compounds the challenge of accurately projecting the future expenditure path.

5. Capital expenditures are projected to increase significantly mainly due to the planned repairs to the HQ1. 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.

[1] About $6 million is included in the projected expenditures when the Annual Meetings are scheduled to be held abroad, in FY 13 and in FY 16.

[2] These projections are consistent with the established practice to use, in the absence of projections for the salary index, the salary increase adopted for the current year as a placeholder for the two outer years of the MTB, without prejudicing future salary discussions. The resulting hypothetical FY 14 and FY 15 envelopes will be updated in the context of future budget discussions, reflecting the actual salary increases in the relevant years.

[3] This norm is based on an annual average of what the new deflator formula would have delivered over the period FY 04–11.

Annex II. Income Projections, FY 2012–18

1. Income projections are 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.[1] Box II.1 provides further details.

2. The updated projections include arrangements approved through end-March 2012. Following the January projections, one new four-year arrangement was approved in mid-March and an arrangement was cancelled. This resulted in a net increase in access under approved arrangements of SDR 15 billion and relatively longer phasing of disbursements under approved arrangements.

3. Fund credit outstanding is at historic levels and the resulting increase in lending income is expected to remain high in the medium-term. Average Fund credit is projected to peak at SDR 100 billion in FY 13, and remain high at an average of about SDR 76 billion over the following five financial years (see Table II.1). Surcharges are projected on the assumption that the current thresholds for their application, i.e., credit above 300 percent of quota, remain unchanged following the doubling of quotas under the 14th General Review of Quotas. The baseline scenario assumes no advance repurchases are made.

4. Non-lending income in the medium-term is constrained by the global interest rate environment. The gold endowment is expected to become fully operational in FY 14. The endowment size is assumed to be SDR 4.4 billion based on an average gold price of US$850 per ounce from the limited gold sales. Projected income from the non-gold portfolio of the Investment Account is expected to increase only gradually over the medium-term as market indicators point to a slow rise in interest rates from their current low levels.

5. The pace of reserve accumulation is projected to significantly increase in coming years. The high lending income, including surcharges, will increase precautionary balances, which are needed to help mitigate the elevated credit risks that face the Fund in light of the high lending activity. The new indicative medium-term target of SDR 20 billion for precautionary balances could be reached in about five years based on current projections.

6. The long-term outlook remains broadly balanced. In a post-crisis environment when the current high lending has subsided, the steady-state illustrates the outlook when the Fund has diversified its income sources under the new income model. Fund credit is assumed to stabilize at SDR 10 billion in the steady state (from FY 24) when drawings under current arrangements have been repurchased. Commitments under contingent lending facilities are also assumed to decline from current levels. The illustrative steady state would continue to yield a positive income-expenditure position.

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

Table II.1. Consolidated Income and Expenses, FY 2012–24: Baseline Scenario

		FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY24
				(in SDR millions)					
A.	Operational income 1/	**1180**	**1789**	**1404**	**1383**	**1425**	**1447**	**1514**	**913**
	Lending income	992	1577	1035	894	794	656	548	136
	Margin for the rate of charge	805	1006	971	862	766	656	548	100
	Service charge	163	106	55	32	28	0	0	12
	Commitment fees	24	465	9	0	0	0	0	24
	Investment income	171	130	282	376	492	628	779	559
	Non-gold portfolio	140	65	148	239	353	486	634	396
	Gold profits portfolio	31	65						
	Gold endowment pay-out	0	0	134	137	139	142	145	163
	Interest free resources	14	15	20	45	70	93	115	138
	SCA-1 and other	6	7	9	21	32	42	51	44
	Gold book value	8	8	11	24	38	51	64	94
	Reimbursements 2/	3	67	67	68	69	70	72	80
	MDRI-I Trust and SDR Department	3	3	3	3	3	3	3	3
	PRG Trust	0	64	64	65	66	67	69	77
B.	**Expenses**	**653**	**683**	**685**	**690**	**713**	**723**	**731**	**898**
	Net administrative budget	617	643	643	646	666	673	684	855
	Capital budget items expensed	3	7	9	9	9	9	6	6
	Depreciation	33	33	33	35	38	41	41	37
C.	**Net operational income (A-B)**	**527**	**1106**	**719**	**693**	**712**	**724**	**783**	**15**
	Surcharges 3/	905	1216	1270	1464	1349	1164	950	0
	Gain on sale of assets	13	0	0	0	0	0	0	0
	IAS 19 timing adjustment	7	0	0	0	0	0	0	0
	Retained endowment income 4/	0	0	89	91	93	95	97	109
	Net income	**1452**	**2322**	**2078**	**2248**	**2154**	**1983**	**1830**	**124**
				(in US$ millions)					
D.	**Operational income 1/**	**1852**	**2773**	**2176**	**2141**	**2209**	**2244**	**2347**	**1416**
	Lending income	1558	2444	1604	1385	1231	1017	849	211
	Investment income	268	202	437	582	763	974	1208	866
	Interest free resources	22	24	31	70	108	144	179	214
	Reimbursements	4	103	104	104	107	109	111	125
E.	**Expenses**	**1025**	**1059**	**1062**	**1070**	**1105**	**1121**	**1133**	**1392**
	Net administrative budget	968	997	997	1002	1032	1043	1060	1326
	Capital budget items expensed	5	11	14	14	14	14	9	9
	Depreciation	52	51	51	54	59	64	64	57
F.	**Net operational income (D-E)**	**827**	**1714**	**1114**	**1071**	**1104**	**1123**	**1214**	**24**
Memorandum Items:									
	Fund credit (average stock, SDR billions)	80.5	100.6	97.1	86.2	76.6	65.6	54.8	10.0
	SDR interest rate (in percent)	0.3	0.3	0.4	0.9	1.4	1.9	2.4	3.5
	US$/SDR exchange rate	1.57	1.55	1.55	1.55	1.55	1.55	1.55	1.55
	Surcharges (US$ millions)	1421	1885	1969	2269	2090	1804	1472	0
	New income measures (US$ millions) 5/	45	111	406	447	491	534	576	587
	Precautionary balances (end of period, SDR billions)	9.5	11.8	13.8	15.9	18.0	19.9	21.6	10.0

1/ Excludes surcharges assumed to be placed to reserves. The pay-out from the endowment funded by gold profits is assumed to begin in FY 14, when the endowment is fully in place.

2/ Reimbursement of the GRA for the costs of administering the PRG Trust is assumed to resume in FY 13.

3/ Surcharges are projected on the assumption that the existing thresholds for their application are not adjusted following the implementation of the 14th Review of Quotas (doubling of quotas) which is assumed to be effective in the second half of FY 13.

4/ Estimate of gold endowment income retained in the IA to preserve the real value of the endowment.

5/ 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 II.1. Income Projections

Key Parameters	Key Parameters	Key Parameters
US$/SDR exchange rate	1.55	Assumed unchanged from recent levels. A 10 percent rise (fall) in the US$/SDR exchange rate would raise (lower) annual income in FY 18 by US$248 million.
SDR interest rate	Rising to 3.5% by FY 21 from 0.3% in FY12	A 10 basis point higher (lower) average SDR interest rate would raise (reduce) annual income in FY 18 by US$42 million.
Margin for rate of charge (basis points)	100	Assume unchanged from current level. A 50 basis point higher (lower) margin would raise (reduce) income in FY 13 and FY 14 by US$781 million and US$765 million, respectively. A 50 basis point higher (lower) margin from FY 13 would raise (lower) precautionary balances in the period to end-FY 18 by some SDR 2 billion.

Operational lending income (US$211 million or SDR 136 million by FY 24 in baseline scenario, Table II.1)

Fund credit is assumed to decline back to an average steady state level of about SDR 10 billion by FY 24, 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 FY 23 generate about SDR 12 million in annual service charges (at 50 basis points).

Investment income (US$866 million or SDR 559 million by FY 24 in baseline scenario, Table II.1)

Current returns on the Investment Account (IA) non-gold portfolio are assumed to exceed the SDR interest rate by an average of 50 basis points. Net operational income, plus surcharges, are assumed to be transferred annually to the IA for investment in the subsequent year. Broadening of the investment mandate is assumed to take effect in FY 14, allowing average investment returns in this portfolio to exceed the SDR interest rate by 100 basis points, lifting average annual income on reserves to about SDR 400 million in the steady state (FY 24) when precautionary balances are assumed to be at the floor of SDR 10 billion.

In March 2011, currencies equivalent to the gold profits were transferred from the GRA to the IA and invested in short-term deposits. The gold endowment (SDR 4.4 billion, equivalent to an average gold price of US$850 per ounce, plus earnings during the interim period) is assumed to be established in the second half of FY 13 with annual pay-outs of 3 percent beginning in FY 14. The Board-endorsed transfer of SDR 0.7 billion to help finance concessional lending to low-income countries is assumed to take place in September 2012.

Interest free resources (US$214 million or SDR 138 million by FY 24 in baseline scenario, Table II.1)

The gold sales increased GRA currency holdings by the book value of gold (SDR 2,685 million), reducing member reserve tranche positions and thereby cutting annual remuneration expenses by SDR 94 million at an SDR interest rate of 3.50 percent in FY 24. The SCA-1 balance of SDR 1.2 billion also provides additional income.

Reimbursements (US$103 million or SDR 67 million by FY 13 in baseline scenario, Table II.1)

Reimbursements from the SDR Department, MDRI-I Trust, and PCDR Trust, are projected at about SDR 3 million in FY 12. Reimbursement of the GRA for the expenses of administering the PRGT is assumed to resume in FY 13 at SDR 64 million. Administrative costs and the associated reimbursements are assumed to be stable in real terms in the medium term.