

IMF INITIATIVES TO BOLSTER FUNDING AND LIQUIDITY¹

Introduction

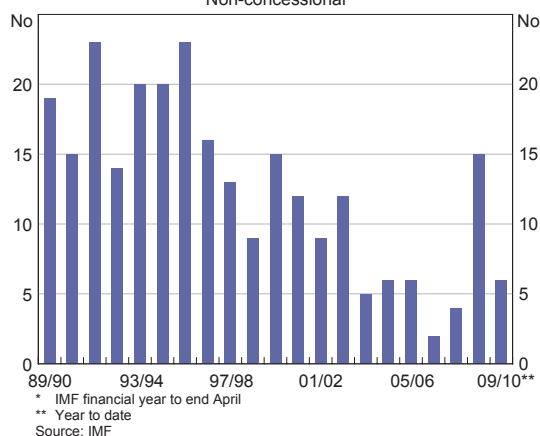
In the years leading up to the financial crisis, strong economic growth in emerging and developing economies and the ready availability of private capital inflows to those economies resulted in a decline in demand for IMF lending. However, the financial crisis has brought renewed demand for IMF assistance. In response, the IMF has increased its traditional lending and explored new ways of providing funding to member countries. The G-20 countries and other members of the international community have supported the IMF in this regard, contributing to a sizeable increase in the IMF's resources. In addition, the IMF has boosted global liquidity by substantially increasing its members' holdings of Special Drawing Rights (SDRs). This article explains how the IMF, with support from its member countries, including Australia, is working to bolster funding and liquidity through these initiatives.

IMF Lending

Since the onset of the financial crisis, and particularly after the collapse of Lehman Brothers in September 2008, many emerging market and developing economies have had difficulty accessing private capital markets. Consequently, a number of countries have recently sought to access IMF lending arrangements (Graph 1).²

The increase in the number of countries seeking IMF assistance has also been influenced by reforms to IMF lending facilities and policies implemented in early 2009.³ These reforms are intended to address two main issues. First, the IMF has sought to reduce the stigma that can be associated with its programs by addressing concerns that the conditions applied to its loans can be too broad-ranging. It has done this by limiting the structural economic

Graph 1
New IMF Lending Arrangements*
Non-concessional



1 This article was prepared by Emma Doherty of International Department.

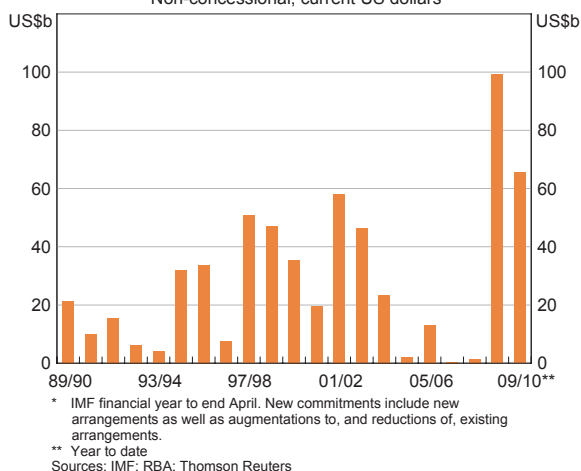
2 The data and analysis presented in this article refer to the IMF's non-concessional lending for actual or potential balance of payments problems. The IMF's concessional lending to low-income countries is not discussed.

3 For a previous discussion of IMF lending arrangements, see Coombs M, P Harvey and D Simpson (2004), 'Recent Developments in IMF Financing Activities', RBA Bulletin, June, pp 1-8.

reform required of borrowing countries to that regarded as strictly necessary for economic recovery.

Second, the IMF has sought to reassure countries that they would have access to sufficient funding to meet their needs. As part of this package of reforms, normal borrowing limits (expressed as a multiple of a member's quota – effectively its paid-in capital subscription) were doubled. Moreover, criteria for obtaining access in excess of these limits were broadened. The IMF also provided members with access to funds in excess of the new borrowing limits on a precautionary

Graph 2
New IMF Lending Commitments*
 Non-concessional, current US dollars



basis (for example, the Flexible Credit Line). These arrangements are labelled precautionary because the recipient country expects not to draw on the funds. Instead, the member gains access to a substantial line of credit that can be drawn upon if the need does arise, providing insurance against the risk that an externally generated crisis precipitates a sudden loss of confidence. Importantly, these precautionary arrangements are available on a 'high access' basis, with the size of the line of credit often far in excess of the normal borrowing limits.

Reflecting all these developments, 21 countries have commenced new arrangements with the IMF since the beginning of September 2008, with many of them granted access to funds in excess of their prevailing borrowing limits. The increased number of new arrangements, in combination with the larger size of these arrangements, has led to a noticeable rise in the value of new funds committed (Graph 2).

IMF Resources

This increase in the value of the IMF's lending commitments (including precautionary arrangements) put pressure on the IMF's funding availability earlier this year. The IMF's capacity to lend is reflected in its one-year Forward Commitment Capacity (FCC), which is approximately equal to useable resources (mainly quota resources of countries in a financially sound position and any borrowed resources) less current commitments and 'prudential' balances (roughly 20 per cent of useable resources). In response to a sharp decline in the FCC and to accommodate expected further calls on the IMF during the crisis, the IMF sought and obtained additional resources through borrowing arrangements (see below) so that the FCC is now above pre-crisis levels.

The bulk of the IMF's resources have traditionally consisted of its members' quotas. IMF members have agreed that this should continue to be the case and committed to reach agreement on new quotas by January 2011.

At their April 2009 summit, the G-20 leaders supported the IMF's request for an increase in its resources, committing to triple the IMF's lending capacity to US\$750 billion in the near term. To achieve this objective, the IMF has been pursuing a very large expansion of the New Arrangements to Borrow (NAB), from US\$50 billion to US\$550 billion. The NAB is an arrangement whereby a number of IMF members (currently 26) lend resources to the IMF in exceptional circumstances. The Australian Government has pledged US\$7 billion to the expanded NAB.

In the interim, the IMF is supplementing its resources through bilateral loan and note purchase agreements. Nine countries have now reached agreement with the IMF to provide bilateral loans, boosting the IMF's resources by around US\$185 billion.⁴ The IMF has begun drawing on some of these loans. Under note purchase agreements, countries agree to purchase (on request) SDR-denominated notes issued by the IMF. An agreement equivalent to around US\$50 billion has already been concluded with China, and other countries are considering potential bilateral loans or note purchase agreements. G-20 countries have indicated that their bilateral lending commitments will ultimately be rolled into the expanded NAB.

Special Drawing Rights (SDRs)

Beyond supporting the capacity of the IMF to lend to countries with balance of payments needs, the international community has also supported the IMF's efforts to boost global liquidity by issuing SDRs to its members. SDRs were created by the IMF in the late 1960s to supplement the supply of international reserve assets, which were in limited supply under the Bretton Woods system of fixed exchange rates. SDRs operate as an international reserve asset because they can be sold to other IMF members in return for foreign exchange, in particular, US dollars, euros, Japanese yen or British pounds. SDRs are not – as is sometimes thought – a currency, although their value is calculated as a weighted average of the above four currencies. They are best viewed as a potential claim on the foreign currency reserves of other IMF members.

Shortly after the creation of SDRs, the Bretton Woods system of fixed exchange rates was abandoned, reducing the SDR's importance. Prior to 2009, SDRs had only been issued ('allocated' in IMF terminology) twice – once in the early 1970s and a second time in the late 1970s/early 1980s. When an SDR allocation takes place, countries receive an increase in their SDR holdings (an international reserve asset on which countries earn interest from the IMF), as well as an equal increase in their SDR allocation (a liability on which countries pay interest to the IMF).⁵ Countries retain the allocation, but may sell their holdings in exchange for foreign currency. Consequently, issuing SDRs enhances global liquidity because it provides countries that want to boost their foreign currency reserves with an off-market mechanism to

4 These nine countries are Canada, Denmark, France, Germany, Japan, the Netherlands, Norway, Spain and the United Kingdom.

5 The SDR interest rate (a weighted average of 3-month sovereign debt issued by the governments of Japan, the United Kingdom and the United States and the 3-month Euro rate) applies to both the asset and the liability. Consequently, countries holding their exact allocation will have no net interest costs related to SDRs.

do so. Given that an SDR transaction involves an exchange between two IMF members of SDRs for foreign currency, the transaction results in a change in the composition of both members' official reserve assets.

In April 2009, G-20 leaders supported the IMF conducting a new general allocation of SDRs and concluding an outstanding special allocation of SDRs in order to bolster global liquidity by SDR 183 billion. These allocations occurred over August and September 2009. As a result, the global stock of SDRs has increased roughly ten-fold from SDR 21 billion to SDR 204 billion, with each country's total allocation now broadly equal to its IMF quota (Table 1).

Table 1: Cumulative SDR Allocations and Quotas

September 2009, SDR billions

	Cumulative SDR allocation	Quota
<i>Developed economies</i>	127.5	136.1
– United States	35.3	37.1
– Euro area	47.1	50.4
– Other	45.1	48.6
<i>Emerging and developing economies</i>	76.5	81.4
– Africa and the Middle East	25.6	27.0
– Asia	19.4	21.3
– Central and Latin America	15.6	16.5
– Europe	15.9	16.7
Total	204.1	217.6
<i>Memo item</i>		
Australia	3.1	3.2

Source: IMF

Australia received SDR 2.6 billion from these allocations, leading to a commensurate increase in its official reserve assets. While the Government maintains the allocation of SDRs, it has sold the holdings to the Reserve Bank in exchange for Australian dollars.

In order to facilitate exchanges of SDRs for foreign currency, a selection of members maintain voluntary arrangements with the IMF.⁶ These arrangements outline the willingness of the member to buy or sell SDRs to meet the requests of other members (within pre-set parameters). Australia has agreed to buy or sell SDRs as long as its holdings are kept within a range of 50 to 150 per cent of Australia's total SDR allocation. In this manner, Australia is helping to support liquidity in the SDR market. ✎

⁶ The option also exists for the IMF to designate members in financially sound positions to purchase SDRs from countries needing to sell them for balance of payments reasons. However, voluntary arrangements have been sufficient to meet the demand for SDR transactions since 1987.