INTERNATIONAL MONETARY FUND

PRGT Interest Rate Mechanism—Extension of Temporary Interest Rate Waiver

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(In consultation with the Legal Department)

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I. Introduction

1. **The first bi-annual review under the Poverty Reduction and Growth Trust (PRGT) interest rate mechanism was completed by the Executive Board in December 2011**.[1] At that time, Executive Directors agreed to extend the exceptional interest rate waiver on concessional facilities by one year to end-December 2012 in view of downside risks to the global economic outlook.[2] Directors also agreed that the differentiated PRGT interest rate mechanism would thereafter be allowed to operate as envisaged.

2. **In recent months, a number of Directors have expressed support in the Executive Board for a further extension of the temporary exceptional interest waiver**. An extension would send a signal of the Fund's continued support for Low-Income Countries (LICs) at a time when the global economic crisis is still ongoing. In view of the related downside risks to the global economic recovery and a decline in the ability of LICs to respond to a further weakening of global growth, this paper proposes a further extension of

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[1] See *Poverty Reduction and Growth Trust—Review of Interest Rate Structure* (11/23/2011); and Decision No. 15035-(11/116), adopted December 1, 2011.

[2] The exceptional interest rate relief also covered outstanding loans under the previous Exogenous Shocks Facility ("ESF loans") committed until April 7, 2010. In addition, the Executive Board also agreed to extend the subsidization of the rate of charge on outstanding ENDA/EPCA purchases by PRGT-eligible countries to zero percent until January 31, 2013.

the exceptional interest waiver by two years, to end-2014. This paper also proposes to further extend to April 2013 the existing subsidization of the rate of charge on outstanding Emergency Natural Disaster Assistance (ENDA) and Emergency Post-Conflict Assistance (EPCA) purchases by PRGT-eligible members.[3] In addition, it is proposed that the next scheduled review of PRGT interest rates be postponed to December 2014.

II. THE PRGT INTEREST RATE MECHANISM

3. **A framework for determining the interest rates charged on lending under the PRGT was established in the context of the 2009 LIC facilities reforms**.[4] The framework involves setting interest rates for each of the PRGT facilities; links the interest rates charged on the Fund's concessional lending to world interest rates (as reflected in the SDR rate (Table 1)); and provides for a review of interest rates every two years. In 2009, the Executive Board also endorsed a temporary waiver of interest payments on all Trust loans to end-2011 to provide exceptional relief to LICs during the global economic crisis. In this context, the charges on GRA purchases made by PRGT-eligible members under the ENDA and EPCA were also subsidized to zero to end-January 2012.

Table 1. Interest Rate Mechanism for the Fund's Concessional Facilities[1]

	Interest rate for concessional facility (In percent)		
	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

[1] The average SDR rate is based on the most recently observed 12-month period.

4. **The first scheduled review of the PRGT interest rate structure was concluded in December 2011**.[5] Taking into account the evolution of global interest rates, as reflected in the SDR rate, the review indicated that the interest rates for the two-year period to end-2013 should be set at zero percent for loans under the Extended Credit Facility (ECF) and Rapid Credit Facility (RCF), and at 0.25 percent for loans under the Standby Credit Facility (SCF).

[3] The last two outstanding ENDA credits for Dominica and Bangladesh will be fully repaid in February and April 2013, respectively; there are no outstanding EPCA credits.

[4] See *IMF Reforms Financial Facilities for Low-Income Countries*; and Decision No. 14354-(09/79), adopted July 23, 2009.

[5] See footnote 1.

The PRGT interest rate mechanism does not apply to outstanding ESF loans committed up to April 7, 2010, or the outstanding subsidized ENDA and EPCA purchases made as of January 7, 2010 by PRGT-eligible member countries, each of which would carry an interest rate of 0.25 percent when the respective exceptional interest relief terms expire.[6]

5. **At the time of the 2011 review, Executive Directors, however, endorsed the staff's proposal for a temporary extension of the exceptional interest rate relief on concessional loans to end-2012**. Directors also agreed to extend the subsidization of the rate of charge on outstanding ENDA and EPCA purchases made as of January 7, 2010 by PRGT-eligible members to zero percent until end-January 2013. While LICs had recovered reasonably quickly from the global crisis, progress in rebuilding macroeconomic buffers had been slow. This had rendered LICs more vulnerable in the context of an increase in risks to the global economic outlook.

6. **The temporary waiver of interest charges on commitments to LICs has provided modest additional relief to a number of countries during the past three years**. As of October 31, 2012, a total of 18 PRGT-eligible members and one member that graduated from PRGT eligibility in 2010 had received interest relief.[7] Combining this relief with the projected payments for the remaining period of the interest waiver, the total amount of interest payments waived amounted to SDR 8.7 million (Table 2).[8] This largely comprises interest payments on ESF loans (SDR 7.8 million) and ENDA/EPCA credits (SDR 0.8 million) as there had only been a small number of new arrangements under the SCF.

7. **LICs' initial success in rebuilding policy buffers following the 2008–09 global crisis has halted, and was partially reversed over 2011–12 with rising vulnerabilities**.[9] As a result, many LICs have more limited fiscal space and larger current account deficits than prior to the crisis, rendering them less prepared to deal with a crisis. At the same time, short-term risks to the global outlook are tilted to the downside. A sharp slowdown in global growth or sharp increases in global food and fuel prices would significantly erode macroeconomic buffers and result in large financing gaps. A protracted downturn in global

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[6] At the time of the 2009 LIC facilities reforms, it was noted that all credit outstanding under the ENDA and EPCA, as well as all ESF loans would be subject to an interest rate of 0.25 percent which would not be subject to scheduled reviews.

[7] Sri Lanka had an outstanding purchase under ENDA when the interest relief became effective. This was fully repurchased on March 8, 2010, before Sri Lanka's graduation from PRGT eligibility on April 10, 2010.

[8] The cost of subsidizing to zero percent the rate of charge on outstanding ENDA/EPCA purchases from end-December 2012 to end-January 2013 is estimated at SDR 4.3 thousand.

[9] See *Global Risks, Vulnerabilities, and Policy Challenges Facing Low-Income Countries* (10/10/2012).

growth would have a severe effect on LICs in the medium term due to permanent output losses that accumulate over time. Additional external financing needs would be unsustainable and, as a result, almost all LICs would need to adjust their policies to some degree. Policymakers would have to balance their adjustment decisions with the need to support or maintain growth and preserve investment and priority spending.

Table 2. Country Coverage of Temporary Interest Waiver: January 8, 2010-December 31, 2012 [1/]
(In thousands of SDRs)

Countries	Type of Credit			Total
	SCF	ESF	ENDA/ EPCA	
Bangladesh	-	-	777.1	777.1
Cameroon	-	691.9	-	691.9
Congo, Dem. Rep. of	-	836.8	-	836.8
Comoros	-	16.6	-	16.6
Dominica	-	24.4	11.2	35.6
Ethiopia	-	1,261.4	-	1,261.4
Guinea-Bissau	-	-	4.7	4.7
Kenya	-	1,011.2	-	1,011.2
Kyrgyz Republic	-	248.2	-	248.2
St. Lucia	-	51.3	-	51.3
Sri Lanka	-	-	5.2	5.2
Maldives	-	14.7	0.2	14.9
Mozambique	-	829.9	-	829.9
Malawi	-	258.6	-	258.6
Senegal	-	870.4	-	870.4
Solomon Islands	56.1	-	-	56.1
Tanzania	-	1,609.0	-	1,609.0
St. Vincent and the Grenadines	-	27.8	-	27.8
Samoa	-	43.2	-	43.2
Total	56.1	7,795.6	798.4	8,650.0

Source: Finance Department.

[1/] Combines the actual amounts for Jan 8, 2010 through October 31, 2012 and estimates for the remainder of 2012.

8. **The total cost of a further extension of the exceptional interest relief for two years would be small and would be consistent with the self-sustainability of the PRGT**. Based on existing commitments under the ESF and SCF and ENDA/EPCA credits, and projected new commitments under the SCF, the cost of this extension, measured in terms of additional subsidy resources, would amount to about SDR 3 million annually given the

prevailing interest rates implied by the existing rate structure. In view of the modest additional cost, the proposed extension of the temporary interest waiver remains consistent with the three-pillar strategy to establish a self-sustaining PRGT, including a base envelope for lending capacity of SDR 1¼ billion per year.[10, 11]

9. **At the same time however, it remains important for the integrity of the agreed financing framework for the PRGT that the interest rate mechanism be allowed to function as was originally envisaged, once conditions return to normal**. A further extension of the waiver of interest payments on concessional lending would have a significant impact on the self-sustained lending capacity of the PRGT if SDR interest rates increase to more normal levels. Moreover, moving to a permanent framework of zero interest rates on all PRGT facilities would reduce the self-sustained lending capacity of the PRGT by an estimated SDR 0.1 billion. Therefore, it will be critical to allow the mechanism to work as originally envisaged to be consistent with the recently approved self-sustaining financing framework for the PRGT.[12]

10. **On balance, the staff proposes to extend the exceptional interest rate waiver on concessional loans by an additional two years to end-2014**.[13] It is also proposed to further extend the existing subsidization to zero percent of the rate of charge on outstanding ENDA and EPCA purchases by PRGT-eligible members.[14] An extension of exceptional interest relief will send a signal of the Fund's continued support for LICs at a time when the global economic crisis is still ongoing. It would provide additional support to LICs with outstanding balances on SCF, ESF, and ENDA/EPCA credits, as well as new SCF disbursements. In view of this proposal, the staff also proposes that the next scheduled review of PRGT interest rates be postponed to end-2014.

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[10] See *Proposal to Distribute Remaining Windfall Gold Sales Profits and Strategy to Make the Poverty Reduction and Growth Trust Sustainable* (9/17/2012).

[11] The staff will provide regular updates for Executive Directors to review the estimated self-sustained lending capacity of the PRGT in the semi-annual "Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries".

[12] See footnote 10.

[13] As indicated in footnote 2, this waiver would also apply to outstanding ESF loans.

[14] The subsidization of the rate of charge on outstanding ENDA/EPCA purchases to zero percent currently runs through end-January 2013. This proposal would extend such increased subsidization to April 4, 2013 when the last remaining repurchases on ENDA credits are due; there are no outstanding EPCA credits.