Policy Paper

May 2009

Enhancing ADB's Response to the Global Economic Crisis—

Establishing the Countercyclical Support Facility

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
BOP	–	balance of payments
CSF	–	Countercyclical Support Facility
DMC	–	developing member country
DMD	–	deferred and multiple drawdown
GDP	–	gross domestic product
IMF	–	International Monetary Fund
LIBOR	–	London interbank offered rate
OCR	–	ordinary capital resources
SPL	–	special program loan

NOTE

In this report, "$" refers to US dollars.

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CONTENTS

I. BACKGROUND AND INTRODUCTION

A. Spread of the Global Economic Crises to Asia and the Pacific[1]

1. **Adverse Impacts of the Global Economic Crisis in Asia and the Pacific.** The financial crisis that originated in a few developed countries has rapidly spread to the rest of the world. With the major industrial countries already in or close to recession, the global slowdown is expected to be deeper and much more prolonged than previously anticipated. Developing Asia, which initially looked well positioned to weather the global crisis, has come under more pressure. While the degree of impacts varies, all regions in Asia and the Pacific are likely to experience significantly lower gross domestic product (GDP) growth rates in 2009 (averaging 3.4%), compared with 2008 (6.3%) or, except for the Pacific, the pre-crisis record (9.5%) of 2007.

2. **Transmission of Sluggish Aggregate Demand Mainly Through Trade Channels.** It is estimated that global trade will shrink by 3.5%[2]–9% in volume terms in 2009, recording the biggest contraction since the World War II[3] and creating difficulties for regional economies that rely on external demand.[4] Weakening demand for manufactured goods in major industrial countries led to declines in exports from Asia, with knock-on effects for its industrial production. In the absence of robust external demand, a need is emerging for Asian economies to be "rebalanced" with the rest of the world and rely more on domestic demand.

3. **Global Investors Scaling Back Emerging Market Assets.** Amid continued financial system de-leveraging, securities and external funding conditions have been severely hurt in the region. If credit conditions tighten further and affect key economic activities, the growth outlook for the region could be further damaged.[5] Under current market conditions, there is an emerging risk that governments of developing member countries (DMCs) of the Asian Development Bank (ADB) face extreme difficulty raising reasonably priced funds for development expenditures. If the risk materializes in a substantial manner, investments in infrastructure and human development will be affected with long-term implications for growth potential. Declines in overseas remittances and sharp drops in global commodity prices have also exacerbated problems of some of ADB's DMCs.

4. **Risk to Developing Asia's Impressive Record of Poverty Reduction.**[6] The region's strong performance has been powered by high growth, and the current economic downturn is posing a risk to maintaining the sound pro-poor record. It is estimated that more than 60 million individuals who would have been lifted above the extreme income poverty line of $1.25 per day, had the region's high growth continued in 2009, will remain trapped in absolute poverty. The figure could reach nearly 100 million by end-2010. If the impact on the vulnerable (those earning less than $2 per day) is considered, the number of affected people will rise to 80 million in 2009 and 130 million by 2010. A recent ADB-supported study in 25 DMCs suggests that economic

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[1] See ADB. 2009. *The Global Economic Crisis: Challenges for Developing Asia and ADB's Response.* Manila.
[2] ADB. 2009. *Asian Development Outlook 2009: Rebalancing Asia's Growth*. Manila.
[3] World Trade Organization. 2009. WTO sees 9% global trade decline in 2009 as recession strikes. News release. 23 March. Available: http://www.wto.org/english/news_e/pres09_e/pr554_e.htm. The forecast presented by WTO reflects more recent estimates than the one in the Asian Development Outlook 2009.
[4] A collapse of export markets has most strikingly affected highly trade-exposed countries in East and Southeast Asia—in particular, among many others, Malaysia, Singapore, and Thailand.
[5] A sharp rise has been observed in the risk premium on dollar-denominated offshore bonds of Asian issuers, in Indonesia, Pakistan, Philippines, and Viet Nam.
[6] See United Nations Economic and Social Commission for Asia and the Pacific, United Nations Development Programme, and Asian Development Bank. 2008. *A Future Within Reach: Regional Partnerships for the Millennium Development Goals in Asia and the Pacific.* Bangkok.

growth was also a driver of progress towards achieving the non-income Millennium Development Goals (MDGs). Without corrective actions, the region will likely make slower headway towards MDGs.

B. Uniqueness of the Current Crisis

5. **Coping with Recession Originating Abroad, Rather Than Structural Weakness in Asian and Pacific Economies.** Unlike during the Asian financial crisis that began in 1997, many Asian economies have sound banking systems and foreign reserves that have been significantly enhanced based on the lessons learned from the past crisis. The current problem is the global lack of aggregate demand transmitted to Asia mainly through trade links at the macroeconomic level, and the tightened international credit conditions. In short, what is occurring in Asia and the Pacific is a downturn transmitted from abroad, rather than the typical home-grown, balance of payments (BOP) crisis.

C. Group of 20 Mandate to Cope with the Global Economic Crisis

6. **Response to Group of 20's Call for Countercyclical Action.** At the summit held in London on 2 April 2009, Group of 20 (G20) members urged multilateral development banks (MDBs) to step up their countercyclical efforts and to offset capital flight and maintain demand by providing finance for fiscal expansion, support to social safety nets, trade financing, bank recapitalization, and infrastructure investment in emerging markets and low-income countries. They emphasized MDB’s countercyclical role in support of their longer-term development mandate, and called for the adoption of flexible, fast-disbursing, and front-loaded instruments designed to substantially and quickly assist developing countries facing financing gaps because of the current crisis. In response to G20's call, this paper proposes ADB's introduction of a countercyclical instrument for crisis-affected DMCs—the Countercyclical Support Facility (CSF)—as a new instrument for budget support of up to $3 billion to form an integral part of ADB's broader crisis response presented in Appendix 1. New crisis response instruments by other international financial institutions are presented in Appendix 2.

II. NEED FOR A NEW COUNTERCYCLICAL FACILITY

7. **An Urgent Need for Additional Financing at Reasonable Prices to Support Critical Development Expenditures.** Unless the crisis is properly addressed, the current tough market conditions could lead to declines in development expenditures for infrastructure (including that for human capital through education and health). At the same time, the severe recession would hurt the poor and vulnerable, and would risk reversing the impressive reduction in poverty in Asia and the Pacific. Adverse impacts arising from sluggish exports have already been reflected in the labor markets of Asian economies, creating a need for additional expenditures for social safety nets. Sustaining public expenditure is particularly important during an economic downturn, not only as a long-term investment, but for stimulating the aggregate demand and creating employment in the short run.[7]

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[7] A government's direct spending tends to have a higher multiplier effect than revenue measures, which suffer from leaks to savings. If direct spending takes the form of public infrastructure investment, it not only raises aggregate demand in the short run but also aggregate supply, yielding a "double-dividend" for growth. In cases where targeted transfer measures are adopted, focus on the poor and vulnerable have a greater stimulative effect because of their high marginal propensity to consume, while also serving as a social safety net. See Organization for Economic Co-operation and Development. 2009. *OECD Economic Outlook: Interim Report.* Available http://www.oecd.org/dataoecd/3/62/42421337.pdf; and Ghosh, Atish R. et al. 2009. *Coping with the Crisis: Policy Options for Emerging Market Countries*. Washington, D.C.: International Monetary Fund. G20 made a commitment to deliver the scale of sustained fiscal effort necessary to restore growth. See Group of Twenty. 2009. *The Global Plan for Recovery and Reform*. London.

8. **Tough Challenges for Developing Member Countries to Secure Reasonably Priced Funding.** The current problem is the higher cost of international borrowing, coupled with potentially declining revenues. This combination would make it difficult for DMC governments to maintain and, where appropriate, increase development expenditures to ensure continued progress on poverty reduction, achieve MDGs, and stimulate the economy. DMCs need contingency financial support at reasonable prices to mitigate these crisis-induced adverse impacts on development.

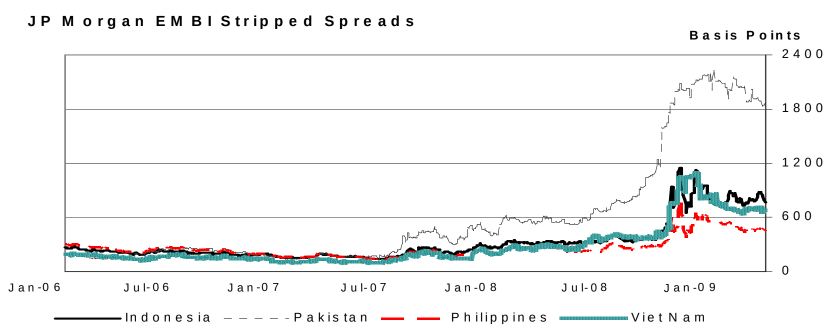
III. DESIGN OF THE COUNTERCYCLICAL SUPPORT FACILITY

A. General Features of the Countercyclical Support Facility

9. The establishment of a new, time-bound budget support instrument—the CSF— will allow ADB to provide more effective countercyclical support to its DMCs. Such an instrument will complement standard program loans and special program loans (SPLs) in the period of 2009–2010.[8] The facility will have the following general features:

(i) **Lending terms**. The terms comprise the interest rate with a spread of 200 basis points above the London interbank offered rate (LIBOR), with a provision of surcharge or rebate reflecting ADB's cost of funds;[9] 5-year maturity, including a 3-year grace period; and the commitment charge at 75 basis points. The proposed pricing is based on three main considerations. First, the facility aims to alleviate the financial burden resulting from the dramatic increase in DMCs' funding costs in international capital markets. The proposed pricing generally reflects the pre-crisis credit spread on dollar-denominated offshore bonds of Asian issuers (Figure).

Figure: Tightened External Financing



Source: ADB. 2009. *Asian Development Outlook 2009: Rebalancing Asia's Growth.* Manila. (Original source: Bloomberg, downloaded 16 March 2009.)

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8 Where the issues at the stake are mainly, but not exclusively, related to structural reforms, use of a standard program loan or a program cluster approach would be more appropriate. In the case of a BOP crisis, an SPL should serve as a more appropriate response, while possibility of access to CSF is not precluded when adverse impacts of the BOP crisis has been exacerbated by exogenous factors unique to the current global economic crisis. The SPL provides, on an exceptional basis, large-scale support as part of an international rescue package to OCR-eligible, crisis-affected countries, allowing (i) higher pricing to help mitigate potential adverse effects on ADB's financial strength and risk-bearing capacity; and (ii) exemption from counting towards the ceiling on regular program lending, set at 20% of the total lending. See ADB. 1999. *Review of ADB's Program Lending Policies*. Manila.

9 The cost of funds would be defined as the average cost of borrowings ADB issued to fund the CSF. The cost of funds may change during the life of the facility. Currently, a surcharge rather than a rebate may be expected.

Second, the proposed pricing takes into account ADB's risk-bearing capacity. That, combined with the shorter maturity enables ADB to expand its lending within the capital adequacy framework as measured by the pre-shock equity-to-loan ratio, thereby increasing its total lending and spreading its assistance more broadly among DMCs (Appendix 3). Third, the higher pricing should help contain the demand and rationalize the provision to each DMC out of the limited CSF pool. The commitment charge on the undisbursed loan balance is set at 75 basis points to provide an incentive for quick utilization. The main loan terms are summarized in Table.

(ii) **Economic policy dialogue and assessment.** Proper macroeconomic policy management is a prerequisite for CSF operations. Individual CSF loan proposals should be screened based on an objective set of access criteria, comprising (a) the adverse impact of the global economic crisis, (b) planned countercyclical development expenditures for poverty reduction, and (c) sound macroeconomic management (for more details, see box below).[10] Article IV consultations with the IMF should have been conducted within the previous 18 months, and its findings should provide inputs for the review of macroeconomic policy and public finance of the potential CSF borrower. An IMF assessment letter should be secured before the Board discussion.

Access Criteria for Countercyclical Support Facility

Adverse Impact of the Global Economic Crisis. The following conditions should have been observed as adverse effects of the global economic crisis within 2008–2010 before the Board of Directors consider a countercyclical support facility (CSF) loan:

(i) The developing member country (DMC) experienced a significant reduction in growth, or has experienced a sharp slowdown in exports or inflow of remittances.

(ii) The DMC is facing significant fiscal constraints because of the effect of the global financial crisis. Relevant indicators include projected fiscal deficit and lower revenue collections.

(iii) For DMCs relying on international capital markets as a financing source for public expenditures, their access at favorable terms has been disrupted by a rise in the spread on offshore bonds from the pre-crisis level.

Planned Countercyclical Development Expenditures for Poverty Reduction. The first condition and either of the second or the third condition should be applicable:

(i) The government has a specific countercyclical development expenditure/policy program to be supported by the CSF, and is committed to its implementation.

(ii) The countercyclical development expenditure/policy program includes investment in public infrastructure.

(iii) The countercyclical development expenditure/policy program has a social safety net scheme targeting the poor or vulnerable group.

[10] Any assessment of qualification involves a degree of judgment. The assessment of the qualification criteria will need to take into account the diversity in DMCs' circumstances and the uncertainties underpinning economic projections. Strong performance against all relevant criteria would not be necessary to secure qualification under the CSF. However, significant shortcomings on one or more of these criteria—unless there are compensating factors, including corrective policy measures underway—could generally signal that the DMC is not among the strong performers for whom the CSF is intended.

Sound Macroeconomic Management. The following conditions should be generally applicable, within the country context and constraints, including availability of statistical information:

(i) Monetary policy addresses price stability as one of its core objectives. Inflation is controlled.

(ii) Public finances are sound, including a sustainable public debt position. Relevant indicators may include the recent evolution of fiscal balances in relation to the economy's cyclical position; the quality of any adjustment measures being considered; and an overall sound institutional budgetary framework.

(iii) International reserves are determined to be adequate, taking into account the imports coverage ratio and the short-term external debt financing requirement. Debt sustainability of the borrower is confirmed. Relevant indicators may be based on the debt sustainability analysis (DSA) of the International Monetary Fund and the World Bank or a similar assessment where DSA is not conducted.

(iii) **Confirmation of development focus.** The development policy letter states that the government has the countercyclical development expenditure/policy program to be supported by the CSF, and that it is committed to its implementation. Given the facility's nature as a countercyclical response, structural reforms at the microeconomic level are not required.

(iv) **Development partnership.** The CSF operations are conducted in coordination with the concerned development partners, in the spirit of the Paris Declaration on Aid Effectiveness.[11]

(v) **Application of streamlined business processes.** Individual CSF loans will require Board approval. There is a case for facilitating delivery to avoid intermittence of essential development expenditures. At same time, any public expenditure for demand-priming should come quickly. Fast-track business processes and documentation requirements similar to those applicable to emergency assistance loans[12] should be adopted for CSF loans.[13]

(vi) **Monitoring and reporting.** Developments in macroeconomic and fiscal conditions of CSF borrowers, including the countercyclical development expenditure/policy program, will be monitored about every 6 months during the life of the facility, and should be reported to the Board annually.[14]

10. Other than the items in para. 9, CSF incorporates all the features of program lending.

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[11] The Paris Declaration on Aid Effectiveness: Ownership, Harmonisation, Alignment, Results, and Mutual Accountability. 2005. Paris. Available: http://www.oecd.org/dataoecd/11/41/34428351.pdf

[12] ADB. 2004. *Disaster and Emergency Assistance Policy*. Manila.

[13] For CSF loans, an economic assessment is conducted in lieu of the damage and needs assessment. Unless the Management advises otherwise, a project preparatory note (in the absence of project preparatory technical assistance), concept clearance, and the second management review meeting should not be required.

[14] Financing matters are separately reported to the Board of Directors through the quarterly Treasury Report.

Table: Key Features of Loans under Countercyclical Support Facility

Item	**Features**
Lending Spread	200 basis points.
Cost of Funds	(i) Cost Base Rate: 6-month LIBOR. (ii) Rebate or Surcharge: Rebates or surcharges are announced semi-annually based on the difference of the actual average cost of funds issued for CSF and the 6 month LIBOR rate for the preceding semester. For the first semester, current average cost of funds will apply.
Available Currencies[a]	US dollar, Japanese yen, and Euro.
Grace Period and Maturity	3-year grace period and 5-year maturity.
Repayment Terms[b]	Equal installments or annuity method.
Commitment Charge	75 basis points per year on the undisbursed loan balance.
Interest Rate Fixing	Available subject to relevant swap market opportunities being available to ADB.
Local Currency Conversion	Not available.

ADB = Asian Development Bank, CSF = Countercyclical Support Facility, LIBOR = London interbank offered rate.
[a] Borrowers may request for other currencies and availability will be assessed based on market conditions and whether ADB can efficiently intermediate.
[b] For annuity method, the general practice of 10% discount rate will apply.
Source: Asian Development Bank staff.

B. Country Eligibility

11. **Ordinary Capital Resources-Eligible Countries Only.** Given the lending terms set above those for standard loan products based on LIBOR, only OCR-eligible sovereign borrowers designated under ADB's Graduation Policy[15] will have access to the CSF, provided that the country partnership strategy does not recommend disqualifying the concerned DMC from the use of budget support.

C. Resource Provision and Allocation

12. **Up to $3 Billion of Ordinary Capital Resources.** ADB will allocate up to $3 billion from OCR to the CSF. Given the unexpected nature of the crisis, CSF loans are not counted towards the ADB-wide program lending ceiling (20% of total lending on a 3-year moving average basis). To maintain accessibility for a wide range of crisis-affected DMCs, each country's access to the CSF is capped at $500 million. ADB will call for DMCs' requests for financial assistance under CSF, and these will have to be received within 1 month of Board approval of the facility.[16]

13. **Administrative Resources.** Assistance under the CSF will be implemented by the existing staff. The resources required for this temporary increase in the work program will be provided separately through, for example, use of the budget carryover and more flexibility in staff consultant recruitment and business travel.

IV. RECOMMENDATIONS

14. The President recommends that the Board approve the proposed establishment of a time-bound countercyclical budget support instrument, the CSF, for 2009–2010, with a total amount up to $3 billion equivalent and with the features specified below:

[15] See ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila.
[16] If the total requested amount from this initial call exceeds $3 billion, allocation among DMCs that meet the eligibility and access criteria should be prioritized based on need and equity. Subsequent requests for financing from the residual CSF pool, if any, will be studied as they are submitted to ADB. Countries from Southeast Asia, South Asia, and Central and West Asia have indicated that they might request assistance under the CSF.

(i) The lending terms for CSF loans shall comprise interest rates set 200 basis points over LIBOR, rebate or surcharge reflecting the cost of funds, 5-year maturity including a 3-year grace period, and commitment charge at 75 basis points per year on the undisbursed loan balance.

(ii) The DMC concerned must have concluded consultation with IMF under Article IV of the Articles of Agreement of IMF within 18 months and the assessment letter should be secured prior to consideration by the Board of Directors of the proposed assistance under the CSF.

(iii) Debt sustainability of the CSF borrower, including potential impacts of the prospective CSF loan, shall be confirmed by ADB.

(iv) The streamlined business processes similar to those applicable to the 2004 Disaster and Emergency Assistance Policy and as detailed in footnote 13 shall apply.

(v) OCR-eligible countries under the 2008 Review of the 1998 Graduation Policy, as amended from time to time, have access to CSF.

(vi) Total lending to each country under the CSF is capped at $500 million.

(vii) CSF loans will not be counted towards the ADB-wide program lending ceiling.

(viii) A development policy letter shall indicate a countercyclical development program; a policy matrix for structural reforms is not required.

(ix) Except for the above-mentioned provisions, all operational policies applicable to program lending, including the 1999 Review of Program Lending Policies, as amended from time to time, shall be observed.

15. The authority to grant loans pursuant to above provisions shall expire on 31 December 2010, unless extended by the Board of Directors.

ADB'S RESPONSE TO THE CRISIS[1]

1. The Asian Development Bank (ADB) will act aggressively to support its member countries in responding to the crisis. It will significantly enhance its lending and guarantee services, as well as its policy advice and regional cooperation support. ADB's support will cover public and private sectors. New initiatives are planned to provide policy advice and quick-disbursing financial support, and to build capacity. Others will be implemented regionally in close collaboration with regional organizations such as the Association of Southeast Asian Nations (ASEAN) and South Asian Association for Regional Cooperation (SAARC), and other development partners. ADB will work with its partners and member countries to:

- (i) restore the three critical global public goods essential to economic growth: market confidence and economic stability, a well functioning financial system, and an open trading regime;
- (ii) adopt countercyclical policies and programs consistent with the global call for fiscal stimulus measures to compensate for the collapse in private demand worldwide;
- (iii) minimize the cutbacks in investments that are essential for the long-term growth and social stability (infrastructure, education, health programs), despite expected shortfalls in government revenues and private capital flows;
- (iv) protect the most vulnerable members of societies (poor and near poor) and the progress made in recent years in reducing poverty, by supporting the continuation of existing or creating new social safety nets; and
- (v) support structural changes in the region's economy necessary to make future economic growth more robust and less susceptible to volatility in financial markets elsewhere, particularly by helping boost domestic demand and recycle a larger proportion of the region's vast savings into investments within the region.

2. Replenishments of the resource base of ADB—ordinary capital resources (OCR) and the concessional Asian Development Fund (ADF)—will considerably increase its ability to support the region. ADB's Strategy 2020[2] concentrates operations in sectors that are key to generating employment, stimulating domestic demand, and boosting investor confidence during the crisis, led by infrastructure, finance, and education.

3. To help its member countries effectively respond to the crisis, ADB plans to increase its lending in 2009–2010. The support will comprise project investments, quick-disbursing policy-based support, and guarantees. Several new initiatives are planned to address the unique needs of the region in these unusual times.

4. ADB proposes to establish a Countercyclical Support Facility[3] to provide fast-disbursing crisis assistance and to maintain credit flows to the real economy. The facility will help offset the diminished external credit available to DMCs and sustain growth. It will also improve macroeconomic conditions by expanding domestic demand and production, strengthening social protection, facilitating trade, and protecting employment from fresh external shocks. The facility will help contribute to DMC efforts to address the short-term liquidity crunch and provide fiscal stimulus.

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[1] See ADB. 2009. *The Global Economic Crisis: Challenges for Developing Asia and ADB's Response.* Manila.
[2] ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–202*0. Manila.
[3] Establishment of the Countercyclical Support Facility is subject to the approval of ADB's Board.

5. ADB will accelerate and increase its support for low-income countries in 2009–2010. ADB will allow front-loading 2009–2010 allocation of ADF X resources, helping ADF countries increase use of ADF loans and grants in 2009. A planned contribution from ADB's liquidity reserve will raise the ADF pool available for 2009–2010. To help strengthen the ADF resource position, annual OCR net income transfers will be three times higher during ADF X than during ADF IX. [4]

6. ADB aims to substantially increase cofinancing for its projects in 2009–2010. The risk-mitigating technical and financial features of ADB projects make them attractive investments for bilateral development partners and commercial financiers. ADB is pursuing framework agreements with interested counterparts covering trade financing guarantees, as well as infrastructure financing.

[4] This is subject to ADB's Board of Directors' annual reviews of ADB's capital adequacy and net income outlook, and ADB's Board of Governors' approval of the net income allocation.

NEW CRISIS-RELATED FACILITIES
OF OTHER INTERNATIONAL FINANCIAL INSTITUTIONS
(Established in 2008–2009)

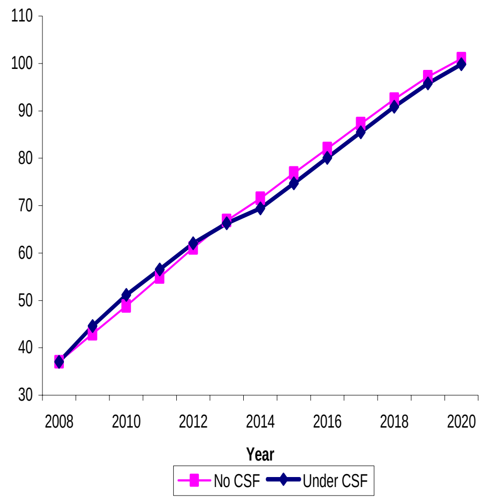
Institutions	New Facilities
African Development Bank (AfDB)	**Emergency Liquidity Facility (ELF)**. The AfDB Group established a $1.5 billion ELF as part of a global response to the financial crisis. ELF aims to provide financial support to eligible clients in exceptional cases. The range of beneficiaries includes AfDB's middle-income countries (MICs); central banks in MICs for onlending to domestic financial institutions; public and private financial institutions in all of AfDB Group's regional member countries for onlending to the productive sector; nonsovereign guaranteed projects in all regional member countries exposed to risks of delays, postponement, financing or refinancing risks; and nonbank clients, provided they are already receiving assistance from other international financial institutions whose due diligence is similar to that of AfDB. Eligible beneficiaries could use ELF resources to finance a broad range of obligations, including underpinning a fiscal stimulus and supporting public–private partnerships at risk. Given the urgent nature of the financing needs to be addressed by the ELF and the need for a fast-tracked process, proposals for the use of the resources will be considered by the Board within 10 working days. Sovereign guaranteed loans have maturities of up to 5 years (and a grace period of up to 3 years), interest of 6-month London interbank offered rate (LIBOR)/Euro interbank offered rate (Euribor), with a liquidity premium of 250 basis points, and a front-end fee of 0.5%.
Inter-American Development Bank (IDB)	**Liquidity Program for Growth Sustainability.** IDB's $6 billion Liquidity Program for Growth Sustainability will be provided to member governments. The aim is for the funds to be made available to domestic firms via commercial banks that may face transitory difficulties in accessing foreign and interbank credit lines as a result of the financial crisis in the United States and Europe. Countries eligible to borrow from IDB's ordinary capital can tap the $6 billion fund. The loan amounts would be determined by IDB on a case-by-case basis. Terms comprise 5-year maturity (3-year grace period), interest of 6-month LIBOR, reset semiannually, plus a loan spread of 400 basis points per year, a front-end fee of 1% of the principal amount, and a commitment fee of 0.75%.
International Monetary Fund (IMF)	**Flexible Credit Line (FCL).** The IMF is introducing this new credit line to provide large and upfront financing to members with very strong fundamentals and policies. As access to the FCL is restricted to members that meet strict qualification criteria, drawings under it are not tied to policy goals agreed with the country. The flexibility built into the design of the FCL relates to its uncapped access, its long repayment terms (3.25–5 years), its unrestricted renewals, and its dual-use for contingent (precautionary) and immediate balance of payments needs. The cost of borrowing under the FCL is the same as that under IMF's traditional Stand-By Arrangement (SBA). If borrowing on a precautionary basis, countries pay only a commitment fee that is refunded if they opt later to draw on the loan. Commitment fees range with the scale of lending and are about 24–27 basis points for lending between 500% and 1000% of quota. The cost of drawing under the FCL varies with the scale and duration of lending. Considering the currently low world interest rates, the effective cost of borrowing under the FCL (or an SBA) for access between 500% and 1000% of quota currently ranges between 2.3%–2.9% before duration-based surcharges apply. (These surcharges would raise the cost of borrowing up to 2.7%–3.6% whenever the country's outstanding credits have been above 300% of its IMF quota for more than 3 years.) These interest rates exclude a flat 50 basis points service charge, which is applied to all IMF disbursements.

FINANCIAL IMPLICATIONS OF THE COUNTERCYCLICAL SUPPORT FACILITY

1. The Countercyclical Support Facility (CSF) allows the Asian Development Bank (ADB) to accelerate budget support for developing member countries affected by the global financial crisis within the financial policy framework. In response to the crisis, ADB has significantly increased its planned ordinary capital resources lending in 2009 and 2010.

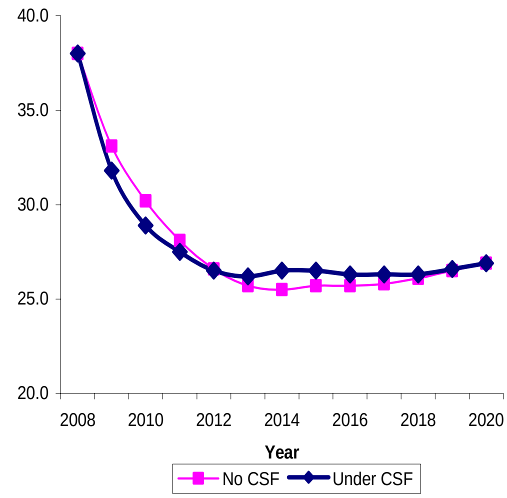
2. The recent rapid loan growth presented in Figure A3.1 is expected to decrease ADB's equity-to-loan ratio (ELR) quickly in the medium term. Even after a general capital increase (GCI), the expected higher lending and the staggered receipt of paid-in capital over about 10 years will require ADB to closely monitor the loan growth and equity balance to manage its capital adequacy. Figure A3.2 shows that, even before establishing the proposed CSF, the ELR was projected to reach the minimum long-term ELR requirement of 26% by early 2013. This constrains ADB from increasing its lending commitment in 2009–2010. In addition, since the ELR is sensitive to the disbursed and outstanding balance of loans and guarantees, there is little flexibility to substitute project loans with fast-disbursing loans within the planned level.

Figure A3.1: Loans and Guarantees
($ billion)



CSF = Countercyclical Support Facility.
Note: The figure shows disbursed and outstanding loans and present value of guarantees. Projections as of 31 December 2008.
Source: Asian Development Bank staff.

Figure A3.2: Equity-to-Loan Ratio
(%)

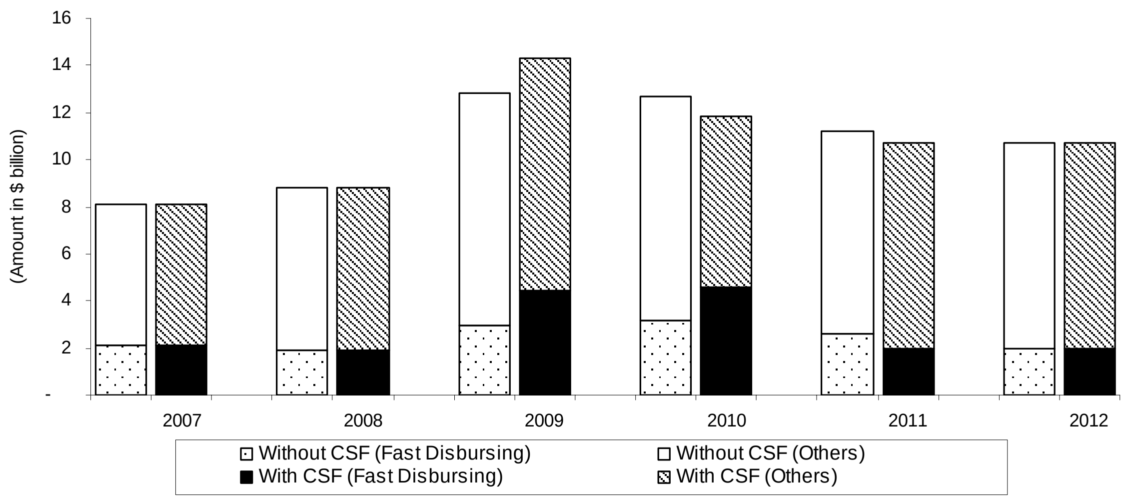


CSF = Countercyclical Support Facility.
Note: Projections as of 31 December 2008.
Source: Asian Development Bank staff.

3. The proposed pricing of the CSF, combined with its shorter maturity, allows ADB additional flexibility in its lending within the capital adequacy framework in providing fast-disbursing loans immediately. The proposed higher loan pricing of the CSF, compared to standard Ordinary Capital Resource terms, leads to additional income for ADB. This additional income feeds directly into the ELR to support a higher level of lending under the CSF. The lending terms under the CSF will allow ADB to provide additional fast-disbursing loans in 2009 and 2010, which will result in higher loan exposure from 2010 to 2012, while maintaining sound capital adequacy. There is a trade-off between pricing and volume of lending. While the trade-off is not linear, it is estimated that varying the

lending spread by 100 basis points will increase or decrease the size of the CSF by about $500–700 million.

Figure A3.3: Possible Lending Commitments
($ billion)



CSF = Countercyclical Support Facility.
Source: Asian Development Bank staff.

4. After the approval of the fifth GCI and subscription of the member countries, the lending and borrowing headroom is expected to be adequate to support the commitments under the CSF. Before receiving subscriptions for the GCI, the lending headroom is expected to be adequate, but the borrowing headroom is projected to be low. Management will closely manage and monitor the situation, and provide regular reports to the Board of Directors through the quarterly Treasury Report.