# Box 1
# Colombia's Flexible Credit Line with the IMF

On May 25, 2018, the Executive Board of the International Monetary Fund (IMF) approved a new agreement that was favorable to Colombia, within the framework of the flexible credit line (FCL), for 384% of the country's quota in this organization. This percentage corresponds to 7.848 billion (b) of special drawing rights (SDR), which was equivalent to approximately USD 11.4 b on the date of its approval.[1] This new line replaces the one that was approved for 400% of the quota in 2016 and which expired in June 2018. In all cases, Colombia has reported that it requests this credit line for precautionary reasons.

The FCL is an instrument created by the IMF which only countries with very strong economic fundamentals and institutional frameworks with a solid economic policy have access to. As indicated by its name, this is a credit line that Colombia has with the IMF and which it can use without meeting any conditions to deal with adverse events abroad. In this sense, the FCL complements the international reserves. At the end of May 2018, Colombia had an external liquidity buffer of USD 58.498 b (equivalent to the sum of the international reserves and the FCL amount), which could be used to face adverse shocks.

The IMF Executive Board decided that Colombia still met the criteria needed to have access to this line of credit and highlighted the soundness of the country's institutional policy framework, specifically the inflation targeting regime, the flexible exchange rate, the fiscal rule, and effective financial supervision and regulation. The renewal of the FCL constitutes the IMF's vote of confidence in the country and its economic authorities. Currently, only Colombia and Mexico have access to this credit line.

This box introduces some background information on Colombia's access to FCL within the framework of the different instruments offered by the IMF as well as a description of each instrument. Finally, some evaluation criteria with references to their benefits and costs are presented.

1 As of June 28, 2018, the amount of this credit line in dollars was equal to USD 11.025 b given that the USD / SDR exchange rate on that date was 1.404920.

## Background and description of the FCL

The FCL was created in March 2009 as a temporary and preventive instrument[2] designed to mitigate the effects of extreme external events on member countries which are characterized by strong economic fundamentals, a solid institutional framework for economic policy, the implementation of prudent policies, and the commitment to maintain them in the future. In addition to these, the country must meet certain qualification criteria, the compliance of which is validated by the IMF in the application for access to the instrument. These criteria are: 1) a sustainable external position; 2) a capital account in which private flows predominate; 3) a history of access to international markets under favorable terms; 4) a relatively ample level of reserves at the time an application is made for the precautionary FCL; 5) sound public finances (including sustainable conditions in terms of public debt); 6) a low and stable level of inflation in the context of a solid framework of monetary and foreign exchange policy; 7) the absence of bank solvency issues that pose a systemic threat to the stability of the banking system; 8) effective oversight of the financial sector; and 9) integrity and transparency of information.

In addition to complying with these conditions, in their request, the country must argue that external and exogenous risks exist and that they could affect their ability to finance the balance of payments. Although the risks may be considered extreme and low in probability, this credit line would provide coverage for the country if such risks materialize.

Given that access to the FCL is restricted to those countries that meet strict qualification criteria, the disbursements from this line of credit are not subject to compliance with policy goals agreed upon with the country and can be used on a contingency basis, i.e., they are available when the country needs them.[3] The FCL works as a revolving line of credit that, at the discretion of the country, can be used for one or two years initially after which an evaluation of the country's right to access it is done at the end of the first year.[4] It does not

2 Even though the temporary nature of this instrument was not defined at the time of its creation in 2009, the FCL operational guidelines (page 5) indicate that, under the revision of conditions carried out in 2014, the directors of the IMF have reiterated that this instrument provides a temporary complement to the international reserves and the countries that use it are expected to stop doing so at the appropriate time. That is why the countries are required to define and provide a withdrawal strategy. Guide available at: http://www.imf.org/external/np/pp/eng/2015/060115.pdf

3 Article 14 of Act 31/1992 establishes that "*Banco de la República* may contract non-monetizable balance of payments loans."

4 This modification was made on August 30, 2010. Previously, the credit line could have a period of either six months or one year that included a review of the country's access rights after the first six months.

have a maximum amount established,[5] and the amount may be increased during the period the agreement is in effect as long as the country continues to meet the qualification criteria. If the country decides to use it, the funds would be transferred to the Central Bank and would become part of the international reserves.[6] The use of these resources is to address exclusively critical conditions in the balance of payments. The repayment of the borrowed funds would be made between 3.25 and 5 years after their disbursement.[7]

Since it was implemented, this line of credit has been approved for three countries: Mexico, Poland, and Colombia. This credit line has remained in effect for Mexico and Colombia since 2009 as a precautionary mechanism while it was in effect for Poland from 2009 until November 3, 2017, when the country decided to cancel it.[8]

Among the financial support mechanisms offered by the IMF (Table B1.1), the FCL is described as an instrument that is exclusively designed for member countries which, prior to their request, have the fundamentals and a record of implementing very effective policies. According to the IMF statement,[9] the IMF is convinced that the Colombian authorities are committed to maintaining strong policies and implementing a structural reform that strengthens the resilience of the economy and boosts economic growth. However, the country remains vulnerable to foreign risks such as a rise in protectionist measures, a sudden tightening of the worldwide financial conditions, and a reduction in global economic activity associated with a drop in the price of crude oil, which could affect the current process of adjustment in the economy.

## Access of Colombia to the FCL

Colombia has had access to the FCL since it was created. The first request was approved in May 2009 for an amount equal to 900% of Colombia's quota in the IMF[10] (approximately USD 10.4 b). This credit line was renewed for a period of one year and for an amount equivalent to 300% of the quota (about USD 3.5 b) on May 7, 2010.[11] On May 6, 2011, the IMF again approved an FCL for 500% of the quota for Colombia (approximately USD 6.1 b), this time for a period of two years. Later, on June 24, 2013, its renewal was approved for a period of two years[12] and for 500% of the quota for Colombia. On June 17, 2015, the FCL was again renewed for a two-year term and 500% of the quota.

Given the adverse situation that the Colombian economy was experiencing as a result of the drop in the price of crude oil, the next-to-last renewal was made on June 13, 2016. At that time, the country decided to cancel the credit line and request a new one for a two-year term. The IMF approved a line of credit for 400% of the quota (USD 11.5 b) after this was raised to SDR 2.044,5 b on February 10, 2016.[13] The most recent request was made in March 2018 and was approved by the IMF Executive Board on May 25, 2018, for a term of two years and 384% of the quota (Table B1.2).

At every point during the approval and renewal process, the Colombian financial authorities have stated that, considering the precautionary nature of these credit lines, they had no intention of using them unless external conditions make this necessary.

## Costs and Benefits of the FCL

An important benefit of the FCL is the signal it sends to the market with regard to the prudent management of the economy and its ability to react when there is a crisis,

5 Initially, the credit line had an access limit of 1,000% of the country's quota in the IMF.

6 These funds would have the same use, including intervention in the foreign exchange market.

7 This means that each disbursement is repaid through eight equal quarterly installments starting 3.25 years after the date of each disbursement.

8 Starting in 2015, Poland began to reduce its access to the FCL in line with their intention to withdraw from the agreement once the conditions abroad had improved. Article IV of the 2017 IMF Guidelines concluded that, in a context in which the foreign risks for Poland were declining, maintaining sound institutions and policies would reinforce the country's strength with respect to external risks.

9 The IMF statement available at: https://www.imf.org/en/News/Articles/2018/05/25/pr18196-imf-executive-board-approves-flexible-credit-line-arrangement-with-colombia

10 Colombia's quota in the IMF at that time (up to January 26, 2016) was SDR 774 million.

11 In May 2010, the renewal was made for an amount lower than that of the credit line approved in 2009 since the perception of risk was substantially lower than the one prevailing at that time. The economic results for 2009 were better, both for Colombia and worldwide, than what had initially been forecast; the projections for 2010 had been revised upwards and the risk premiums had been significantly reduced.

12 It was considered appropriate to request a credit line equal to 500% of the quota in February 2013 when access to the FCL was analyzed. This took into account the increase in the level of uncertainty in Europe and in Arab countries, and the fact that the historical minimums that the indicators of risk perception for Colombia showed could reverse themselves at any time and generate instability for the economy. According to the Financial Stability Board (FSB), "Vulnerabilities in the Global Financial System", Note for the FSB Plenary, January 28, 2013, at that time, it was difficult to analyze the extent to which there was an erroneous assessment of the investors' risk.

13 Based on information from the IMF, the conditions for implementing the increases in the quota, which were agreed upon in the framework of the Fourteenth General Review of Quotas, were met on January 26, 2016. As a result, the combined quotas of the 189 member countries of the IMF increased throughout 2016 as they went to a level of SDR 477 b (some USD 659 b) from a level of SDR 238.5 b (about USD 329 b). The IMF Board of Governors carries out general quota reviews with some regularity (usually every five years). Based on information provided by the IMF, a general review of quotas addresses two main questions: the volume of the overall increase and the distribution of this increase among the member countries. A general review of quotas allows the IMF to assess the suitability of the quotas based on the financing needs of the member countries' balance of payments and the IMF's own capacity to help meet those needs. In addition, a general review makes it possible to increase the quotas of the member countries based on changes in their relative position in the world economy. Information available at: https://www.imf.org/external/np/exr/facts/spa/quotass.htm

Table B1.1
Mechanisms of IMF Financial Support

| Mechanism | Purpose | Conditions | Monitoring | Access Limit (percentage of quota) | Period |
|---|---|---|---|---|---|
| Stand-by Drawing Rights Agreement. | Short- and medium-term assistance for countries with short-term difficulties with the balance of payments. | Adopt policies that make it possible to solve the difficulties in the balance of payments within a reasonable period of time. | Disbursements are made each quarter. These are contingent upon the performance of the country. | Annual: 145% Cumulative: 435% | 3.25 to 5 years. |
| IMF's Extended Fund Facility (EFF) | Long-term assistance to support structural reforms carried out by members in order to long-term difficulties with the balance of payments. | Adopt a program for up to four years with a structural agenda and a detailed definition of policies for the upcoming twelve months. | Disbursements are made each quarter or every six months. These are contingent upon the performance of the country. | Annual: 145% Cumulative: 435% | 4.5 to 10 years |
| Flexible Credit Line (FCL) | Flexible tool that makes it possible to manage the current or potential needs of the balance of payments. | The country must have strong economic fundamentals, a solid institutional framework for economic policy, and the implementation of prudent policies beforehand. | Access is approved in advance for the entire period of the agreement. The 2-year agreements are subject to a review after one year. | There is no limit | 3.25 to 5 years |
| Precautionary and liquidity line (PLL) | Tool for countries with sound fundamentals and policies. | Soundness in the institutional framework, in the external position, in access to the market, and in the financial sector. | Access in advance subject to semi-annual reviews. | 6 months: 125% For the first year, approval for one to two years: 250%<br>After twelve months of satisfactory progress: 500% | 3.25 to 5 years |
| Fast-track financing instrument (FFI) | Rapid access financial support for all members facing urgent needs in their balance of payments. | Efforts to solve balance of payments difficulties. | Direct purchases with no need for a program or reviews. | Annual: 37.5% Cumulative: 75% | 3.25 to 5 years |

Note: the fees charged for all IMF instruments in cases of disbursement are:
a. Basic fee: SDR interest rate (SDR) plus a margin [100 percentage points (pp)] The SDR rate on June 28, 2018 was 0.979%
b. Surcharges: depending on the amount and period of the loan. A surcharge of 200 bp is paid for amounts higher than 187.5% of the quota. If the loan remains above this level for more than three years, the surcharge increases to 300 bp.
c. Service charge: 50 bp which applies to all IMF disbursements.
Source: IMF (Financial Operations Manual, edition 2018).

which makes it less vulnerable to speculative attacks. This should also contribute to lowering the cost of external financing for the economy.

The FCL complements the accumulation of international reserves as an economic alternative that makes it possible to expand coverage of external liquidity. Note that, under the current scenario, having a FCL is less expensive than accumulating and sterilizing international reserves.[14]

To compare how expensive the accumulation of international reserves versus having a FCL is, the following factors are usually considered: 1) the net cost of sterilizing purchases of international reserves, which is estimated by using the difference between *Banco de la República's* policy interest rate minus the return on international reserves, and 2) the cost of the FCL, assuming that the funds from that line of credit are used.[15]

14 Normally, countries that have an inflation targeting framework use different instruments to collect the money supply that is generated when they purchase reserves. This operation is known as sterilization. If the central bank (CB) does not sterilize purchases of international reserves, the interest rate of the economy is likely to move away from the CB benchmark rate.

15 The cost of having access to the FCL depends on whether or not the funds have been disbursed. If the funds are not disbursed, Colombia must pay an annual commitment fee that the IMF would reimburse if the funds were used. This fee rises along with the level of access and varies within a range of 15 to 44 bp. In a case in which the funds are disbursed, the cost will vary depending on the amount and the loan, as described in Table B1.1.

Table B1.2
History of FCL Approvals

| Approval Date | Period (years) | Amount (millions in SDR) | Amount (millions of dollars) | Percentage of the quota |
|---|---|---|---|---|
| Mexico | | | | |
| 17-Apr-09 | 1 | 31,500 | 47,000 | 1,000 |
| 25-Mar-10 | 1 | 31,528 | 48,000 | 1,000 |
| 10-Jan-11 | 2 | 47,292 | 72,000 | 1,500 |
| 30- Nov-12[a/] | 2 | 47,292 | 72,000 | 1,305 |
| 26-Nov-14 | 2 | 47,292 | 69,247 | 1,305 |
| 27-May-16[b/] | 2 | 62,389 | 88,000 | 700 |
| 29-Nov-17 | 2 | 62,389 | 88,000 | 700 |
| Colombia | | | | |
| 11-May-09 | 1 | 6,966 | 10,400 | 900 |
| 7-May-10 | 1 | 2,322 | 3,500 | 300 |
| 6-May-11 | 2 | 3,870 | 6,100 | 500 |
| 24-jun-13 | 2 | 3,870 | 5,837 | 500 |
| 17-jun-15 | 2 | 3,870 | 5,450 | 500 |
| 13-jun-16[c/] | 2 | 8,180 | 11,500 | 400 |
| 25-May-18 | 2 | 7,848 | 11,400 | 384 |
| Poland | | | | |
| 6-May-09 | 1 | 13,690 | 20,580 | 1,000 |
| 2-Jul-10 | 1 | 13,690 | 20,430 | 1,000 |
| 21-Jan-11 | 2 | 19,200 | 29,000 | 1,400 |
| 18-Jan-13[d/] | 2 | 22,000 | 33,800 | 1,303 |
| 14-Jan-15 | 2 | 15,500 | 23,000 | 918 |
| 13-Jan-16[e/] | 1 | 13,000 | 17,940 | 770 |
| 13-Jan-17[f/] | 2 | 6,500 | 9,200 | 159 |

a/ In March 2011 the quota went from SDR 3.152 b to SDR 3.625 b.
b/ In February the quota went from SDR 3.625 b to SDR 8.912 b.
c/ In February 2017, the quota went from SDR 774 m to SDR 2.044,5 b.
a/ In March 2011 the quota went from SDR 1.360 b to SDR 1.688 b.
e/ The line that was approved for them decreased on 1/14/2015 and the quota went from SDR 1.688 b to SDR 4.095,4 b.
f/ November 3, 2017 Poland decided to cancel the credit line.
Source: IMF (organization's communiqués).

In the case of Colombia, and using data up to 2018, the cost of accessing the FCL is lower than the alternative of accumulating reserves (and sterilizing them) under any possible scenario in which this instrument would be used (Table B1.3). This same situation has taken place every time Colombia has requested this line of credit.

Thus, the FCL is not only less expensive than accumulating reserves, but it also improves market confidence through the signal it sends regarding the quality of the macroeconomic policy framework. Given the temporary nature of this financial instrument, access to it is understood to depend on the changes in external conditions and the country's vulnerability to such shocks. Therefore, the Colombian authorities have stated that, to the extent that the risks decline, access to this instrument should decrease in the future.

Table B1.3
Comparison between the cost of sterilizing and the cost of FCL

| Probability of using the FCL. | Return on International Reserves (A)[a/] | Bank Benchmark Rate (B) | Net cost of sterilizing (C=B-A) | FCL cost[b/] (D) | Difference in bp (C-D) |
|---|---|---|---|---|---|
| | (percentage) | | | | |
| 0 | 1.38 | 4.25 | 2.87 | 0.26 | 261.31 |
| 0.5 | 1.38 | 4.25 | 2.87 | 1.37 | 149.62 |
| 1 | 1.38 | 4.25 | 2.87 | 2.49 | 37.93 |

Note: FCL is assumed to be 384%. An SDR interest rate of 0.979% is used (June 26, 2018).
a/ The yield forecast for the international reserves consists of the return seen as of May 31, 2018, the return from interest, and the yield based on price projected for the rest of the year.
b/ (Probability of using FCL x annual cost for use) + (probability of not using the FCL × annual premium).
Source: calculations by *Banco de la República*.