IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

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REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR 1997

I. INTRODUCTION

1. At its Thirty-Sixth Session in April 1989, the Executive Board approved a proposal to present the Report on IFAD's Investment Portfolio twice a year, covering the previous calendar year and the first six months of the current year at its April and September sessions respectively. Furthermore, progress reports on the diversification of the investment portfolio are presented at December sessions of the Executive Board. Accordingly, the following report covers the year ending 31 December 1997, and includes comparative figures for the year ending 31 December 1996.

II. INVESTMENT CONDITIONS AND STRATEGY

2. This section reviews the economic and investment environment prevailing in 1997, and the strategic and technical responses applied.

A. Economic Background

Gross Domestic Product

3. Annex I shows percentage changes in real Gross Domestic Product (GDP) for the thirteen member countries of the Organization for Economic Cooperation and Development (OECD), whose bonds are included in the J.P. Morgan Global Government Bond Traded Index. The figures demonstrate generally robust economic growth, with the exception of Japan, which underwent a notable slowdown in its domestic activity.

4. After posting growth of 2.8% in real GDP in 1996, the United States economy maintained an estimated rate of growth of 3.9% during 1997. Low inflation and continued job creation helped sustain a healthy economic environment.

5. The Japanese economy grew by an estimated rate of 0.5% in 1997, dropping significantly from 3.5% during the previous year. An increase in consumption taxes and a fall in public works expenditure were seen as the main catalysts for slowing down economic growth. Currency devaluations in other Asian economies are expected to weigh on Japan's export competitiveness in 1998.

6. In Europe, both the French and German economies attained an exports-led recovery with growth in the range of 2.3% to 2.4% despite growing unemployment rates. The United Kingdom has attained a level of growth of approximately 3.4% in 1997, which is expected to taper off in 1998, as a result of monetary tightening.

Labour Market Development

7. Annex II shows unemployment rates as a percentage of the labour force. Overall unemployment is estimated to ease in 1997, with the exception of France, Germany and Italy where it has increased.

8. In the second half of 1997, United States unemployment dipped to 4.6%, a 23 year-low, while overall unemployment in the United Kingdom is estimated to have dropped below 7.0% for the first time in seven years.

Inflation

9. Annex III shows percentage changes in consumer prices over the previous year. Overall inflation in OECD member countries is estimated to have remained under 3.0% due to generally restrictive monetary policies and declining commodity prices.

10. Despite the tightening job markets in the United States, inflation remained subdued because of the appreciation of the United States Dollar, productivity improvements, and stabilizing healthcare costs. Creeping labour costs, as measured by the Employment Cost Index (ECI), could revive inflation in 1998, after the ECI index increased by 3.3% in the final quarter in 1997, following a 2.8% and 3.0% rise in the second and third quarters respectively.

11. Inflation in continental Europe also remained under control despite the tendency for import prices to rise. Any upward price pressures were swiftly dampened by central banks, reflecting their commitment to combat inflation as part of the European Monetary Union (EMU) economic convergence provisions.

Monetary Policies

12. Annex IV shows the evolution of Central Bank and Government-controlled interest rates for the five currencies included in the Special Drawing Rights (SDR) valuation basket. Uneven growth in the five countries led to different monetary policies throughout 1997. In the United States the Federal Funds rate was increased in March 1997 from 5.25% to 5.50%. Thereafter interest rates remained unchanged; low inflation and the economic crisis in Asia contributed to the Federal Reserve’s neutral stance.

13. In Germany, the Bundesbank produced a restrictive monetary environment after it raised its repurchase rate by 30 basis points to 3.30% in October 1997. In the United Kingdom, the Bank of England increased its base rate five times, by 25 basis points at each adjustment to reach 7.25%. Inflation, however, remained above the 2.5% government inflation target at 2.7%.

Exchange Rates

14. Annex V illustrates the end-of-the-month exchange rates of the United States Dollar against the other four currencies included in the SDR evaluation basket during 1997. At year-end 1997, the United States Dollar had appreciated against all four currencies compared with rates at 31 December 1996.

15. The economic slowdown in Japan and sustained growth in the United States caused the Japanese Yen to weaken by 11.0% against the United States Dollar. Growing unemployment and dependence on an exports-led recovery in France and Germany, caused the French Franc and the Deutsche Mark to weaken by about 13% in both cases against the United States Dollar. The Pound Sterling, while appreciating against other European currencies, ended the year some 2.6% lower against the United States Dollar than at 31 December 1996.

Fiscal Policy

16. Annex VI shows budget deficits as a percentage of Nominal GDP as projected by the OECD. Overall government imbalances continued to trend down. The United States came close to a balanced budget due to cuts in defence spending, and increased tax receipts stemming from both payments of capital gains taxes and the upsurge in the economy.

17. In Europe, a combination of accounting recalculations and increased tax revenues kept fiscal deficits hovering around 3.0% of GDP; the level required for meeting the Maastricht Treaty requirements to qualify for participation in the EMU in 1999. In Japan, a hike in direct and indirect taxes is expected to have reduced the budget deficit to 2.8% of GDP in 1997, down sharply from 4.4% of GDP in 1996.

B. Financial Markets

18. Annex VII shows the evolution of interest rates and bond yields for the five currencies included in the SDR valuation basket. The trend during 1997 has been for bond yields to fall and for interest rates to remain steady or to rise slightly, as in the case of the United Kingdom, where bond yields have fallen below the level of short-term interest rates.

19. Annex VIII shows bond market returns for the 1997 measured in terms of local currency. Both bond coupon income and capital gains are included as elements in the measurement of returns.

20. In the United States, the return on Treasury bonds was 10.00% (1996 - 2.94%). The rally was caused due to continued low inflation reports and a flight to quality as the Asian currency and financial crisis evolved during the second part of the year. The benchmark 30-year Treasury bond yield fell from 6.80% at 31 December 1996 to 5.97% at the end of December.

21. In Japan, the return on Japanese Government bonds was 7.22% (1996 - 5.91%). The rally was caused by a slowdown in the economy after the consumption tax hike in April took affect, and the fear of re-entering into a recession in 1998.

22. In France and Germany, bond yields continued to fall, due to low inflation. However, a number of peripheral European markets such as Italy and Spain outperformed core Europe. In Italy, the rally was influenced by the increased chance of Italy forming part of the first wave of countries to participate in the EMU scheduled to commence on 1 January 1999, and by consecutive interest rate cuts by the Bank of Italy.

23. In the United Kingdom, the Gilts market registered the highest return in Europe at 14.85% (1996 - 7.35%). This was due to the prospects of lower growth in 1998, following short-term interest rate hikes by the Bank of England, and by investors being attracted to the appreciating currency.

24. World equities markets continued to rally in 1997, with high returns being recorded in the United States and European markets. Japan fared less well due to sluggish growth and the fear that Japan's deep involvement in trade and finance with South East Asia and the Republic of Korea, might lead to adverse effects in the manufacturing and banking sectors. Fears concerning cancellations of orders from United States and European manufacturers and increased competitiveness on the part of Asian countries which had devalued their currencies, caused a correction in the United States and European equities markets in October 1997, which was short-lived due to action by investors who regarded the temporary fall in equities prices as a buying opportunity.

25. Annex IX shows the evolution in 1997 and the beginning of 1998 of the two equities markets in which IFAD initiated investment in 1997, namely the Japanese equities market, and Asia and Australasia (excluding Japan). The graphs indicate that while the markets fell in the second half of 1997, a more optimistic sentiment prevailed at the beginning of 1998, due to the satisfactory conclusion of negotiations between the International Monetary Fund (IMF) and ailing Asian countries, and the announcement of measures to boost the economy on the part of the Japanese Government, causing a rally in the stock markets.

C. Investment Strategy

26. Throughout the year IFAD's external fixed-income managers adopted a strategy which was largely defensive with regard to duration. The prospect of the Federal Reserve raising interest rates due to rising wage costs and the booming economy was very real, at least in the first half of 1997. Hence the managers tended to maintain a lower than benchmark duration, which prevented them from benefiting to the full from the rally in the bond markets in the second half of the year.

27. With regard to their choice of markets, the results were very positive. The fixed-income managers overweighted the higher yielding markets such as Australia, Denmark, Italy, Spain, the United Kingdom and the United States and underweighted lower yielding markets such as Japan and core Europe.

28. Equities managers responded to the Asian crisis by avoiding financial institutions in Japan, and in the case of Asia and Australasia (excluding Japan), by delaying entry into the troubled markets of the Republic of Korea, Indonesia, Malaysia, The Philippines, and Thailand, and concentrating initially on the less volatile sectors of markets in Australia, Hong Kong, New Zealand and Singapore.

III. RATE OF RETURN

Overall Performance

29. Investment income in 1997 amounted to USD 163 940 000 equivalent (1996 - USD 148 852 000 equivalent). In line with market practice capital gains and losses include both realized and unrealized gains and losses. All amounts are included on an accruals basis. Table 1 summarizes net investment income earned during the period under review.

Table 1: Investment Income
(USD'000 equivalent)

	1997	1996
Interest from fixed income investments and bank accounts	128 779	132 710
Dividend income from equities	94	-
Realized capital gains/ (losses)	21 535	(83)
Unrealized capital gains	19 657	22 040
Subtotal: Gross investment income	170 065	154 667
Securities lending revenue	463	427
Investment management and custody fees	(5 457)	(5 857)
Provision for withholding tax	(1 131)	(385)
Net investment income	163 940	148 852

30. After taking into account custodian and management fees, the overall rate of return of the portfolio in 1997 was 7.54% (1996 - 6.67%). The main reason for the increase in revenue over the previous year was the major rally in the bond markets which occurred during the second half of 1997.

31. The performance of the internally managed portfolio, and the externally managed portfolios (both fixed income and equities) is measured against pre-assigned independent benchmarks that indicate the return which could be expected through passive management of a defined segment of the market. Table 2 compares the return of each of the major sections of the portfolio with the rate of return resulting from the composite of the benchmarks in use during the course of 1997. Table 2 shows an overall outperformance of 47 basis points against the composite benchmark in 1997.

Table 2: 1997 Performance Compared with Composite Benchmarks

Portfolio	Portfolio Rate of Return (%)	Benchmark Rate of Return (%)	Over/(Under) Performance (Basis Points)
Internally managed portfolio	6.00	6.30	(30)
Externally managed portfolio (fixed income)	8.88	8.66	22
Externally managed portfolio (equities)	(5.16)	(8.85)	369
Overall portfolio Gross rate of return	7.82	7.35	47
Less: management fees, etc.	(0.28)	(0.28)	-
Overall portfolio Net rate of return	7.54	7.07	47

32. In addition to the benchmarks included in table 2 above, which were selected to measure the performance of IFAD treasury and external investment managers for various defined mandates, IFAD uses a benchmark which sets a threshold for the expected overall rate of return of the investment portfolio. This consists entirely of instruments denominated in the component currencies of the SDR

basket, and is used to measure both the effect of active management and of diversifying the portfolio into assets denominated in currencies other than those included in the SDR basket. The SDR benchmark returns for 1997 are shown in table 3.

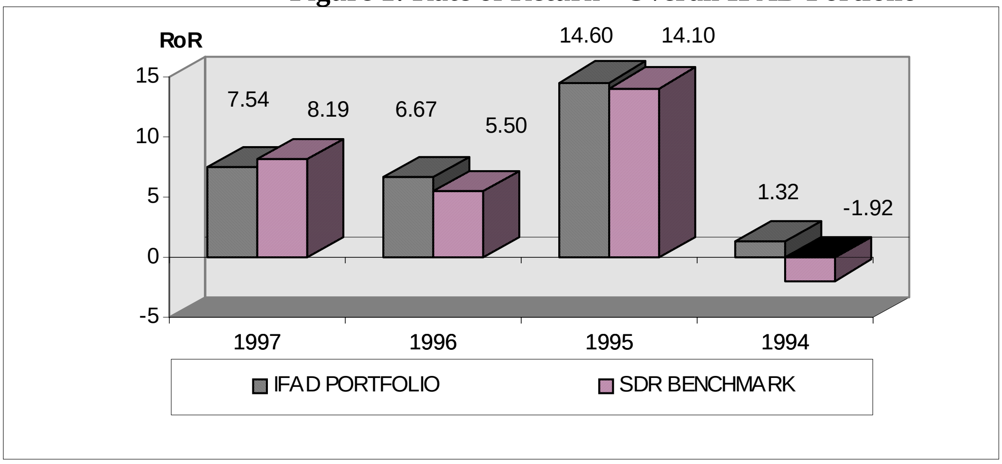
Table 3: 1997 SDR Benchmark Returns

Component Currencies[a/]		Bond Market Return	Money Market Return	Composite Benchmark Return [b/]
USD	40.5	10.00	5.80	9.16
DEM	20.0	6.28	3.34	5.69
JPY	16.3	7.22	0.57	5.89
FRF	10.8	7.64	3.44	6.80
GBP	12.4	14.85	7.01	13.28
SDR	100.0	9.15	4.35	8.19

[a]/ Ratios of the SDR valuation basket at 1 January 1997.
[b/] Consists of 80% of bond market return and 20% of money market return.

33. Figure 1 shows actual portfolio returns compared with SDR benchmark returns consisting of 80% of bonds and 20% of time deposits over the four-year period 1994 to 1997.

Figure 1: Rate of Return - Overall IFAD Portfolio



34. Table 4 shows the average annual return of the IFAD portfolio, and the SDR benchmark return over periods of one, two , three and four years respectively. The cumulative effect of active portfolio management and diversification over this four-year period is approximately USD 63 000 000 in additional income over and above the SDR benchmark return.

Table 4: Average Returns

	1997	1996 - 1997	1995 - 1997	1994 - 1997
Portfolio return %	7.54	7.11	9.60	7.53
Target return %	8.19	6.85	9.26	6.47
Outperformance/ (underperformance) basis points	(65)	26	34	106

Internally Managed Portfolio

35. The main purpose of the internally-managed portfolio is to ensure the availability of liquid funds to meet disbursements of loans and grants and administrative expenses.

36. During the period under review, the amount of the internally-managed portfolio was greatly reduced, as holdings of bonds were liquidated, and the proceeds transferred to externally-managed equity mandates. This process continued in January 1998, when a further USD 100 million which had been ear-marked for the Emerging Markets equities mandate was also transferred. Total flows relating to the internally-managed portfolio are outlined in table 5.

Table 5: Movements in Cash and Investments Under Internal Management
(USD'000 equivalent)

	1997	1996
Opening balance	398 858	507 677
Allocated to external managers	(183 584)	(53 584)
Other net outflows	(45 338)	(74 749)
Gross investment income	19 463	19 087
Movements on exchange	(1 384)	427
Closing balance	188 015	398 858

37. As indicated in table 2, the rate of return of the internally managed portfolio in 1996 was 6.00% compared with the composite benchmark rate of return of 6.30%, representing an underperformance of 30 basis points. This was largely due to the lower-than-benchmark duration of the portfolio during the first half of the year.

Externally-Managed Portfolio (Fixed Income)

38. There were two major revisions to the externally managed fixed income portfolio during the course of 1997. The first of these was to reduce the number of managers from fourteen to eight, and the second to change the investment guidelines to provide for an unhedged benchmark, and for the performance of all managers to be measured uniformly in terms of United States Dollars. The new investment guidelines are provided in annex XVII.

39. There were no additions or withdrawals from the aggregate externally managed fixed income portfolio in 1997. The portfolios of the six managers who had underperformed the benchmark during the course of the past three years were transferred and aggregated with the portfolios of those managers who had outperformed during the same period. Total flows relating to the externally-managed fixed income portfolio are outlined in table 6.

Table 6: Movements in Investments under External Management - Fixed Income
(USD'000 equivalent)

	1997	1996
Opening balance	1 783 365	1 675 017
Additional allocation	-	53 584
Gross investment income	159 287	125 559
Movements on exchange	(146 954)	(70 795)
Closing balance	1 795 698	1 783 365

40. As indicated in table 2, the rate of return of the externally-managed fixed income portfolio in 1997 was 8.88% compared with a composite benchmark rate of 8.66%, representing an outperformance of 22 basis points. This is attributable to overweighting investments in the higher-yielding markets such as Australia, Denmark, Italy, Spain, Sweden, the United Kingdom and the United States and underweighting investments in France, Germany and Japan. However, as indicated in table 7 the duration of the portfolio was substantially below benchmark duration. This defensive position prevented the managers from taking full advantage of the rally in the second half of 1997.

Table 7: Duration of the Externally-Managed Fixed Income Portfolio
(Years)

	31 December 1997	31 December 1996
Duration of the portfolio	5.18	4.74
Benchmark duration	5.43	4.92

41. The use of futures and options by the external investment managers continues to be modest. Only one manager used these instruments for eleven trades during the course of 1997, and there were no contracts outstanding at 31 December 1997. Details of the use of options and futures in 1997 are provided in annex X.

Externally-Managed Portfolio (Equities)

42. As part of the diversification programme, two equities mandates were funded in 1997, namely the Japan equities mandate amounting to JPY 12 500 000 000 or USD 103 584 000 equivalent at the time of inception on 22 October 1997, and the Asian and Australasian (excluding Japan) equities mandate amounting to USD 80 000 000 at inception on 1 December 1997.

43. Both mandates were affected by the financial and banking crisis originating in SouthEast Asia, as fears of the potential knock-on effect drove equities prices down in Japan and the Asian and Australasian markets, as shown in table 8.

Table 8: Movements in Investments under External Management - Equities
(USD'000 equivalent)

	1997	1996
Opening balance	-	-
Initial allocations	183 584	-
Gross investment income	(8 685)	-
Movements on exchange	(7 882)	-
Closing balance	167 017	-

44. As indicated in table 2 above, while the market value of IFAD's equities portfolio fell during the last quarter of 1997, it did so to a much lesser extent than the benchmark index. This was due to sector allocation in the case of Japan equities, by overweighting export sector oriented industries, and underweighting the financial sector, and to market timing in the case of Asian and Australian (excluding Japan) equities, by retaining some 71% of the portfolio in cash and time deposits at the year end.

45. By February 1998, the equities markets had recovered to a large extent following the provision of emergency credits by the IMF to the ailing Asian economies, and by the announcement of a package of measures by the Japanese Government to stimulate the economy.

IV. COMPOSITION OF THE PORTFOLIO

General

46. As of 31 December 1997, IFAD's investment portfolio amounted to USD 2 150 730 000 equivalent (31 December 1996 - USD 2 182 223 000 equivalent) excluding amounts subject to restriction provided by donors for participation in specific IFAD projects and activities.

47. In 1997, prior to taking into account the effect of movements in exchange rates, the amount of the investment portfolio increased by USD 124 727 000 equivalent (1996 - USD 69 897 000 equivalent). A detailed analysis of cash flows is presented in annex XI, which is summarized in table 9.

Table 9: Analysis of Cash Flows
(USD ’000 equivalent)

	12 Months to 31 December 1997		12 Months to 31 December 1996	
Opening Balance		2 182 223		2 182 694
Investment income	163 940		138 831	
Other inflows	299 375		265 819	
Outflows	(338 588)		(334 753)	
Increase, prior to exchange adjustment		124 727		69 897
Exchange movement		(156 220)		(70 368)
Closing balance		2 150 730		2 182 223

Composition of the Portfolio by Type of Mandate and by Instrument

48. IFAD’s portfolio is divided into three main sections by type of mandate:

(a) An internally managed liquidity portfolio, which is managed by IFAD treasury. As of 31 December 1997 this portfolio consisted mainly of short-term instruments such as cash and time-deposits, held pending disbursement for administrative expenses and loan and grant disbursements over the near term, and including some USD 100 million of funds earmarked for investment in equities early in 1998.

(b) An externally managed fixed-income portfolio, whose management has been entrusted since 1994 to a number of external investment managers under investment guidelines provided by the Fund. Instruments consist of bonds issued by sovereign States and international development institutions, and pools of cash and time deposits used for operating purposes.

(c) An externally managed equities portfolio, under which two mandates had been entrusted, in October 1997 and December 1997 respectively, to external investment managers under investments guidelines provided by the Fund. As of 31 December 1997, some USD 58 213 000 was held in cash and time deposits, reflecting the fact that the process of making initial investments in equities may be spread over a period of some months following the funding of a new mandate.

49. Table 10 provides an analysis of the instruments held in each of the main sections of the portfolio at 31 December 1997:

Table 10: Analysis of the Portfolio by Type of Mandate and by Instrument at 31 December 1997
(USD‘000 equivalent)

	Internally Managed Portfolio	Externally Managed Portfolio (Fixed Income)	Externally Managed Portfolio (Equities)	Overall Portfolio
Cash	46 291	26 614	1 454	74 359
Time deposits	128 267	94 722	56 759	279 748
Treasury bills	1 709	-	-	1 709
Bonds	10 000	1 649 213	-	1 659 213
Equities	-	-	108 748	108 748
Open trades	-	(12 097)	-	(12 097)
Accrued income	703	37 246	10	37 959
Dividends receivable	-	-	46	46
Non-convertible currencies (NCC)	1 045	-	-	1 045
Total	188 015	1 795 698	167 017	2 150 730
%	8.7	83.5	7.8	100.0

50. An analysis of the composition of the overall portfolio, which provides fuller details of open trades, etc., and comparative figures at 31 December 1996 is found in annex XII.

Composition of the Equities Portfolio

51. As of 31 December 1997, investments in equities amounted to USD 108 748 000 equivalent (1996- NIL), comprising 82 different stocks denominated in Australian Dollars, Hong Kong Dollars, Japanese Yen, New Zealand Dollars, and Singapore Dollars, as indicated in annex XIII. The composition of the equities portfolio by sector at 31 December 1997 is provided in table 11.

Table 11: Composition of the Equities Portfolio by Sector at 31 December 1997

	Japan		Asia & Australasia (excluding Japan)		Total	
	Number of Stocks	Amount	Number of Stocks	Amount	Amount	%
Basic industries	7	3 543	-	-	3 543	3.5
Capital goods	12	13 775	-	-	13 775	12.6
Consumer basics	3	5 185	-	-	5 185	4.7
Consumer durables	7	18 949	-	-	18 949	17.4
Consumer non-durables	6	13 567	2	2 375	15 942	14.6
Consumer services	2	1 103	-	-	1 103	1.0
Energy	1	806	-	-	806	0.7
Finance	6	9 007	5	5 388	14 395	13.2
General business	4	7 893	3	2 560	10 453	9.6
Miscellaneous	1	288	9	7 843	8 131	7.5
Shelter	2	721	-	-	721	0.7
Technology	4	6 986	-	-	6 986	6.4
Transportation	4	4 670	-	-	4 670	4.3
Utilities	-	-	4	4 089	4 089	3.8
	59	86 493	23	22 255	108 748	100.0

Composition of the Portfolio by Currency

52. The majority of IFAD's commitments are expressed in SDR. Consequently, IFAD's overall assets are maintained in such a way as to ensure that, to the extent possible, commitments for undisbursed loans and grants denominated in SDR are matched by assets denominated in the currencies and in the ratios of the SDR valuation basket. Similarly, the general reserve and commitments for grants denominated in United States Dollars are matched by assets denominated in United States Dollars.

53. The Executive Board of the IMF, reviews the valuation basket of the SDR every five years in order to determine which currencies should be part of the valuation basket, and which percentage weight should apply to each currency at the date of the reweighting of the valuation basket.

54. The last such review was made in September 1995 and weights were determined for each of the five component currencies which were applied to the reweighting of the valuation basket on 1 January 1996. The units of each currency which would constitute the valuation basket for the

five-year period 1 January 1996 to 31 December 2000 were determined on the basis of the agreed weights and market exchange rates on 31 December 1995. The units and weights applicable to the SDR valuation basket at 1 January 1996 and 31 December 1997 are shown in table 12.

Table 12: Units and Weights Applicable to the SDR Valuation Basket

	1 January 1996		31 December 1997	
Currency	Units	Percentage Weight	Units	Value %
USD	0.582	39.0	0.582	43.1
DEM	0.446	21.0	0.446	18.4
JPY	27.200	18.0	27.200	15.5
FRF	0.813	11.0	0.813	10.1
GBP	0.105	11.0	0.105	12.9
		100.0		100.0

55. Under the terms of the Treaty of Maastricht, member countries of the European Union will have the option of participating in a currency union from 1 January 1999 onwards provided they have met certain economic, fiscal and financial criteria. The list of initial participating countries will be determined in May 1998.

56. Since the currency union will become effective at the beginning of the fourth year of the five-year SDR valuation basket cycle, it is likely that the IMF will decide to merge the allocations for the Deutsche Mark and the French Franc (which at 31 December 1997 represented 28.5% of the value of the valuation basket), and allocate the combined weighting for the two currencies to the Euro.

57. During the course of the two-year period 1999 to 2000, the IMF will then discuss the various options for the future of the valuation basket, which included the possibility of a tri-polar SDR comprising the Euro, the Japanese Yen and the United States Dollar, or a larger basket of currencies.

58. By mid-1997 the convergence of the bond markets for European currencies which are most likely to merge in 1999 was largely accomplished. In order not to have too heavy a weighting of investments in the Euro candidate currencies, currency matching procedures were amended to include nine additional European currencies in the SDR allocation for the Deutsche Mark and the French Franc, namely the Austrian Schilling, the Belgian Franc, the Finnish Markka, the Irish Pound, the Italian Lira, the Luxembourg Franc, the Netherlands Guilder, the Portuguese Escudo, and the Spanish Peseta.

59. As of 31 December 1997, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth Replenishment amounted to USD 2 782 721 000 equivalent. An analysis of cash and investments in terms of currency composition is included in annex XIII, while an overall analysis including promissory notes and amounts receivable from contributors is found in annex XIV. The alignment of assets with the currency composition of the SDR valuation basket at 31 December 1997 is shown in table 13.

Table 13: Alignment of Assets with the Currency Composition of the SDR Valuation Basket at 31 December 1997
(USD'000 equivalent)

Currency	Investment Portfolio and Holdings of Promissory Notes	Less: USD Commitment[a/]	Assets Subject to Alignment with SDR		Composition of SDR Valuation Basket %
			Amount	%	
USD	1 300 032	(138 500)	1 161 532	50.8	43.1
JPY	255 918		255 918	11.2	15.5
GBP	274 530		274 530	12.0	12.9
Euro-candidate currencies	593 774		593 774	26.0	28.5
Subtotal	2 424 254	(138 500)	2 285 754	100.0	100.0
Other convertible currencies	354 167				
Non-convertible currencies (NCC)	4 300				
Total	2 782 721				

[a/] Consists of the balance of general reserve (USD 95 000 000) and the undisbursed balance of grants denominated in USD (USD 43 500 000)

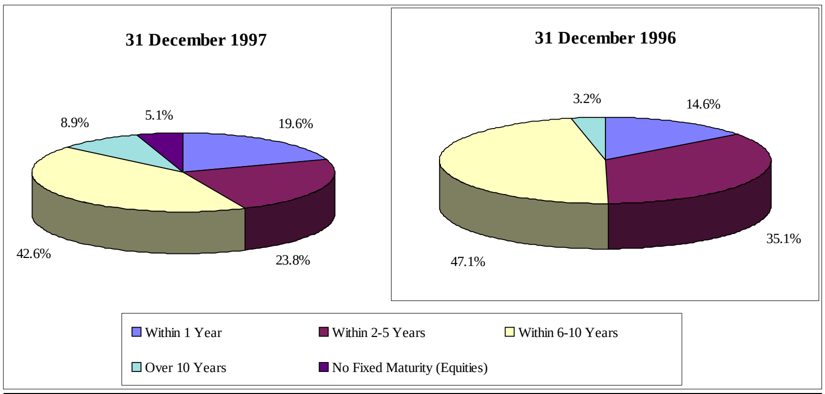
60. As of 31 December 1997 there were excess holdings of United States Dollars, and shortfalls of holdings in the other currencies included in the SDR valuation basket. Excess holdings of United States Dollars include some USD 158 213 000 held in cash and short term instruments pending investment in Asian and Emerging Markets equities.

61. As of 31 December 1997 net resources available for commitment denominated in freely-convertible currencies amounted to USD 387 428 000 equivalent. If one adds to this amounts receivable from contributors under the Fourth Replenishment of USD 160 643 000 equivalent, one arrives at a gross amount of USD 548 701 000 equivalent. This amount exceeds IFAD's holdings of convertible currencies not included in the SDR valuation basket, and related Euro-candidate currencies by USD 194 534 000 equivalent (31 December 1996 - USD 139 612 000 equivalent), indicating that the exchange rate risk was fully covered.

Maturity of Investments

62. Annex XV provides details of the composition of the portfolio by maturity at 31 December 1997, while figure 2 shows the maturity of the portfolio graphically:

Figure 2: Maturity Structure of the Investment Portfolio

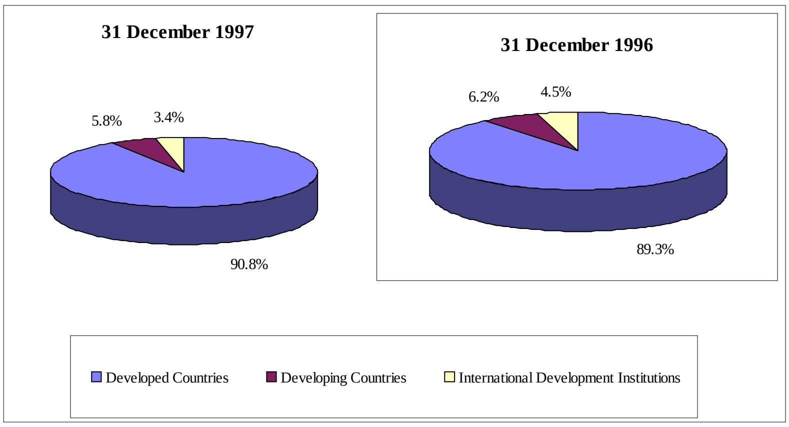


63. The average life to maturity at 30 December 1997 was 66 months (31 December 1996 - 60 months).

Diversification by Countries

64. It is IFAD's practice to diversify its investments with respect to countries. IFAD invests in suitable instruments issued by eligible institutions in both industrialized and developing Member States, as well as in obligations issued by eligible development-related intergovernmental institutions. Annex XVI provides details by type of instrument while figure 3 shows the overall diversification by Member States graphically.

Figure 3: Diversification by Member Countries (per cent)



65. The overall level of investment in developing countries and in international development institutions declined during the course of 1997, as holdings of bonds issued by developing countries and international development institutions which formed part of the internally managed portfolio were liquidated, and the proceeds held in time deposits pending investment in Asian and Emerging

Market equities. The level of investments in government bonds of developed countries fell as the diversification process began to take effect.

V. DIVERSIFICATION OF THE INVESTMENT PORTFOLIO

66. In early 1996, there was a growing awareness that IFAD would unlikely be able to maintain the high average rate of return that it had experienced during the first half of the decade if it continued to invest predominantly in government bonds issued by industrialized countries.

67. It was noted that returns on time deposits and government bonds had begun to decrease as the market no longer expected to pay a premium against the possible resurgence of inflation.

68. A symposium on investment policy was convened in May 1996, which brought together the members of the Investments Advisory Committee, IFAD's financial advisors and a number of external investment managers. The symposium addressed the question of what alternative asset classes IFAD should consider for investment purposes in order to maintain its historical rate of return with an acceptable level of risk. The most attractive asset classes for this purpose proved to be corporate bonds and equities, and government bonds of emerging markets.

69. A study was subsequently carried out comparing the performance of equity and bond markets over a 15-year period. The study included an optimization exercise to construct a diversified portfolio that could reach the targeted real rate of return of approximately 5% per annum. In order to achieve this target, the recommendation was that 45% of the portfolio be placed in equities and 10% in corporate bonds, while the remaining 45% of the portfolio would remain in global government bonds and in cash.

70. The study was reviewed by the Executive Board at its Fifty-Ninth Session in December 1996 and was included among the documents on issues and options that the Governing Council considered at its Twentieth Session.

71. The proposal on the diversification of the investment portfolio was considered in-depth by the High-level Working Group on Policy Issues that met on 19 February 1997, just before the meeting of the Governing Council. While recognizing that management of the investment portfolio falls under the authority of the President of IFAD, the working group expressed broad support for the diversification proposal. The Group stressed the need for a prudent and gradual approach in the implementation of the proposal. Similar views were expressed at the Governing Council and by members of the Executive Board in their subsequent discussions.

72. A further symposium on investments was held at IFAD headquarters in March 1997 to discuss strategies for implementation. Papers were presented by IFAD's financial advisors and by representatives of four major investment management firms. The topics covered were as follows:

(i) Overview of the world economy and implications for financial markets;
(ii) Prospects for equities in North America, Europe and Japan;
(iii) Emerging-market equities and fixed-income investments.

73. The outlook for the world economy was deemed to be very positive, with the prospect of moderate growth and relatively low inflation. However, from the perspective of the financial markets, both bond and equity prices were expected to fall in the United States should the Federal Reserve Board decide to raise interest rates during the year.

74. The equities markets that appeared to offer the best value were the emerging markets and Japan. With regard to the United States and European equities markets, opinions were divided: some participants expected the markets to continue to perform well, while others thought they were overvalued and might undergo correction in 1997.

75. With regard to diversification of the investment portfolio, IFAD's financial advisors recommended that a gradual and prudent approach be phased in over a three-year period. In specific markets, investments could be made in equities over a six to twelve-month period, as opportunities arise and taking advantage of market corrections to obtain good value.

76. The possibility of hedging the portfolio against potential drops in value was also carefully considered at the symposium. However, it was agreed that hedging would be too costly and would limit possibilities for realizing capital gains.

77. Following the symposium, a diversification programme was drawn up in consultation with IFAD's financial advisors whereby USD 1 000 million equivalent (representing 45% of the overall investment portfolio) was to be allocated for investment in equities markets. A breakdown of this programme is shown in table 14, which also indicates the allocations for the first year (1997) reflecting the market valuation analysis undertaken.

Portion of the Investment Table 14: Allocation of the Equities Portfolio
(USD'000 equivalent)

		Initial Allocation: 1997	
Market	Amount	%	Amount
Global	360	0	0
North America	180	28	50
Europe	180	50	90
Japan	100	100	100
Emerging Markets	100	100	100
Asia and Australasia (excluding Japan)	80	100	80
	1 000	42	420

78. The global equities allocation is intended to cover investments in equities on a worldwide basis, while the other five equity allocations cover specific markets.

79. The allocations for 1997 focused on Japan, the emerging markets and the Asia and Australasia (excluding Japan), where market conditions appeared particularly favourable for initiating investments in equities.

80. Furthermore, an allocation of USD 200 million was made for investment in a fixed-income portfolio comprising corporate bonds, emerging-market debt and government bonds. It was also decided to appoint a currency overlay manager, to be responsible for managing the portfolio's exposure to currency risk.

81. Following a rigorous selection process in which 24 managers were interviewed, three specialist managers were appointed in July 1997 to manage equity portfolio investments for Japan, the emerging markets and Asia and Australasia (excluding Japan) for a total amount of USD 280 million.

82. It was decided that these mandates would be funded out of the proceeds from the liquidation of a large portion of the internally managed portfolio. Direct investment by IFAD's treasury would henceforth be limited to short-term instruments (essentially time deposits), which would be rolled over to provide liquidity for loan and grant disbursements and administrative expenses.

83. IFAD's treasury as been reorganized to deal with this change in the workload. In the future, the treasury's investments section will focus all of its attention on monitoring the externally managed portfolio and dealing with related issues, such as taxation, custody and reporting, while the cash management and contributions section will handle, *inter alia*, the function of placing liquid funds in short-term investments.

84. A review was conducted of the performance of the 14 fixed-income portfolio managers appointed in 1994. The contracts of six managers who had underperformed the benchmark for the 30-month period under review were terminated, and the funds under management were reallocated to the other eight managers, subject to withdrawal during subsequent phases of the investment diversification process.

85. During the course of the second half of 1997, the guidelines for fixed-income portfolio managers were revised and investment management service agreements were negotiated with each of the eight remaining managers.

86. The new guidelines for fixed-income portfolio managers, which became effective on 1 October 1997, are found in attachment XVII. A new feature of these guidelines is that the United States Dollar is used as the base currency for all fixed-income portfolio investments. This facilitates accounting and enables a more accurate comparison of the performance of the various managers.

87. The weights applying to the benchmark for the fixed-income mandates have also be radically changed with effect from 1 October 1997. The weights which applied at 31 December 1997 are found in annex XVIII.

88. Another new feature is that the investment management service agreements will now include a statement of IFAD's investment policy, which is found in attachment XIX. The statement is identical in form for both fixed-income and equities portfolio managers, and is intended to provide a philosophy for guiding managers in their efforts to achieve the level of investment performance desired by IFAD.

89. The first investment management service agreement for an equities portfolio investment was signed on 20 October 1997, and includes the guidelines found in attachment XIX. It will be noted that the approach to the use of derivative instruments, i.e., futures and options contract, is identical to the cautious, conservative approach followed in the guidelines for fixed-income portfolio managers.

90. The Japanese equities mandate was funded on 22 October 1997, and the Asian and Australasian (excluding Japan) equities mandate on 1 December 1997. The Emerging Market mandate, however, was funded in January 1998.

91. Hence the target for diversification in 1997 was not fully met. A good deal of preparatory work was undertaking, however, in interviewing managers for the North American equities

mandate, and for the diversified fixed-income mandate and the currency overlay mandate. The selection of managers for the North American equities mandate and the diversified fixed-income mandate is scheduled to take place in late February 1998.

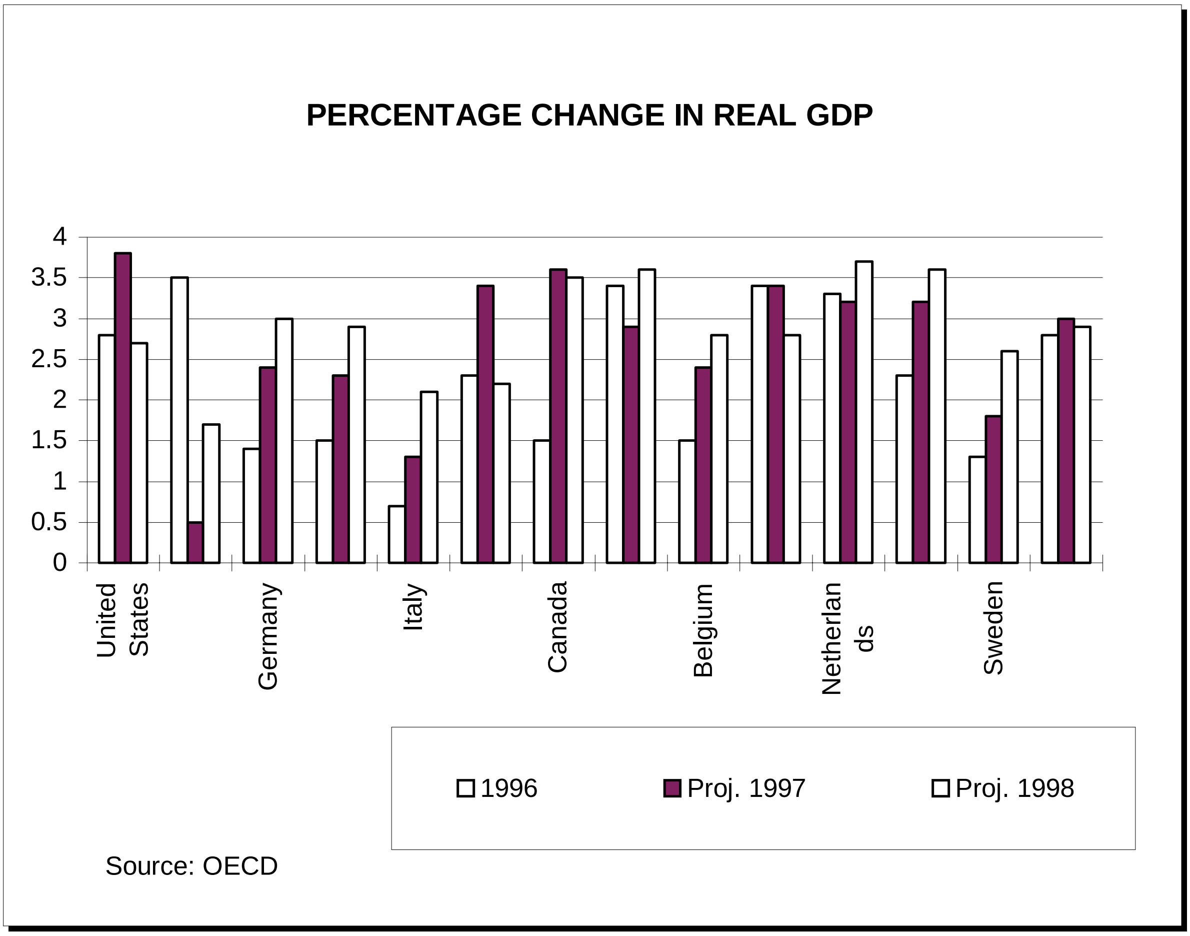
92. It is foreseen that the identification and selection of managers for the Global and European Equities mandate will also be completed in 1998. However, total funding for North American, Global and European equities mandates in 1998 will not exceed USD 360 million, with funding of a further USD 360 million in 1999.

93. A seminar on the diversification of the investment portfolio was held on 2 December 1997, Mr Henry Ouma, Chief of Investment Management Services of the United Nations Joint Staff Pension Fund acted as moderator, and introduced five speakers drawn from Cambridge Associates, IFAD’s financial advisors, and representatives of fund management firms who covered following topics:

(i) The diversification process in IFAD
(ii) The manager selection process
(iii) The European equities investment outlook
(iv) Recent developments in the developed equities markets
(v) The Emerging Markets outlook

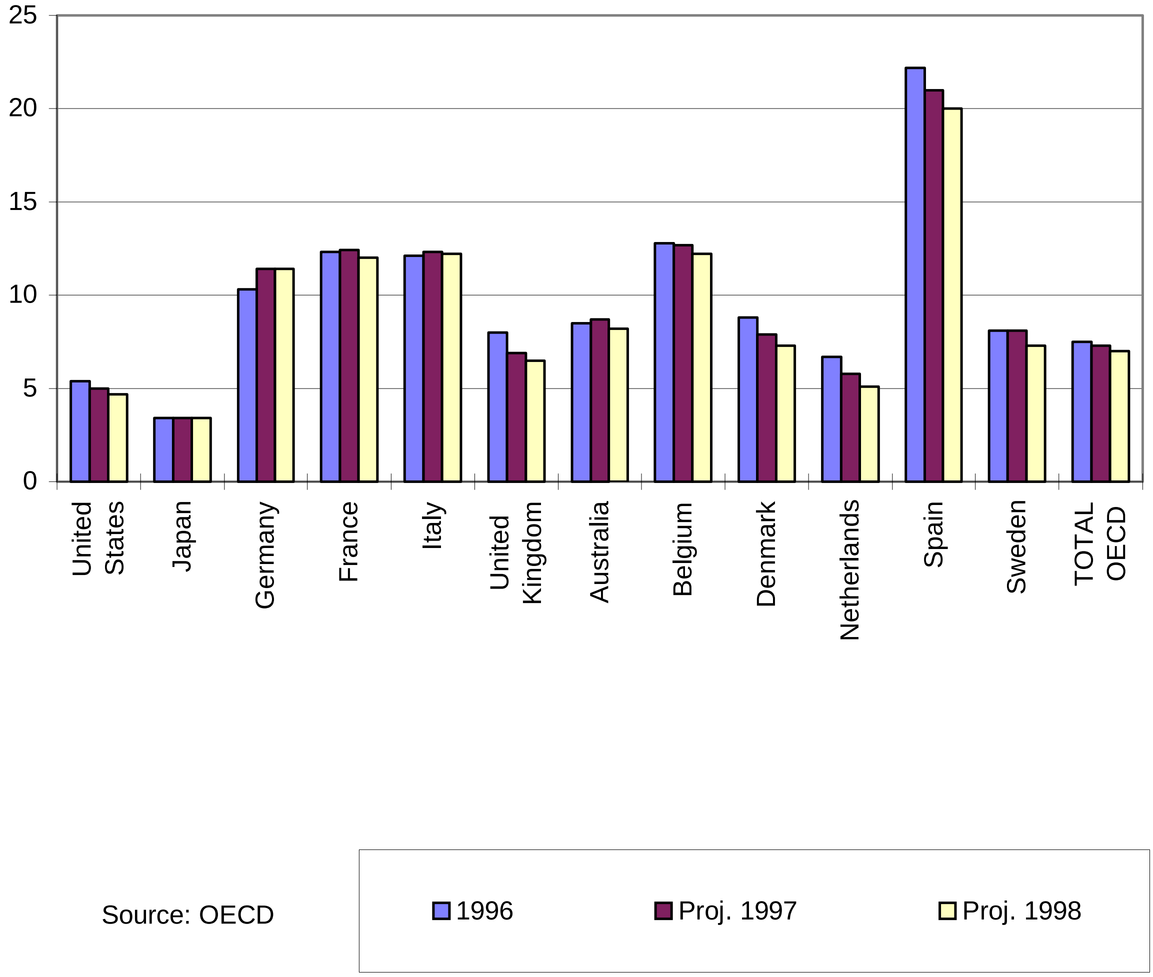
94. IFAD’s external auditors, Price Waterhouse S.p.A. conducted a review of investment management activities at the request of the Audit Committee. The external auditors have finalized their report which includes a number of recommendations concerning the documentation of IFAD’s approach to investment and risk management and the monitoring of the external investment managers. All the recommendations have been accepted by IFAD, and a time-table for their implementation has been drawn up in consultation with IFAD’s treasurer.

ANNEX I


PERCENTAGE CHANGE IN REAL GDP
4
3.5
3
2.5
2
1.5
1
0.5
0
United States
Germany
Italy
Canada
Belgium
Netherlands
Sweden
1996
Proj. 1997
Proj. 1998
Source: OECD

ANNEX II

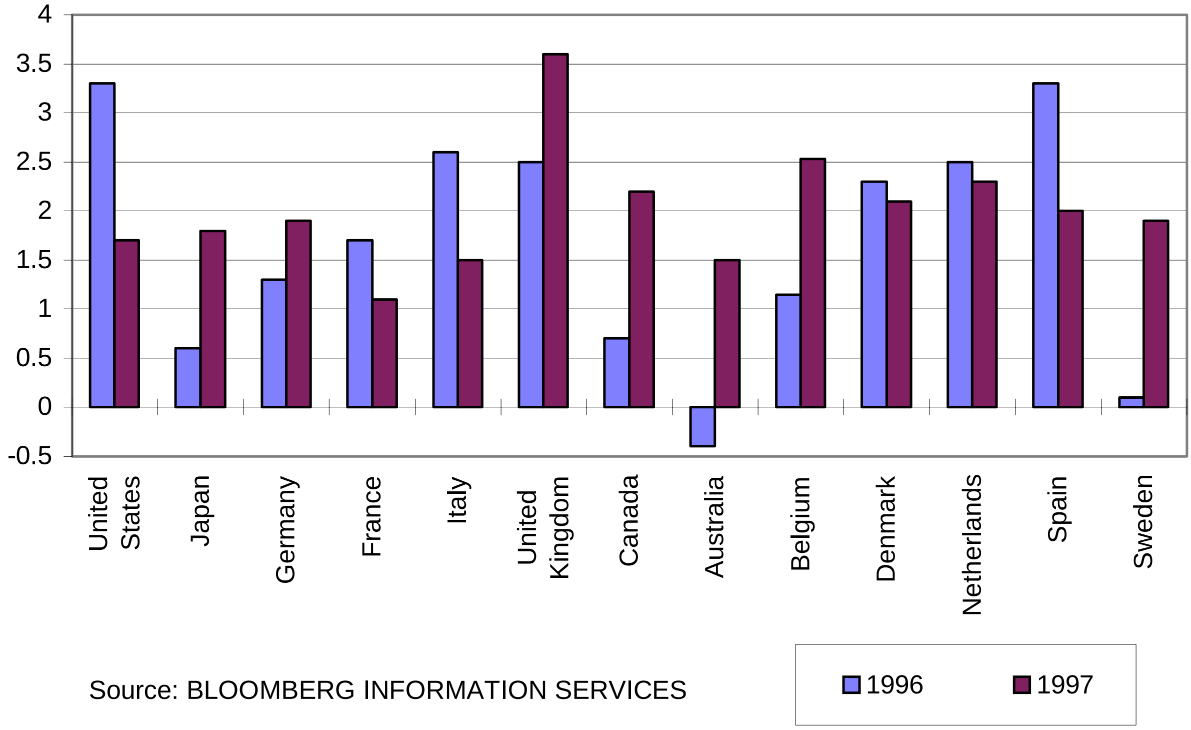
UNEMPLOYMENT RATES AS A PERCENTAGE OF THE LABOUR FORCE



Source: OECD

ANNEX III

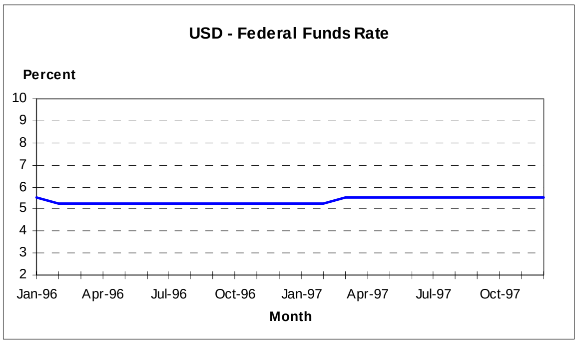
CONSUMER PRICE INDEX (Annualized Rates)

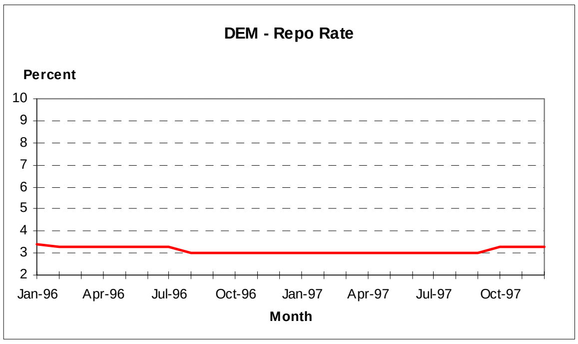


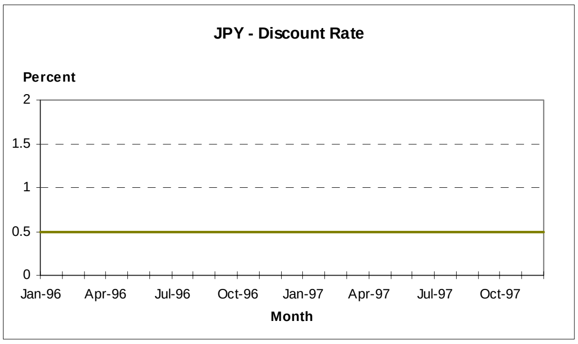
Source: BLOOMBERG INFORMATION SERVICES

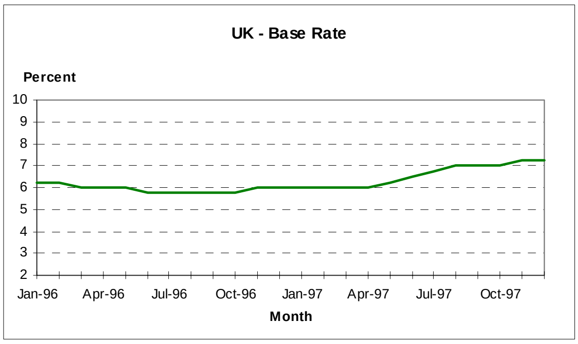
ANNEX IV

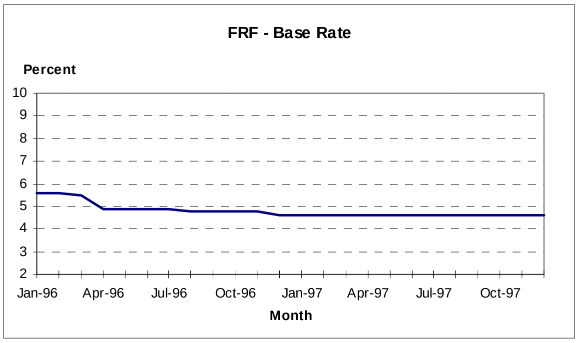
CENTRAL BANK AND GOVERNMENT-CONTROLLED INTEREST RATES





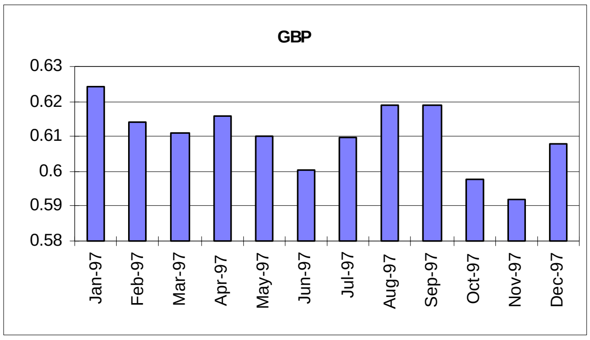


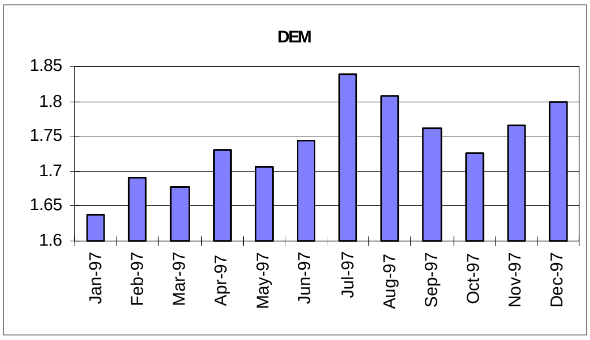


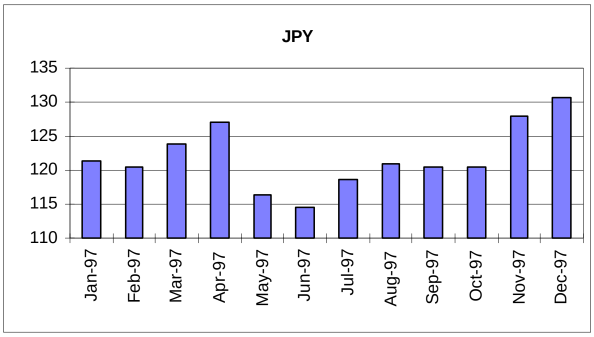


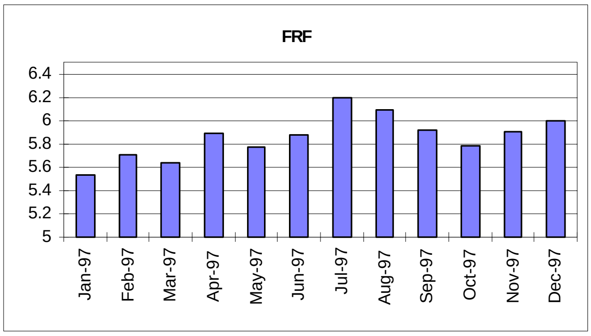
ANNEX V

VALUE OF THE UNITED STATES DOLLAR AT IMF JONTH-END EXCHANGE RATES
1997



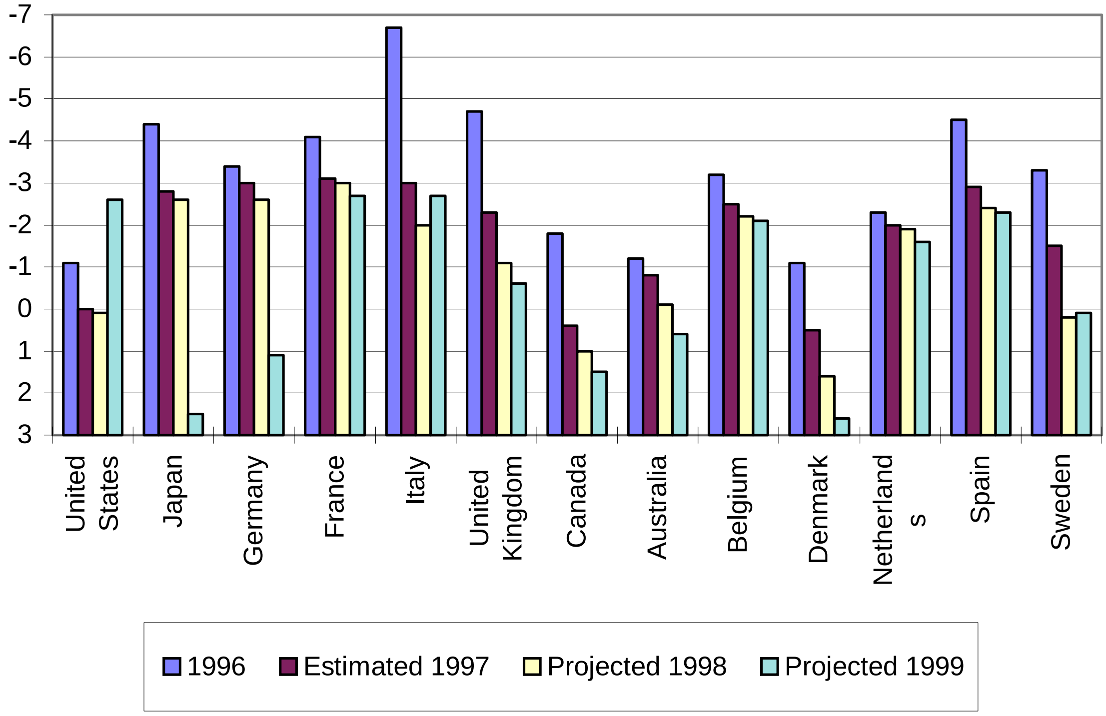






ANNEX VI

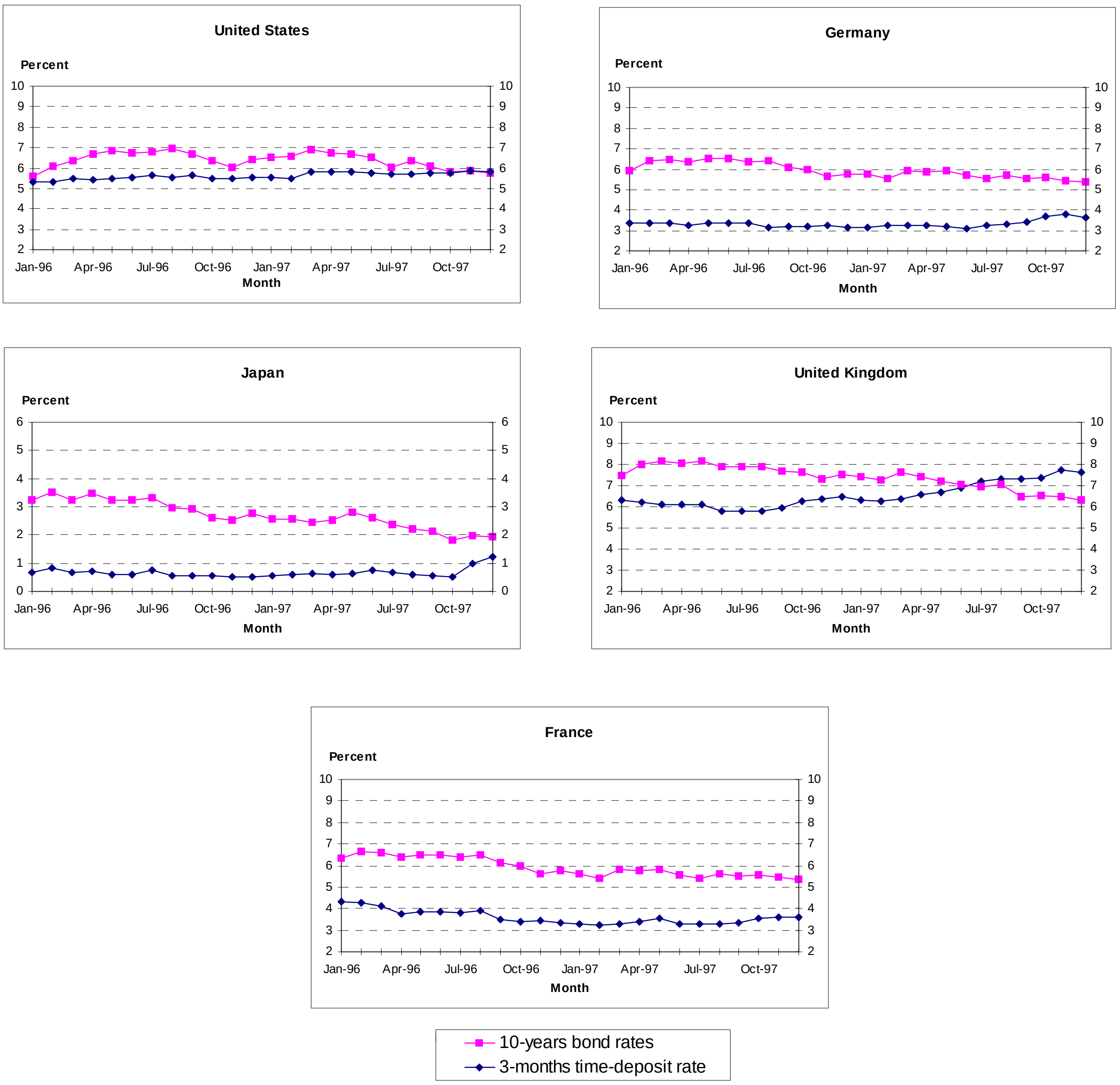
BUDGET DEFICITS AS A PERCENTAGE OF NOMINAL GDP



Source: OECD

ANNEX VII

SHORT AND OONG-TERM INTEREST RATES



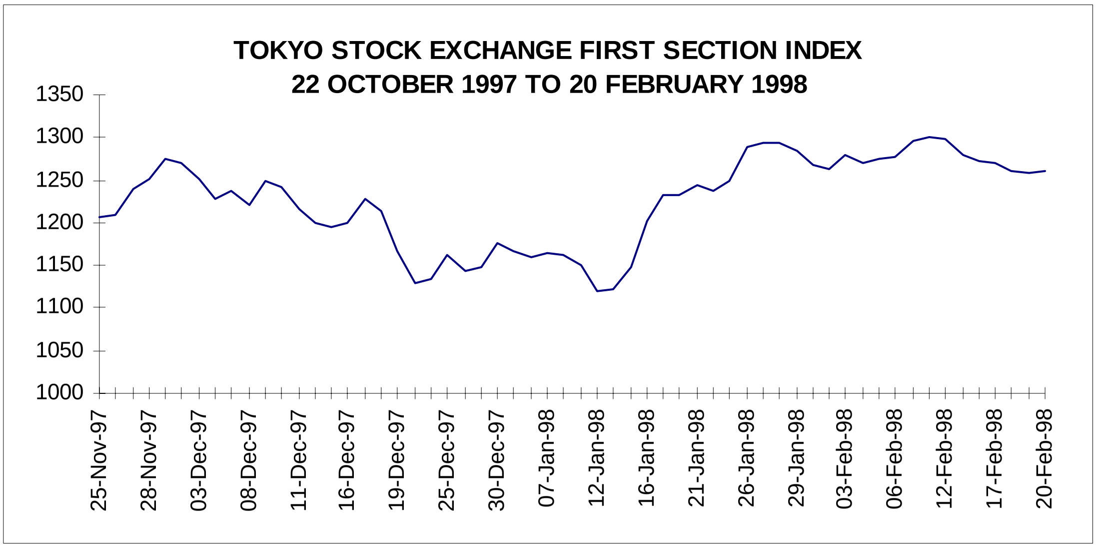
ANNEX VIII

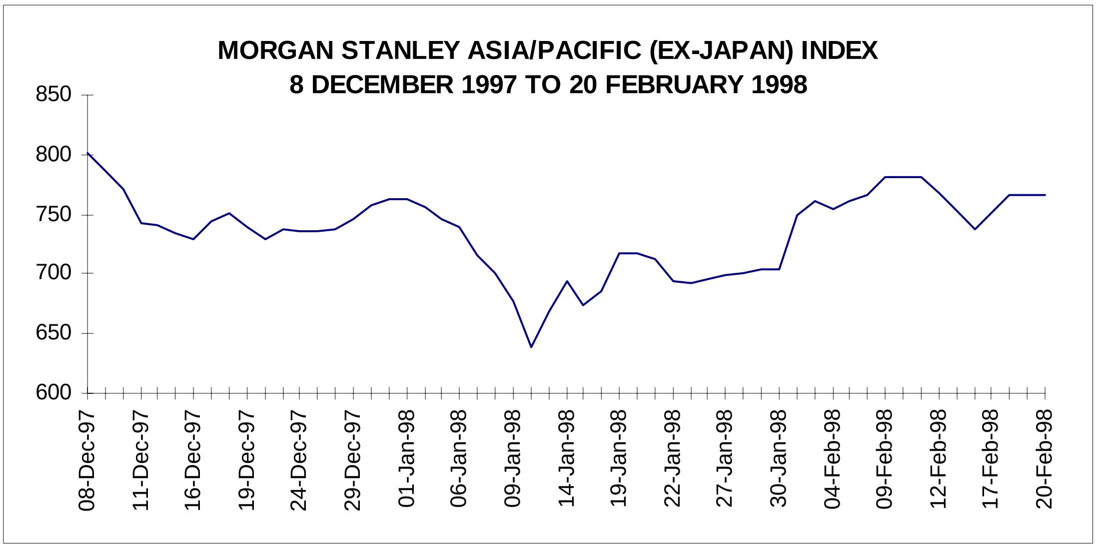
BOND MARKET RETURNS MEASURED
IN TERMS OF LOCAL CURRENCY
(per cent)

Currency	1 QTR	2 QTR	3 QTR	4 QTR	12 months 1997	12 months 1996
USD	(0.69)	3.49	3.48	3.48	10.00	2.94
DEM	0.98	2.37	1.22	1.58	6.28	7.38
JPY	2.23	(0.12)	3.39	1.55	7.22	5.91
FRF	1.46	2.39	1.63	1.95	7.64	11.40
GBP	0.98	4.99	5.35	2.83	14.85	7.35
AUD	(0.75)	6.56	5.35	1.41	13.00	12.24
BEF	0.88	2.59	1.28	1.95	6.87	10.96
CAD	(0.41)	3.51	4.13	1.91	9.39	11.81
DKK	0.66	4.08	1.77	2.61	9.42	10.71
ITL	(1.48)	6.67	4.71	4.02	14.45	24.23
NLG	1.03	2.30	1.20	1.99	6.69	8.00
ESP	(0.03)	5.25	2.97	2.35	10.90	22.20
SEK	(0.58)	3.84	2.88	1.65	7.96	18.59
GLOBAL	0.31	3.08	3.15	2.20	9.50	7.58

ANNEX IX

EVOLUTION IN EQUITIES MARKETS





ANNEX X

OPTIONS AND FUTURES CONTRACTS IN 1997
(USD '000 EQUIVALENT)

OPTIONS

Type of Option	No. of trades	Nominal Amount CALL (USD '000)	Nominal Amount PUT (USD '000)	Premium Paid (USD '000)
Bonds				
Call	5	42 391		83
Put	4		32 582	75
Total	**9**	**42 391**	**32 582**	**158**

FUTURES

Type of Future	No. of trades	Opening Value (USD '000)	Closing Value (USD '000)	Gain/(Loss) (USD '000)
Buy	2	4 893	4 874	-19
Sell	0			
Total	**2**	**4 893**	**4 874**	**-19**

ANNEX XI

ANALYSIS OF CASH FLOW
(USD'000 EQUIVALENT)

	1997	1996
Balance at 1 January	2 182 223	2 182 694
Investment income	163 940	138 831
Other inflows:		
Loan income received	43 014	39 805
Loan principal repayments	115 618	110 746
Encashment of promissory notes	122 499	112 264
Contributions received in cash	18 244	3 004
	299 375	265 819
Outflows:		
Loan disbursements	(259 808)	(261 909)
Grant disbursements	(21 569)	(18 917)
Payment of administrative expenses	(44 311)	(49 057)
Miscellaneous	(12 900)	(4 870)
	(338 588)	(334 753)
Effects of movements in exchange rates	(156 220)	(70 368)
Balance at 31 December	2 150 730	2 182 223

ANNEX XII

COMPOSITION OF THE INVESTMENT PORTFOLIO
(USD'000 EQUIVALENT)

Type of Instrument	31 December 1997		31 December 1996	
	Amount	%	Amount	%
Freely Convertible Currencies				
Cash	74 359	3.45	47 715	2 18
Time deposits	279 748	13.01	226 231	10.37
Treasury bills	1 709	0.08	451	0.02
Bonds at market value	1 659 213	77.15	1 874 728	85.91
Equities at market value	108 748	5.06	-	0.00
	2 123 777	98.75	2 149 125	98.48
Open Trades				
Receivable for bonds sold	4 427		6 846	
Payable for bonds bought	(19 253)		(21 543)	
	(14 826)	(0.69)	(14 697)	(0.67)
Spot currency purchases	15 856		5 991	
Spot currency sales	(15 927)		(6 003)	
	(71)	(0.01)	(12)	(0.01)
Forward currency purchases	820 070		1 628 579	
forward currency sales	(817 270)		(1 634 740)	
	2 800	0.13	(6 161)	(0.28)
Other Receivables				
Accrued income	37 959		45 277	
Dividends receivable	46		-	
	38 005	1.77	45 277	2.08
Total Freely Convertible Currencies	2 149 685	99.95	2 173 532	99.60
Non-convertible Currencies				
Cash	537		8 129	
Time deposits	508		562	
Total Non-Convertible Currencies	1 045	0.05	8 691	0.40
Grand Total	2 150 730	100.00	2 182 223	100.00

CURRENCY COMPOSITION OF THE PORTFOLIO AT 31 DECEMBER 1997
(USD'000 EQUIVALENT)

Currency	Cash	Time Deposits	Treasury Bills	Bonds	Equities	Open Trades	Accrued Income	Dividends Receivable	Overall Portfolio
USD	52 234	269 244	-	648 756	-	91 111	12 695	-	1 074 040
JPY	4 707	1 706	1 154	96 091	86 493	26 297	826	23	217 297
GBP	4 176	889	-	261 105	-	(39 326)	4 627	-	231 471
Subtotal	61 117	271 839	1 154	1 005 952	86 493	78 082	18 148	23	1 522 808
DEM	2 451	4 361	555	176 328	-	(16 700)	6 494	-	173 489
FRF	6 501	-	-	33 327	-	683	993	-	41 504
IEP	-	-	-	8 074	-	-	229	-	8 303
ITL	746	1 548		86 427	-	22 500	2 463	-	113 684
NLG	-	-	-	14 546	-	3 084	806	-	18 436
ESP	-	-	-	42 894	-	2 569	1 949	-	47 412
Subtotal	9 698	5 909	555	361 596	-	12 136	12 934	-	402 828
AUD	1 222	-	-	112 534	9 271	(93 881)	2 271	-	31 417
CAD	197	-	-	43 460	-	2 679	502	-	46 838
DKK	2 107	1 794	-	71 726	-	(2 724)	1 247	-	74 150
HKD	9	-	-	-	9 295	-	-	23	9 327
NZD	11	-	-	-	752	-	-	-	763
SEK	(2)	206	-	63 945	-	(8 389)	2 857	-	58 617
SGD	-	-	-	-	2 937	-	-	-	2 937
Subtotal	3 544	2 000	-	291 665	22 255	(102 315)	6 877	23	224 049
NCC	537	508	-	-	-	-	-	-	1 045
Grand Total	74 896	280 256	1 709	1 659 213	108 748	(12 097)	37 959	46	2 150 730

ANNEX XIV

CURRENCY COMPOSITION OF THE INVESTMENT PORTFOLIO, HOLDINGS OF PROMISSORY NOTES, AND AMOUNTS RECEIVABLE FROM CONTRIBUTORS AT 31 DECEMBER 1997
(USD'000 EQUIVALENT)

Currency	Cash and Investments	Promissory Notes	Amounts Receivable	Total
USD	1 074 040	168 350	57 642	1 300 032
JPY	217 297	38 621	-	255 918
GBP	231 471	28 079	14 980	274 530
Subtotal	1 522 808	235 050	72 622	1 830 480
DEM	173 489	17 976	21 655	213 120
FRF	41 504	42 819	15 255	99 578
ATS	-	7 031	3 942	10 973
BEF	-	20 774	1 381	22 155
FIM	-	6 006	1 845	7 851
IEP	8 303	-	490	8 793
ITL	113 684	-	19 166	132 850
LUF	-	321	229	550
NLG	18 436	31 198	-	49 634
PTE	-	220	638	858
ESP	47 412	-	-	47 412
Subtotal	402 828	126 345	64 601	593 774
AUD	31 417	8 717	-	40 134
CAD	46 838	21 456	12 729	81 023
DKK	74 150	32 194	-	106 344
HKD	9 327	-	-	9 327
NZD	763	1 831	-	2 594
NOK	-	5 468	10 691	16 159
SEK	58 617	32 290	-	90 907
SGD	2 937	-	-	2 937
CHF	-	4 742	-	4 742
Subtotal	224 049	106 698	23 420	354 167
NCC	1 045	3 255	-	4 300
Grand Total	2 150 730	471 348	160 643	2 782 721

ANNEX XV

COMPOSITION OF THE PORTFOLIO
BY MATURITY OF INVESTMENTS
(USD'000 EQUIVALENT)

Period	31 December 1997		31 December 1996	
	Amount	%	Amount	%
Within 1 Year	421 244	19.6	317 679	14.6
Within 2-5 Years	512 816	23.8	767 051	35.1
Within 6-10 Years	916 809	42.6	1 027 201	47.1
Over 10 Years	191 113	8.9	70 292	3.2
No Fixed Maturity (Equities)	108 748	5.1	-	-
Total	2 150 730	100.0	2 182 223	100.0

ANNEX XVI

DIVERSIFICATION OF THE INVESTMENT PORTFOLIO BY MEMBER COUNTRIES (USD'000 EQUIVALENT)

31 December 1997

	Cash	Time Deposits	Bonds/ Treasury Bills	Equities	Other Assets	Total	%
Developed Countries	74 350	179 748	1 577 978	96 536	25 159	1 953 771	90.8
Developing Countries	546	100 508	10 000	12 212	524	123 790	5.8
International Development Institutions	-	-	72 944	-	225	73 169	3.4
Total	74 896	280 256	1 660 922	108 748	25 908	2 150 730	100.0

31 December 1996

	Cash	Time Deposits	Bonds/ Treasury Bills	Equities	Other Assets	Total	%
Developed Countries	47 715	141 819	1 738 026	-	20 637	1 948 197	89.3
Developing Countries	8 129	84 974	41 204	-	1 148	135 455	6.2
International Development Institutions	-	-	95 949	-	2 622	98 571	4.5
Total	55 844	226 793	1 875 179	-	24 407	2 182 223	100.0

Annex XVII

INVESTMENT GUIDELINES FOR FIXED-INCOME INVESTMENTS

Investment Objectives

1. IFAD's objective is to achieve an average annual return of at least 2% (net of fees) over the agreed benchmark as measured over three-year rolling periods. Emphasis is on total return - that is, there is no preference for either earnings or capital gains to serve as the main component of return.

2. IFAD expects managers to understand that investment emphasis must also be placed upon capital protection, that is, the achievement of adequate investment income so that the purchasing power of the asset portfolio is maintained over time.

3. These objectives are to be achieved through investment in eligible instruments, as defined below.

Base Currency

4. The base currency shall be the United States Dollar.

Performance Benchmark

5. The benchmark used to measure managers' performance shall be the J.P. Morgan Global Government Bond Traded Index (unhedged) reweighted with respect to the five component currencies of the Special Drawing Rights evaluation basket of the International Monetary Fund, to which the following weightings shall be applied with respect to the sum of the weightings of the five currencies in the index:

Currency	**%**
United States Dollar	53
Deutsche Mark	11
Japanese Yen	15
French Franc	5
Pound Sterling	16

Eligible Currencies

6. Managers may invest in instruments denominated in the currencies included in the J.P. Morgan Global Government Bond Traded Index and in other convertible currencies. Currency positions may be hedged, provided that there is no negative exposure to any currency.

Eligible Instruments

7. Managers shall have the authority to trade, buy, sell or otherwise acquire, hold or dispose of the following securities and instruments as indicated:

(a) Treasury bills and bonds issued by national governments or by entities guaranteed by national governments, including notes, bonds and debentures (except mortgage-backed securities) of the agencies and instrumentalities of the United States Government included in the List of Eligible Agencies and instrumentalities of the United States Government, which is provided and amended from time to time by IFAD.

(b) Issues of supranational organizations and international development institutions included in the List of Eligible Institutions, which is provided and amended from time to time by IFAD.

(c) Current accounts and call accounts. Such accounts are allowed only with the custodian.

(d) Time deposits and certificates of deposit are allowed only with the banks included in the List of Eligible Banks, which is provided and amended from time to time by IFAD.

(e) Spot and forward contracts for the purchase and sale of currency. Such contracts are allowed only with the counterparties included in the List of Eligible Banks and Financial Intermediaries for Currency Exchange Transactions, which is provided and amended from time to time by IFAD.

(f) Exchange-traded futures contracts and options for currencies and fixed-income securities. Such contracts are only allowed to the extent that they are traded on the exchanges included in the List of Eligible Exchanges, which is provided and amended from time to time by IFAD.

Instrument Quality

8. Investments are restricted to eligible instruments, as defined above, issued by borrowers with a given rating or themselves having a given rating of Aa3 or better from Moody's, or AA- or better from Standard and Poor's. If the applicable ratings are lowered below these levels subsequent to the date of purchase of an instrument, the manager shall dispose of the instrument concerned within 30 days of the date of downgrading by the rating agency.

Minimum and Maximum Portfolio Duration

9. (a) The overall duration of the portfolio may be no less than zero and no longer than 6.5 years.

(b) The end date of floating and variable instruments shall be the date upon which the interest rate is next scheduled to be fixed; for extendible bonds, the ultimate maturity shall be when the purchaser has the first put option.

Other Provisions

10. (a) The maximum amount that may be invested in any specific debt issue shall not exceed 10 % of the total amount of the portfolio. This limitation does not apply to government issues of France, Germany, Japan, the United Kingdom and the United States of America.

A. The maximum amount that may be invested in any specific debt issue shall not exceed 10% of the total amount of the issue.

B. The maximum amount that may be deposited with any single bank at any time shall not exceed USD 10 000 000, with the single exception of the custodian.

C. Overdrafts shall not be authorized except in the case of trades that are not settled on the due date. Such trades must be notified immediately, in writing, to IFAD.

D. The asset portfolio may not be levered.

E. Futures contracts and options may not be used to lever the asset portfolio.

F. Options may not be written.

H. Managers shall not charge IFAD for any transaction costs.

ANNEX XVIII

J.P. MORGAN GLOBAL GOVERNMENT BOND
TRADED INDEX WEIGHTS
AT 31 DECEMBER 1997

	Global Weights	**Reweighting Ratios**	**Reweighted**
G5 Currencies			
USD	40.03	53.00	41.20
JPY	13.95	15.00	11.66
GBP	7.05	16.00	12.44
Subtotal	61.03	84.00	65.30
Euro-Candidates			
DEM	8.67	11.00	8.55
FRF	8.03	5.00	3.88
BEF	2.71	-	2.71
ITL	5.81	-	5.81
NLG	3.14	-	3.14
ESP	3.19	-	3.19
Subtotal	31.55	16.00	27.28
Other Currencies			
AUD	1.01	-	1.01
CAD	2.95	-	2.95
DKK	1.65	-	1.65
SEK	1.81	-	1.81
Subtotal	7.42	-	7.42
Grand Total	100.00	100.00	100.00

Annex XIX

STATEMENT OF IFAD'S INVESTMENT POLICY

1. This investment policy (the "Investment Policy") outlines IFAD's policies concerning investments and is intended to provide a philosophy for guiding managers in their efforts to achieve the level of investment performance desired by IFAD.

General Investment Principles

2. Investments shall be made solely in the interest of IFAD and for the exclusive purpose of providing and maintaining committable resources to be used by IFAD in accordance with the objectives set out in the Agreement Establishing IFAD dated 13 June 1976 - that is, generally, "to mobilize additional resources to be made available on concessional terms for agricultural development in developing Member States".

3. Investments shall be invested with the care, skill, prudence and diligence and under the circumstances prevailing such that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.

4. Investments are to be managed in accordance with the performance objectives stated in the Investment Guidelines.

5. Investments shall be made in accordance with the Investment Guidelines.

6. Investments shall be diversified so as to minimize the risk of large losses.

7. Short-term fluctuations in value shall be considered secondary to long-term results.

8. The dynamic, flexible management of the portfolio is encouraged and permitted.

Selection of Managers

9. IFAD has prudently chosen and will continue to prudently choose independent investment managers to manage its assets.

10. Managers must meet the following criteria to be considered for selection;

    (a) Managers must adhere to the provisions of a national investment management regulatory organization and be duly registered under national law;

    (b) Managers must provide historical quarterly performance data calculated on a time-weighted basis, reflecting a composite of all fully discretionary accounts of similar investment style, reported net and gross of fees;

    (c) Managers must provide detailed information on the history of the firm, key personnel, key clients, fee schedule and support personnel; and

    (d) Managers must clearly articulate the investment strategy that will be followed and give evidence that the strategy has been adhered to over time.

Performance Benchmark

11. Each manager’s performance, whether for equity or fixed-income investments will be measured against the specific benchmark contained in that manager’s investment management service agreement. Volatility will also be monitored, relative to the appropriate benchmark and in absolute terms.

Discretionary Authority

12. Subject to this Investment Policy and the Investment Guidelines, managers are responsible for making all investment decisions regarding assets placed under their management, and they will be held accountable for achieving the investment objectives for those assets.

13. Such discretion shall include decisions to buy, sell and hold securities in amounts and proportions that are reflective of the manager’s stated investment policy.

Frequency of Review

14. IFAD recognizes that all investments go through cycles and that, accordingly, there will be short periods in which long-term investment objectives are not met. For that reason, IFAD has established the goal that the stated investment objective be achieved by each manager over a rolling three-year period., Generally, no changes in assets or managers will be made until said assets or managers have had at least that much time to achieve the investment objectives stated in the Investment Guidelines. However, IFAD reserves the right to discharge managers at its sole discretion and at any time.

15. Performance results for each asset portfolio will be evaluated on a monthly basis. A more extensive evaluation will take place at the end of each calendar quarter. At all times, consideration will be given to the extent to which investment results are consistent with the investment objectives contained in the Investment Guidelines.

Communications

16. Managers will inform IFAD on a timely basis of any major changes regarding investment outlook, investment strategy, asset allocation or other matters affecting their investment strategy or philosophy.

17. Managers are to inform IFAD of any significant changes in their ownership, organizational structure, financial condition or senior staffing.

18. If a manager has reason to believe that a portion of this Investment Policy, or the Investment Guidelines to which it is subject should be modified or deleted, it will be the manager‘s responsibility to initiate written communication to IFAD so as to express its views and recommendations.

19. When requested, managers are expected to meet with IFAD in order to review past performance, evaluate current capital markets and discuss investment strategy. In addition, it is expected that managers will provide quarterly written correspondence on these matters to IFAD

Adherence to IFAD's Investment Policy

20. Managers are expected to observe this Investment Policy, the Investment Guidelines and all specific limitations, attitudes and philosophies expressed herein or therein, as amended from time to time.

21. A manager's acceptance of responsibility of managing the assets entrusted to it shall be considered an affirmation by that manager that it is realistically capable of achieving IFAD's objectives within the Investment Guidelines and this Investment Policy.

22. The manager and IFAD hereby acknowledge that this Investment Policy has been read, understood and accepted.

Annex XX

INVESTMENT GUIDELINES FOR EQUITY INVESTMENTS IN JAPAN

Investment Objectives

1. IFAD's objective is to achieve an average annual return of at least 2%, (net of managers' fees and transaction costs) over the agreed benchmark as measured over three-year rolling periods. Emphasis is on total return - that is to say, there is no preference for either earnings or capital gains to serve as the main component of return.

2. IFAD expects managers to understand that investment emphasis must also be placed upon capital protection, that is, the achievement of adequate investment growth such that the purchasing power of the asset portfolio is maintained over time.

3. These objectives are to be achieved through investment in listed Japanese equity and equity-related securities and the listed securities of companies domiciled elsewhere but whose trading activity is conducted primarily in Japan.

Base Currency

4. The base currency shall be the Japanese Yen.

Performance Benchmark

5. The Tokyo Stock Exchange 1st Section Index shall be used as the benchmark to measure managers' performance.

Eligible Instruments

6. Managers shall have the authority to trade, buy, sell or otherwise acquire, hold or dispose of the following securities and instruments as indicated:

(a) Equity and equity-related securities (including ordinary stock and rights, convertible bonds and preferred stock) admitted to an official listing on a stock exchange included in the List of Eligible Stock Exchanges and issued by (i) companies domiciled in Japan or (ii) companies domiciled elsewhere but whose trading activity is conducted primarily in Japan.

(b) Current accounts and call accounts. Such accounts are allowed only with the custodian.

(c) Time deposits and certificates of deposit. Such instruments are allowed only with the banks included in the List of Eligible Banks, which is provided and amended from time to time by IFAD.

(d) Treasury bills and short-term investment instruments issued by the Japanese Government.

(e) Exchange-traded futures contracts and options on securities indices are only allowed to the extent that they are traded on the exchanges included in the List of Eligible Exchanges, which is provided and amended from time to time by IFAD.

(f) Pooled vehicles, such as unit trusts, are permitted to the extent that the underlying shareholdings are reported to IFAD on a daily basis and that investment in such vehicles does not exceed 10% of the total amount of the asset portfolio. When pooled vehicles are used, managers shall deduct the management fee charged within the fund from any fees charged to IFAD.

Eligible Countries

7. Investments shall be made exclusively in Japan.

Other Provisions

8. (a) The maximum amount that may be invested in shares or other securities of any single Japanese company at the time of purchase shall not exceed more than 5% of the total book cost of the asset portfolio.

(b) The maximum amount that may be invested in any security shall not exceed 5% of the total amount of shares or securities authorized by the issuer, with the exception of approved pooled vehicles.

(c) Managers shall not use any portion of the asset portfolio to underwrite security issues.

(d) Overdrafts shall not be authorized except in the case of trades that are not settled on the due date. Such trades must be notified immediately, in writing, to IFAD.

(e) The asset portfolio may not be levered.

(f) Futures contracts and options may not be used to lever the asset portfolio.

(g) Options may not be written.

(h) Managers shall not charge IFAD for any transaction costs.

(i) Cross-transactions and interaccount transactions require specific prior authorization by IFAD.

Annex XXI

DEFINITIONS

Duration

1. Duration is the weighted average term-to-maturity of a security's cash flows.

2. Duration is commonly used by investors to estimate the change in value of a single security or of a whole portfolio relative to a change in bond yields. The greater the duration of a bond, the greater its price volatility.

Forward Contracts

3. A currency forward contract is an agreement for the future delivery of an amount of currency at a specified price at a designated time. Unlike futures contracts which are traded in organized changes, a forward contract is traded by direct contact between buyer and seller.

Futures Contracts

4. A futures contract is an agreement to buy or sell a specific amount of a bond or of a currency at a specific price at a designated time. Such contracts are traded in organized exchanges for standard lots.

Options

5. An option is a contract in which the seller of the option grants the buyer the right to purchase at a specified price and at a specified time. The seller grants this right to the buyer in exchange for a certain sum of money called the premium.

6. A call option gives the buyer the right to buy a specific amount of a bond or of a currency at a specified price. A put option gives the buyer the right to sell a specific amount of a bond or of a currency at a specified price. The buyer of an option has the right but not the obligation to exercise the option.

7. IFAD's investment guidelines only permit the use of exchange-traded options. Tailor-made or over-the-counter options may not be used.

Hedge

8. A hedge is the use of techniques and/or financial instruments to manage or reduce foreign exchange or market risk. Forward exchange contracts are normally used to limit exposure to foreign exchange risk. Losses incurred on forward exchange contracts offset higher levels of interest income earned through investing in markets other than that of the base currency, and are referred to as "hedging costs".

9. Futures and options contracts are normally used to manage market risk.

Leverage

10. Leverage or gearing is the effect of multiplying profits and loses on financial transactions by obligating more funds than one owns.