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October 28, 2020

Statement by Ms. Mahasandana, Mr. Tan, Mr. Mahyuddin, and Ms. Yoe on Review of the Adequacy of the Fund's Precautionary Balances (Preliminary) Executive Board Meeting October 30, 2020

We welcome the opportunity to review the adequacy of the Fund's precautionary balances and thank staff for updating the paper to incorporate the impact of the COVID-19 crisis on Fund lending in this review. In particular, we appreciate the use of scenario analysis to inform our judgment and find it instructive to see how the coverage ratio and path of precautionary balances would be affected under different crisis scenarios.

While we agree that credit risks have increased significantly against the backdrop of high debt and sluggish growth outlook for many members, we emphasize that this does not necessarily translate directly into increased risks of credit losses for the Fund given its multilayered framework for managing credit risks and de facto preferred creditor status. Notwithstanding, we recognize the need to bolster precautionary balances commensurate with the expected increase in Fund lending and credit risks to safeguard the Fund's balance sheet strength and to maintain confidence in the Fund's role in providing the global financial safety net. At the same time, when assessing the adequacy of precautionary balances, we need to consider a broad assessment of financial risks faced by the Fund in addition to credit risks. In this regard, we appreciate that for future reviews of precautionary balances, staff should provide a more holistic update on related policies including the Fund's income position, investment account as well as lending and surcharge policies to better inform the Board's decision.

We support the proposal to raise the medium-term target for precautionary balances to SDR 25 billion for now while keeping it under close review given the high likelihood of additional loan demand as indicated by the desk survey. Between SDR 25 billion and SDR 30 billion, we do not see a compelling reason to go with the higher target at this point given that it is uncertain whether significant additional loan demand or credit losses would materialize. Furthermore, we note that the target of SDR 30 billion may not be reached under the desk survey scenario and a low for long interest rate environment unless the Fund raises the surcharges. Without stronger justifications, this would not be appropriate in the middle of a global crisis. As such, we agree to set the medium target at SDR 25 billion and emphasize the need for close monitoring of the prospective demand for Fund lending and the resultant impact on credit risks. Considering that Fund credit risks can increase sharply amid the current uncertain environment, the Board can and should revisit the target before the next regular review if warranted. *In this regard, can staff comment on what triggers would they monitor for activating an earlier review or the expected timeline for revisiting the target?*

We also agree that there is no need to change the pace of accumulation and minimum floor at this point. We concur that no additional step is necessary to adjust the pace of accumulation as the SDR 25 billion target would be met in the medium-term under the desk survey scenario. However, to guard against a scenario where the accumulation of precautionary balances falls short of the projected path, there may be a need for a contingency plan. *In this regard, can staff comment on what steps would be available for the Fund to speed up the accumulation if warranted*? On the minimum floor, we can go along with staff's proposal to maintain it at SDR 15 billion for now considering that there is no immediate or urgent operational consequence. *In this regard, can staff elaborate on whether there could be circumstances where the precautionary balances would fall below the floor and what would be the remedial actions in such an event?*

We see merit in refining the 2010 framework in future reviews to incorporate a more robust credit risk assessment. For avoidance of doubt, we continue to emphasize the importance of Board judgment and discretion in assessing the adequacy of precautionary balances. That said, we find that the coverage ratio and forward-looking credit measure are relatively blunt as tools for estimating the appropriate medium-term target for precautionary balances, and the framework should make use of other metrics of credit risks to inform the Board's decision for calibrating the appropriate level of precautionary balances. This would ensure a more systematic and consistent manner for assessing the Fund's credit risks under the framework. *Staff comments are welcome.*