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October 28, 2020

Statement by Mr. Poso, Ms. Ekelund, and Mr. Evjen 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, which are an integral part of the Fund's risk management framework. During a period of large demand for Fund support, exceptional uncertainties and a riskier global environment, it is essential that precautionary balances are strengthened to provide protection to the Fund's balance sheet and members' reserve positions as well as to allow to meet the increased demand.

We agree that credit risks in the Fund's lending portfolio have significantly increased since the last review. This was the case already earlier this year and the credit risks have further increased since the onset of the Covid-19 crisis. We further note that the current high share of Fund lending in emergency financing without ex-post conditionality as well as the decisions to temporarily raise access levels have weakened other elements of the Fund's risk management framework. On a positive note, governance safeguards related to emergency financing have been enhanced. *Considering the elevated risks, has staff considered new ways to enhance the Board's ability to monitor the Fund's credit risk developments with greater frequency and with methods capturing interrelated features of different risk factors?*

Well-designed programs together with prudent implementation of lending policies and safeguard assessments are crucial elements of the Fund's multilayered risk management framework. **As a credit risk mitigation measure, we consider a shift from emergency lending to the UCT-quality multi-year programs with strong and tailored conditionality to be paramount and welcome.** Furthermore, program disbursements need to be appropriately designed and linked to the domestic policy and political conditions to ensure strong domestic commitment to conditionality. These are important to create credible prospects for a strong, sustainable and resilient recovery, to improve the capacity to repay, and to ensure the catalytic role of Fund lending.

We agree that there is a strong case for raising the medium-term target of precautionary balances to SDR 25 billion. The transparent and rules-based framework complemented by judgement continues to function well as a guide for these considerations. Based on actual and expected developments in Fund lending and in the credit risk profile of the lending portfolio, a medium-term target of SDR 30 billion could also be justified. Considering the exceptional uncertainties in the global economic environment, the need for a higher medium-term target needs to be kept under close watch. **We call for an interim Board discussion with an opportunity to revisit the decision on the medium-term target prior to the next regular review**. A suitable timing for such an interim review could be in connection to, or ahead of, the next review of the Income Position. Furthermore, regular informal updates to the Board would also be warranted if the developments so require.

According to the baseline projection based on the desk survey of potential demand for Fund lending, precautionary balances are not expected to reach the SDR 25 billion target level until FY2026. The long timeline together with the current low level of precautionary balances of SDR 16 billion is concerning particularly given the rapidly elevated near-term credit risks as well as the heavy bunching of repurchases in coming years. **At this point, we can go along with the proposal of accepting the current pace of reserve accumulation and not taking additional steps to accelerate accumulation**. However, the gap between the development of credit risks facing the Fund and risk buffers providing adequate protection to the Fund balance sheet cannot be allowed to widen. To ensure the Board is kept well-informed and has the opportunity to act, if deemed necessary, we call for staff to present alternative measures that could be considered to accelerate the pace of accumulation in the interim review. *Could staff provide information of the potential options, including their main pros and cons?*

We can support keeping the minimum floor for precautionary balances at SDR 15 billion for now. We note that the minimum floor is important to maintain an adequate buffer to protect against unexpected rise in credit risk and to support a sustainable income position in the medium term. Given the uncertainties over the lending outlook, a potential for higher credit outstanding over a longer period and increased risks to return environment of the Fund's investments, the decision on the minimum floor should be revisited in due course.