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Statement by Mr. Inderbinen, Mr. Trabinski, and Mr. Peter on Review of the Adequacy of the Fund's Precautionary Balances
(Preliminary)
Executive Board Meeting
October 30, 2020

We very much welcome this discussion on precautionary balances and thank staff for the updated analysis. Precautionary balances are an important element in the Fund's strategy for managing financial risks and ensuring the strength of the Fund's balance sheet.

We emphasize that the financial risks the Fund faces have increased significantly since the last review of precautionary balances in 2018. Credit outstanding has nearly doubled to about SDR 85 billion. Lending is concentrated to the largest borrower, who faces very challenging circumstances. The recent surge in emergency lending is associated with higher risks, given the lack of ex-post conditionality of such lending. The size of the Fund's precautionary arrangements has become larger. The worsened global environment also implies higher risks, as do the large and concentrated upcoming repurchases, which will jump sharply in FY2023-25 to about SDR 63 billion and include historically large repurchases from a single borrower. Moreover, the Fund's burden sharing capacity has declined to new lows and offers very limited protection if new unpaid charges were to emerge.

Against this background, raising the medium-term target for precautionary balances to at least SDR 25 billion is crucial. We would even be open to a larger increase and note that staff acknowledge that an increase to SDR 30 billion could also be justified. An increase of the target by SDR 10 billion would be more in line with the similar increase of the midpoint of the calculated indicative range (baseline scenario) since the last review (para. 30). It would also seem appropriate on the basis of the qualitative risk considerations. *Could staff elaborate on the potential implications of an increase of the target for precautionary balances to SDR 30 billion?* In any event, staff should keep the situation under close watch, and, like others, we call for an interim review before the next regular review.

The pace and scale of precautionary balance accumulation are highly uncertain – and could be insufficient – and thus need to be kept under close review. Under the baseline scenario, incorporating arrangements approved through August 31, 2020, precautionary balances would only reach SDR 20 billion by the end of FY2023 and then remain flat, according to staff's projections. Meanwhile, under the desk survey scenario, precautionary balances are projected to attain the new target of SDR 25 billion, yet not before FY2026. *Could staff elaborate on potential steps to accelerate the pace of reserve accumulation?* More generally, while higher demand for Fund lending would translate into higher lending income and, thus, to the accumulation of precautionary balances over time, credit risk would increase much faster, in line with credit outstanding.

We regret the decrease in precautionary balances in the last financial year caused by a large pension-related loss. In FY2020, precautionary balances have dropped for the first time in a decade to SDR 16 billion. The drop was caused by drastic pension-related losses amounting to about SDR 3 billion. This illustrates that the defined-benefit staff pension plan exposes the Fund to significant financial risks. Not tackling this issue in the context of the recent Comprehensive Compensation and Benefits Review represents a missed opportunity. Given the magnitude of the associated risks, we might have to come back to this issue at some point in the future.

The projections for reserve accumulation could be too optimistic, as they seem to exclude expenditure increases and make no assumptions on pension-related losses. On expenditure, staff refers to the medium-term budget assumptions of April 2020 and states that expenses are projected to «trend slightly higher» (para. 27). *Do the projections of staff reflect the significant expected increase in expenditure in the next three years that is part of the proposed budget strategy to deal with the high work pressure from the Covid-19 crisis?* In addition, staff continues to make no assumptions on potential future pension-related losses, although experience shows that such losses can be high. *We would welcome staff's comments on risks to the expenditure assumptions and on the likelihood of future pension-related losses.*

Finally, we would advocate raising the minimum floor for precautionary balances, based on income and credit risk considerations. Fund credit could increase rapidly and markedly, as also suggested by the less benign scenarios used in assessing the adequacy of precautionary balances. Raising the minimum floor would help protect against risks from such an increase. In addition, raising the floor would also be prudent to strengthen income given the prospects of a prolonged low-interest-rate environment. *Could staff comment on the desirability and implications of raising the minimum floor now?*