GRAY/20/3198

October 28, 2020

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

We thank staff for a comprehensive assessment of the adequacy of the Fund's precautionary balances. Precautionary balances remain an essential element of the Fund's multilayered financial risk management framework. They also provide contribution to the Fund's operational income. Thus, it is important to maintain an adequate level of precautionary balances, which is consistent with the level of risks for the Fund and requirements of the new income model.

We agree with staff assessment that since the last review in 2018, the Fund's credit risks have increased significantly. Credit outstanding almost doubled since mid-2018. It became more concentrated toward a single large borrower and one particular region. The sovereign credit ratings of the Funds' borrowers have deteriorated on average since the last review, and many of them have already resorted to the recent debt relief initiatives, such as the DSSI and the CCRT. The above-mentioned risks are exacerbated by extreme uncertainty for the global economic recovery and by peak repurchases falling due in FY2023-25.

Taking into account a noticeable rise in credit risks and expected increase in demand for Fund credit, we support the staff proposal to raise the medium-term target for precautionary balances (PB) to SDR 25 billion. While under the agreed framework, based solely on existing arrangements, the midpoint of the target range for PB is about SDR 21 billion, the situation is changing rapidly and further demand for Fund programs may rise sharply. Several scenarios point to a large increase in forward looking credit measure and, accordingly, to a substantially higher level of necessary PB. In this regard, we agree that the SDR 25 billion medium-term PB target is appropriate at this stage.

As we support the increase in the PB target, we also see the need for accelerated accumulation of PB. While the accumulation of PB is highly unstable due to volatile pension-related (IAS-19) adjustments, the pace of growth of its "core" components could be increased to achieve the medium-term target earlier. This will be helped by the growth of the Fund's lending portfolio and corresponding growth of lending income. The pace of accumulation could be further increased by changes in the level of credit charges and fees, but, at this point, we do not see the need for such a change.

Going forward, the PB targets and the pace of accumulation should be adjusted in accordance with the developments in credit outstanding and evolving risks. However, taking into account that under the most plausible scenarios the new SDR 25 billion target could be achieved no earlier than in FY2023, we do not expect frequent adjustments of the PB target.

Finally, we agree that the minimum floor for PBs should be kept unchanged at SDR 15 billion. This level is necessary to ensure the twin objectives of PBs: as a buffer against an unexpected increase in credit risks and a source of investment income.