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October 28, 2020

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

We thank staff for a well-drafted paper and welcome the first regular review of the adequacy of the Fund's precautionary balances since the outbreak of Covid-19, using the transparent and rules-based framework adopted in 2010, and considering developments since the last review in 2018. Because of the pandemic crisis, Fund faces heightened financial risks in fulfilling its mandate, and precautionary balances, comprising general and special reserves and the special contingent account (SCA-1) help protect Fund's balance sheet and safeguard members' reserve assets, within a multi-layered risk management framework. We note the first decline in precautionary balances in over a decade in FY2020, broadly concur with staff assessment and conclusions, and wish to highlight the following points:

The **framework for assessing reserve adequacy**, consisting of a reserve coverage ratio of 20-30 percent, a 3-year average of credit outstanding, exclusion of commitments under precautionary arrangements from the credit measure, and a minimum floor remains appropriate. It should, however, continue to allow for Board discretion on the broader assessment of financial risks in setting the target.

We agree that sovereign credit ratings and bond spreads of the Fund's borrowers cannot and should not be translated directly to assess credit risk faced by the Fund, given its unique role. However, since the last review, credit and commitments outstanding have risen sharply; loan concentration and credit risks remain elevated; the weighted average maturity of the loan portfolio has shortened; investment risks and uncertainty have increased; income risks remain moderate to low; and arrears have been reduced after Somalia cleared its overdue obligations. While the current target for precautionary balances of SDR 20 billion is still within the forward-looking indicative range under the baseline scenario of existing arrangements, we note that it could well fall below the range under a more likely scenario of additional loan demand related to an uncertain global pandemic. In the circumstances, we agree to **raise the indicative medium-term target for precautionary balances to SDR 25 billion** and revisit the target before the next regular review if warranted.

Notwithstanding significant uncertainty about the projected path of precautionary balances, including from the pension-related (IAS-19) adjustment, potential new programs, and timely completion of program reviews, compounded by the covid-19 pandemic, further reserve buildup is projected over the medium term. Even under the baseline scenario the total operational income would exceed total expenditures by SDR 1.4 billion annually in the three-year period through FY2023. Given that under the more likely desk survey scenario, the proposed SDR 25 billion target would be reached in FY2026, we see no need to take additional steps at this point to accelerate the **pace of reserve accumulation**.

Income and credit risk considerations warrant maintaining a **minimum floor** for the precautionary balances. We agree that invested precautionary balances represent an important source of Fund income; Fund credit can be highly volatile; reserve buildup can take time; and the floor should be changed only occasionally. While prolonged low interest rates could justify raising the floor in any future low credit environment to bolster Fund's medium-term income position, we see no need to raise the floor at this juncture and agree to revisit the case after the next review of the investment account in FY2022.