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October 28, 2020

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

We thank staff for the clear report. This review was appropriately postponed allowing for the assessment of the impact of the COVID-19 pandemic on the Fund's financial risk. We note that credit outstanding has doubled, in part because of the surge in emergency lending in recent months associated with the ongoing crisis, and that some indicators point to a deterioration of the perceived credit quality of Fund borrowers. On the other hand, precautionary balances have more than doubled in SDR terms over the last decade and decreased last year only because of the changes in accounting for pension-related liabilities. In addition, precautionary balance coverage relative to the Fund's total lending capacity has remained relatively stable. However, the Fund is likely to continue facing an uncertain environment in the coming years, and, therefore, we agree with raising the medium-term target to SDR 25 billion which is slightly above the midpoint of the indicative range, and keeping the minimum floor unchanged at SDR 15 billion for now. We note, however, that the table on page 13 suggests an upward bias in setting the indicative target, which appears uncorrelated with the evolution of outstanding credit, an issue that should be reconsidered in future reviews.

We find the way regional exposure is depicted in the report somewhat misleading, as it is partly a result of a decline from a much larger degree of peak concentration in the past concerning other regions, as highlighted by Mr. Guerra and Mr. Arévalo-Arroyo in their Gray. In fact, overall concentration remains stable according to the Herfindahl index, with a higher concentration in Western Hemisphere countries, partly explained by an increase in the use of FCLs, with some countries accessing this facility for the first time. However, as discussed during the recent ORM presentation, precautionary arrangements are a risk mitigator that help to prevent market turmoil that could lead to a higher use of Fund resources, For this reason, the practice of not including commitments under precautionary arrangements in the credit measure used to derive the indicative range for precautionary balances appears appropriate.

Additional steps to accelerate the pace of precautionary balance accumulation are not necessary at this stage. However, close monitoring of evolving risks would be of the essence, and staff should be ready to revisit the overall framework for precautionary balances, especially in the event of a higher-than-envisaged surge in the demand for Fund lending. In this case, an assessment of the overall resource envelope would be necessary, including the impact on burden sharing of not being able to fund operations from a full quota-based structure. On a separate point, we still wonder why changes in the treatment of pension liabilities introduces so much noise in the analysis of Fund finances. *Was the previous approach so inappropriate to measure related liabilities that major adjustments are now needed?*