



International Monetary Fund

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IMF Fall 2022 Global Financial Stability Report

Tobias Adrian

*Financial Counsellor and Director
Monetary and Capital Markets Department*

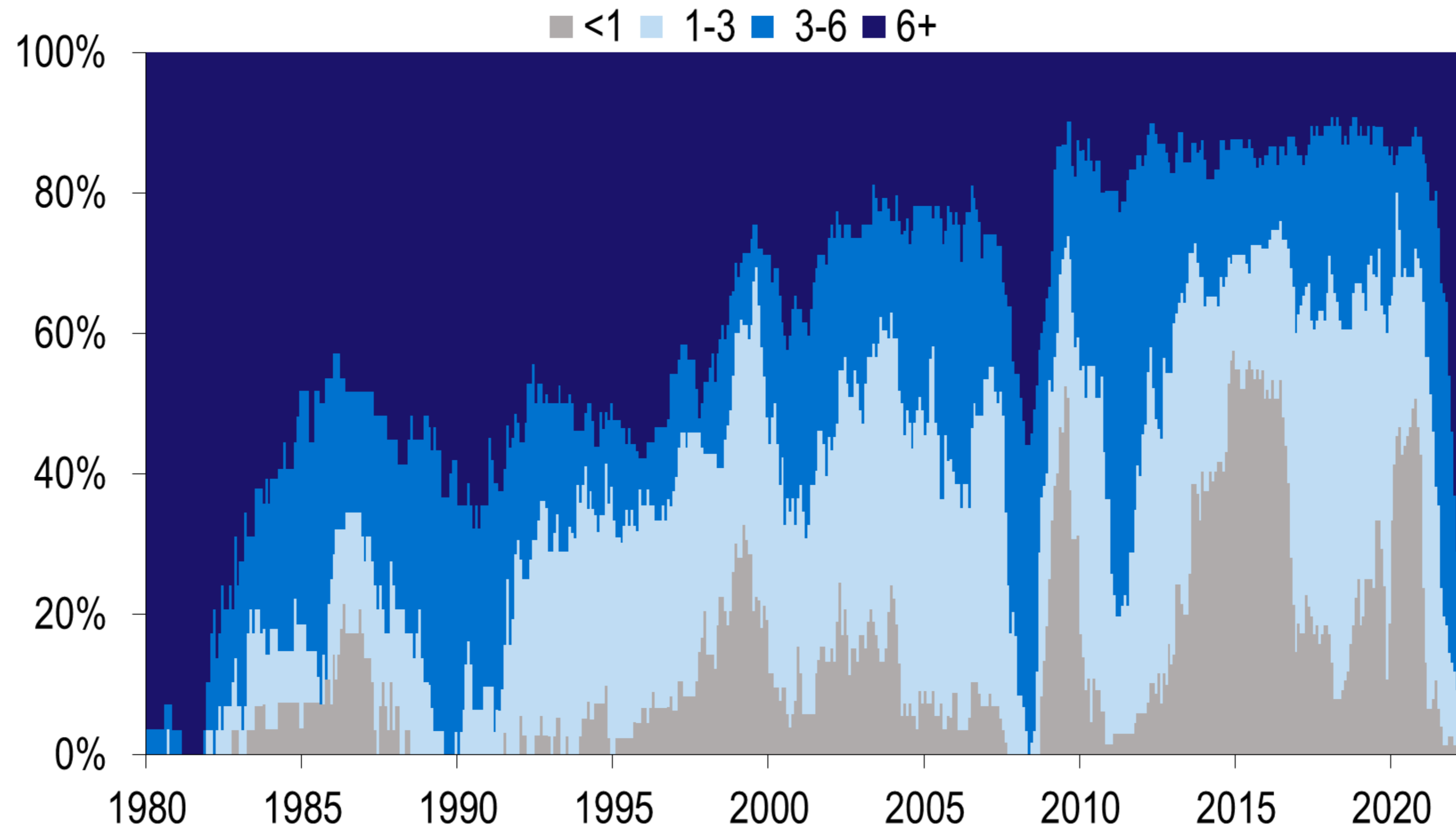


Main Financial Stability Themes Since Last GFSR

- 1) More tightening expected in many countries**
- 2) Stagflation threats loom globally; energy crisis intensifies in Europe**
- 3) Vulnerable EMDEs could face defaults and difficult restructurings**
- 4) Global housing risks intensifying; China property market near crisis**

Worldwide Inflation Has Reached Multidecade Highs

Distribution of inflation globally
(Proportion of countries in each inflation band)



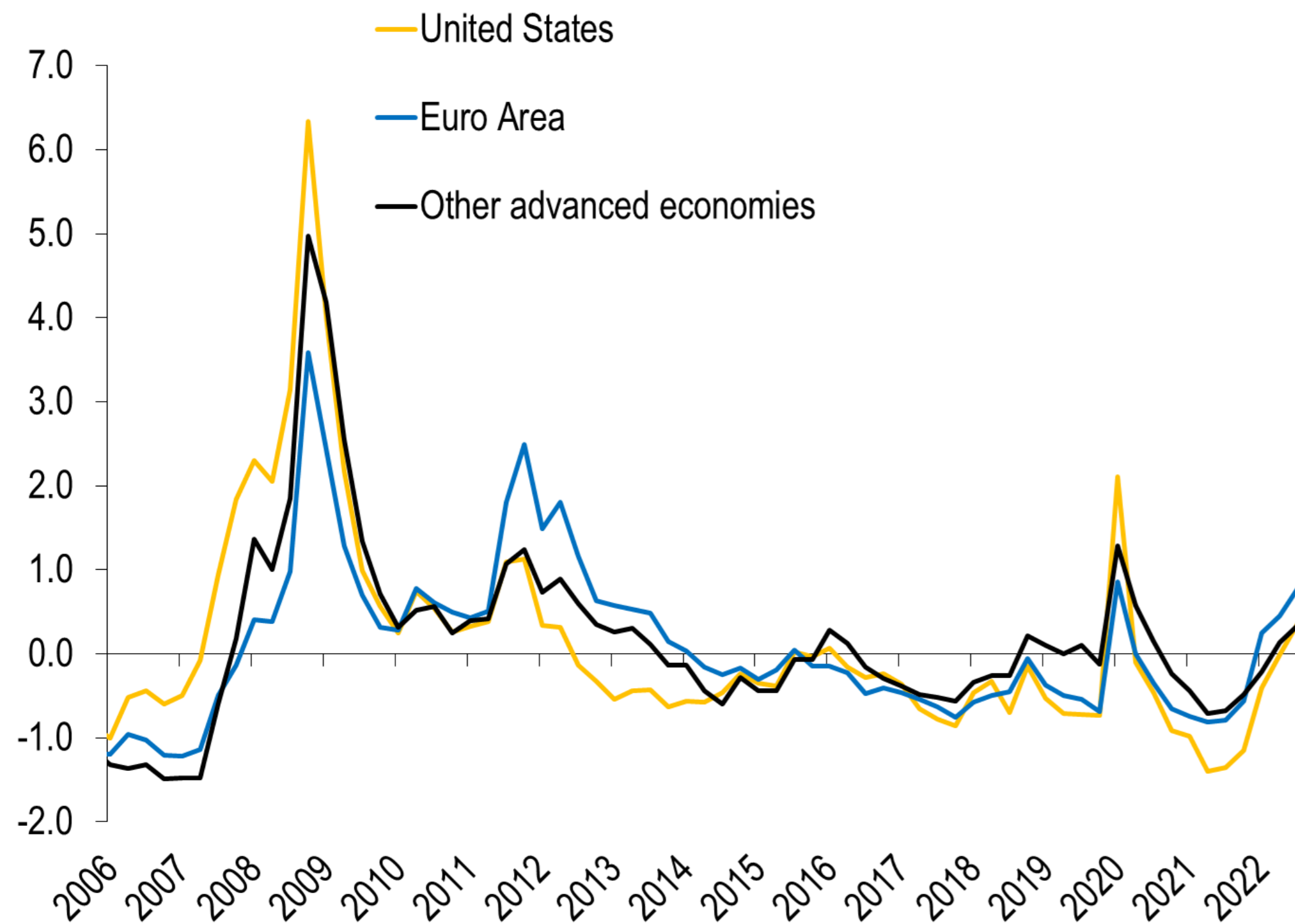
Note: Based on realized y/y headline inflation in 76 countries

Financial Conditions Have Tightened

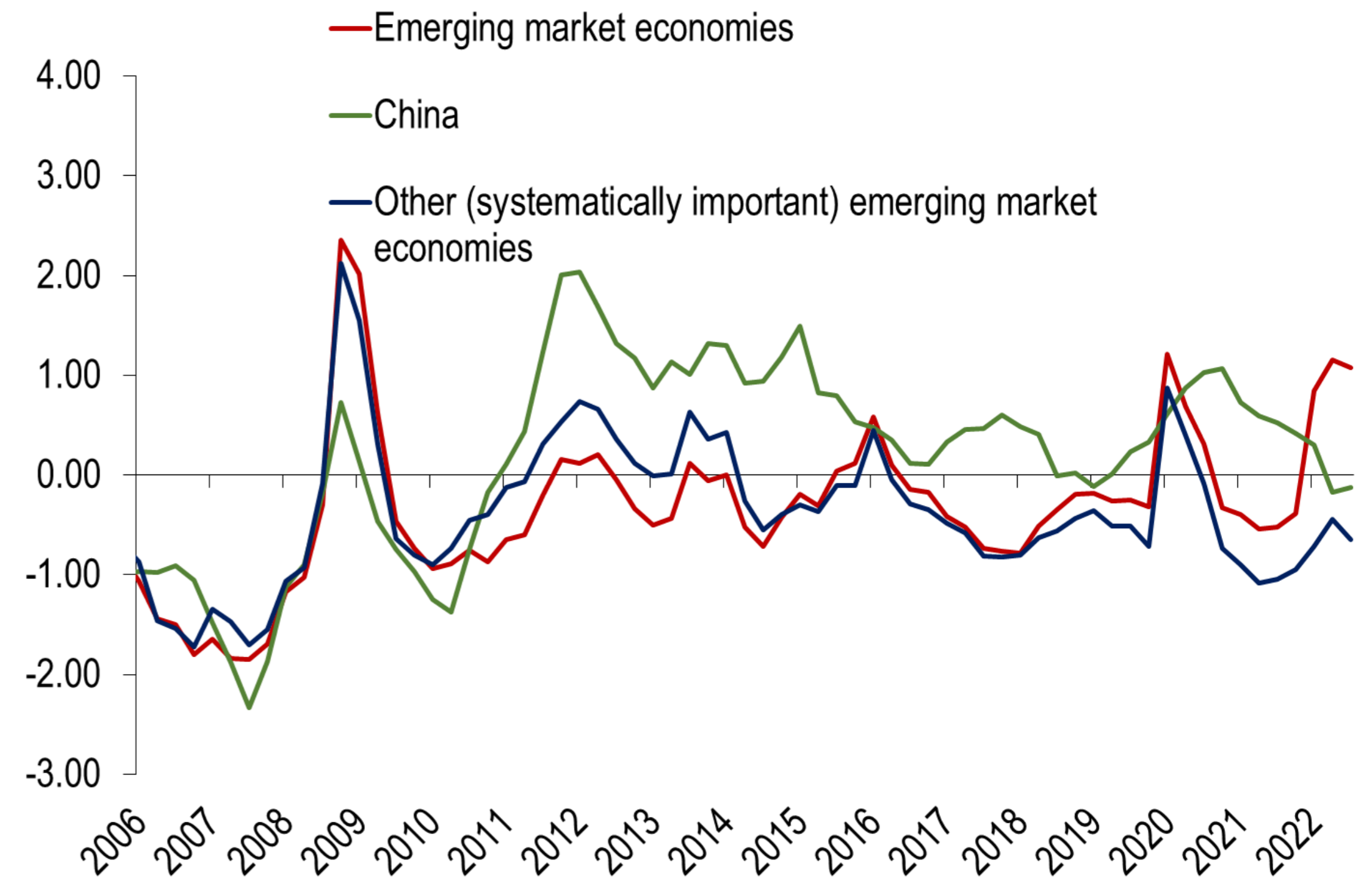
Euro Area FCIs at levels last seen in March 2020 whereas in the US & other AEs close to historical averages...

... meanwhile among some EMs, FCIs have reached March 2020 levels, too.

Financial Conditions: Advanced Economies
(Standard deviations from the mean)



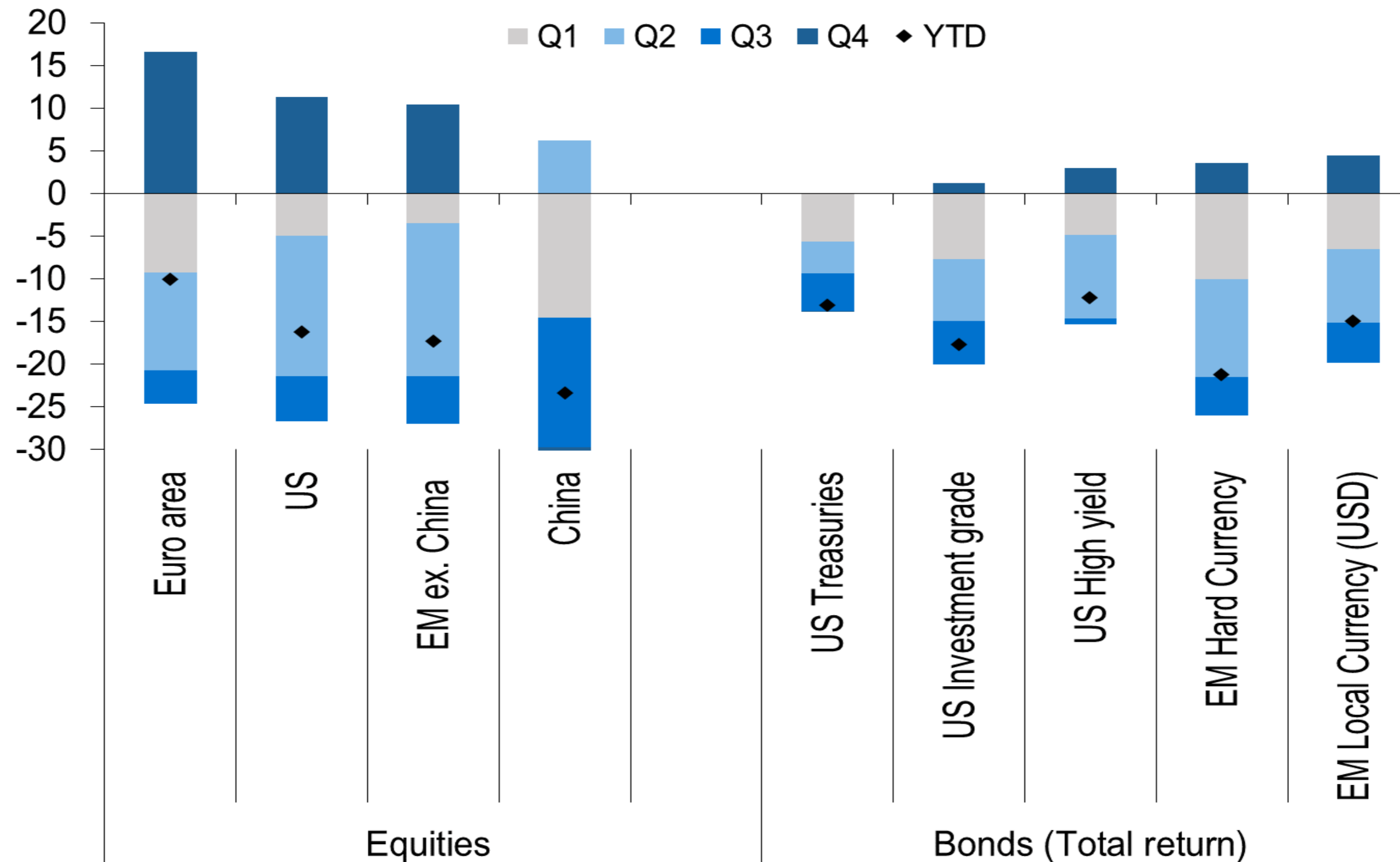
Financial Conditions: Emerging Markets
(Standard deviations from the mean)



2022 Has Been A Particularly Bad Year for Risk Assets

Sell-Off in Risk Assets and Jump in Volatility

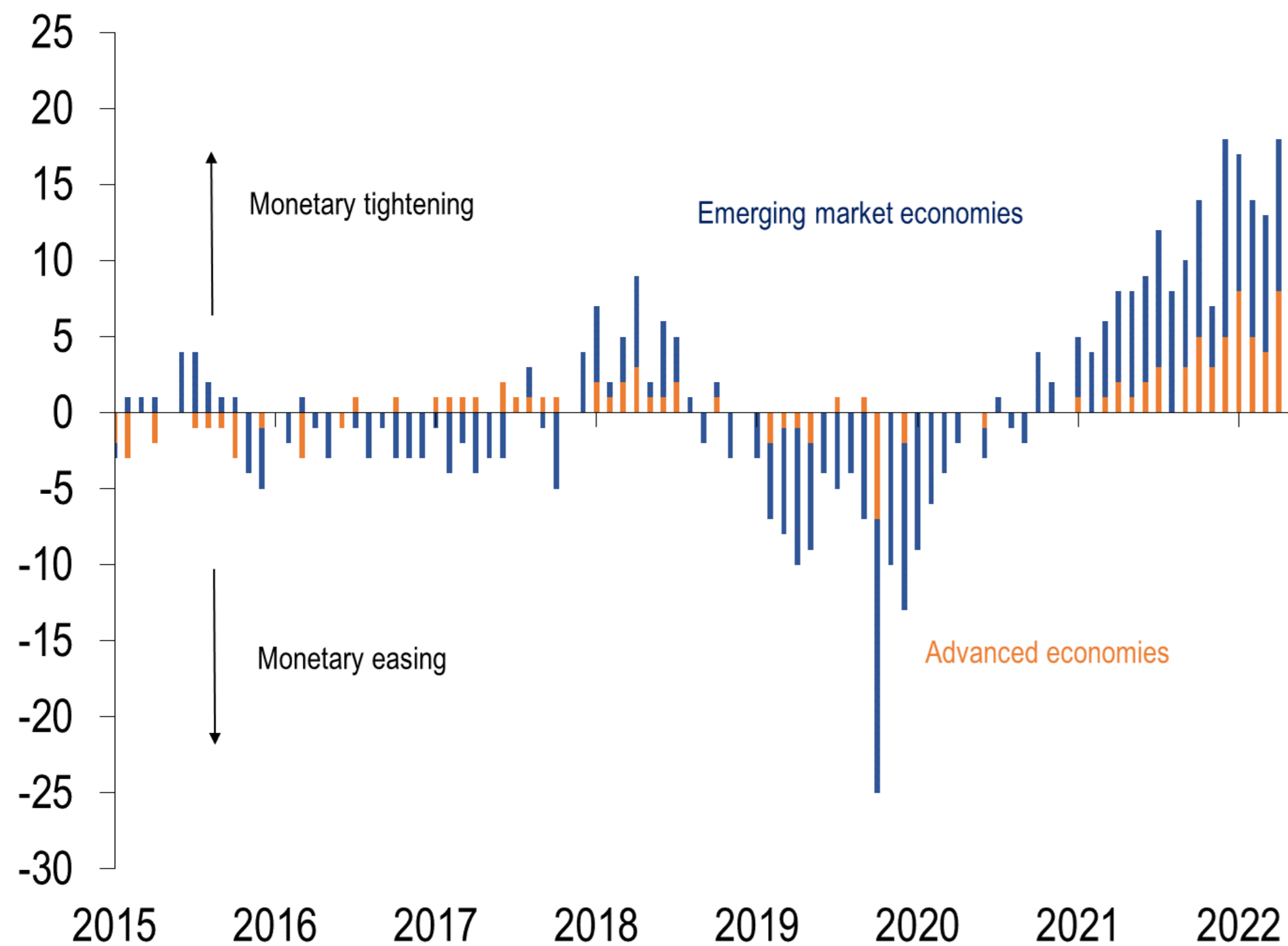
Risk Asset Returns
(Percent return, by quarter)



Persistent Inflation Prompted Central Banks to Act More Aggressively

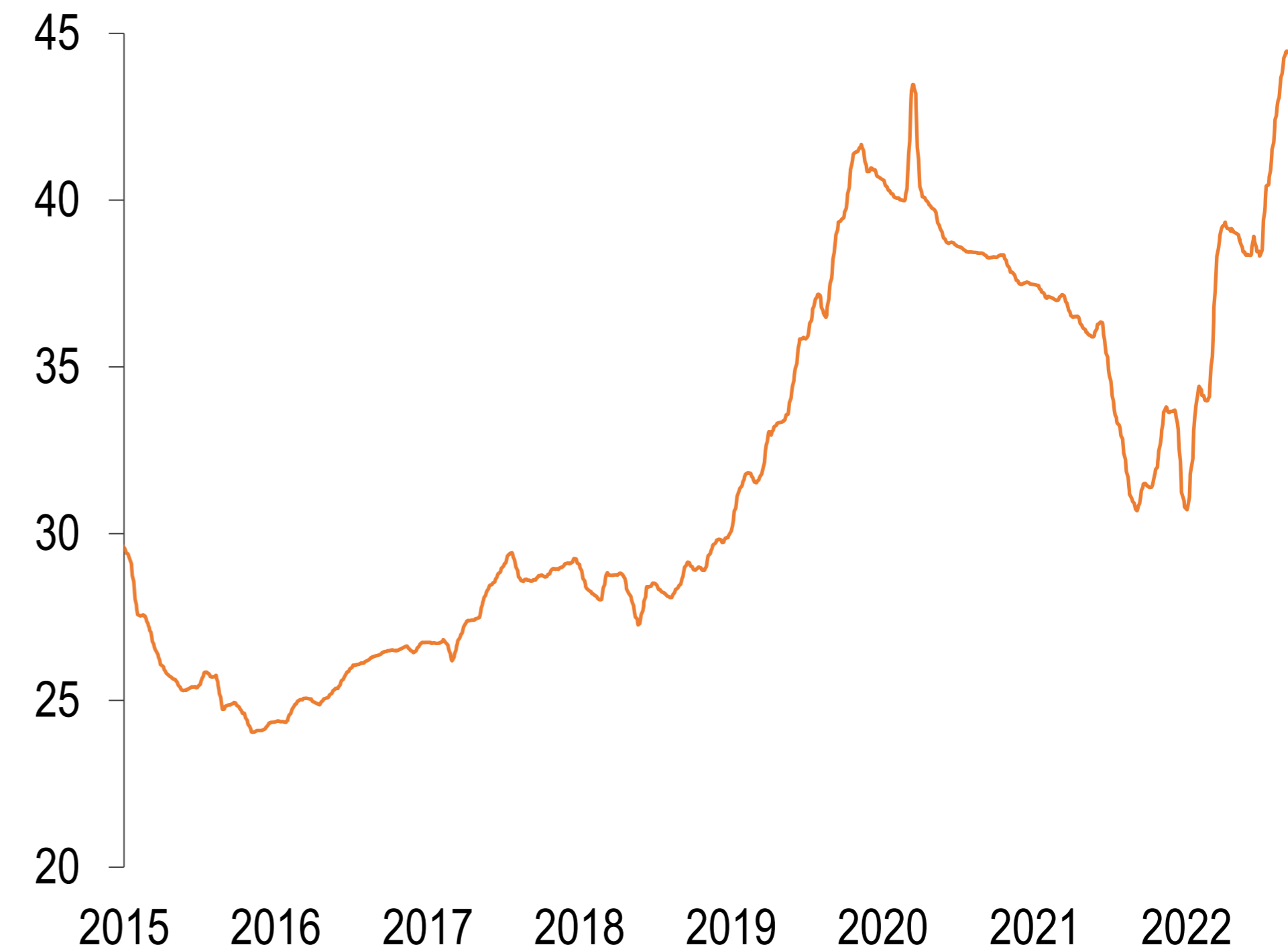
AE and EM central banks have dramatically synchronized monetary tightening...

Number of Central Banks changing policy rates (net)



... so that correlation among global interest rates has been increasing.

Co-movement of G10 sovereign yield changes at 2-year tenor (Proportion of variance explained by common factor)

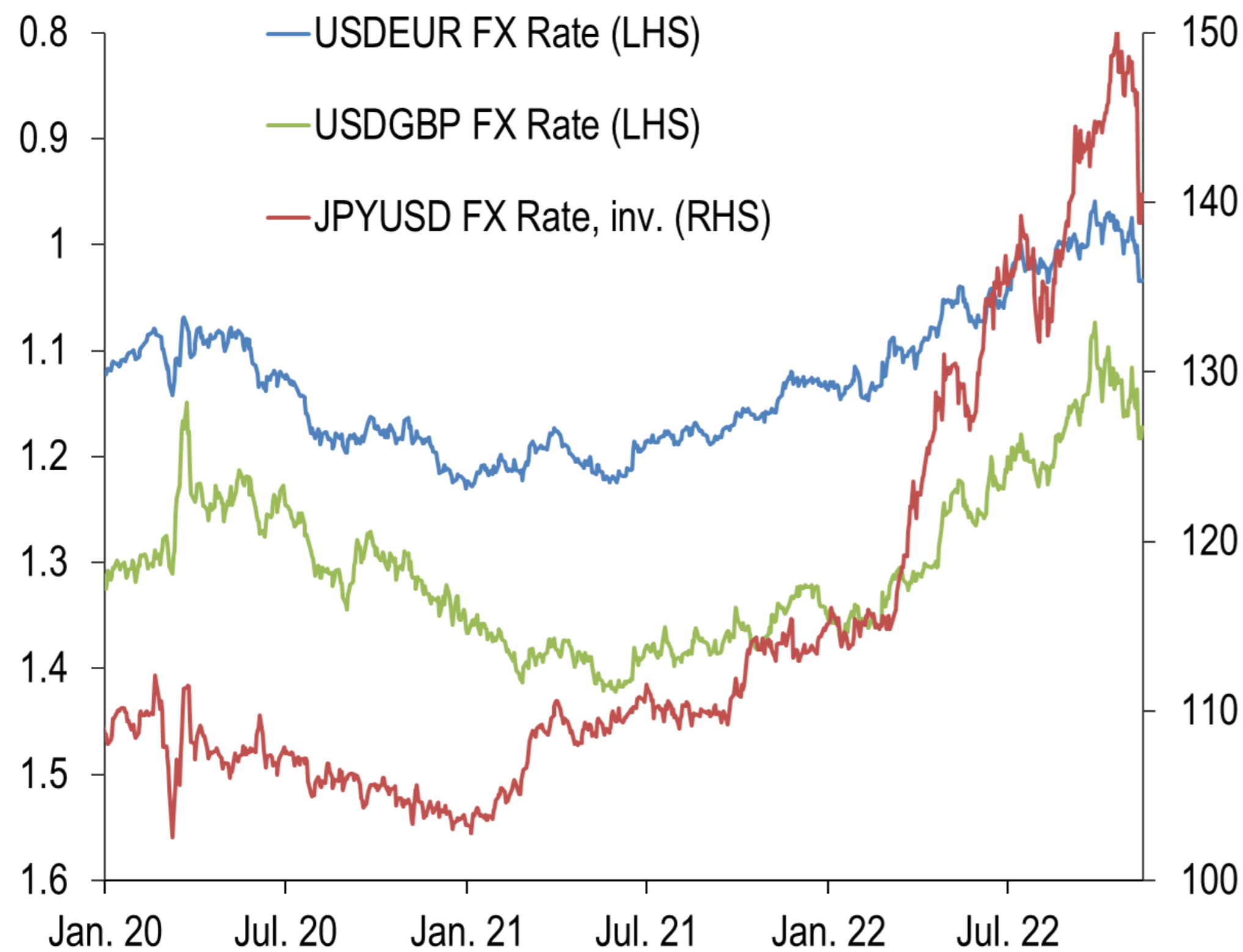


Note: Proportion of G10 daily interest rate changes excluding Japan explain by a common factor, based on rolling 1-year principal component analysis.

Dollar has Strengthened on the Back of Fed Tightening

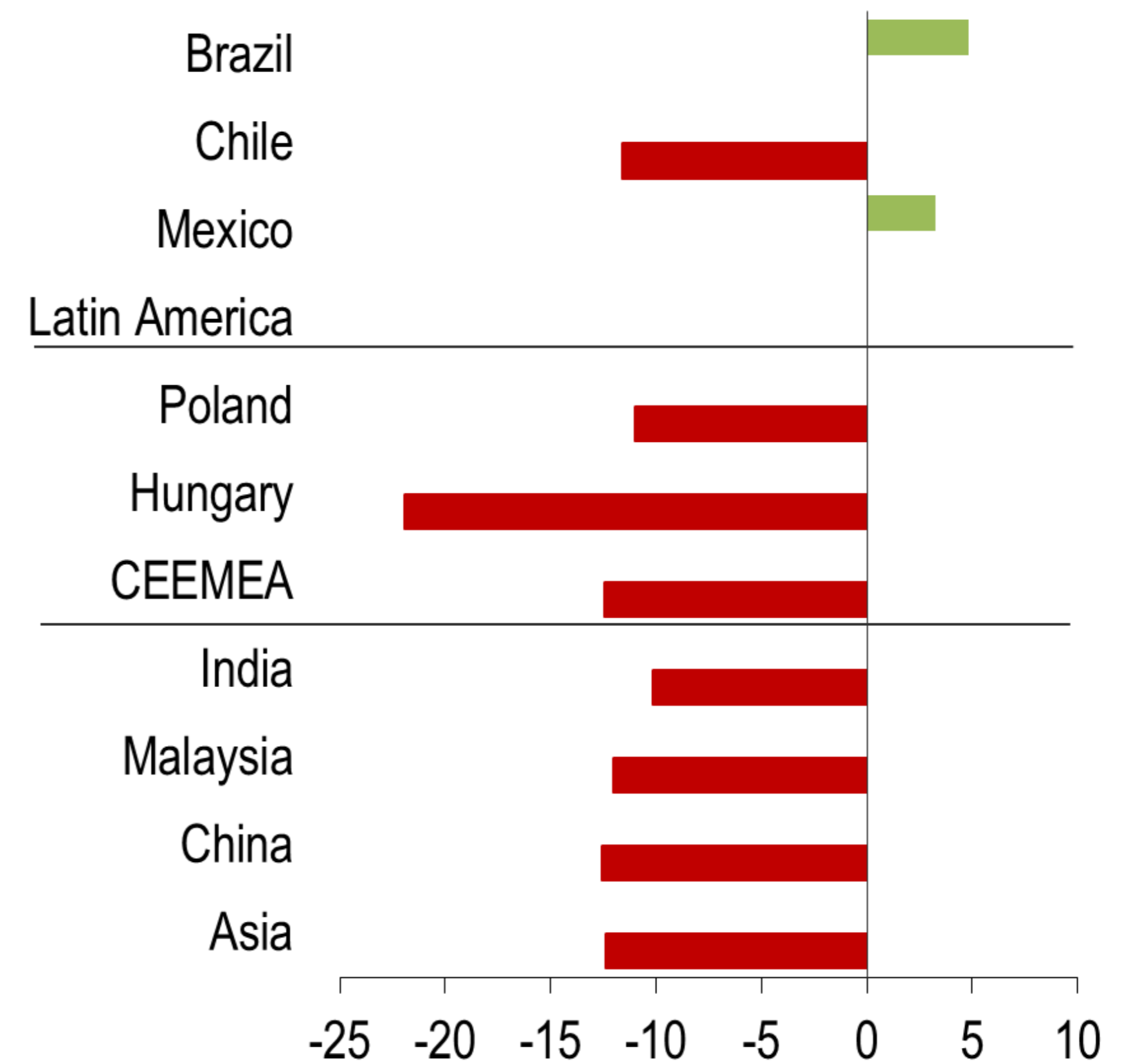
Interest rate differentials have driven USD to historic highs

Euro and Yen Exchange Rates vs Dollar since 2020
(EUR and GBP left scale, JPY right scale)



EM currencies have also depreciated, but with marked regional differences

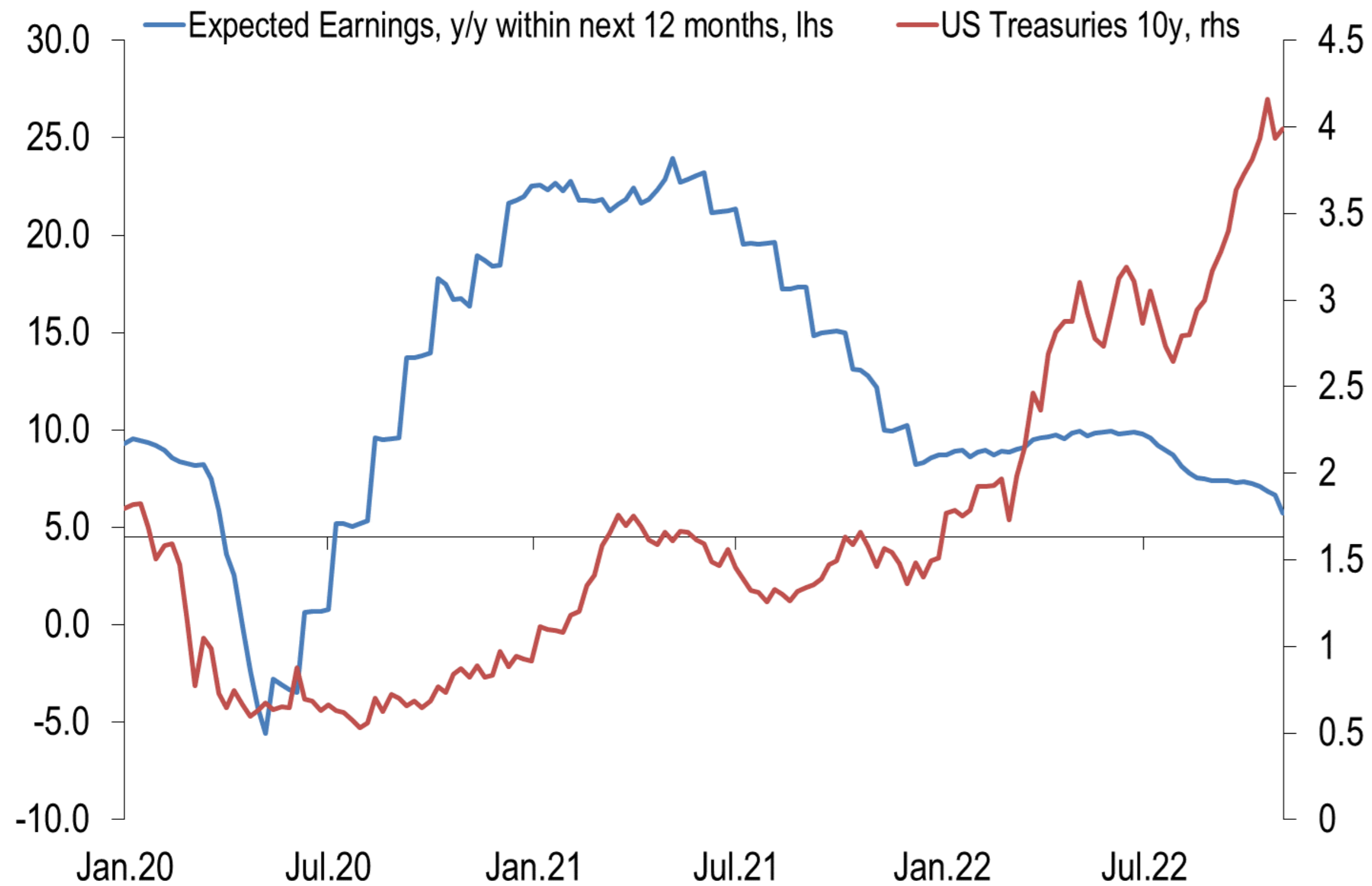
Emerging Market Regional Currencies
(2022 percent return versus US dollar)



Spectre of Stagflation Has Repriced Markets, But More Downside Risk Remains

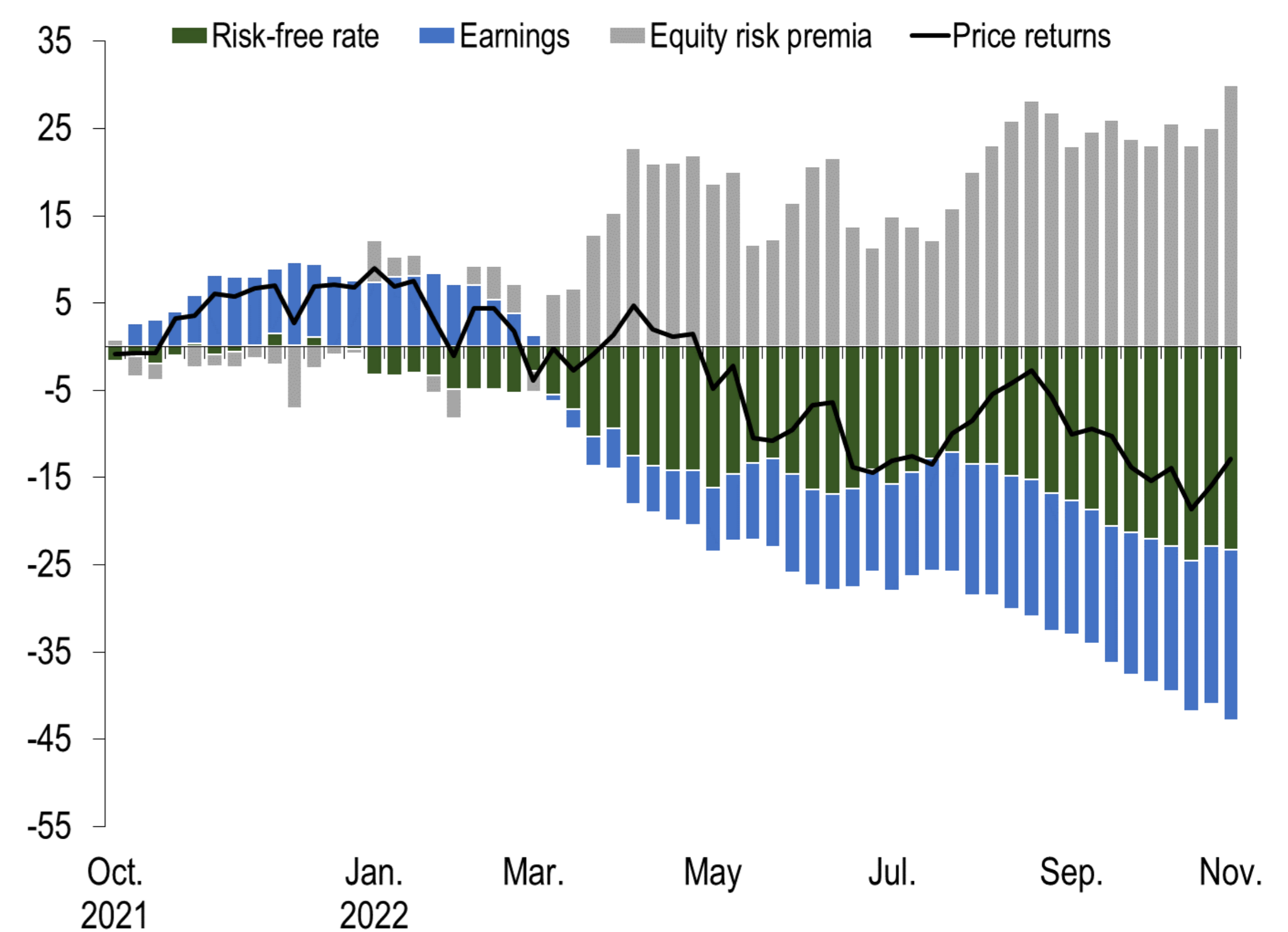
*Rising rates and earnings downgrades
have driven markets down...*

Components of S&P 500 valuation
(y/y percent growth, left scale; percent)



*...but a falling risk premium
has blunted the selloff*

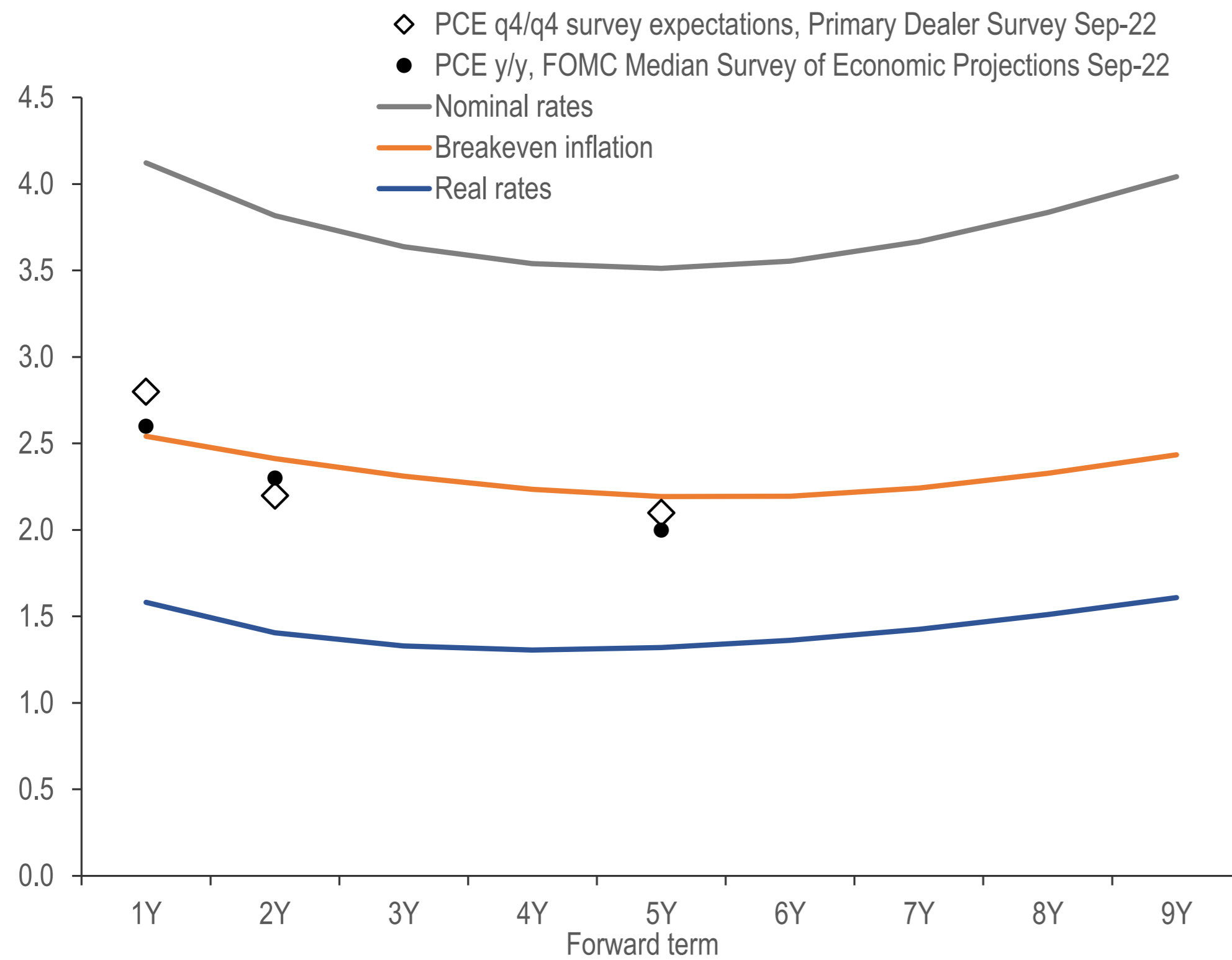
S&P 500 Equity Index Returns Decomposition
(percent)



Real Yield Curves Are Still Fairly Flat

The market expects the Fed to begin cutting rates next year

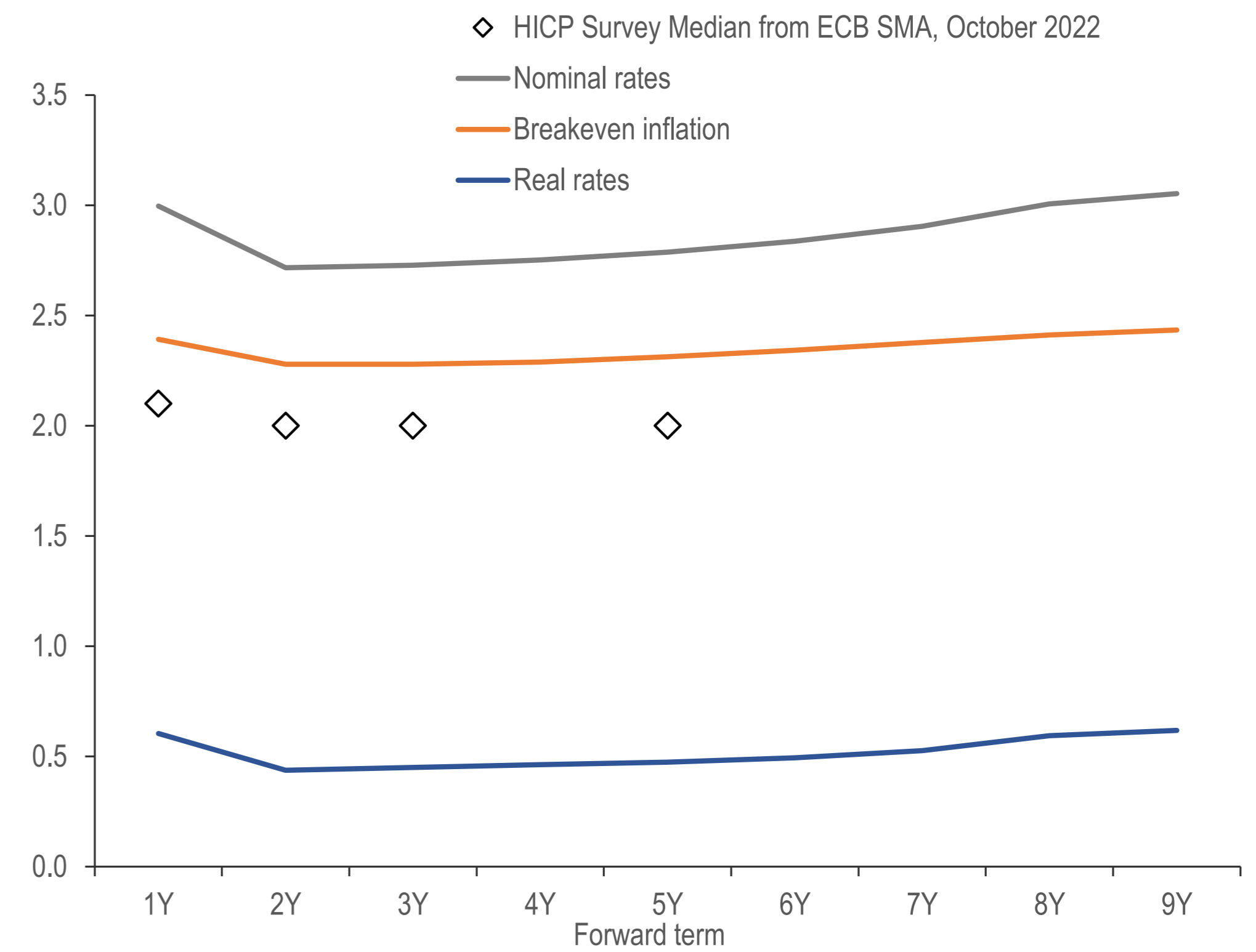
US Term Structure of 1y Forward Rates
(Percent, based on government bonds)



Note: Data as of Nov 11, 2022

In Europe, nominal yields expected to plateau at ~2%

Euro Area Term Structure of 1y Forward Rates
(Percent, based on swaps)



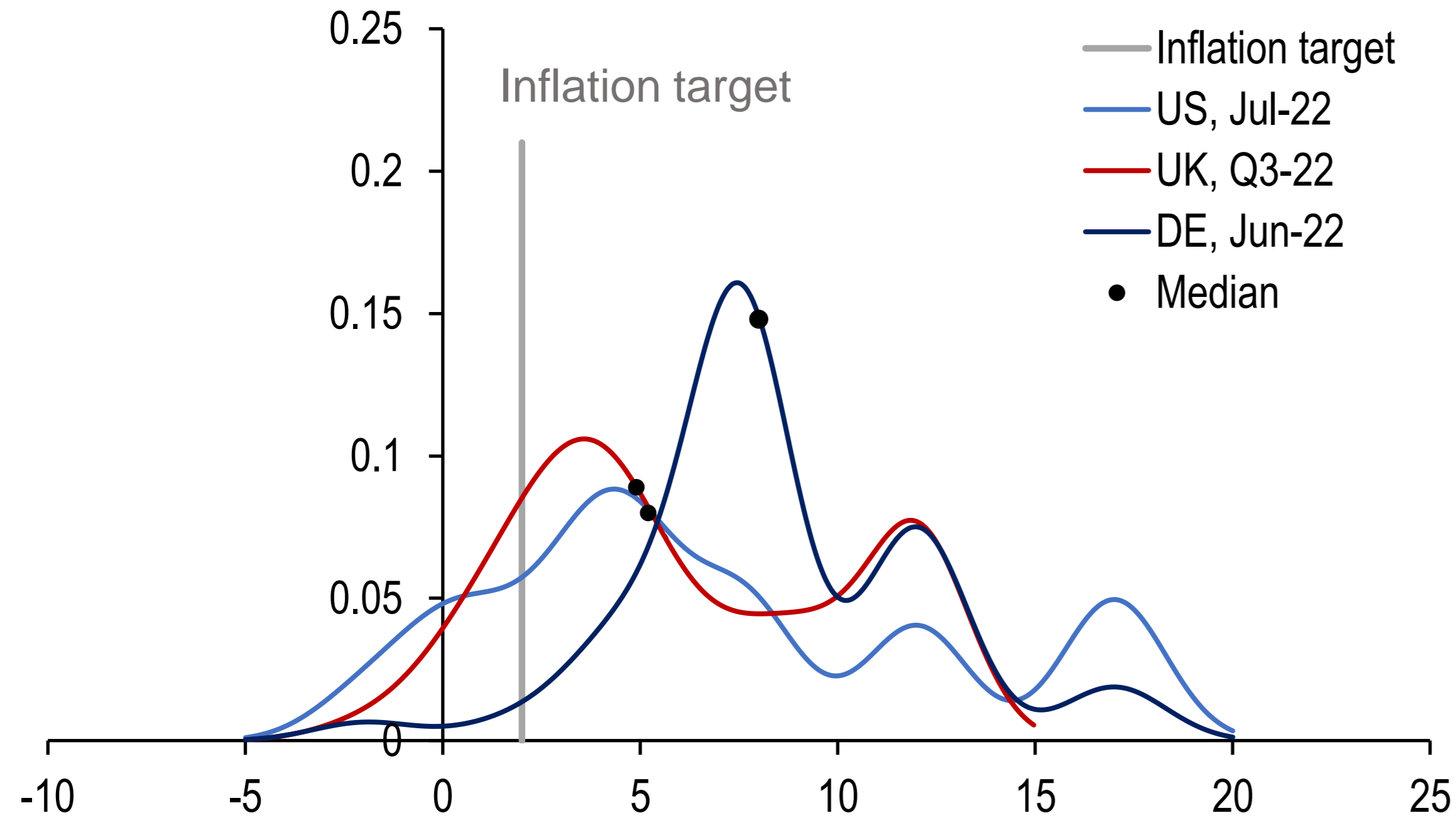
Note: Data as of Nov 11, 2022

Real rates remain relatively low in US and in Europe

Investors Expect Inflation to Remain Elevated

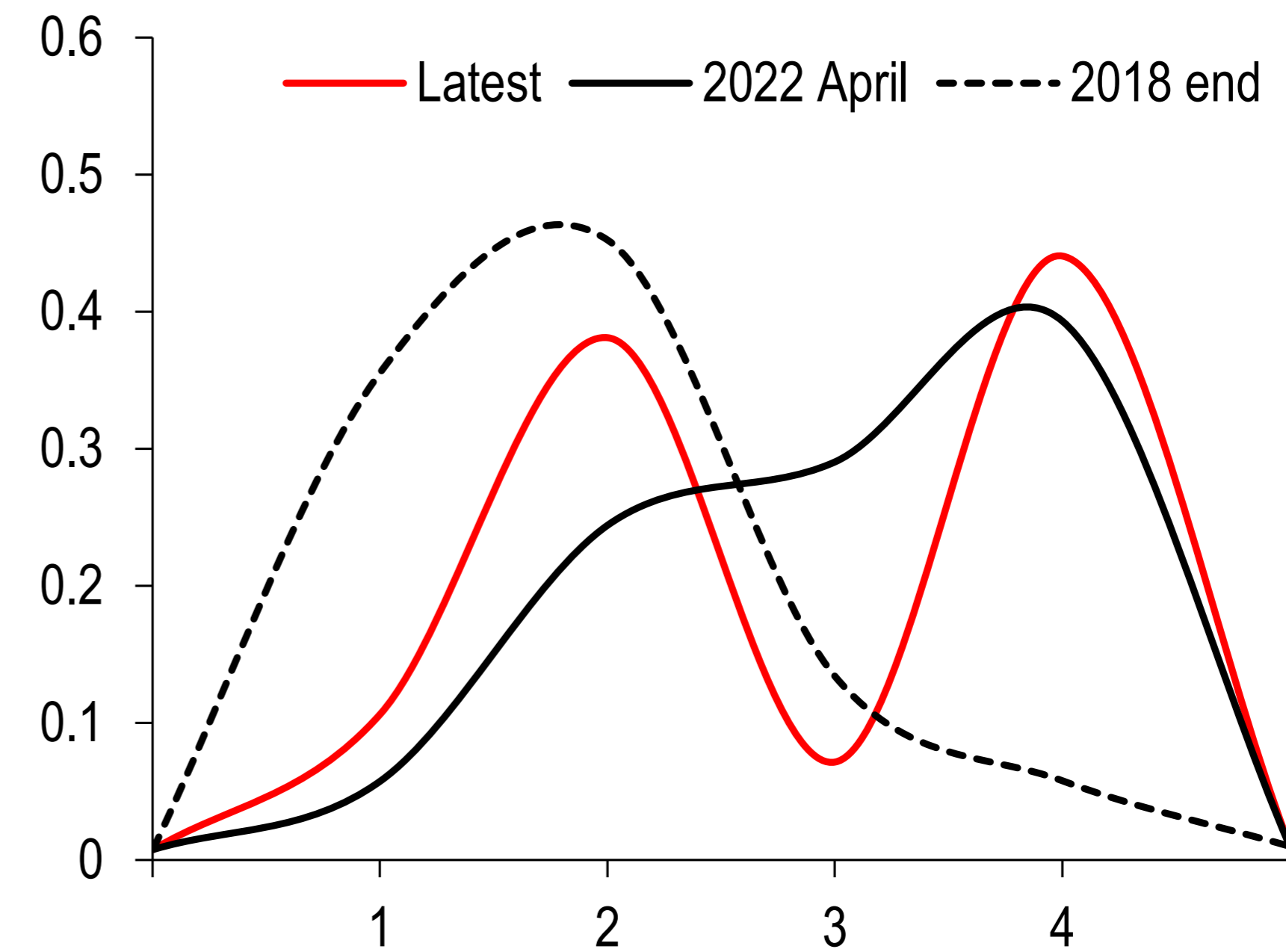
In AEs, household inflation expectations remain high

Household Expectations, 1 year horizon
(Latest, Share Of Respondents, Percent)



While in Euro Area, inflation options point to bi-modal inflation expectations

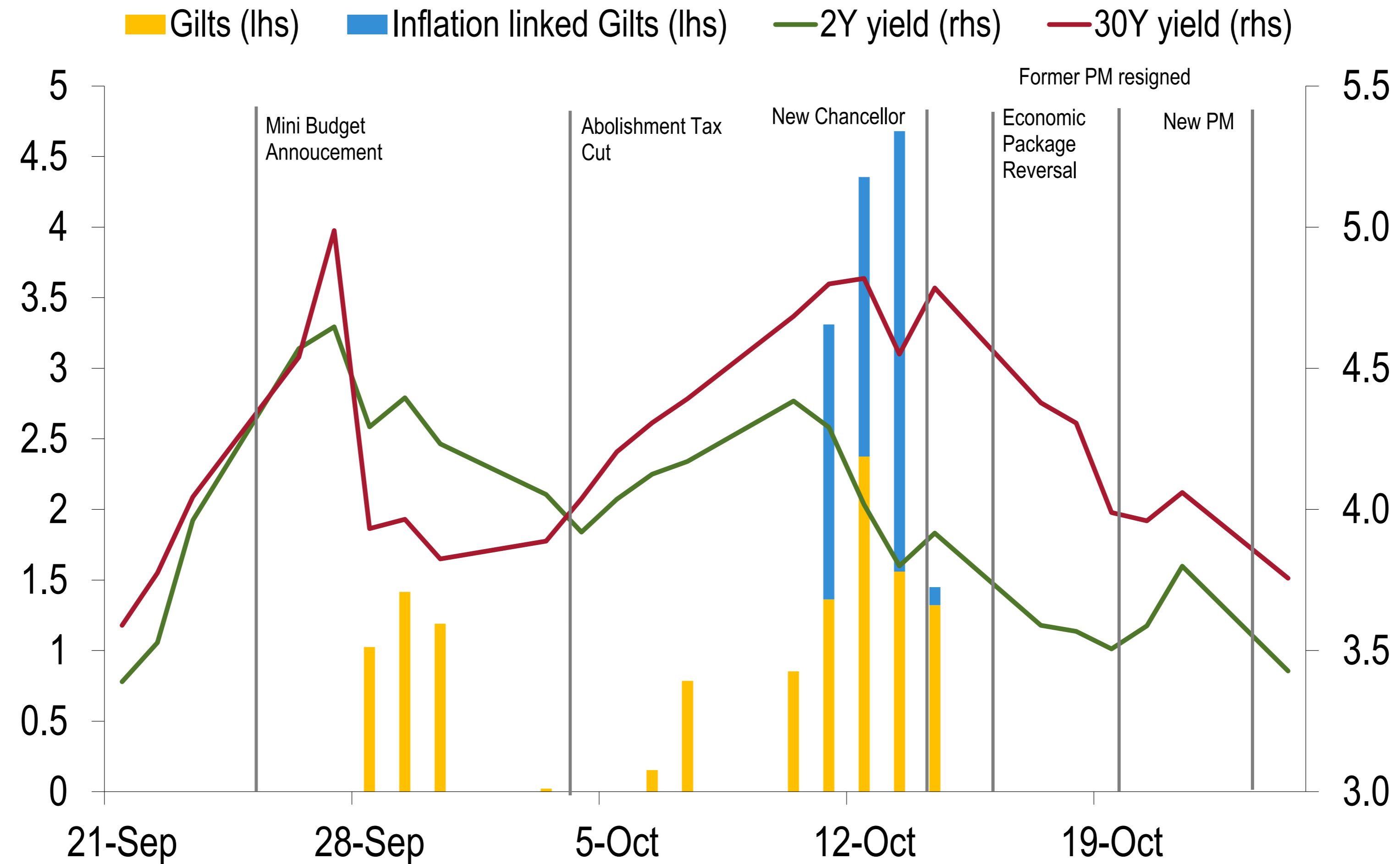
Option-Implied Distributions of Various Inflation Outcomes in the Euro Area, 1 year horizon
(Probability density)



Bank of England Intervened to Remedy Dysfunctional Gilt Market

Intraday Gilt Market Interventions of The Bank of England in September and October 2022

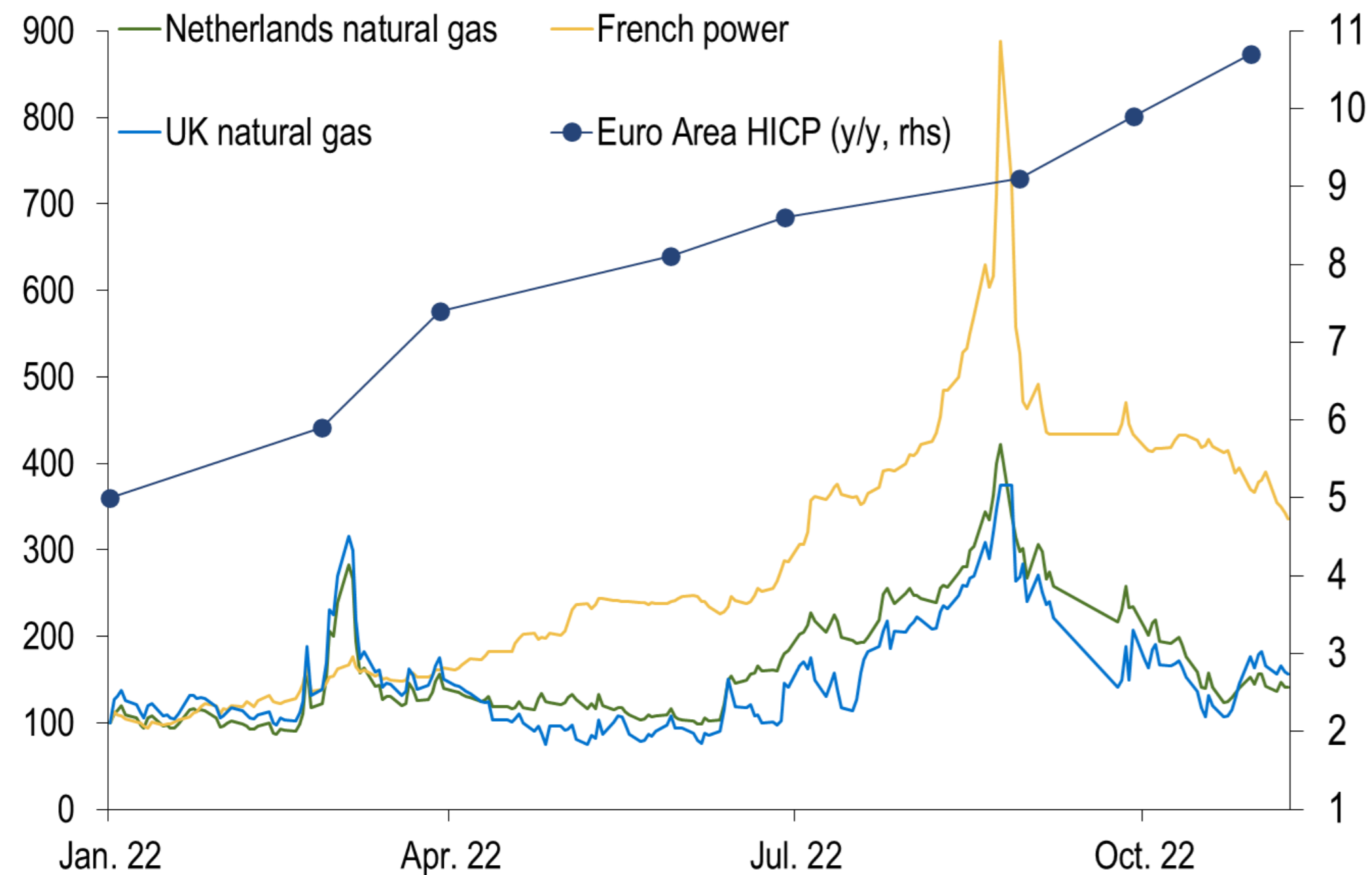
UK Gilt Yields (Percent, basis points)



Euro Area Under Pressure from Energy Crisis and Fragmentation

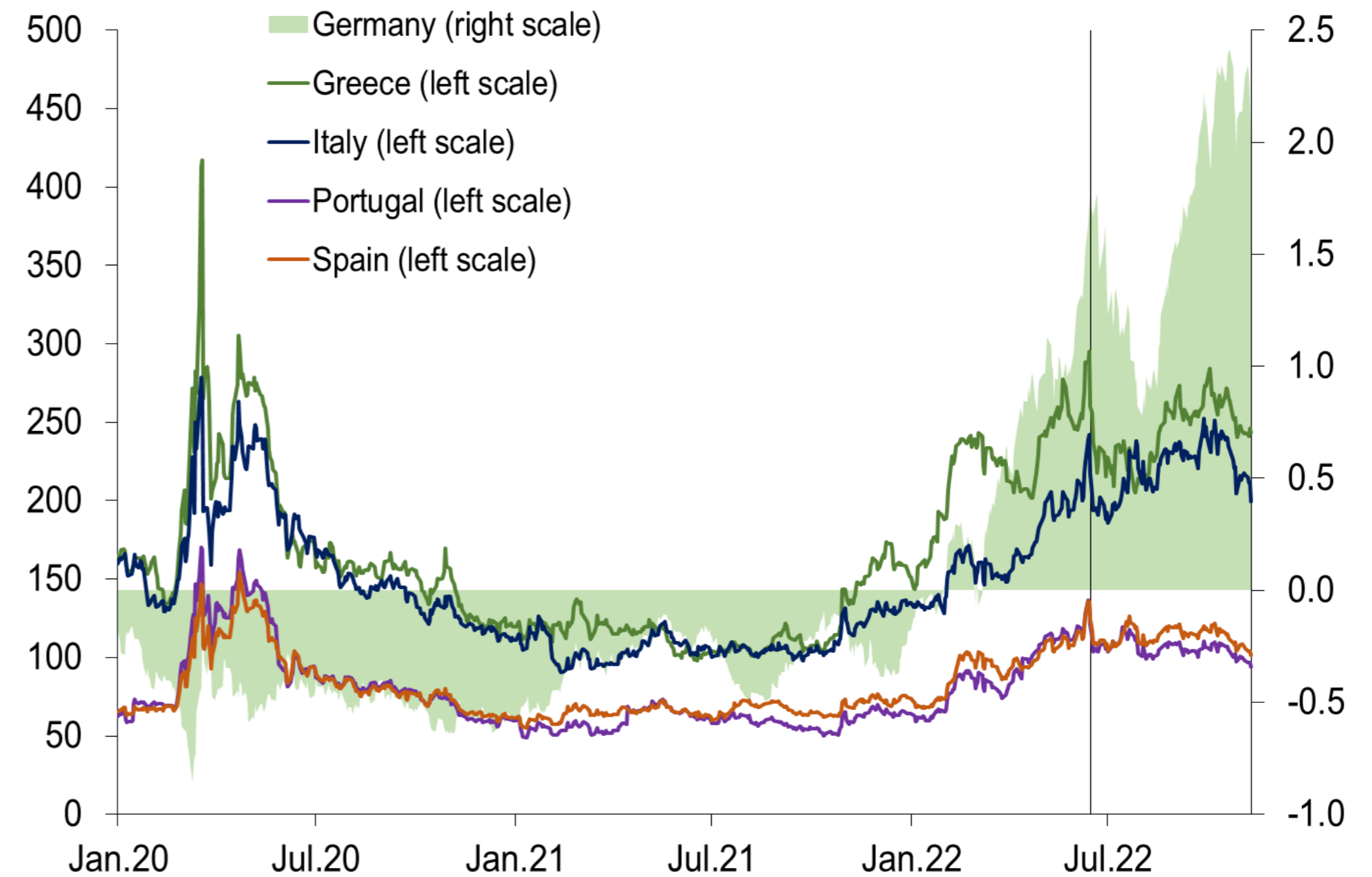
Rising energy prices threaten to tip the continent into recession

European Energy Prices and Headline Inflation
(Prices in Euro, left scale; percent, right scale)



Peripheral euro area sovereign spreads have narrowed from their peaks

German 10-Year Yields and Sovereign Spread
(Basis points, left scale; percent, right scale)



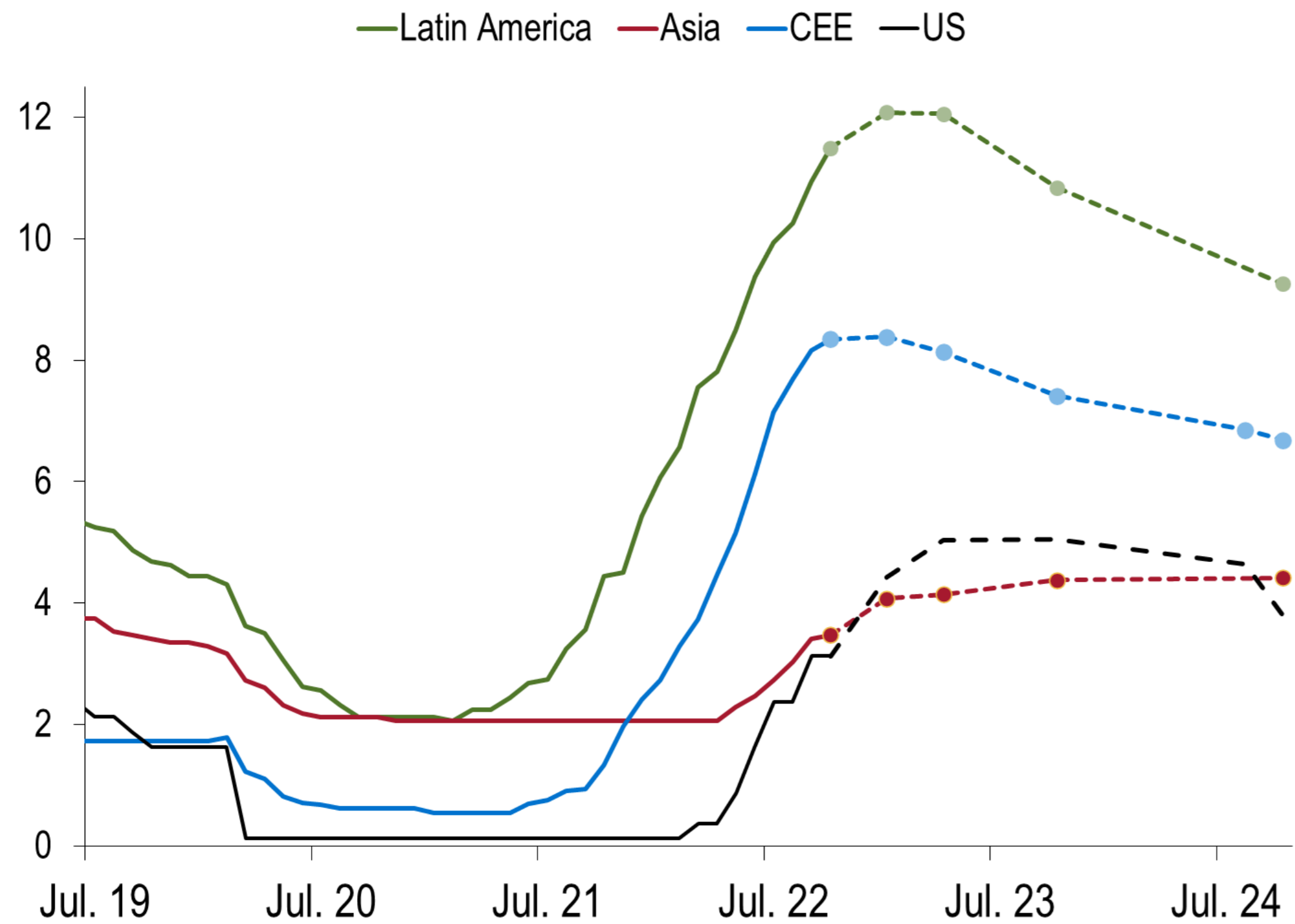
TPI announcement has helped to contain disorderly widening of spreads

EMs Appear Close to Easing, But Face Global Pressures

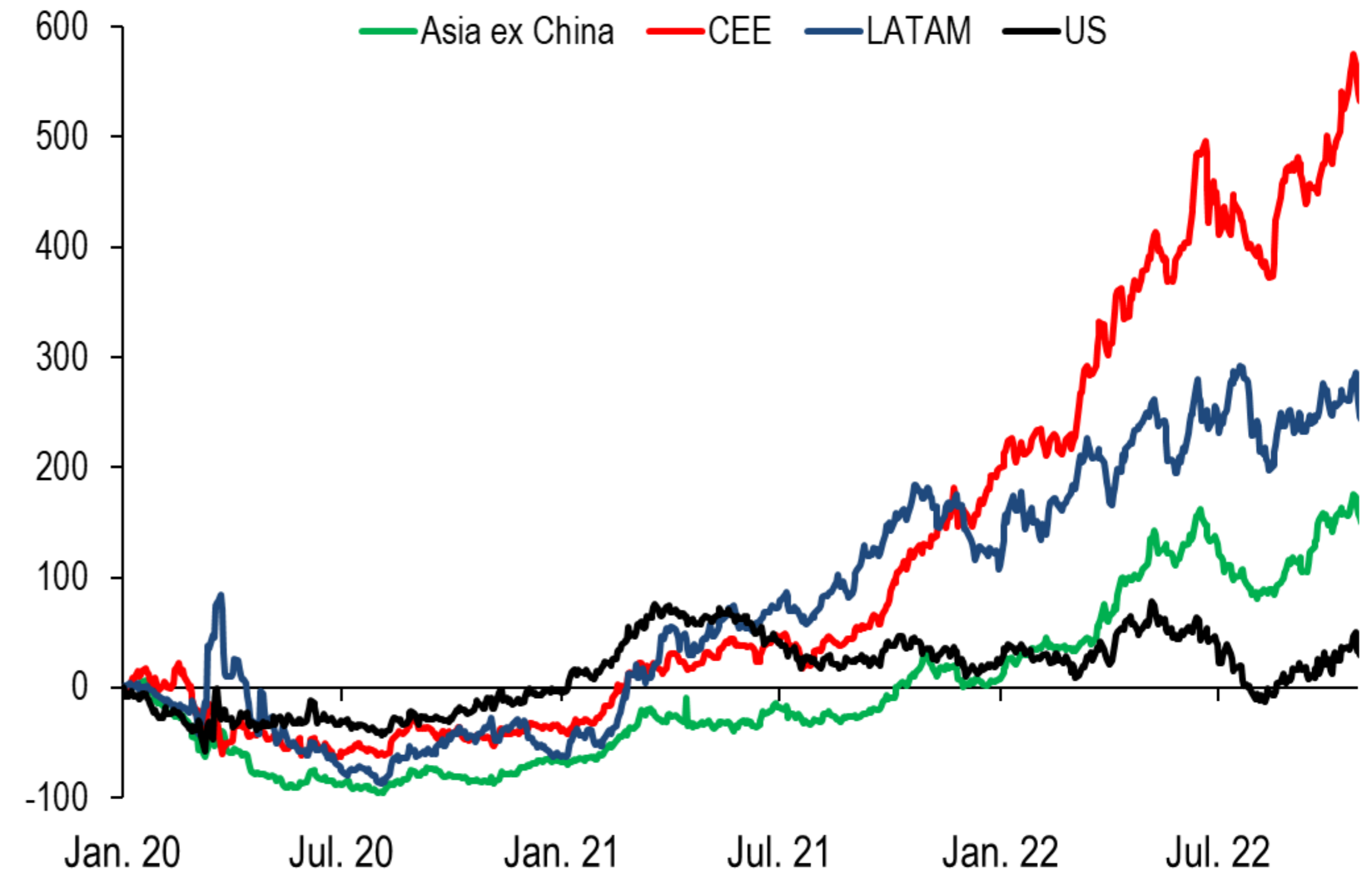
EMs are expected to begin easing in 2023...

...but term premia remain elevated due to global uncertainty

Historical and Market-Implied Policy Rates across Regions (Percent)



Change in Five-year Term Premia since January 2020 (Basis points)



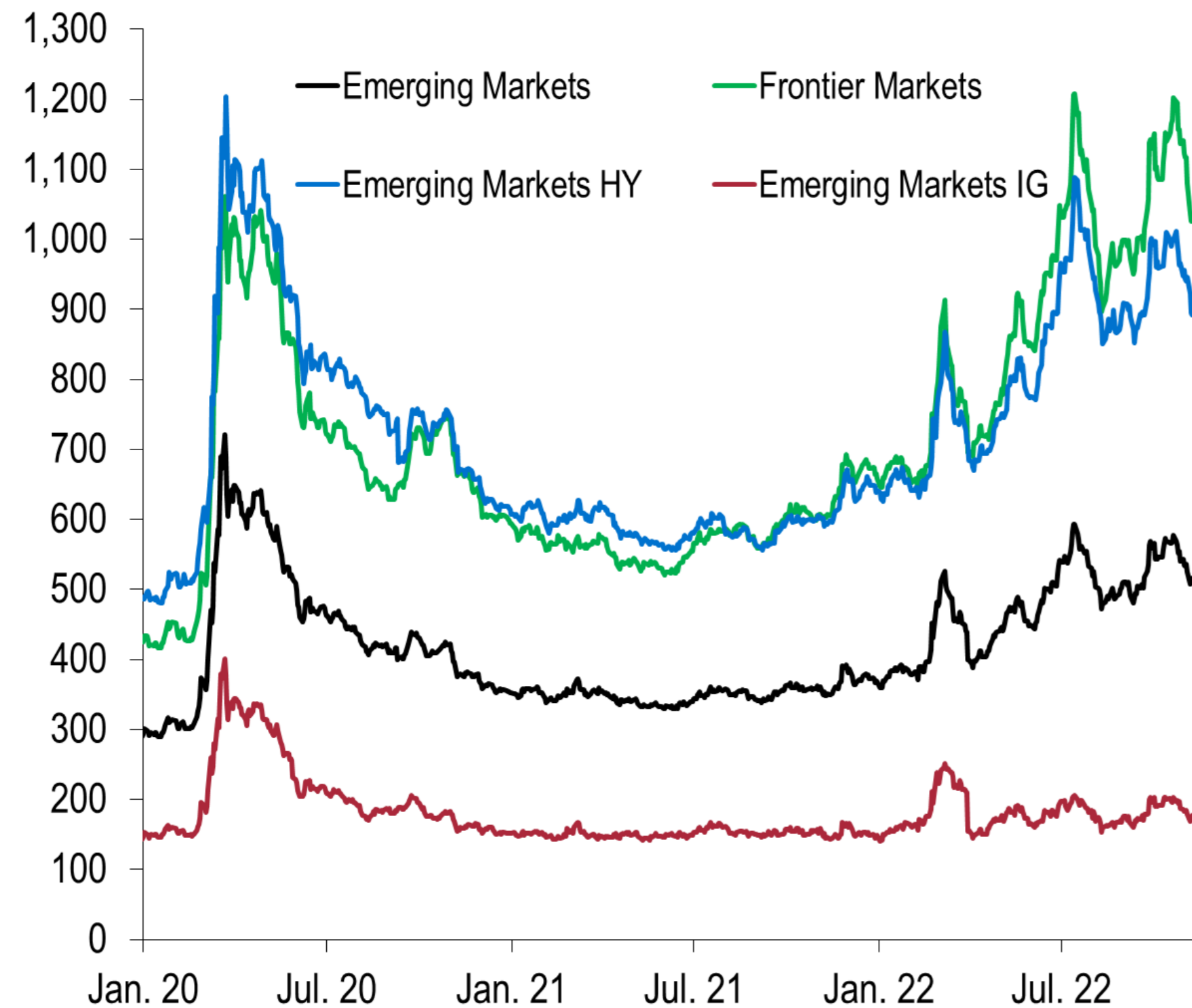
Note: CEE reflecting the average of Poland, Czech Republic and Hungary.

Serious Sovereign Debt Risks In Many Vulnerable EMDEs

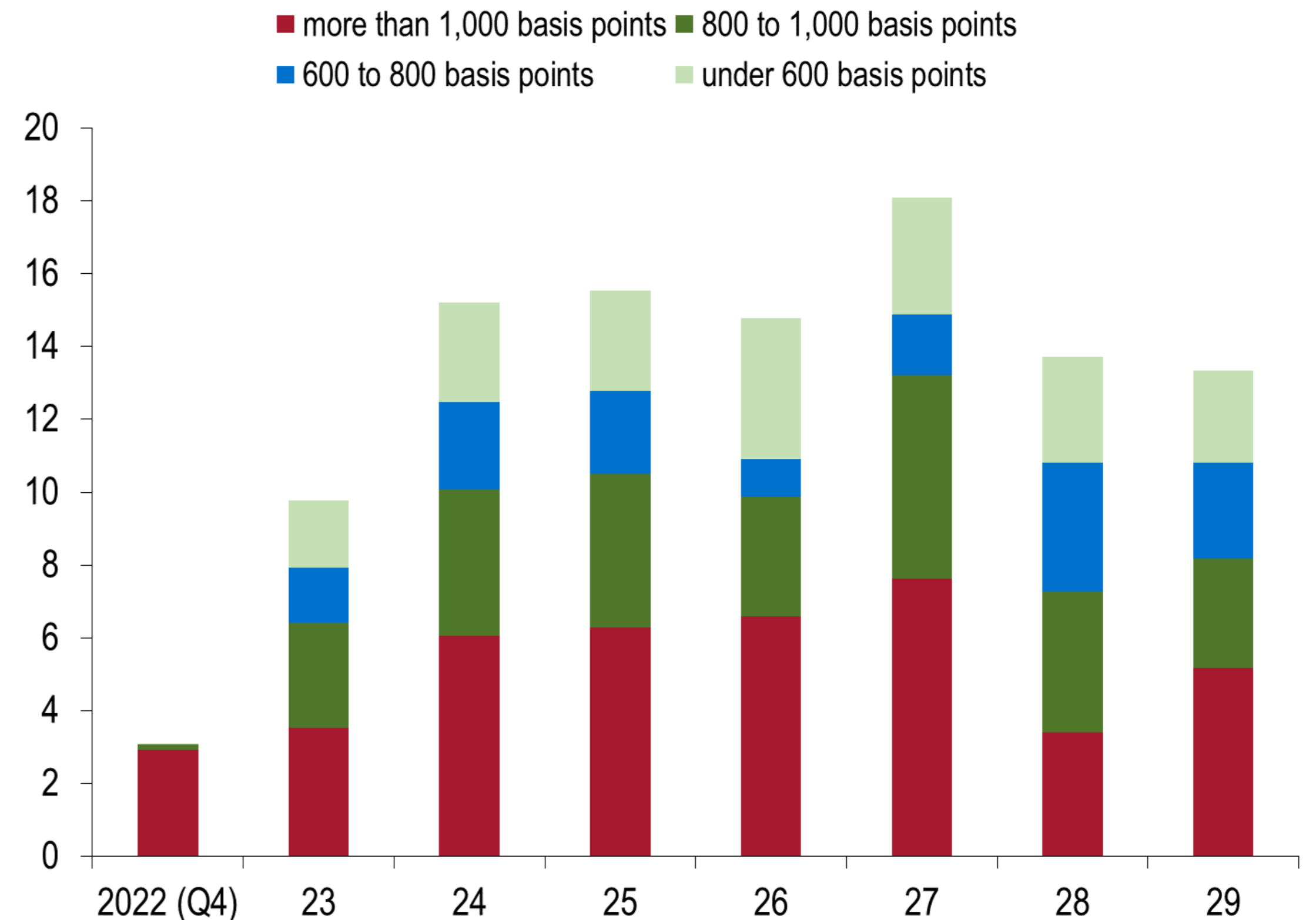
While large issuers have shown resilience, many lower-rated issuers now trade at distressed levels

Frontier markets face challenging re-financings, with ~20 names at high risk of (or already in) default

Emerging market Sovereign Spreads
(Basis points)



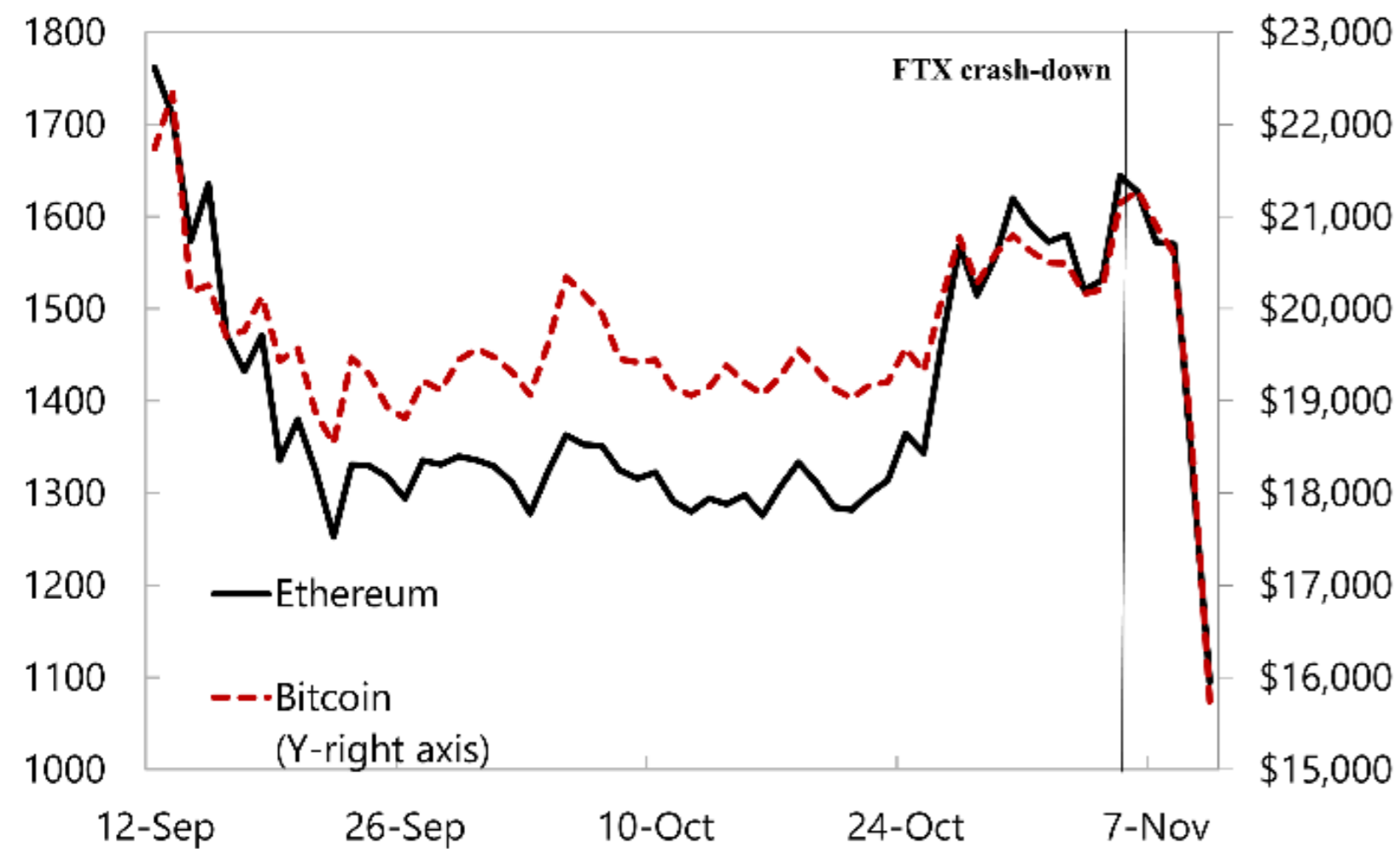
Hard- Currency Bond Maturities and Spreads
(Billions of US dollars)



FTX Bankruptcy Fallout Seems for now Contained Within Crypto

Price of crypto assets has plunged

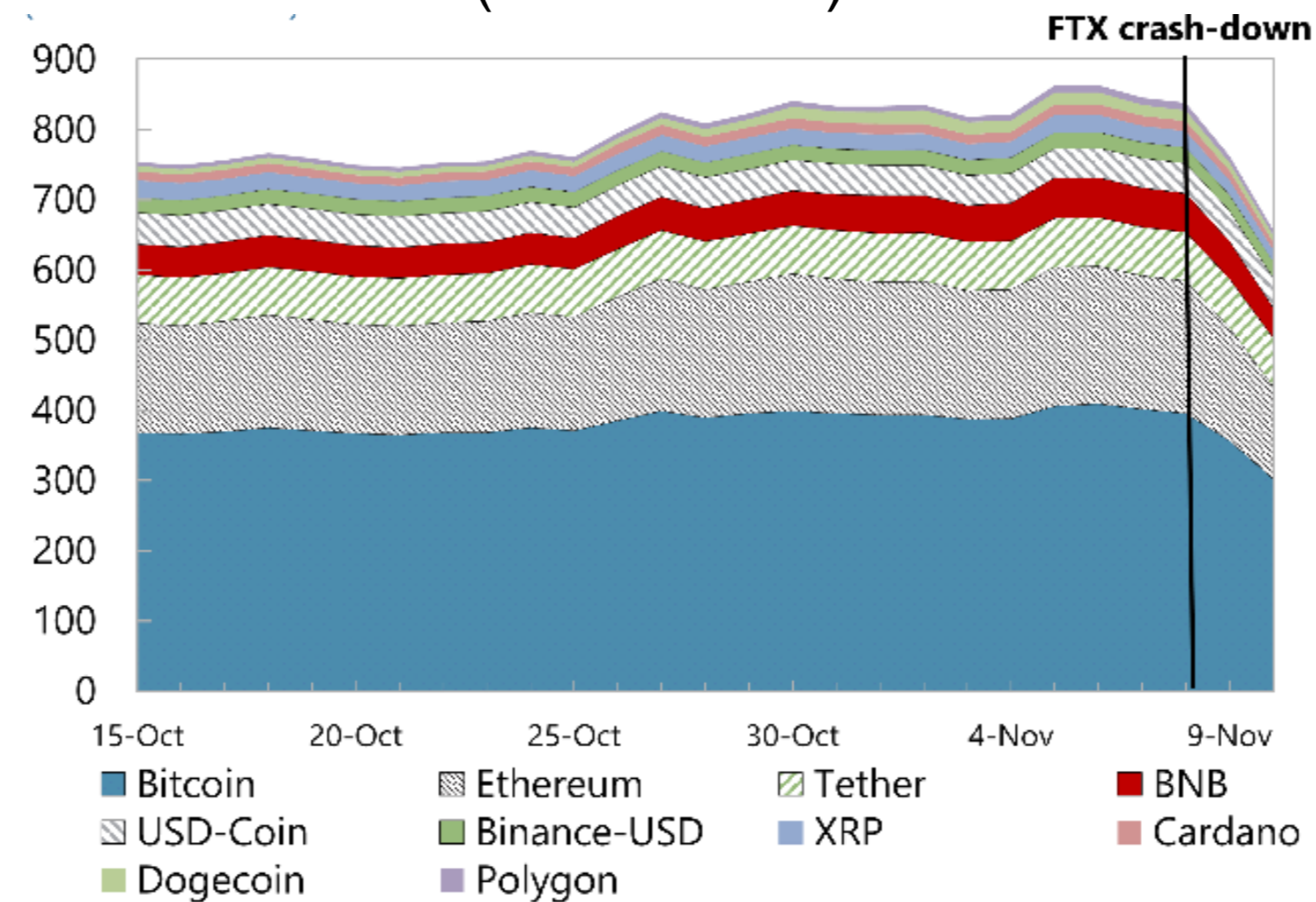
**Price of Bitcoin and Ethereum
(in USD)**



Source: Coingecko

And market capitalization dropped dramatically

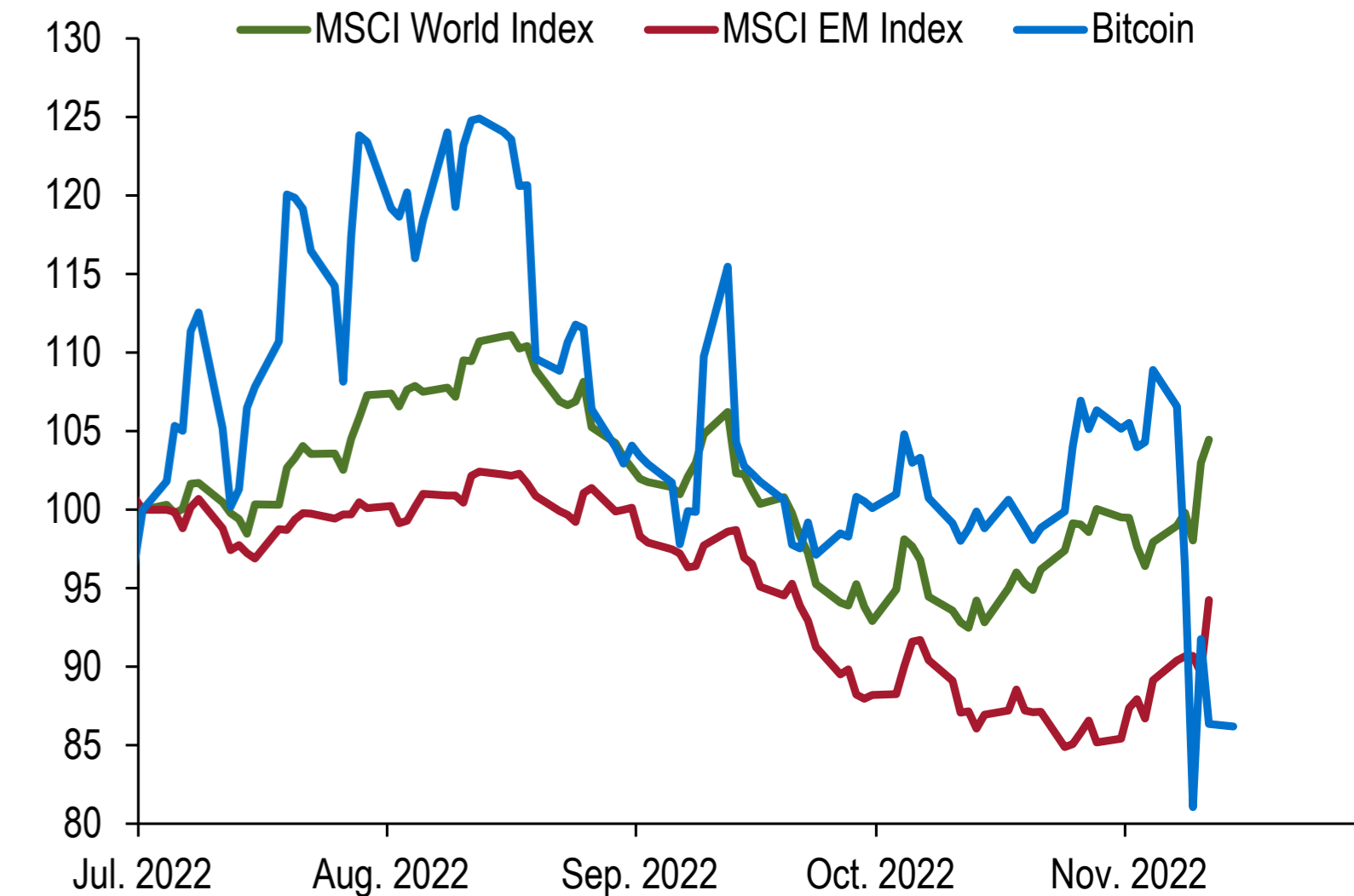
**Market Capitalization of Crypto Market
(USD Billion)**



Source: Coingecko

But there has been little contagion to other risky assets

**MSCI Equity Indices and Bitcoin
(Jul 1, 2022=100)**



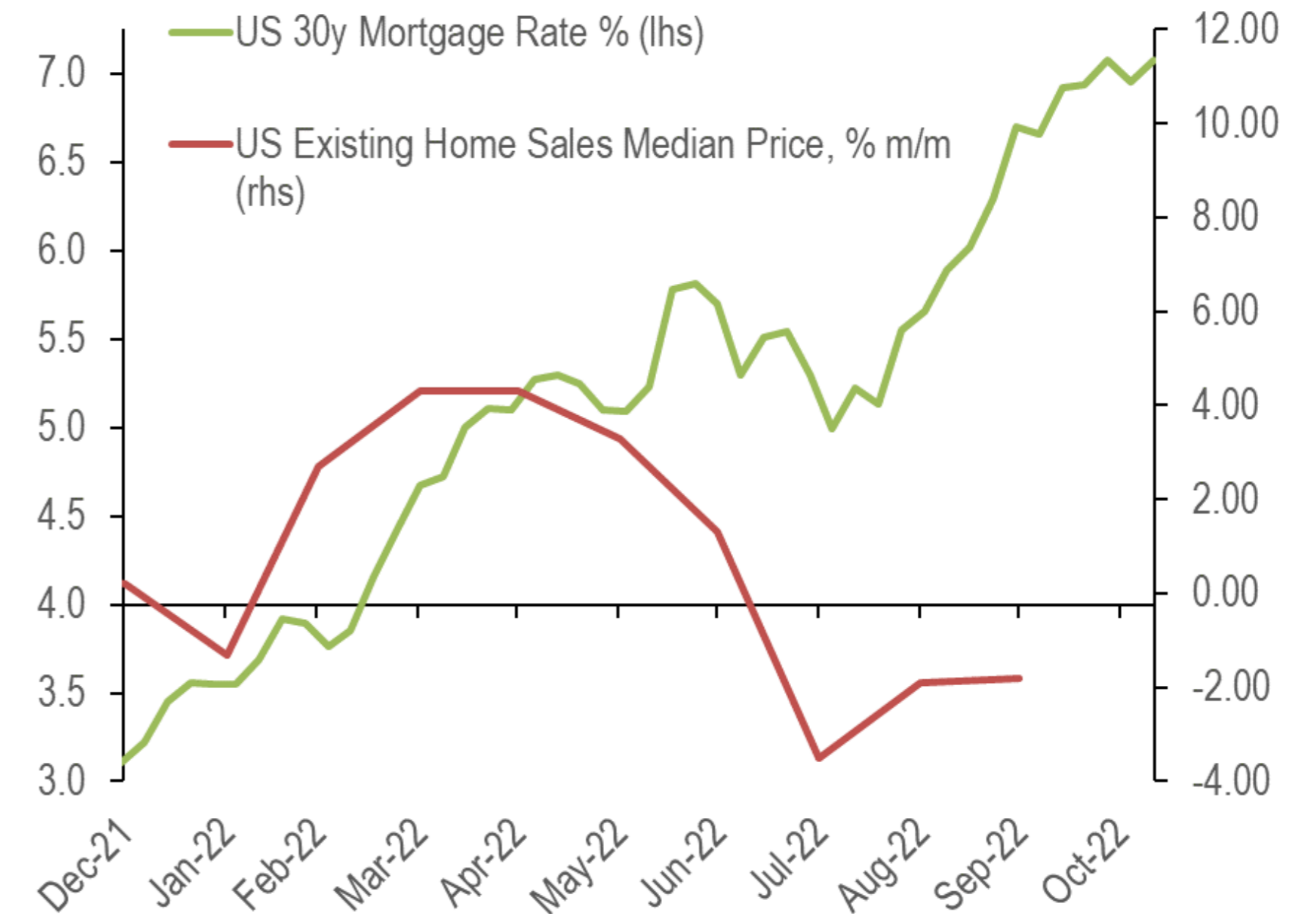
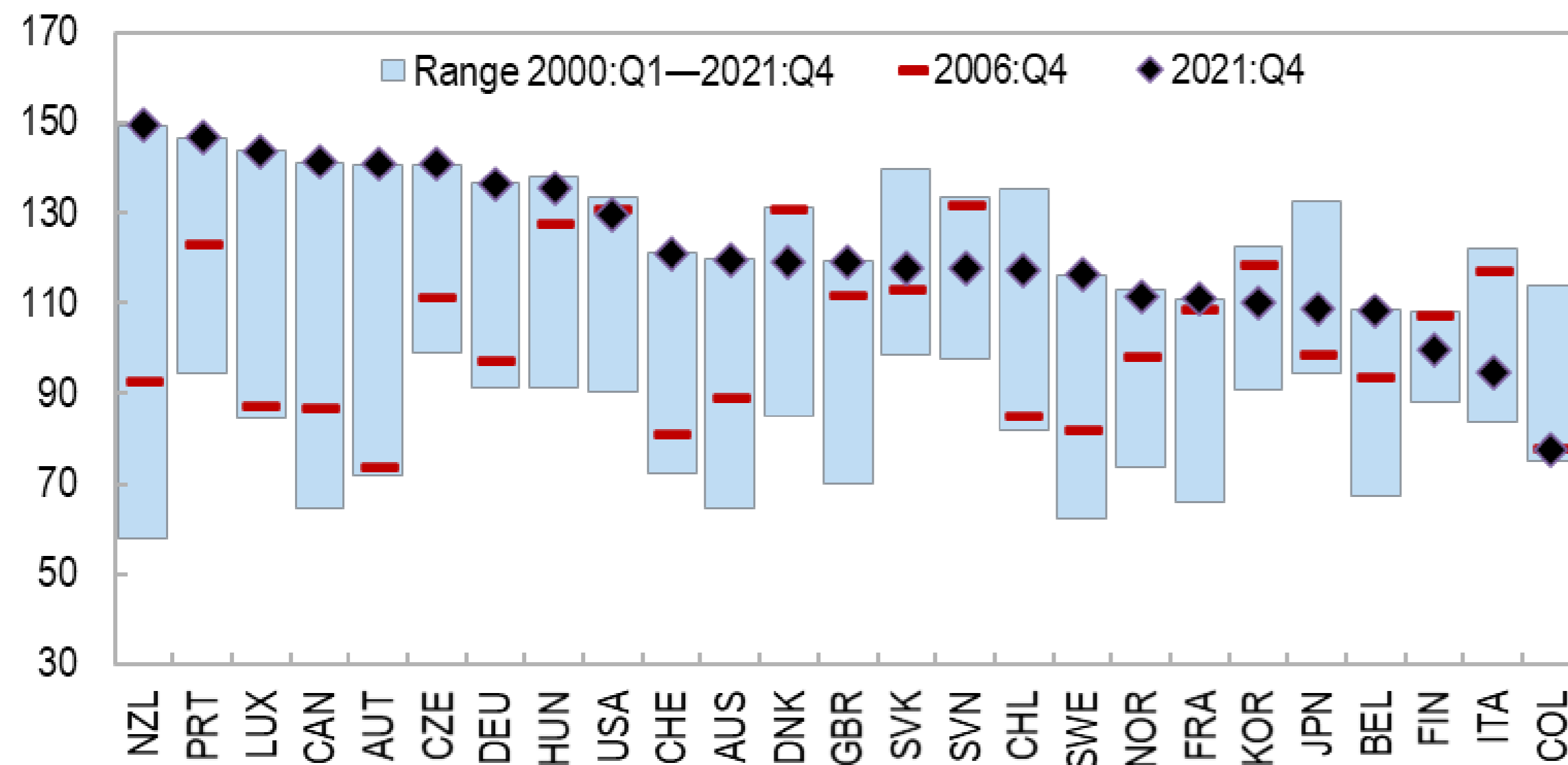
Global Housing Markets May Come Under Further Pressure

Stretched housing valuations relied on low rates to maintain affordability

Prices are beginning to turn as mortgage rates back up dramatically

Price-to-Income Ratio, 2000:Q1–21:Q4
(Index, 2015 = 100)

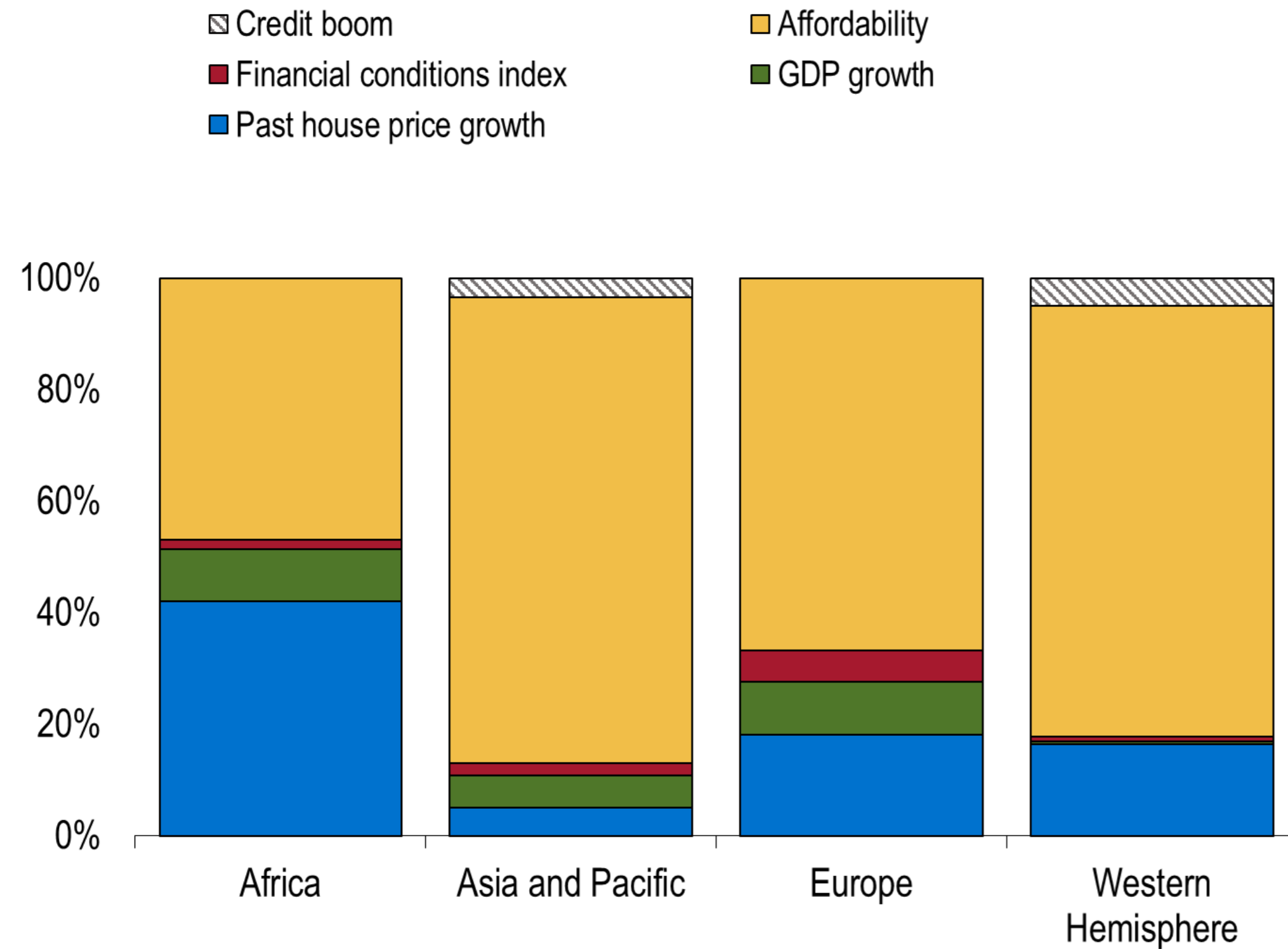
US 30y Mortgage rates and Home prices
(Percent)



House Price at Risk is Substantial, Especially for EMs

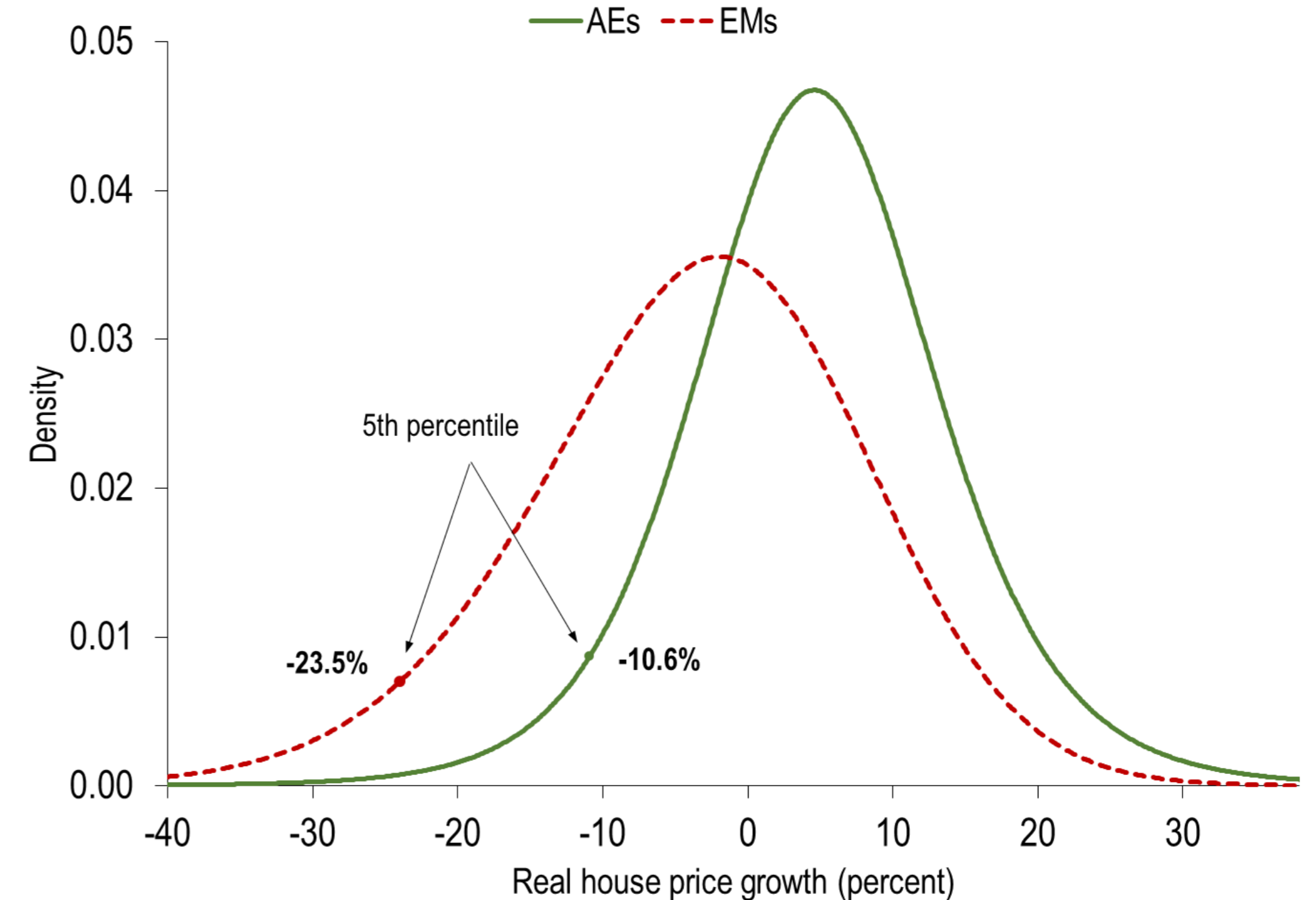
Affordability weighing on house prices

House Price at Risk Decomposition
(Percent, projected contribution, latest)



EM downside risks are elevated

House- Price-at-Risk, Advanced Economies and Emerging Markets, Three Years Ahead
(Density; cumulative growth in percent)

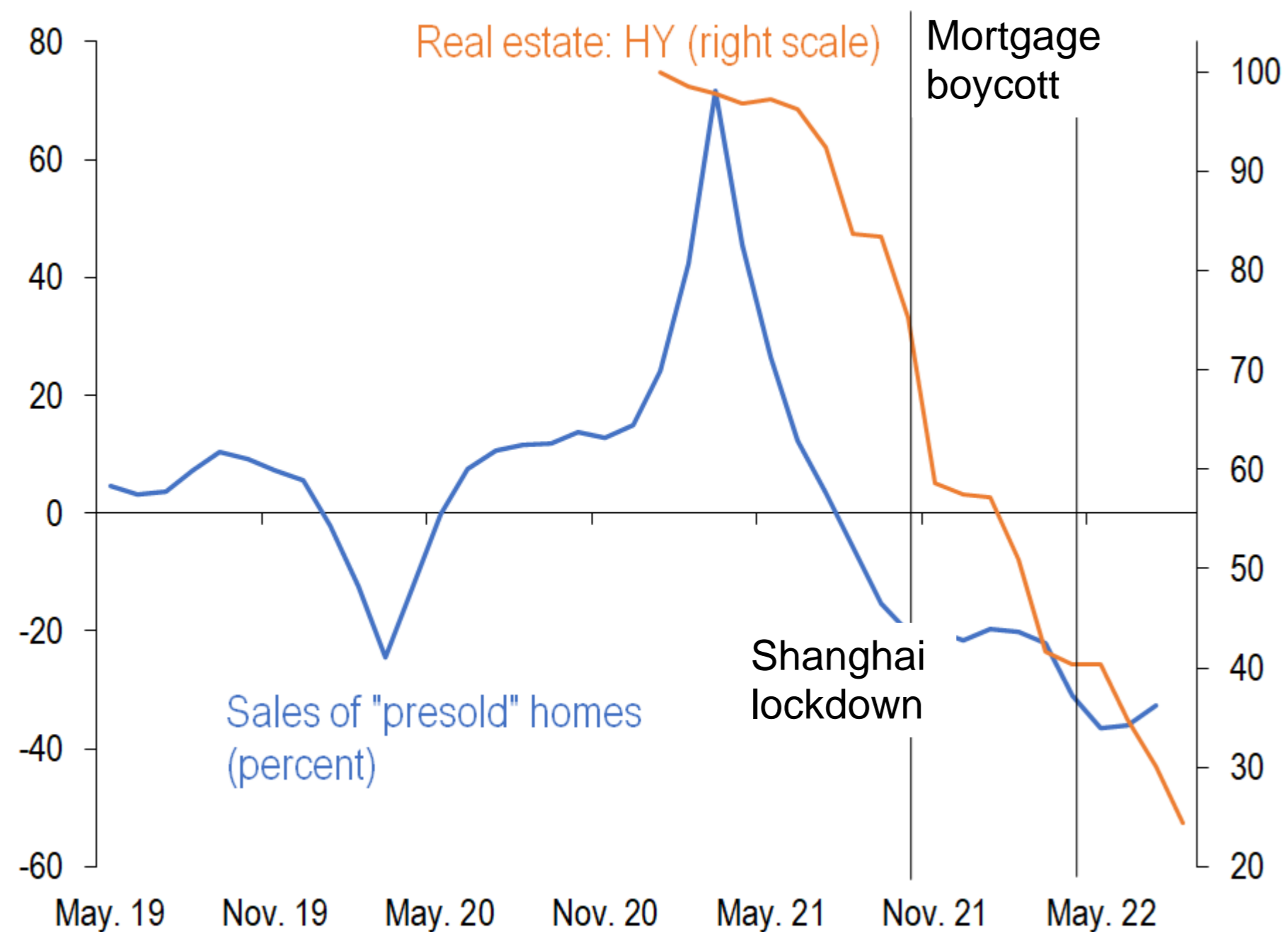


In China, Housing Risks May Spread Far Beyond Property Developers

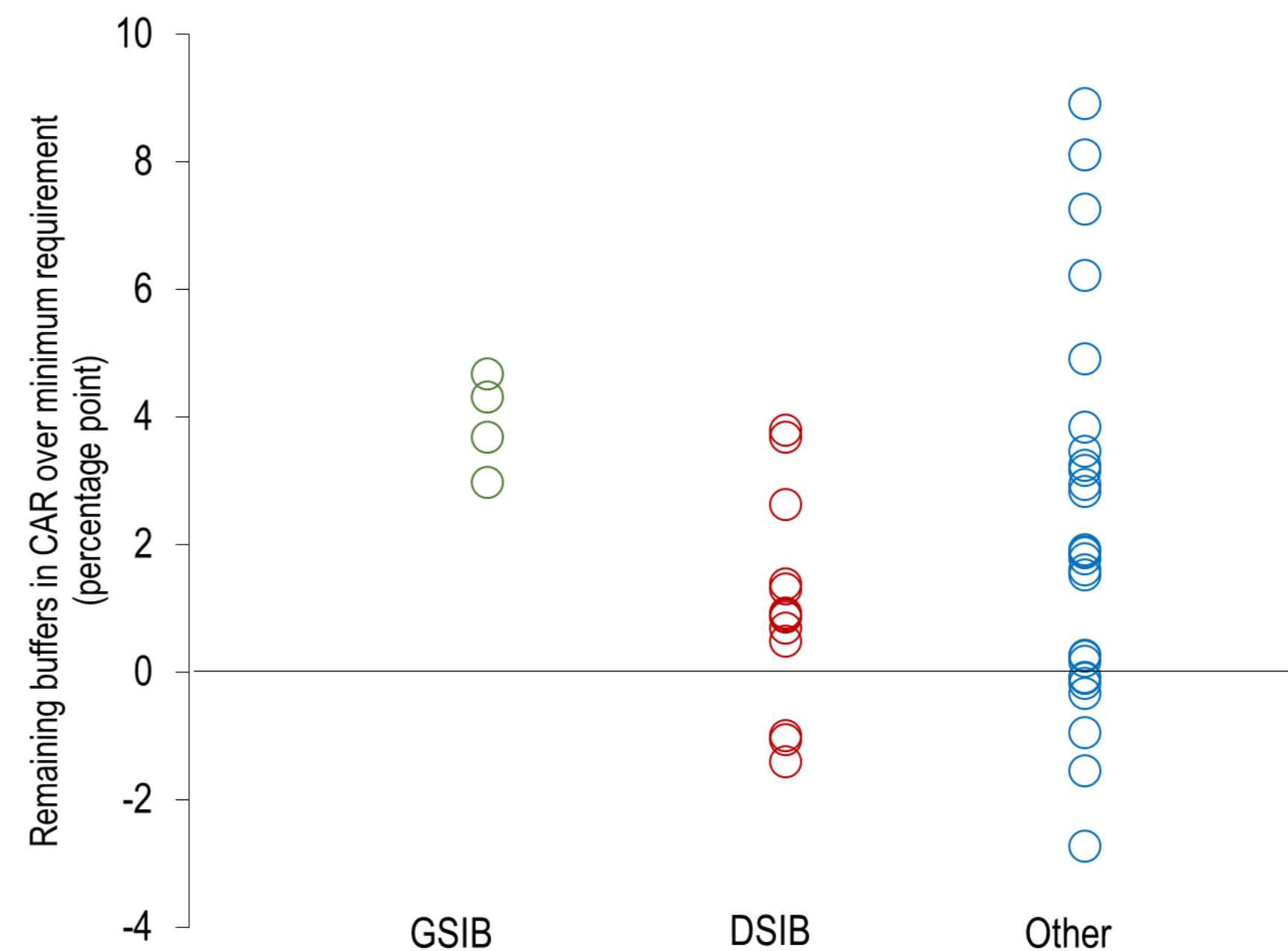
A stalled housing market has put developers into distress, threatening home completions

If pre-sold mortgages end up in default, many banks could face large losses

Residential Real Estate Sales and Property Developer Bonds
(Index, May 2021 = 100)



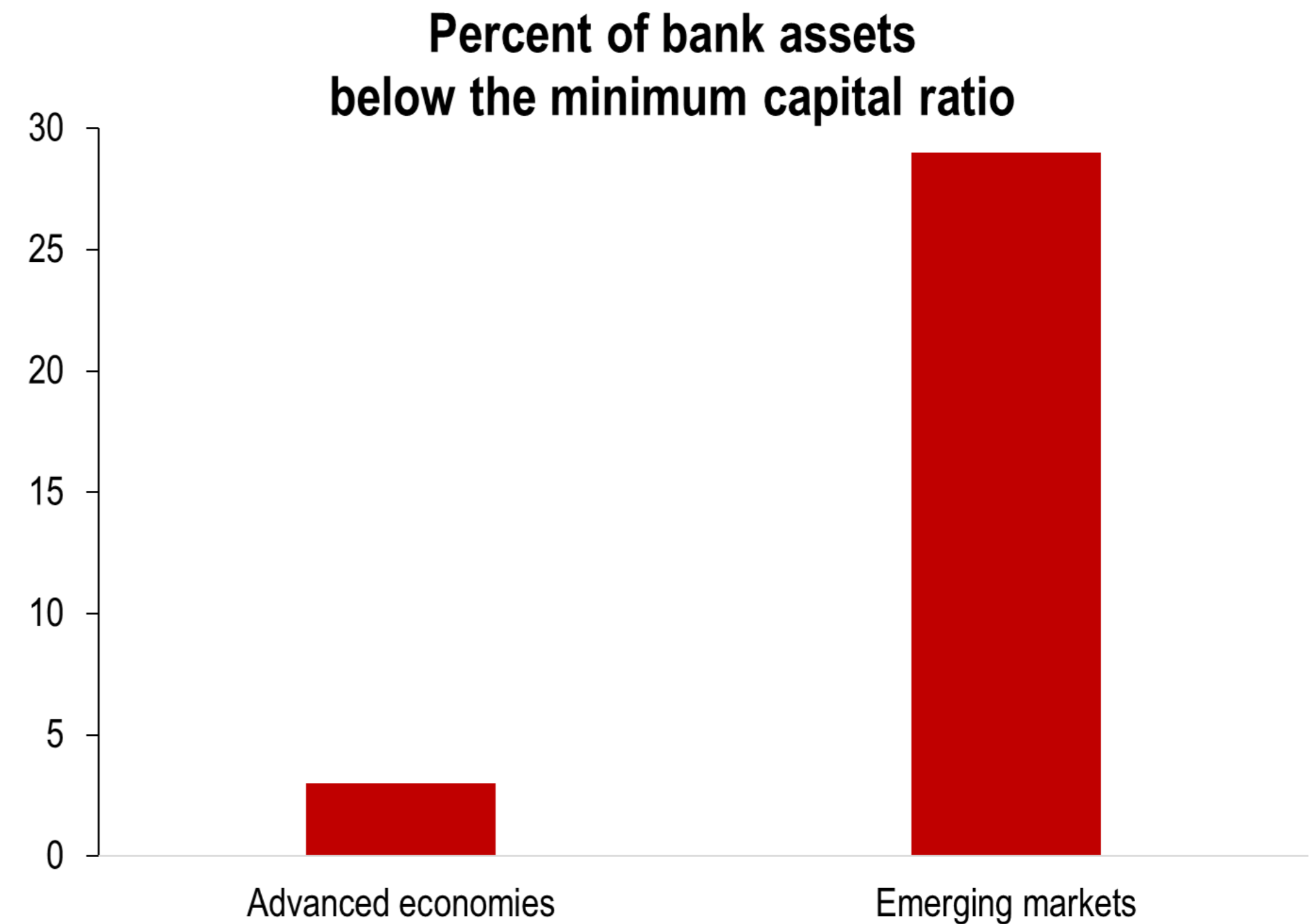
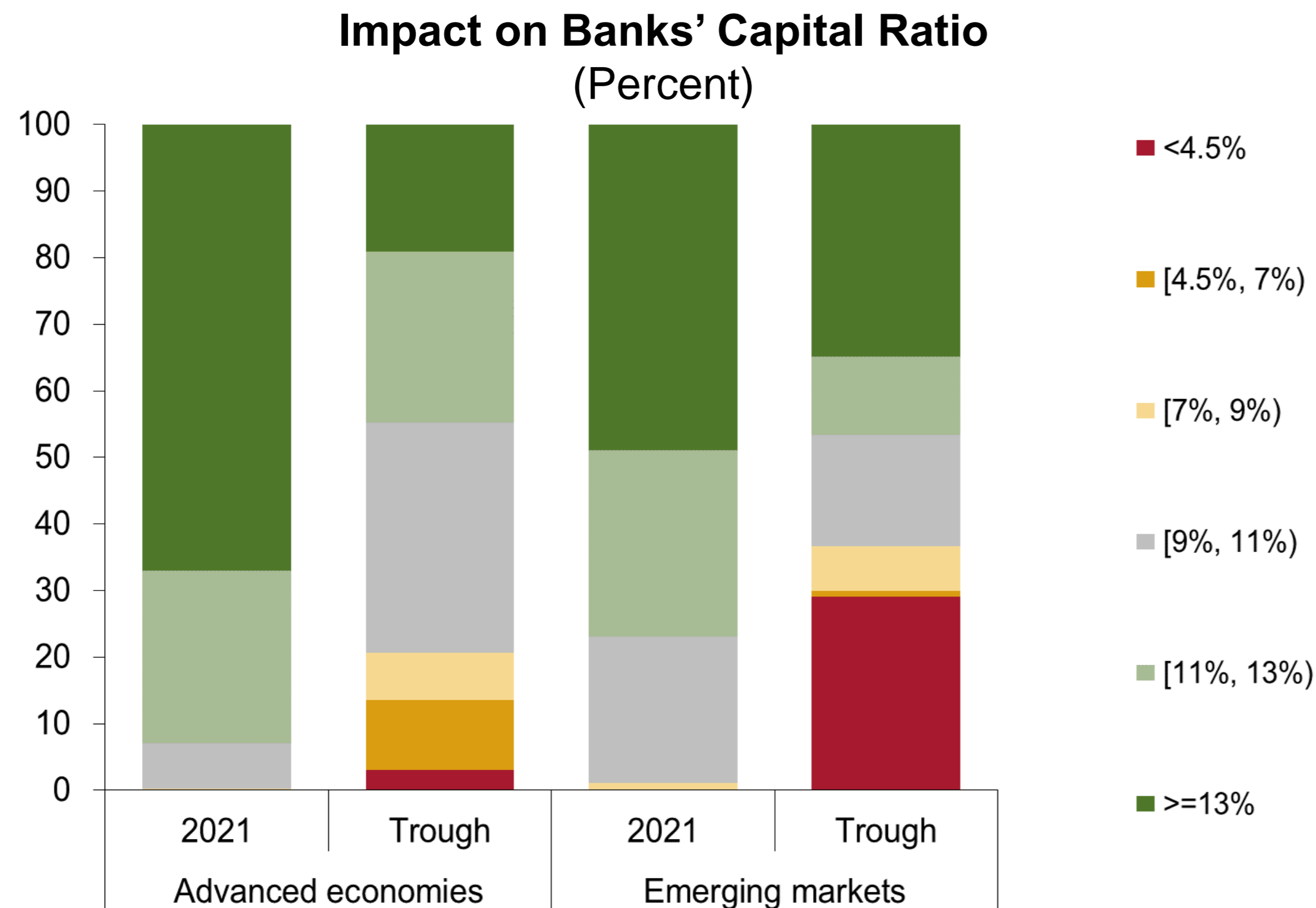
Banks: Potential Credit Losses Related to Real Estate Exposure
(Percent of total risk-weighted assets)



Global Banking Stress Tests Shows Some Weaknesses in EMs

Globally systemic banks and those in advanced economies seem largely resilient to adverse scenarios...

...but many EM banks face significant recapitalization needs under a stress test



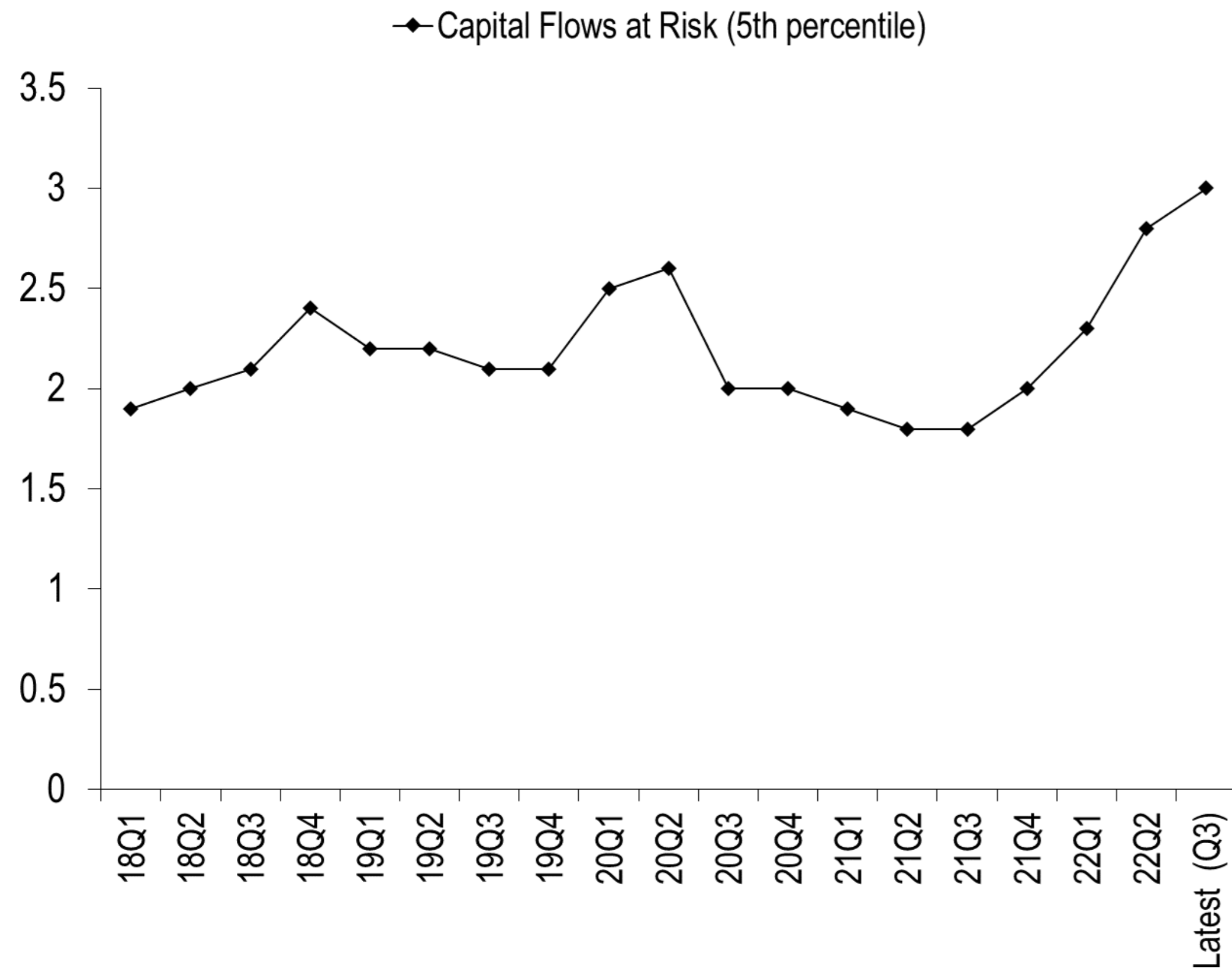
Capital Flows at Risk and Growth at Risk Reach Multi Year Highs

With high global rates and volatile capital markets, EMs face a risk of large outflows...

...and growth downside risk is nearing peak 2020 levels

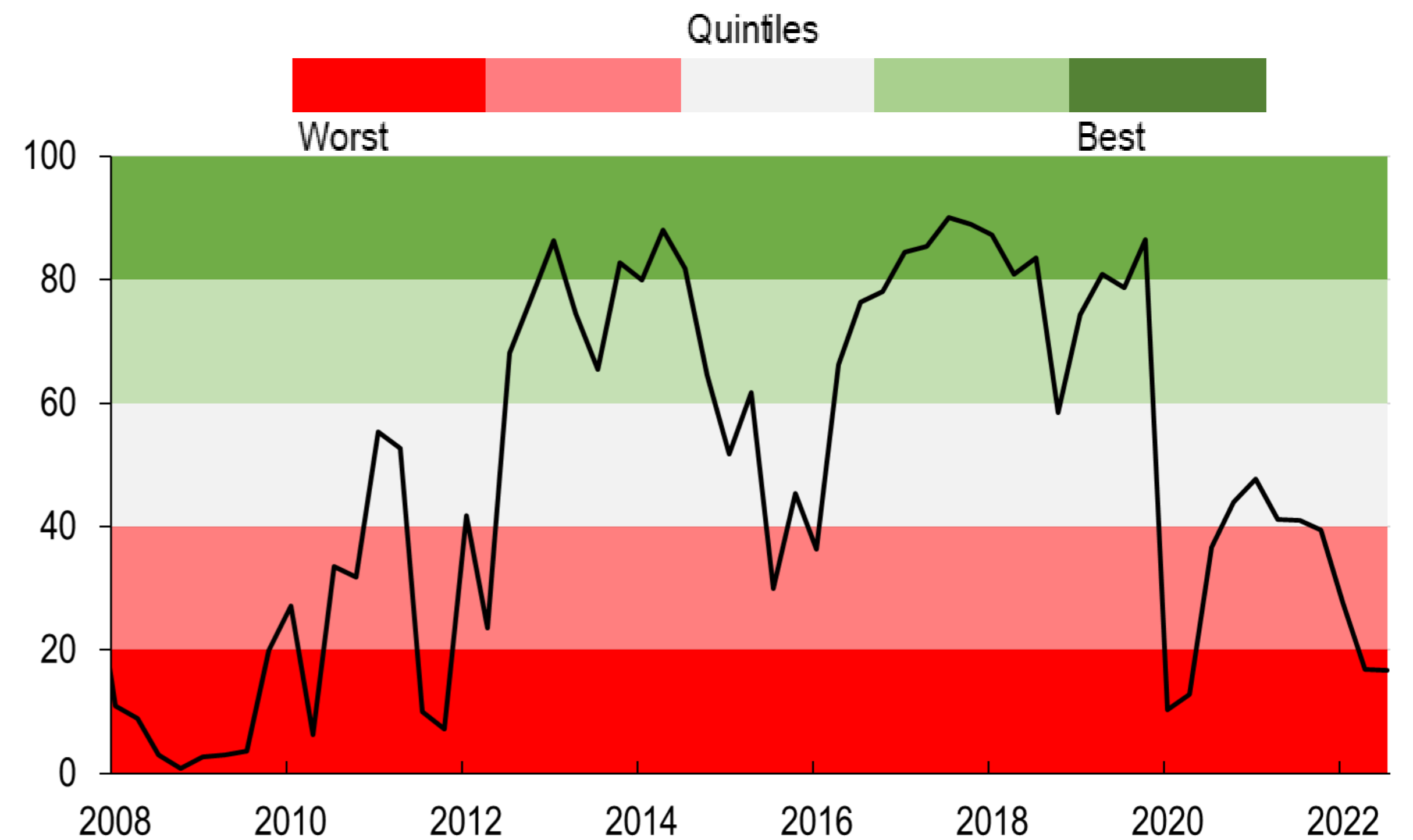
Capital Flows at Risk

(Probability density, percent, left scale; 5th percentile, percent of GDP)



Near-Term Growth at Risk Forecasts

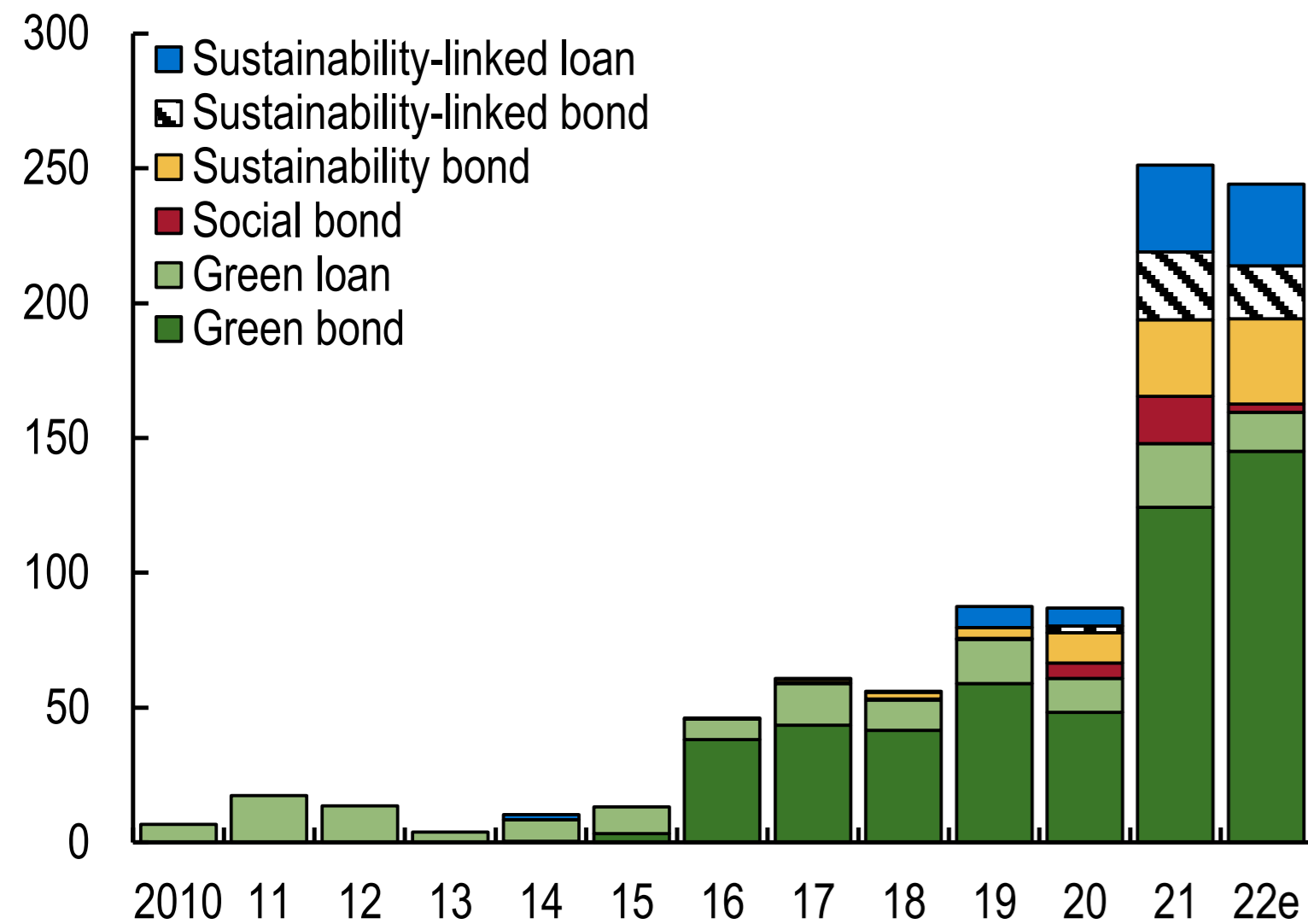
(Percentile rank)



The Market for Sustainable Finance in EMDEs is Growing

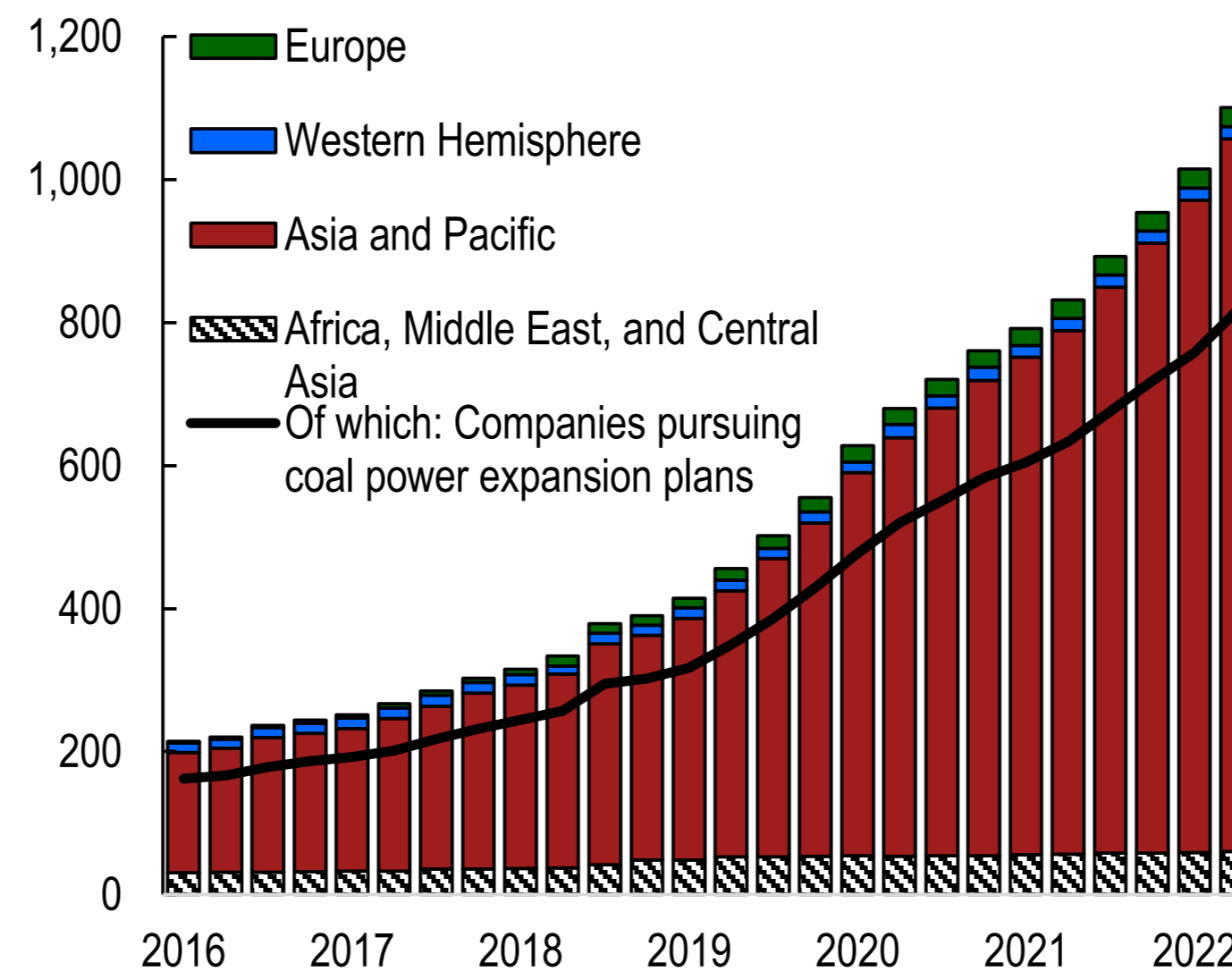
There has been a strong momentum in sustainable debt issuance in EMDEs...

Sustainable Instruments by Issuance Type
(Billions of US dollars; as of mid-2022)



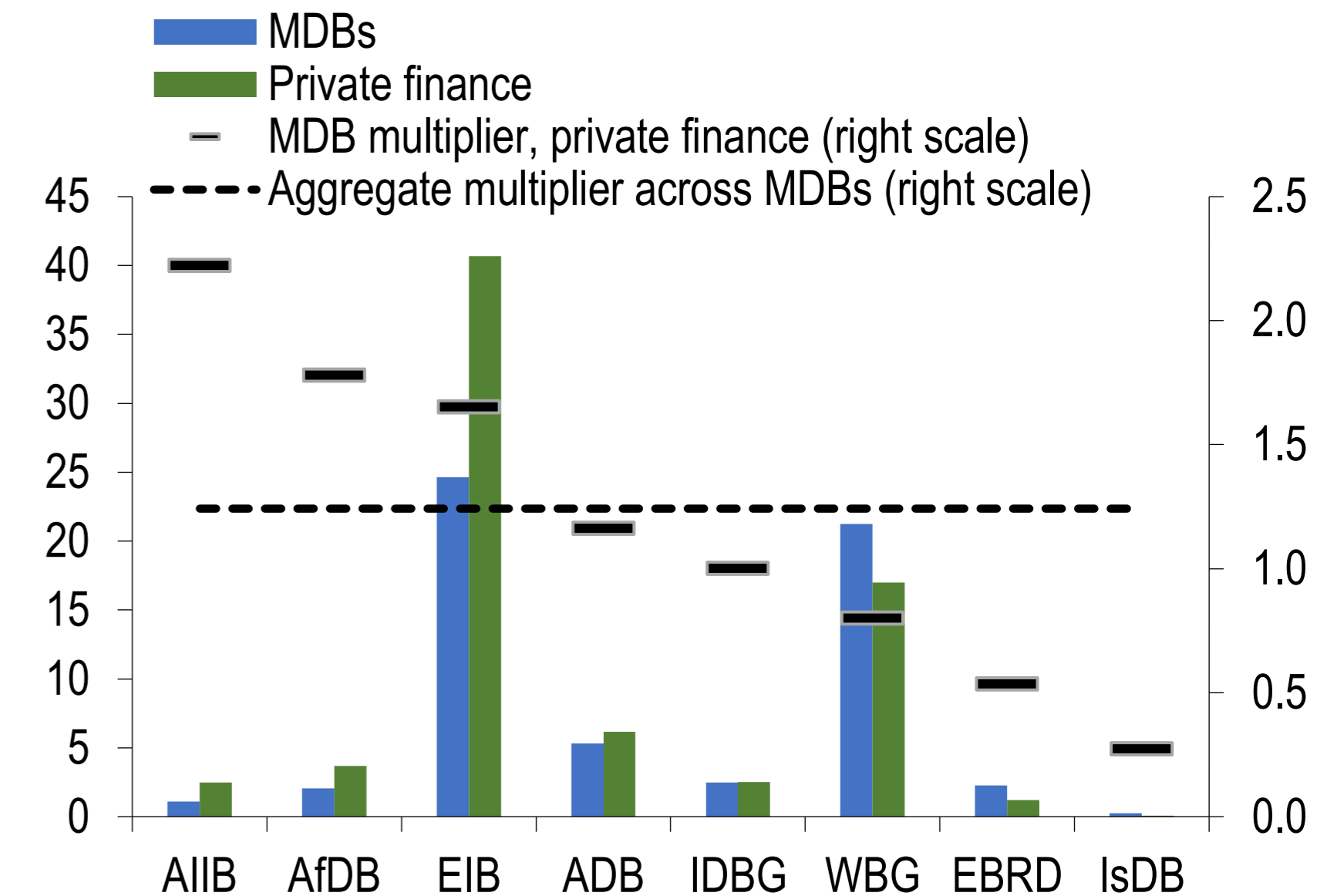
...while financing for fossil fuel firms in EMDEs is still rising rapidly.

EMDE-Domiciled Debt of Companies with Significant Role in Thermal Coal Value Chain
(Billions of US dollars)



MDBs have to play a key role in crowding in private finance.

MDB Climate Finance from Own Resources & Private Investors (private finance), 2020
(Billions of US dollars, left scale; ratio, right scale)



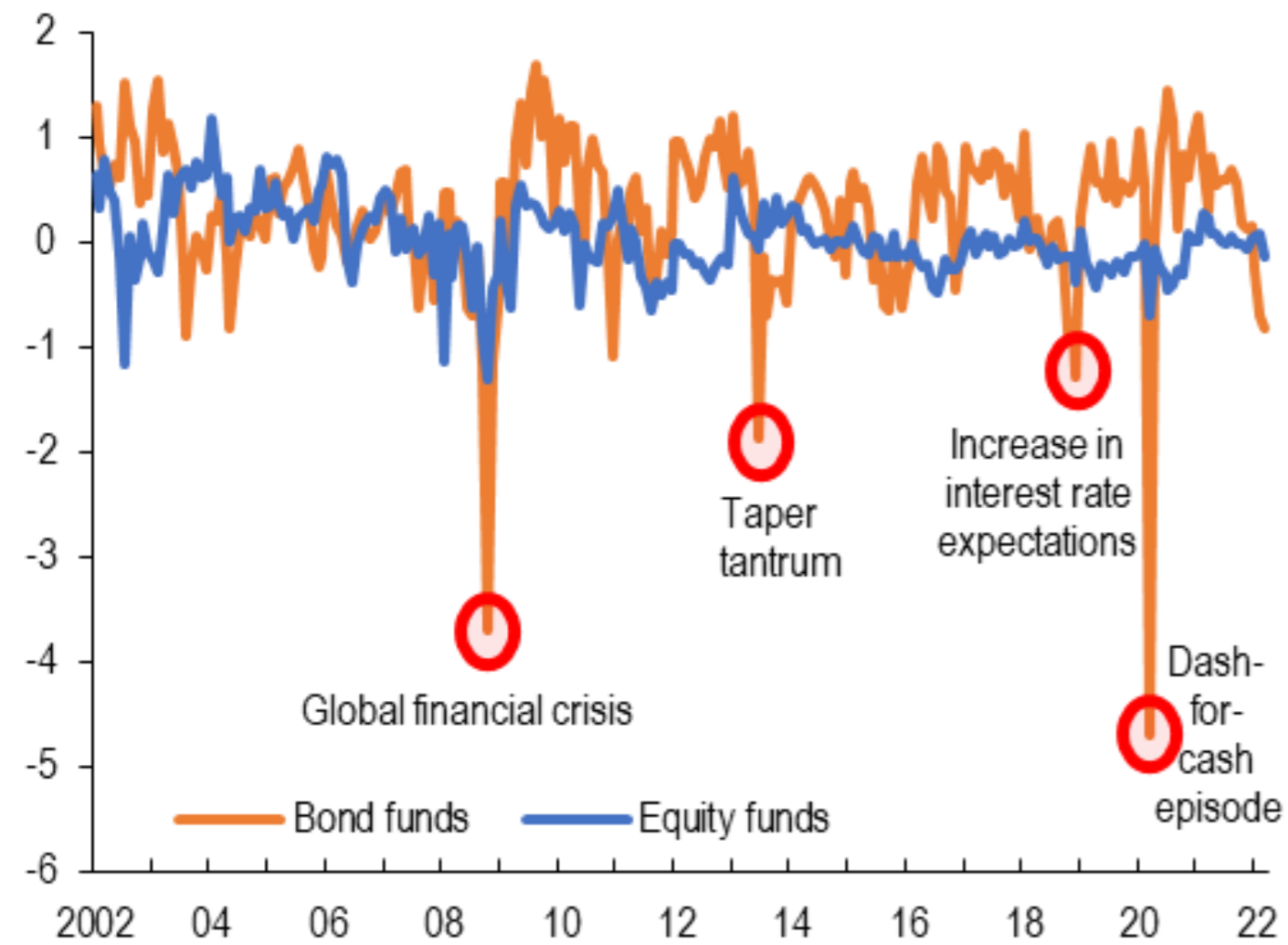
Note: ADB = Asian Development Bank; AfDB = African Development Bank; AiIB = Asian Infrastructure Development Bank; EBRD = European Bank for Reconstruction and Development; EIB = European Investment Bank; IDBG = Inter-American Development Bank Group; IsDB = Islamic Development Bank; MDB = multilateral development bank; WBG = World Bank Group.

But Several Challenges Will Need to be Overcome

Resilience of Open-End Investment Funds May Be Tested Again

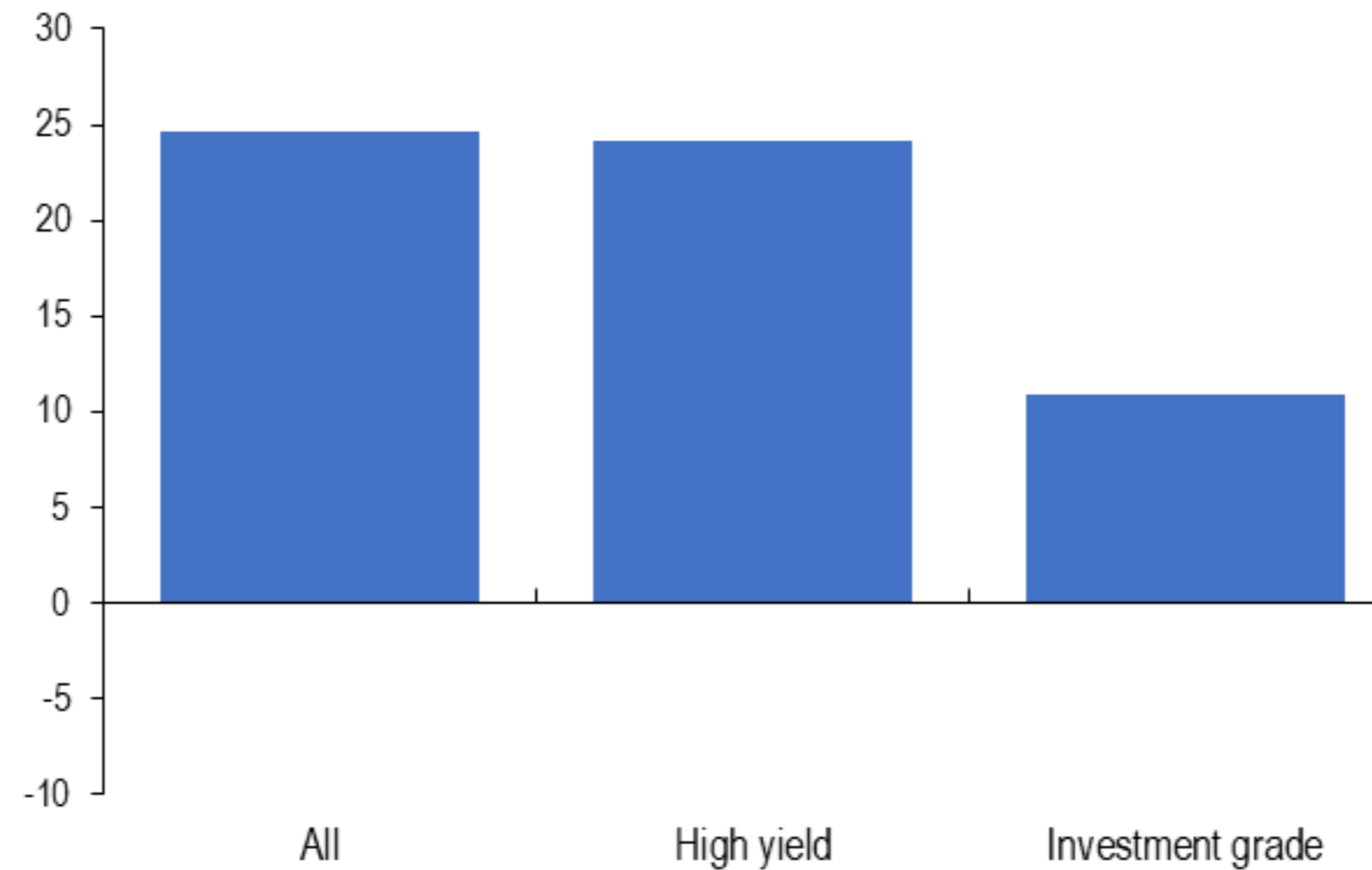
The March 20 market turmoil revealed vulnerabilities of open-end funds.

Monthly Net Flows
(Percent of lagged total net assets)



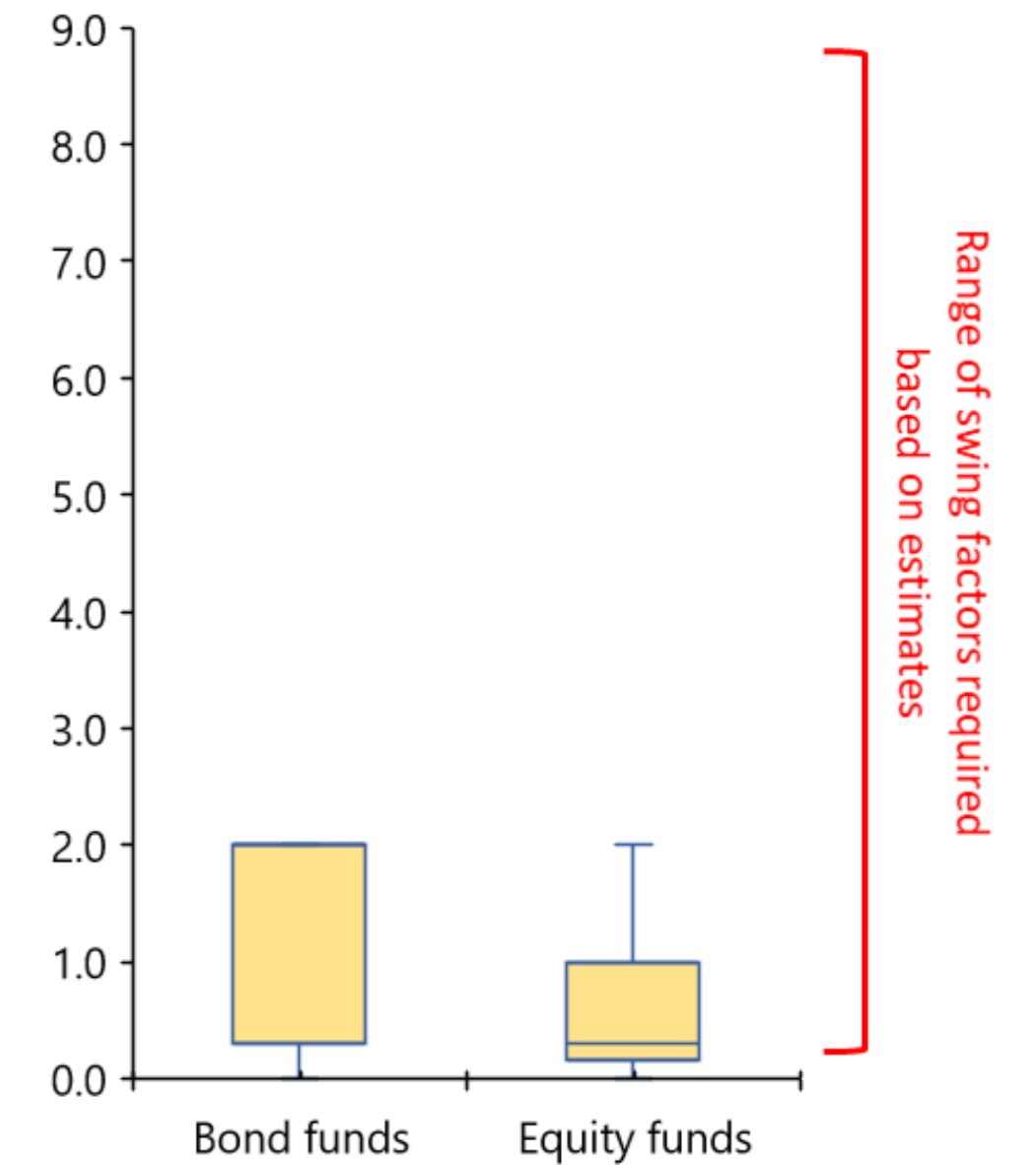
Corporate bonds held by less liquid funds have higher return volatility.

Effect of Vulnerability on Corporate Bond Return Volatility
(Percent of median volatility)



Swing pricing can mitigate fragilities, albeit often capped at levels that appear too low.

Maximum Downward Swing Factor among 200 Sample Funds
(Boxes cover the 25th–75th percentiles)



Effective liquidity management tools are key

GFSR Policy Recommendations to Preserve Financial Stability (1/2)

Monetary and Macroprudential Policy:

- *Central banks should act resolutely to restore price stability and avoid de-anchoring of inflation expectations that would damage credibility. Policymakers need to communicate clearly their policy function, their commitment to achieving their objectives, and the need to further normalize policy to avoid unwarranted market volatility.*
- *Policymakers should contain further buildup of financial vulnerabilities. While considering country specific circumstances and the near-term economic challenges, Policymakers should adjust selected macroprudential tools as needed to tackle pockets of elevated vulnerabilities.*
- *Striking a balance between containing the buildup of vulnerabilities and avoiding procyclicality and a disorderly tightening of financial conditions is important given heightened economic uncertainty and the ongoing policy normalization process.*

Recommendations for the NBFIs sector

- *The increasing importance of nonbank financial institutions (NBFIs) calls for counterparties to carefully monitor intraday activity and leverage exposures, strengthen their liquidity risk management practices and enhance transparency and data availability.*
- *Policy action is warranted to mitigate vulnerabilities and risks associated with open-end investment funds.*
- *Price-based liquidity management tools such as swing pricing can be effective in lowering asset price fragilities, but policymakers should provide further guidance on their implementation.*
- *Additional tools could include linking the frequency of redemptions to the liquidity of funds' portfolios.*
- *Policymakers should also consider tighter monitoring of funds' liquidity risk management practices, additional disclosures by open-end funds to better assess vulnerabilities, and measures to bolster the provision of liquidity.*