International Monetary Fund
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Global Financial Stability Report
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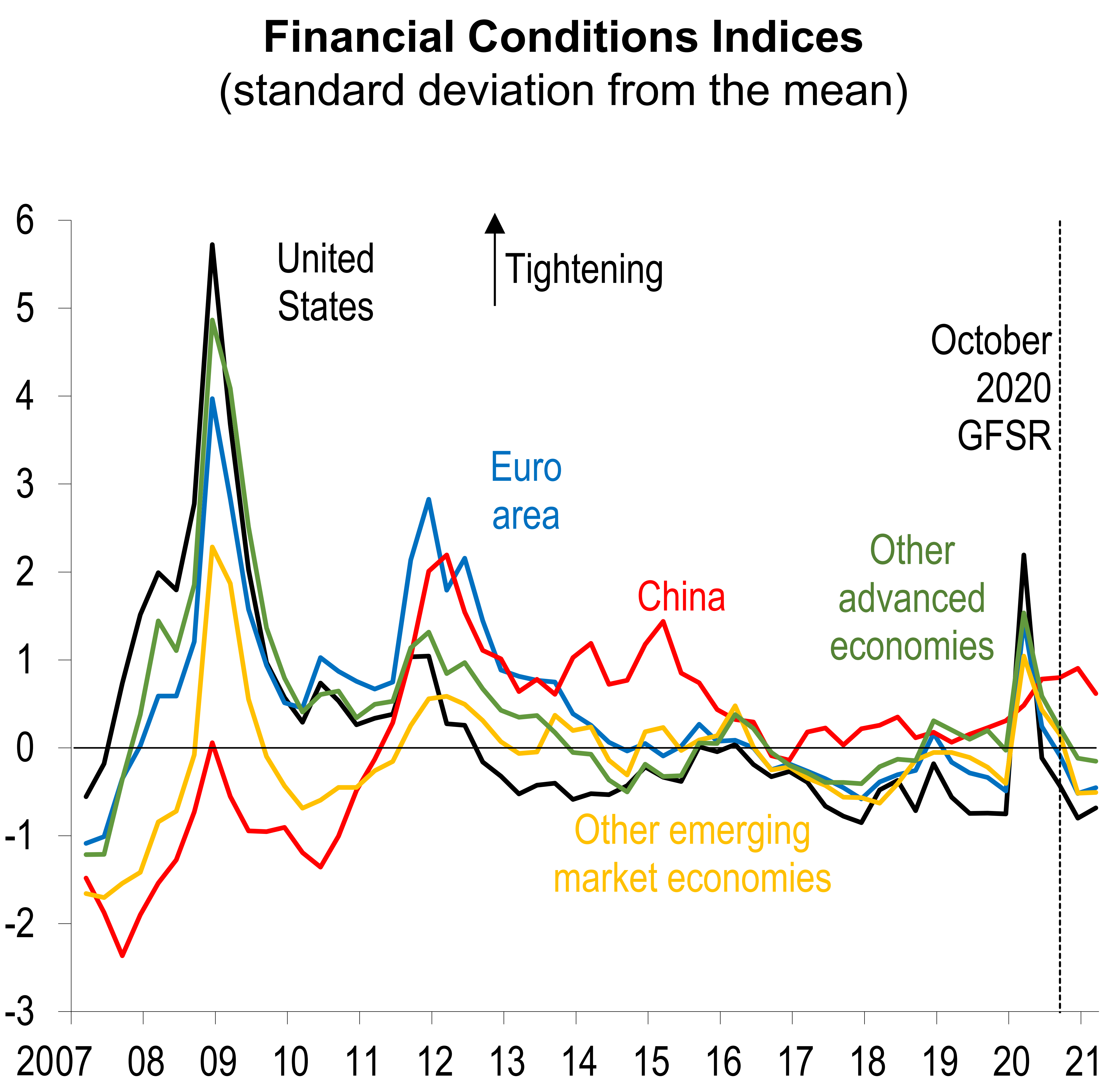
Financial Stability At Risk?

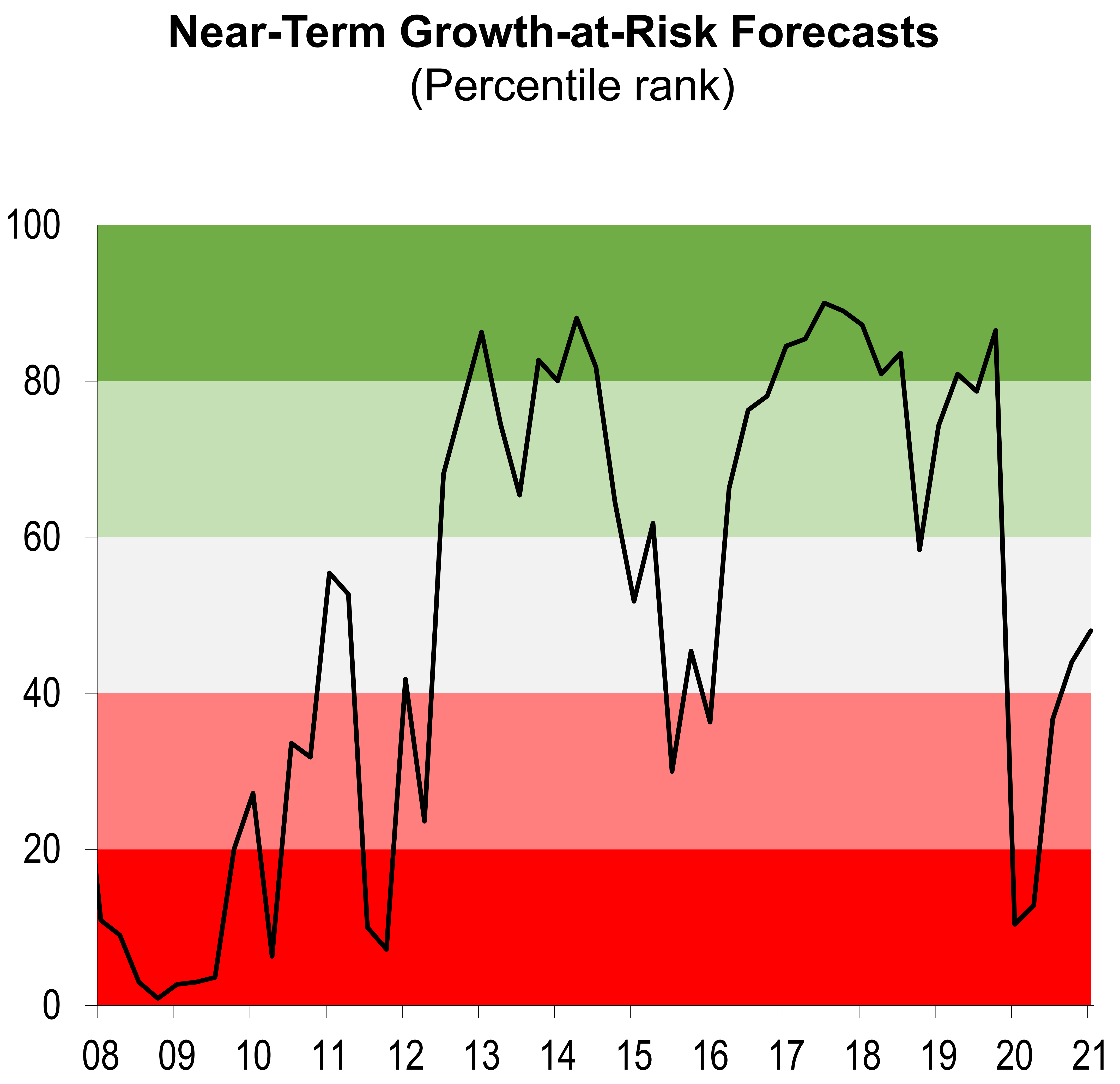
- **Reflation and "Bond tantrum", key risks for 2021: the increase in long-term interest rates could test the resilience of the financial system, possibly leading to a repricing of risk and a tightening in financial conditions.**

- **Risk of asynchronous recovery between AEs and EMs amplified by the rise in long-term US rates while many EMs will face daunting refinancing needs.**

- **Risks of unintended consequences from the unprecedented policy support call for pressing actions to avoid legacy of vulnerabilities.**

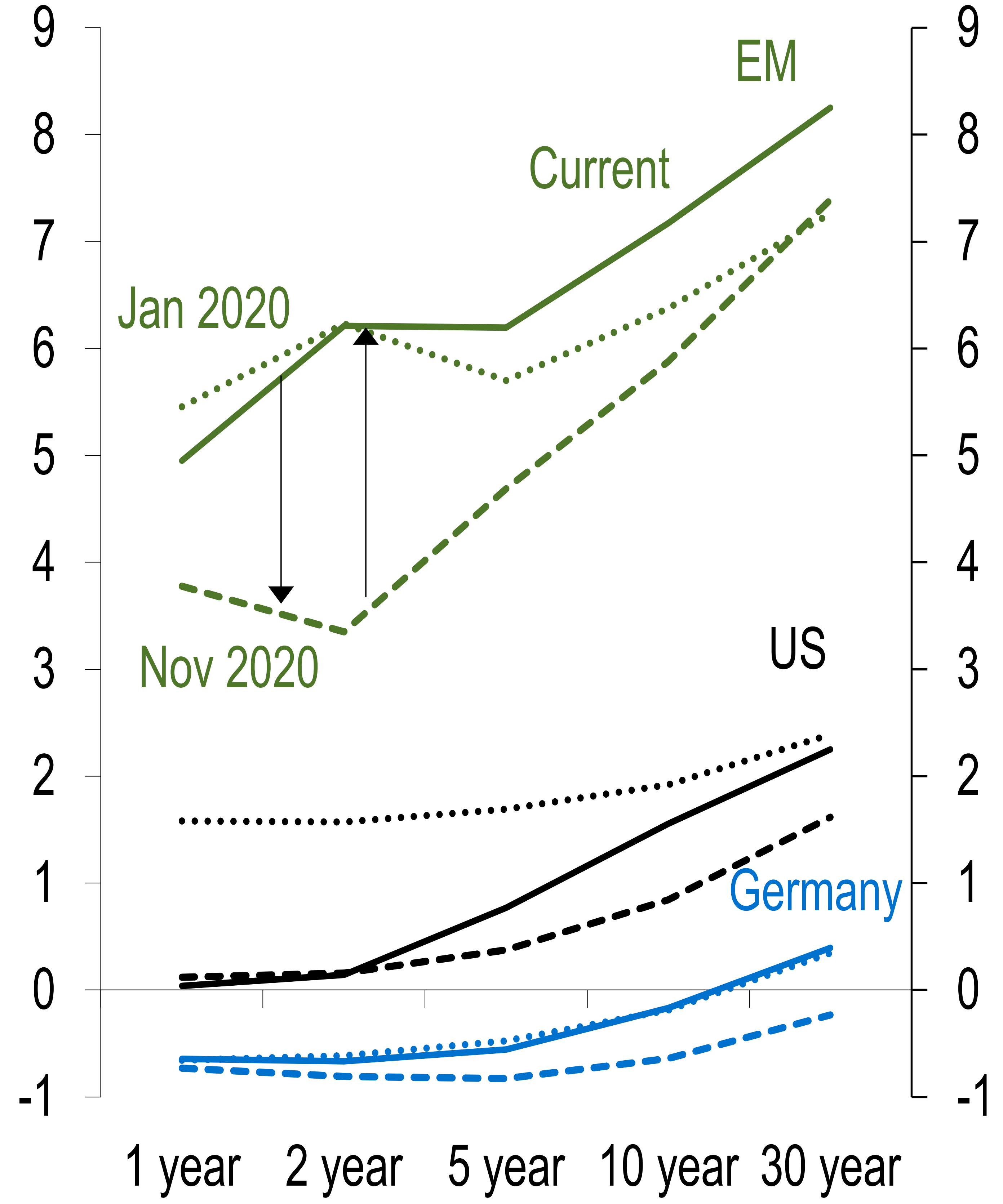
Global Financial Conditions Have Remained Accommodative



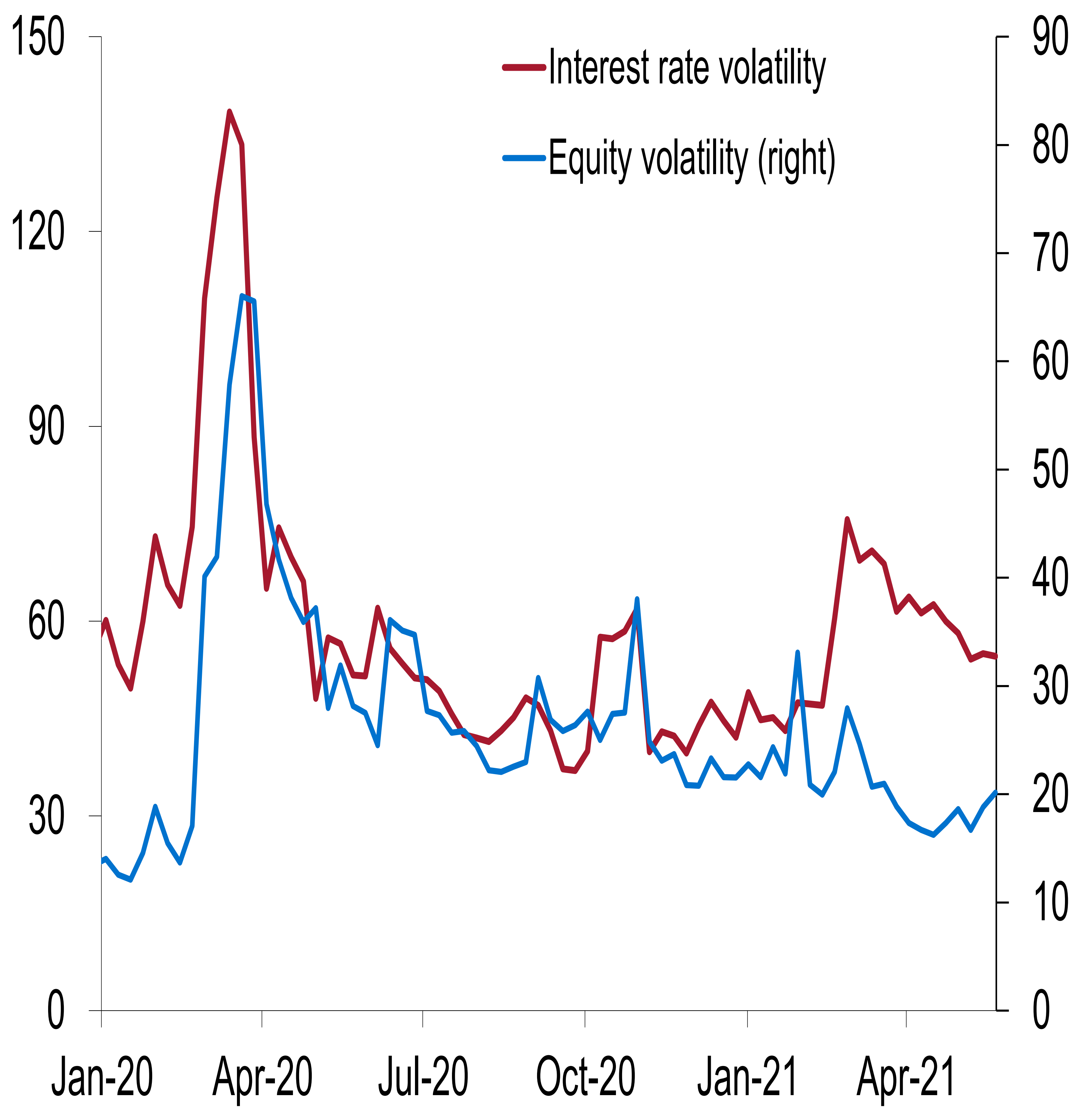


The Rise In Yields This Year Has Triggered A Spike In Interest Rate Volatility

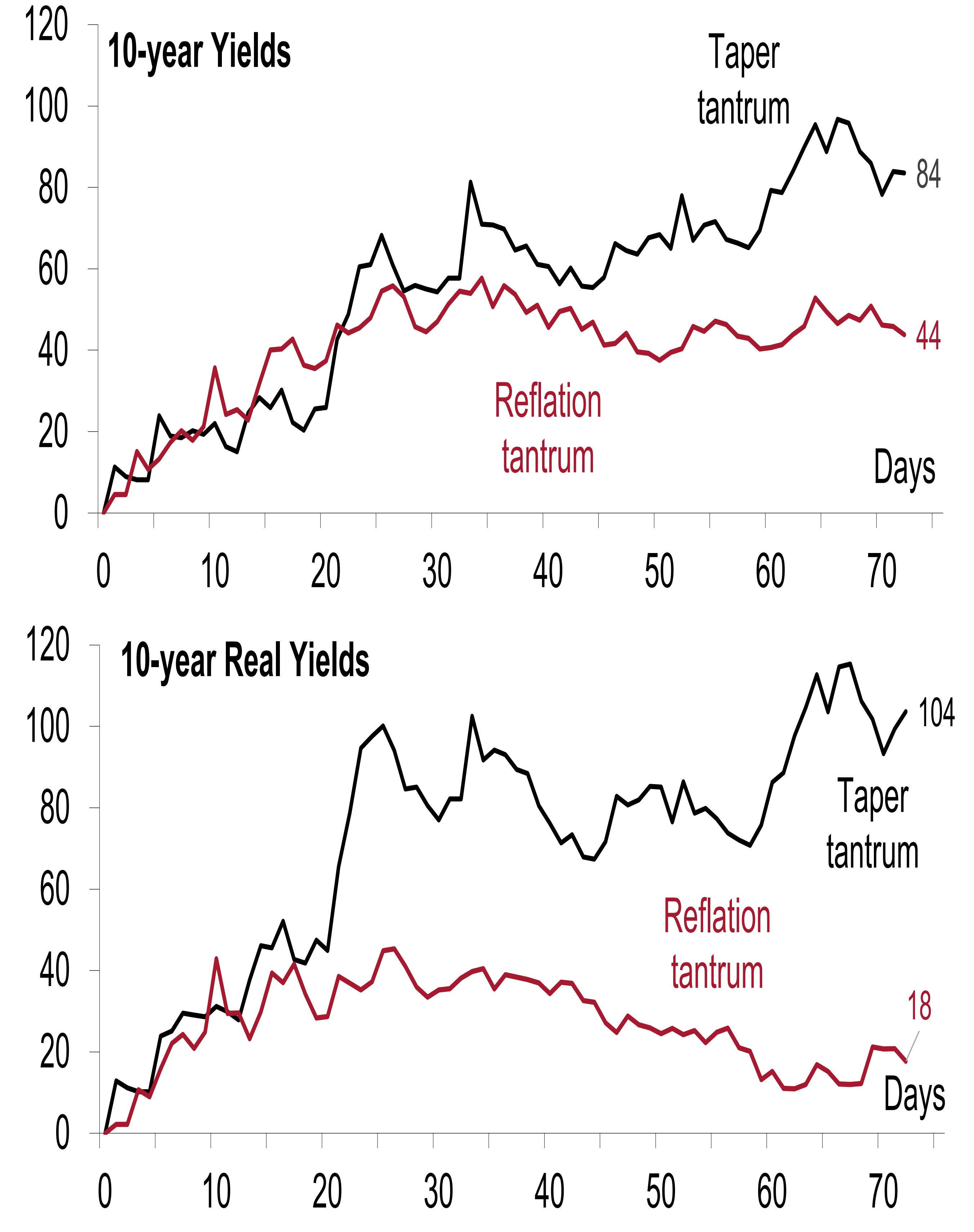
Global Sovereign Yield Curve
(Percent)



Implied Volatility
(Index)



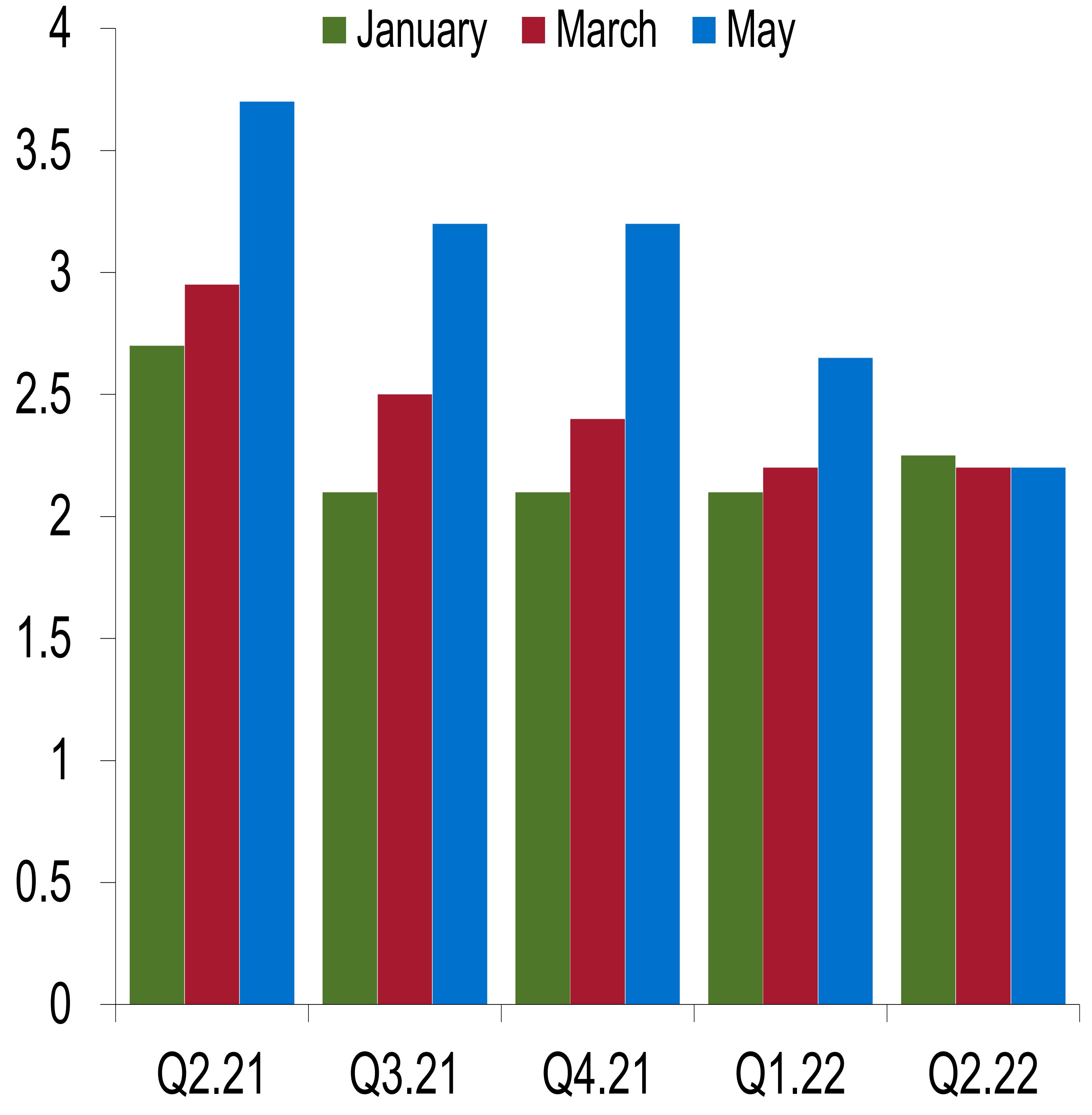
Cumulative Changes in US Rates during Tantrum Episodes
(Basis points)



“Reflation Risk” Takes Center Stage As US Recovery Gains Momentum

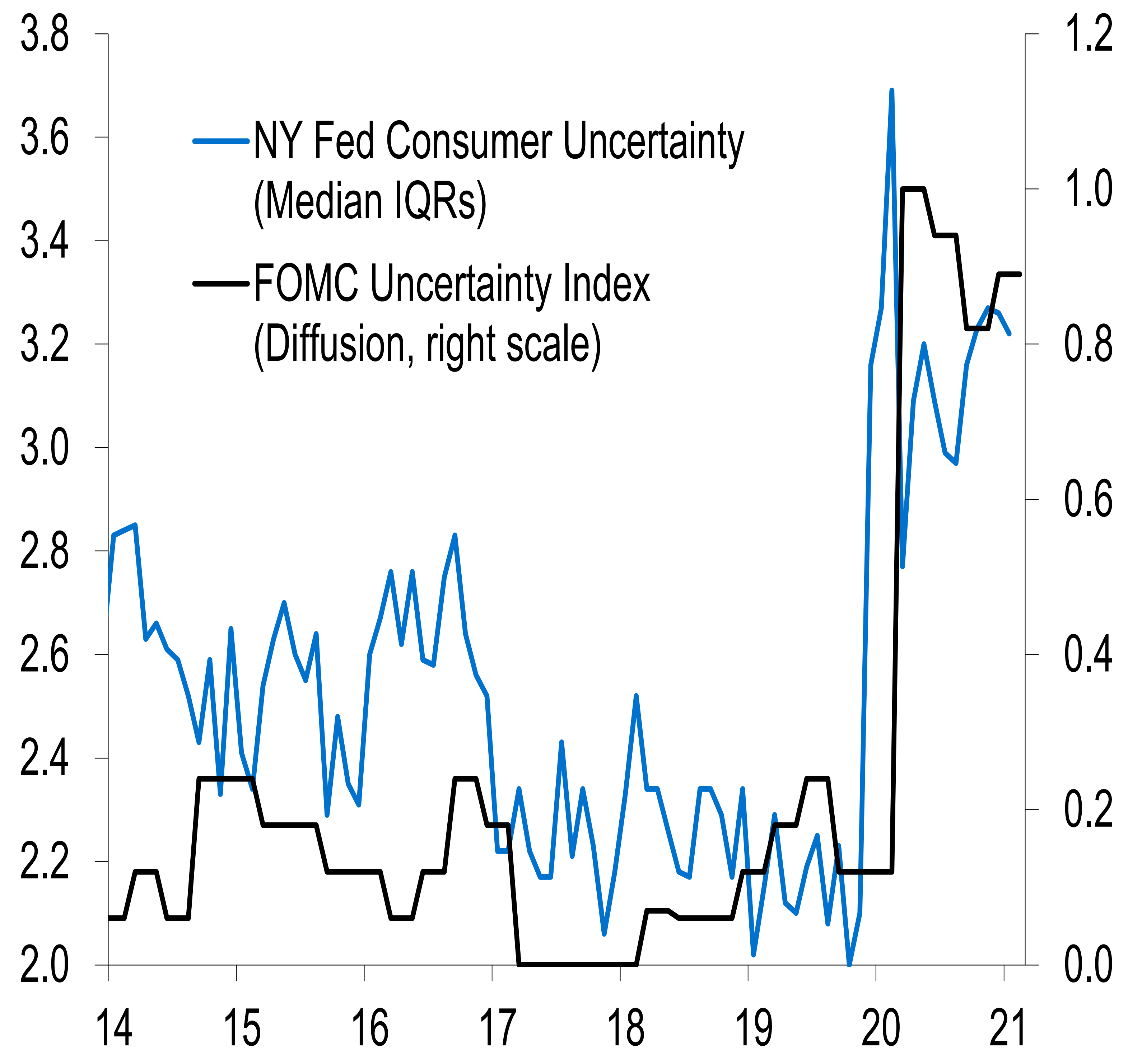
Forecasters have been sharply revising up their inflation forecasts through Q1 2022

CPI Forec`asts, Bloomberg Consensus Median
(percent, year on year)



Both consumers and Fed officials express higher than normal levels of uncertainty around inflation forecasts

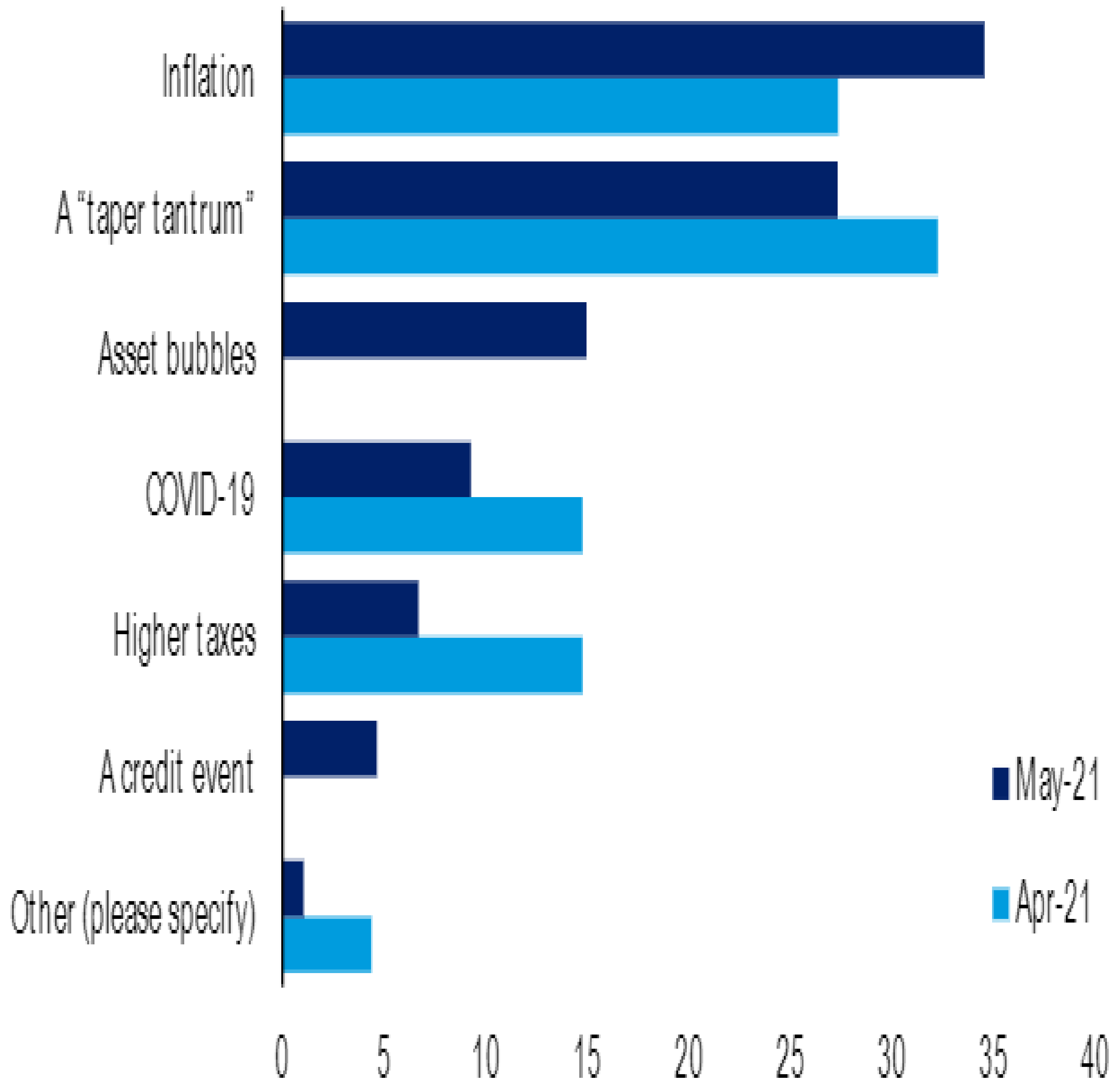
Consumer and Fed FOMC Inflation Uncertainty
(Median IQR, left scale; diffusion index, right scale)



*NY Fed Survey of Consumer Expectations, March ‘21 Fed SEP

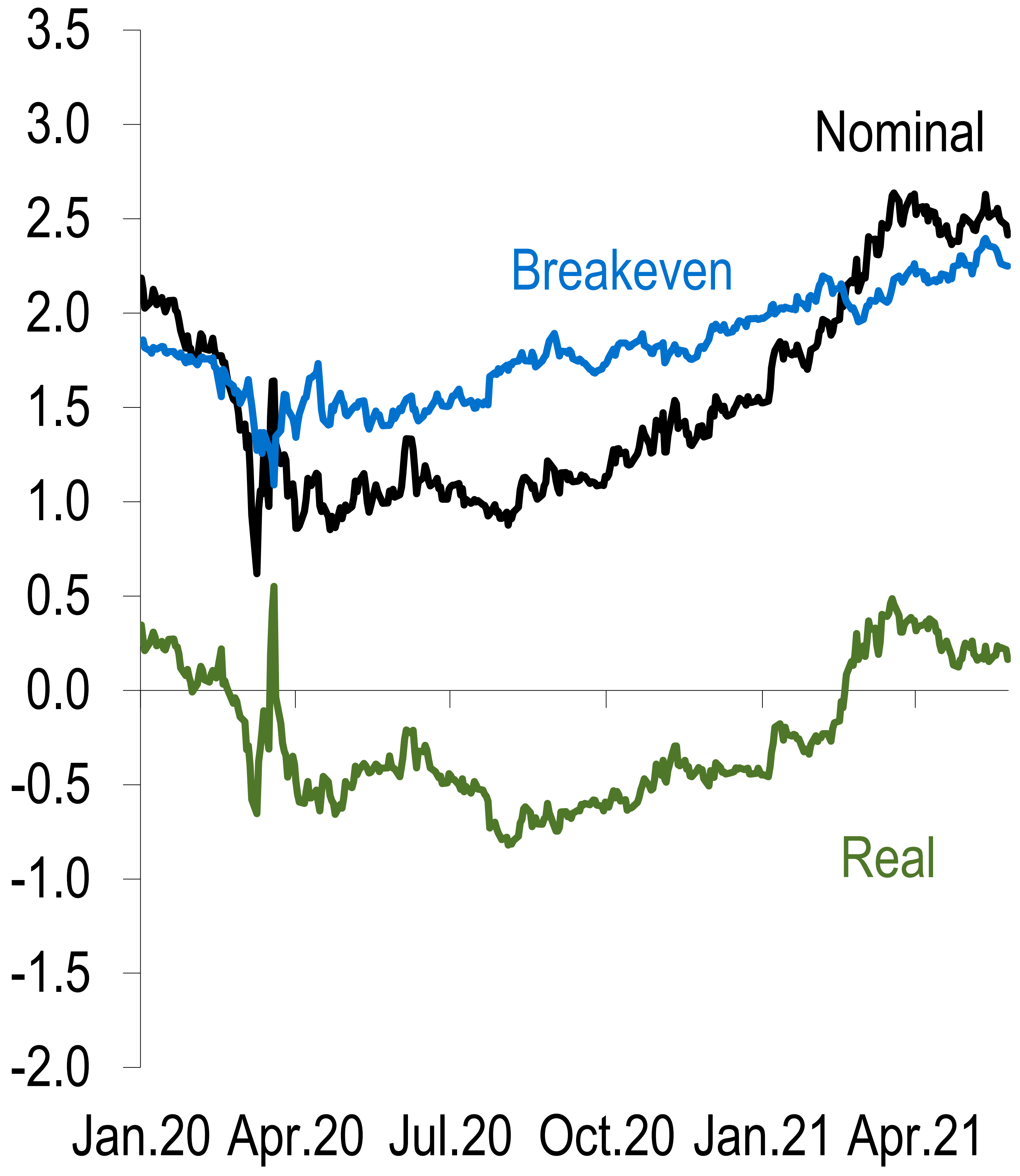
Inflation has become the biggest tail risk for investors

BofA Investor Survey: Biggest Tail Risk
(percent of respondents)

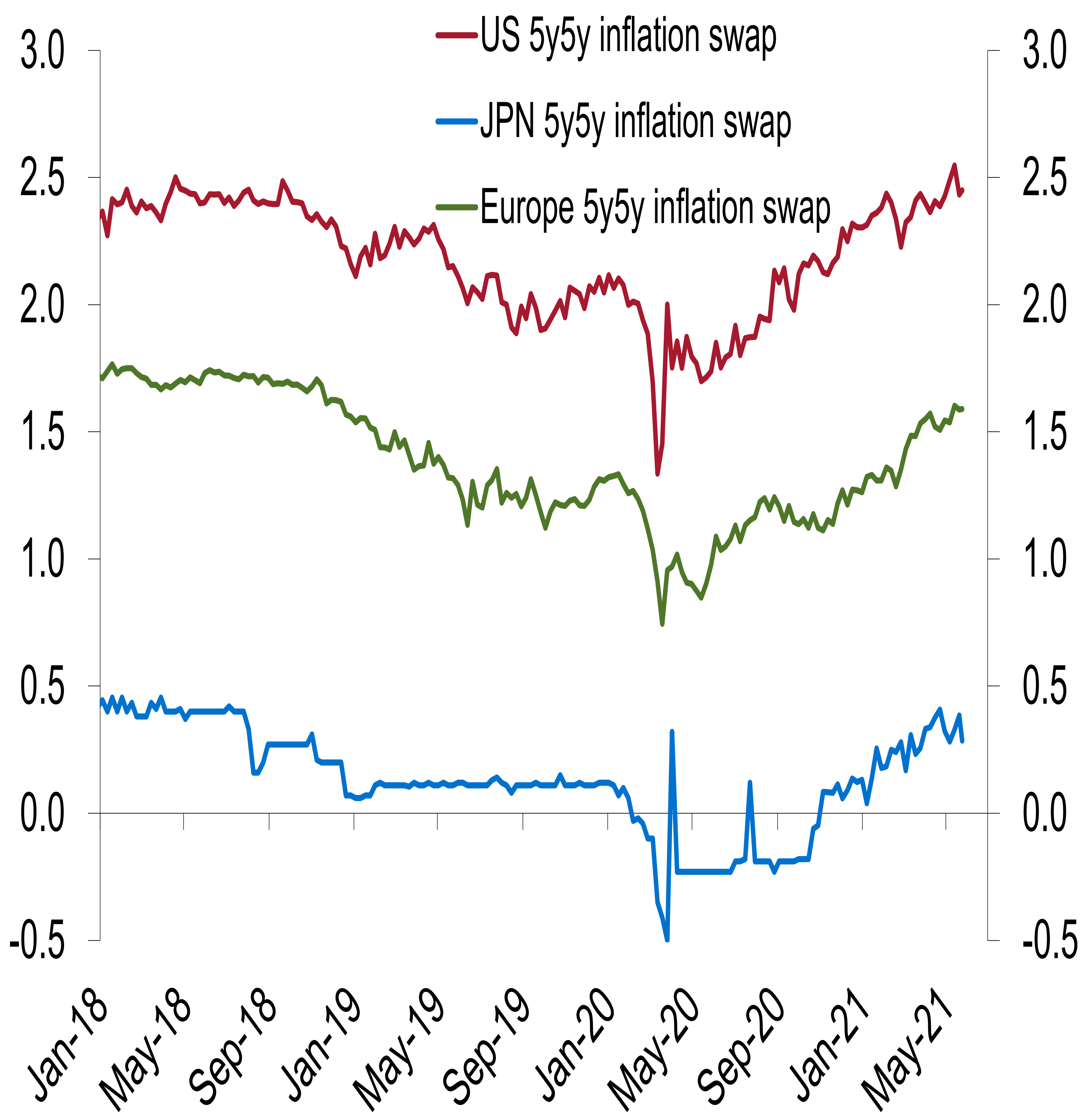


Market-Based Measures Point To Higher Inflation In The US

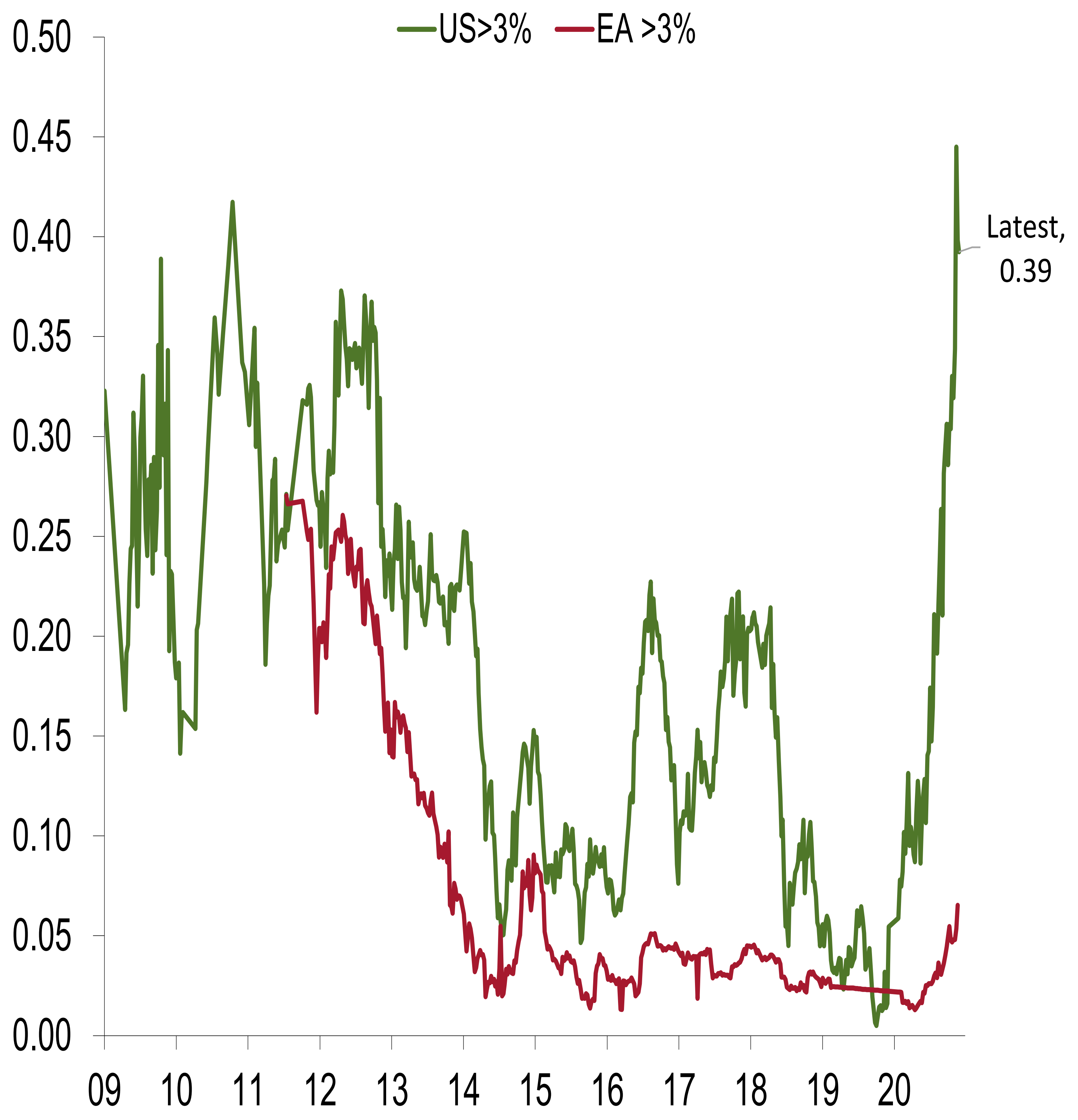
US Long-term Forward Rates
(Percent, 5y-5y forward)



Inflation Swaps
(percent)



Option Implied Probability of Average Inflation above 3% over 5y
(probability)



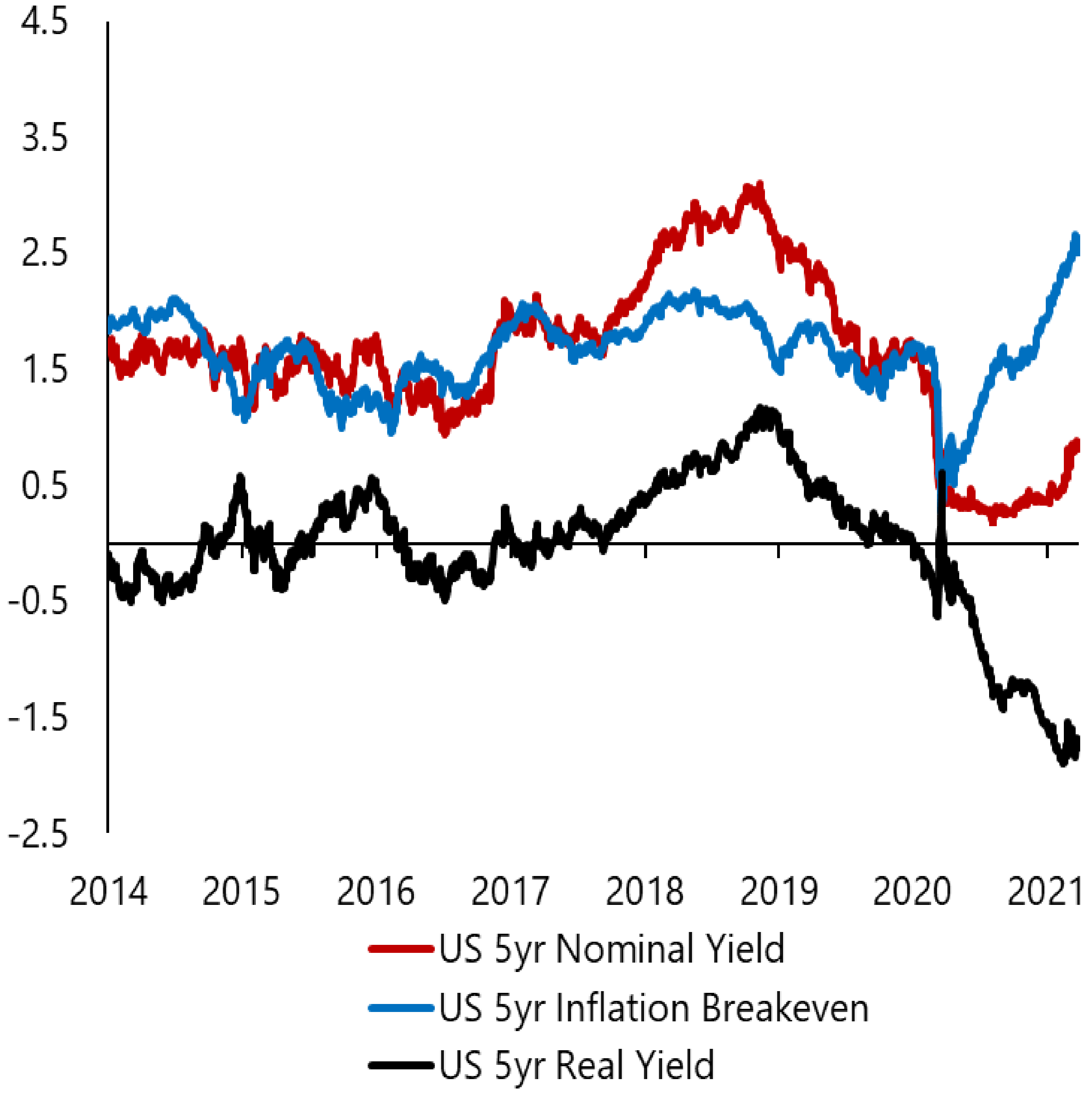
Interplay Between Inflation Breakeven And Real Yields in AEs

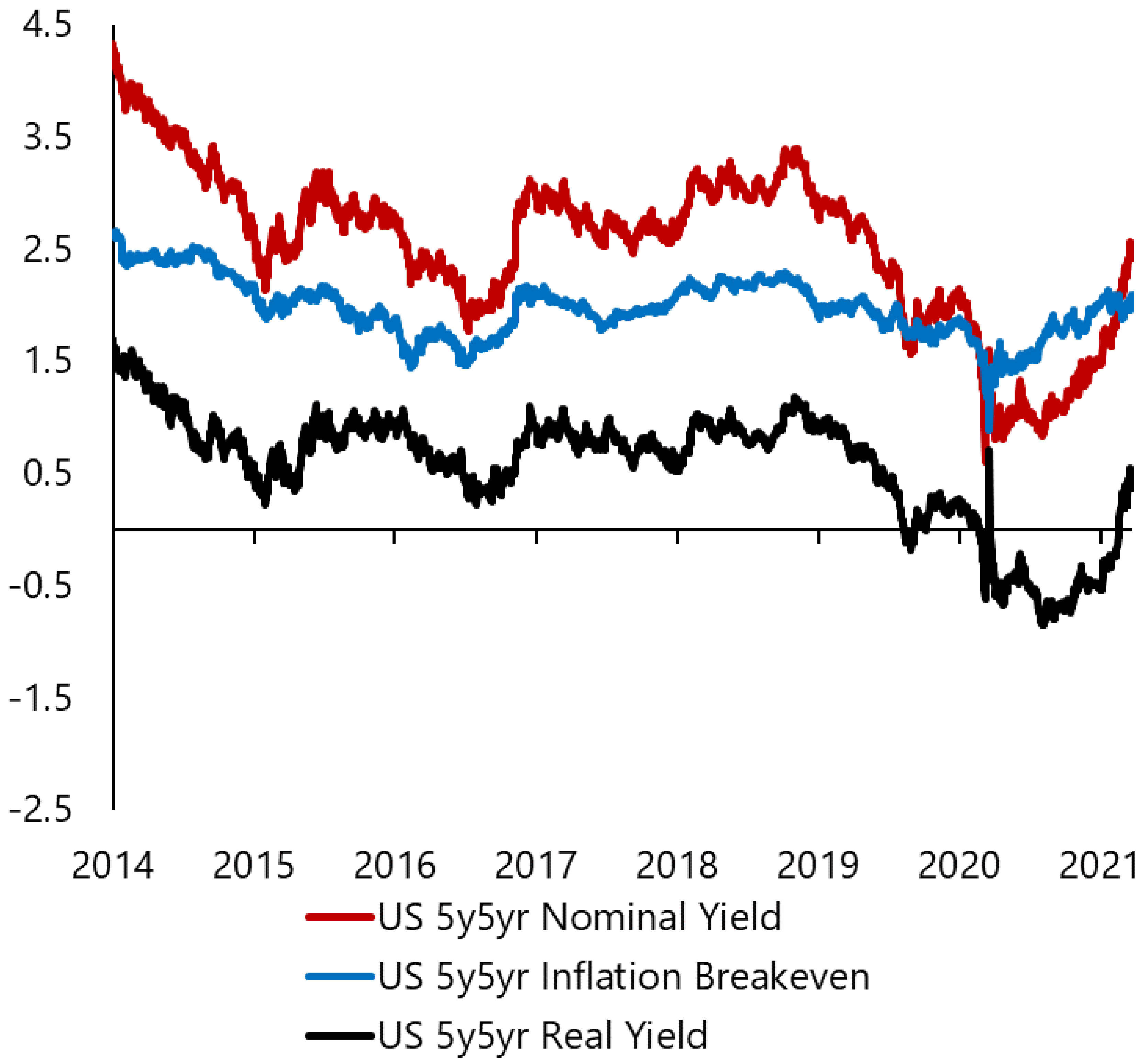
5Y inflation breakeven has risen sharply, real yield has remained low

In contrast, real yield over the 5Y5Y segment has risen sharply

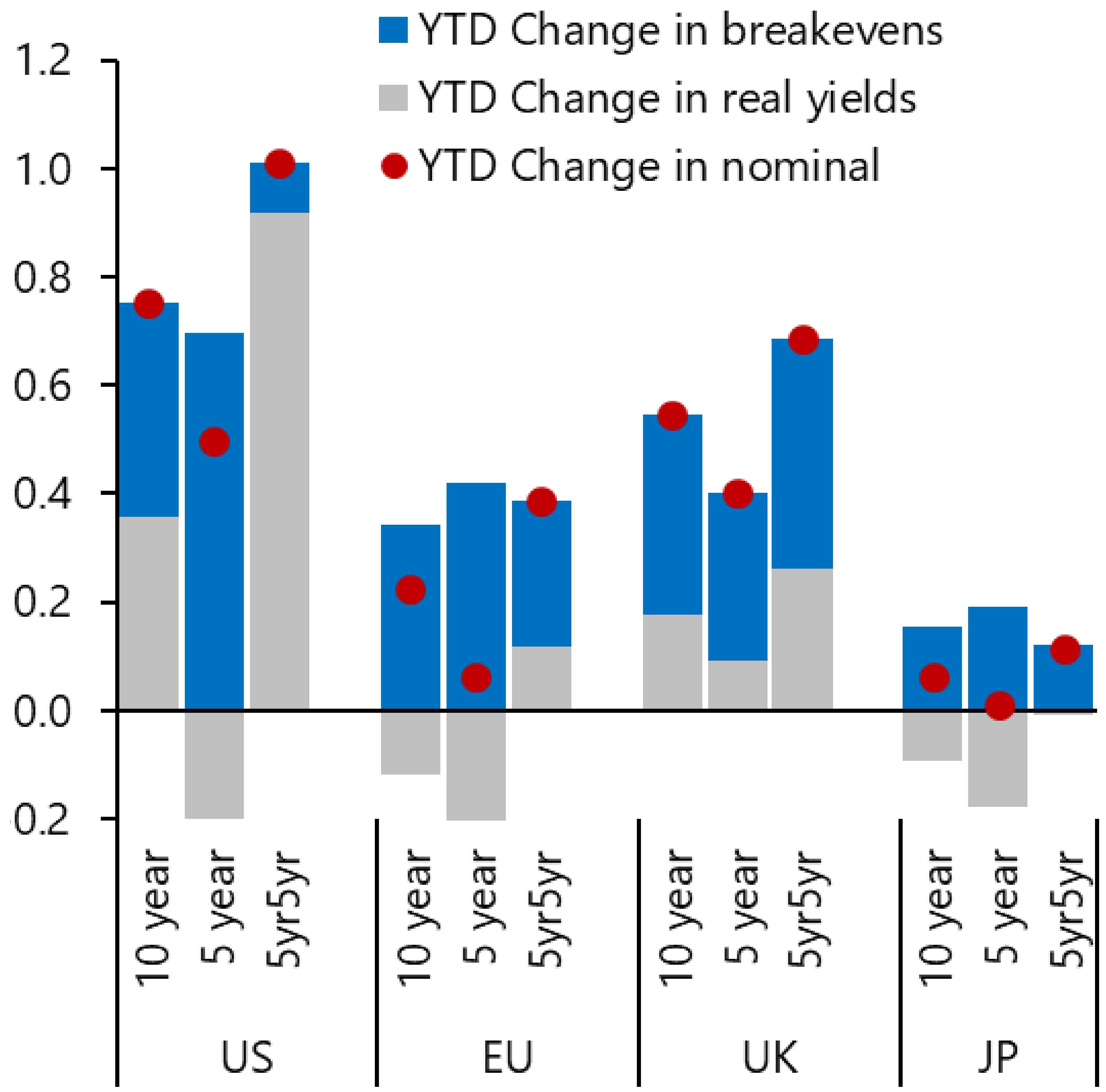
A consistent trend in AEs: Inflation breakevens rising in near term, real yields in the long term

Decomposition of US 5Y and US 5Y5Y nominal yield
(Percent)





Decomposition across major AEs
(Percentage Point)



nominal yield = real yield + inflation breakeven

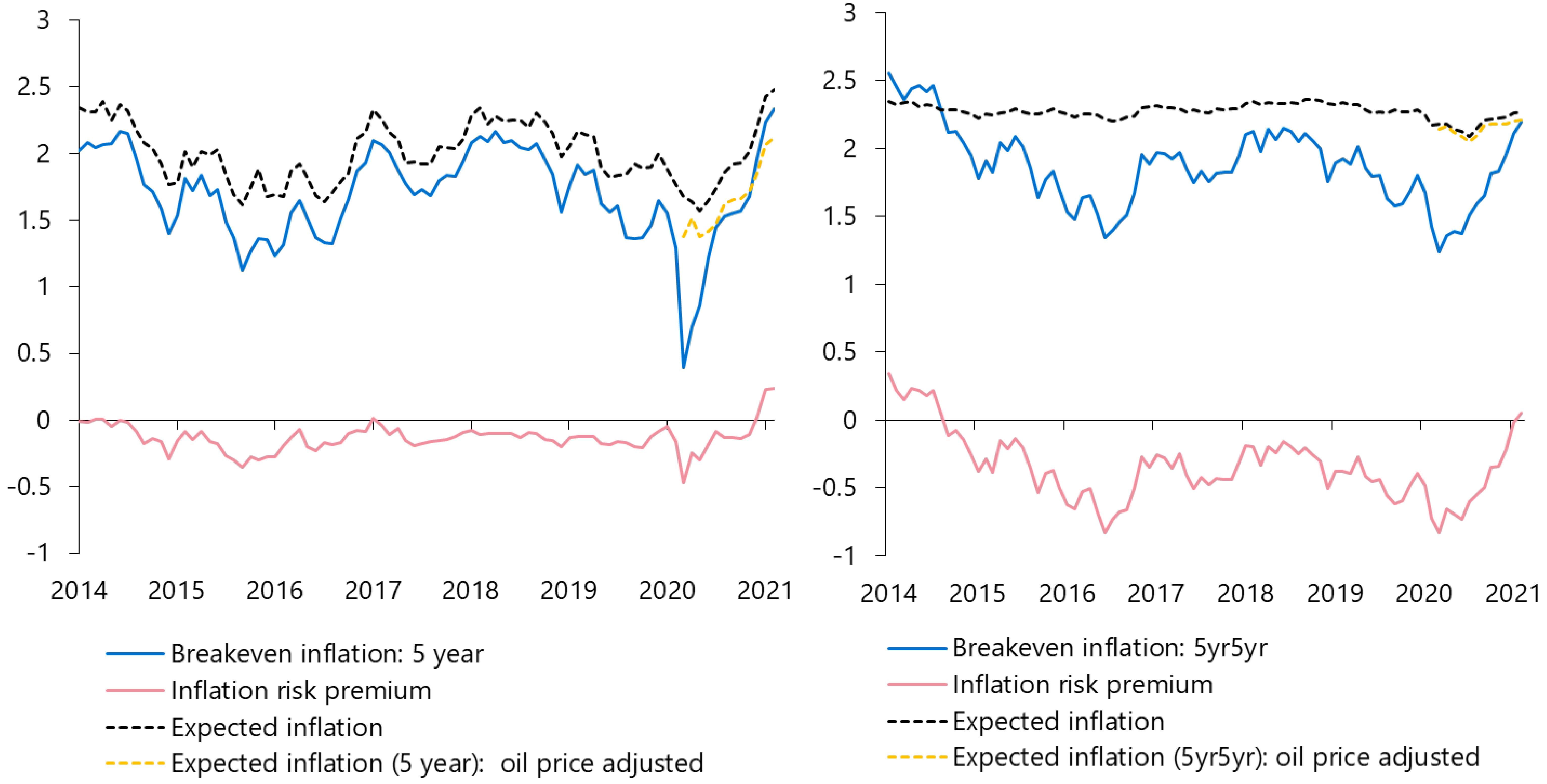
Understanding Drivers of US Inflation Breakevens

5Y inflation breakeven driven by rise in expected inflation and inflation risk premia

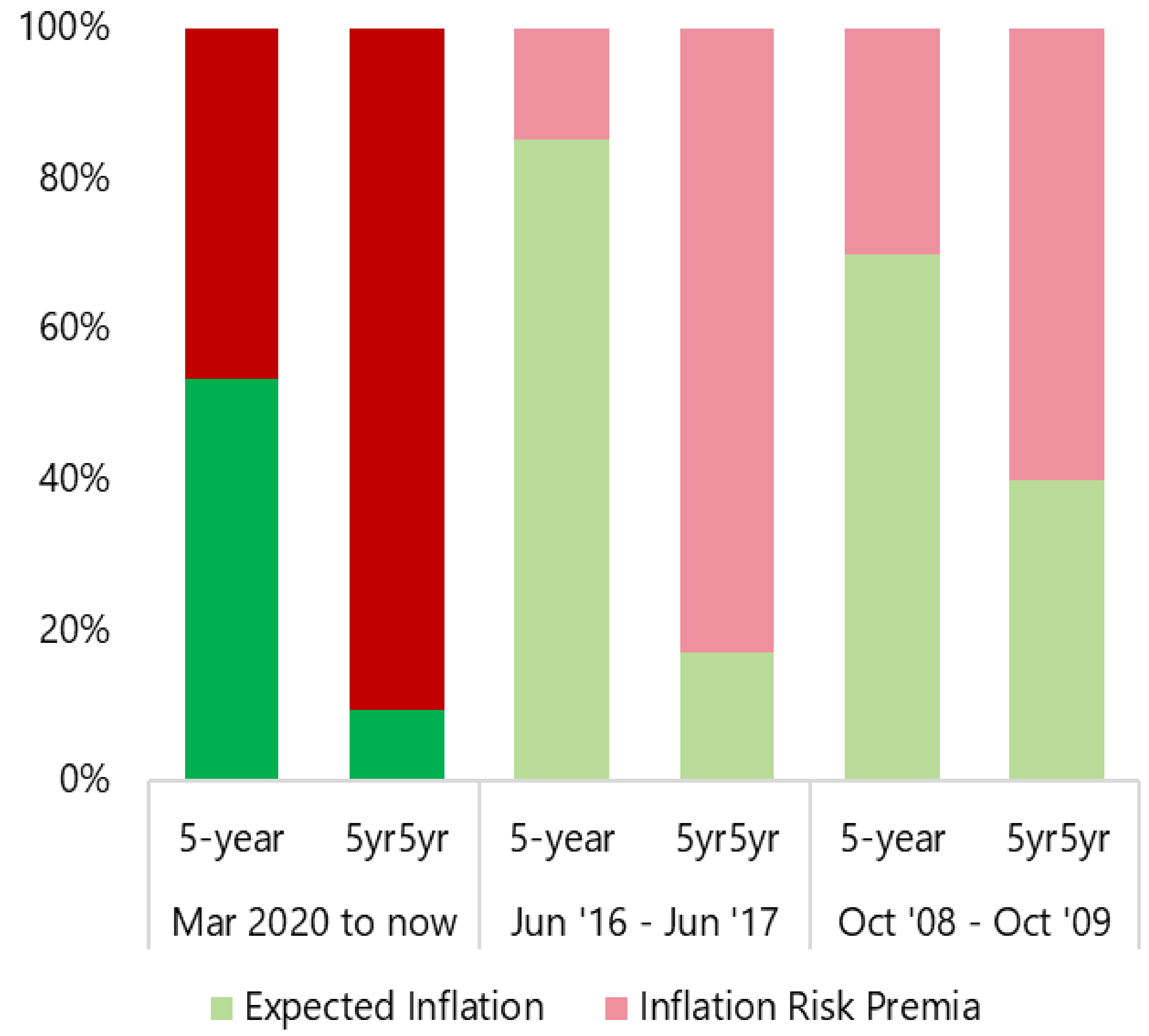
In the 5y5y segment, inflation risk premia have risen sharply

IRP appears to be the key driver of longer-term inflation breakeven

Decomposition of US 5Y and US 5Y5Y inflation breakeven
(Percent)



Relative contribution of expected inflation and risk premia
(Latest time period is highlighted in bold)



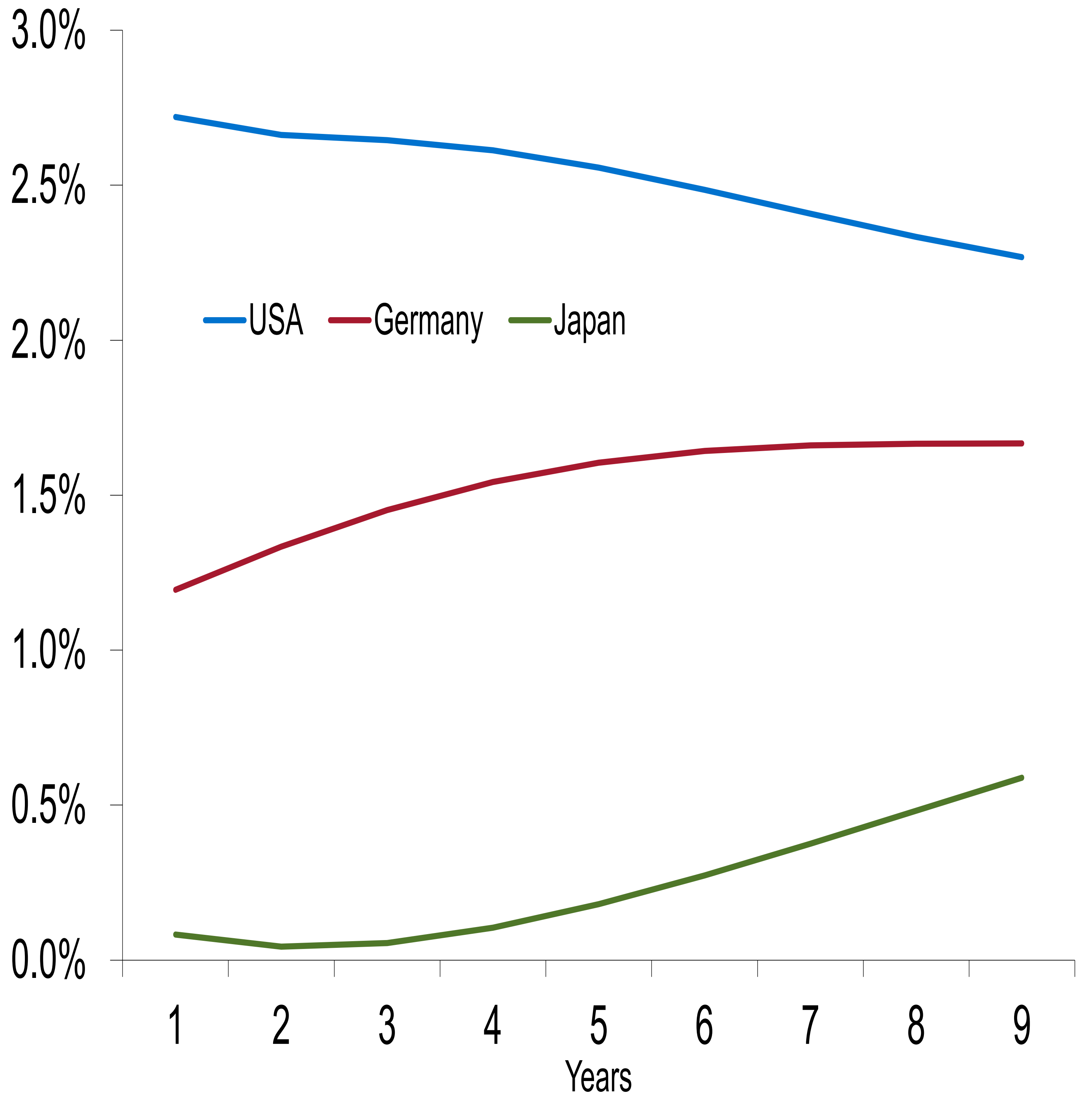
inflation breakeven = expected inflation + inflation risk premium

* The analysis is adjusted for liquidity distortions

Are Investors Prepared for a Possible Rise in Rates?

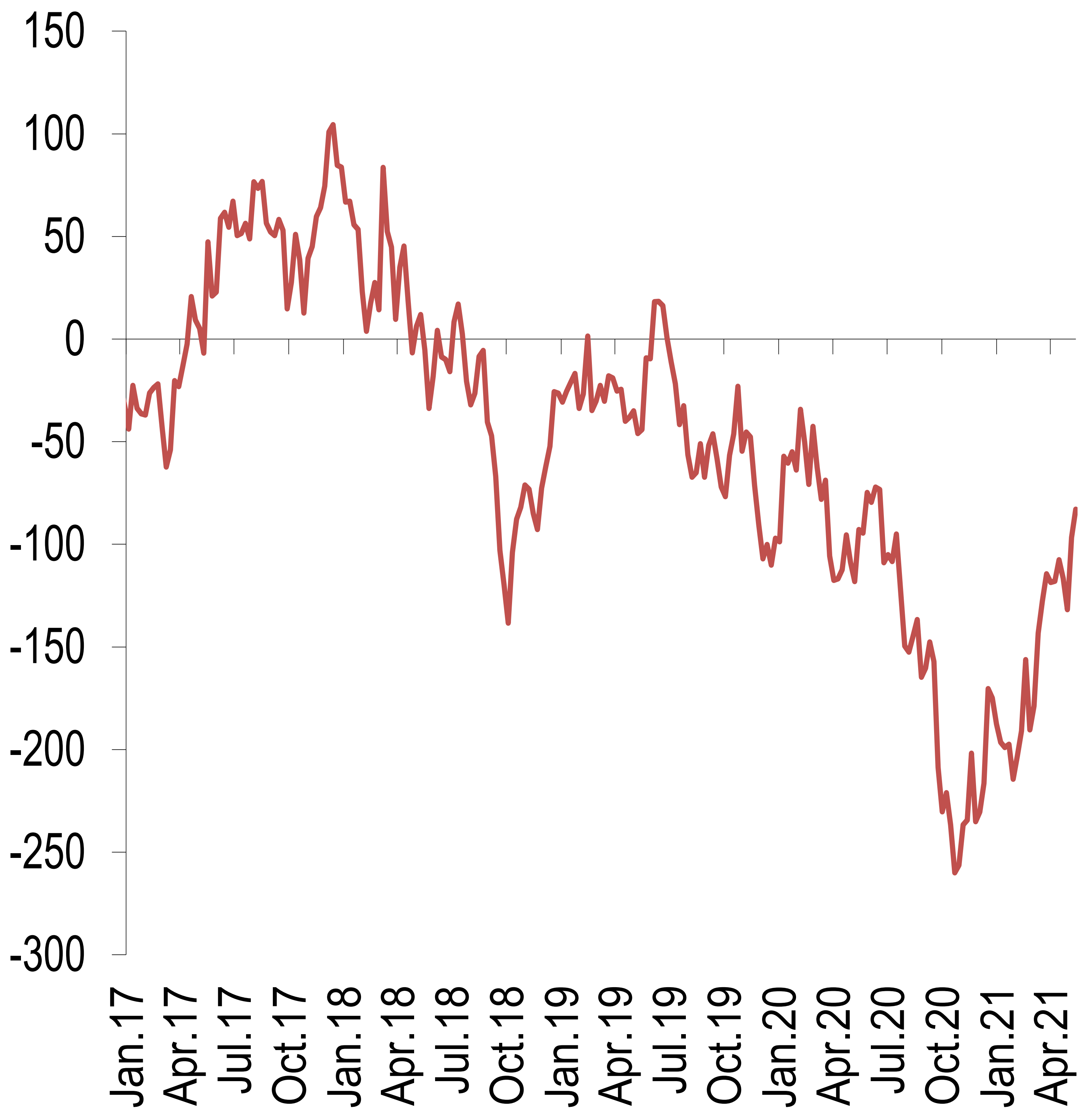
Inflationary pressures likely to be temporary in the US

Forward Breakeven Curve
(percent, 1y forward)



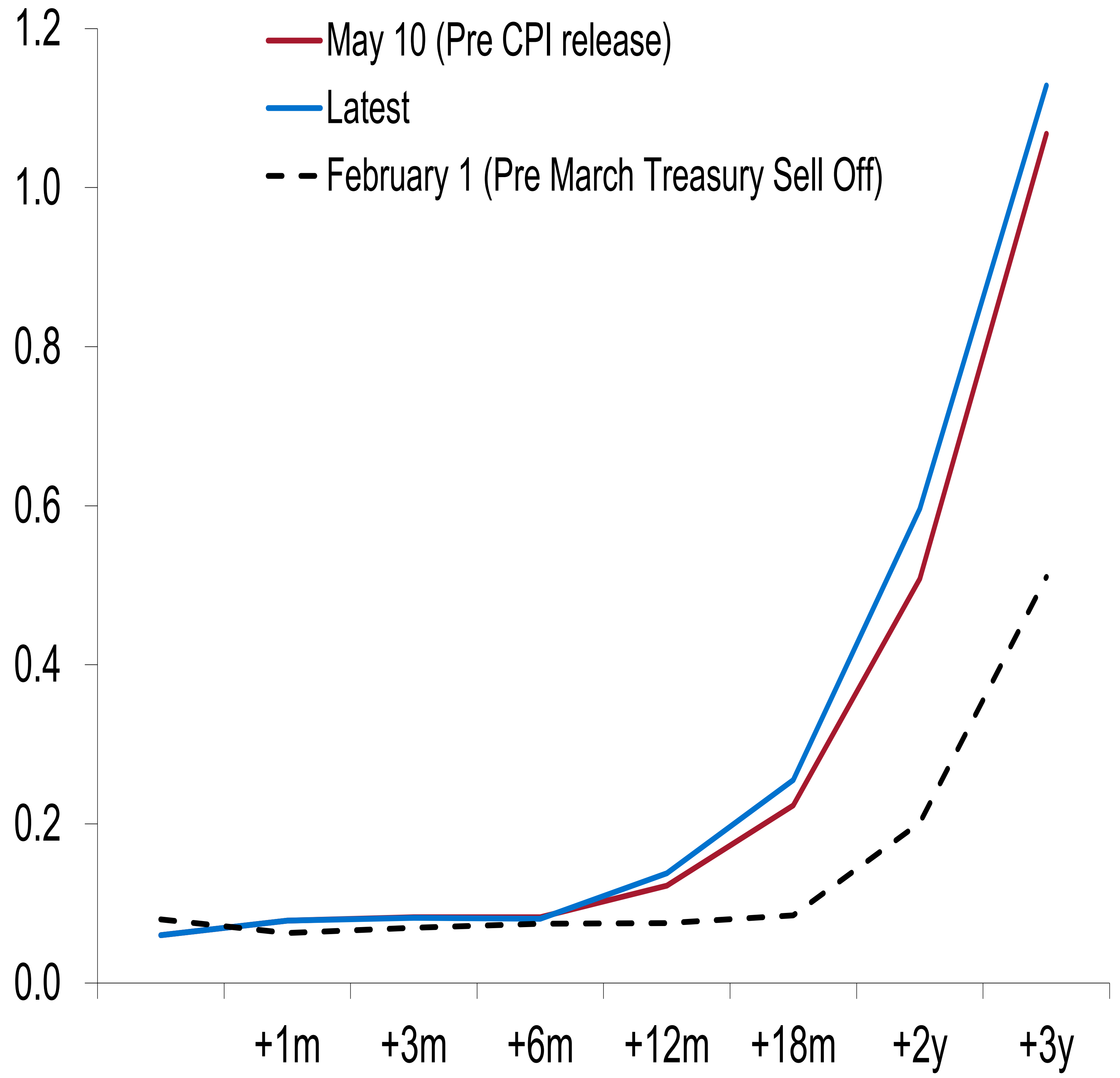
Investors have reduced their short position on Treasuries

CFTC Speculative Positions on Treasuries
(net, thousands of contracts)



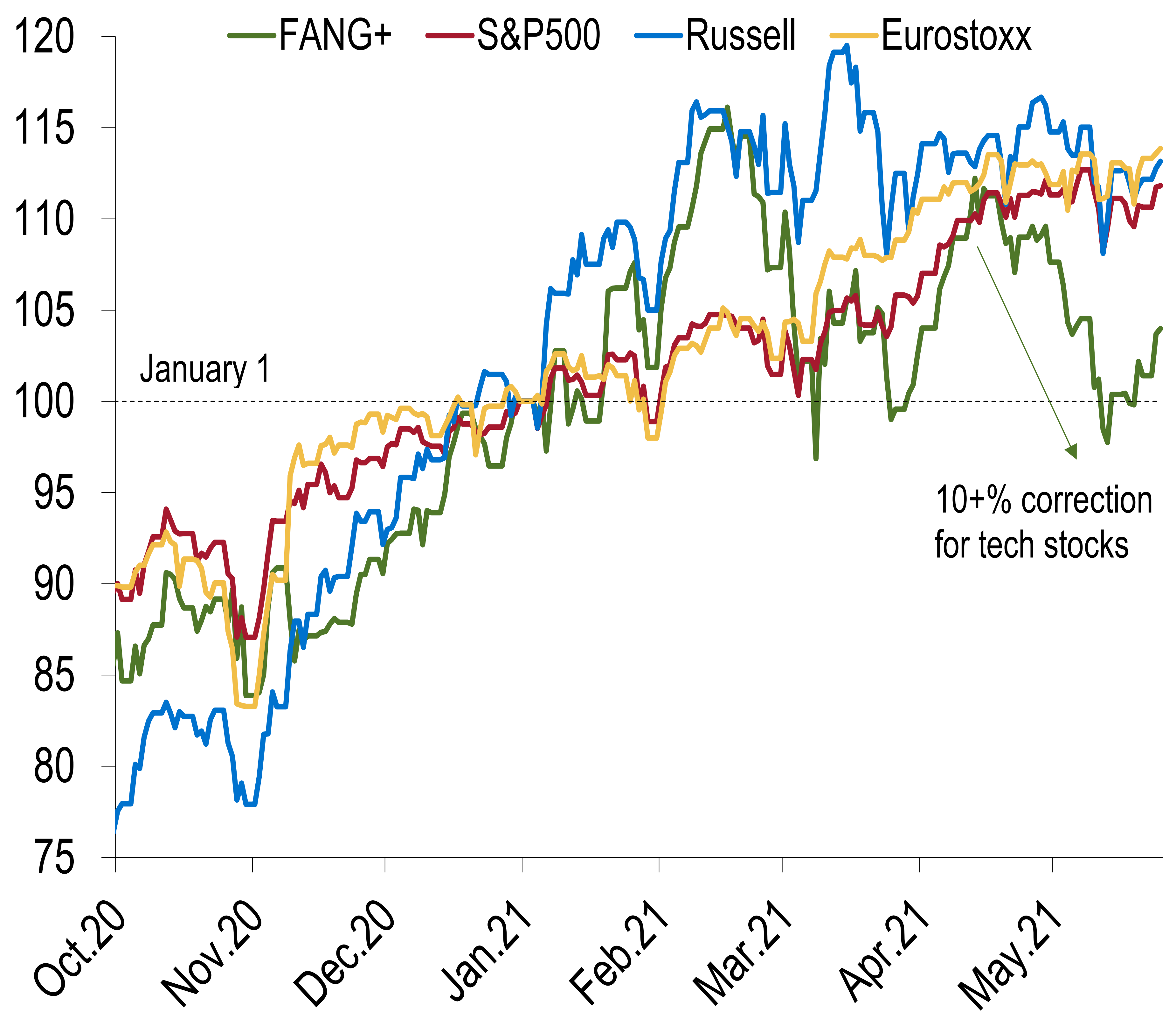
OIS rates edged higher after recent CPI, with the first hike priced in early 2023

Policy Expectations
(USD OIS 1 month)

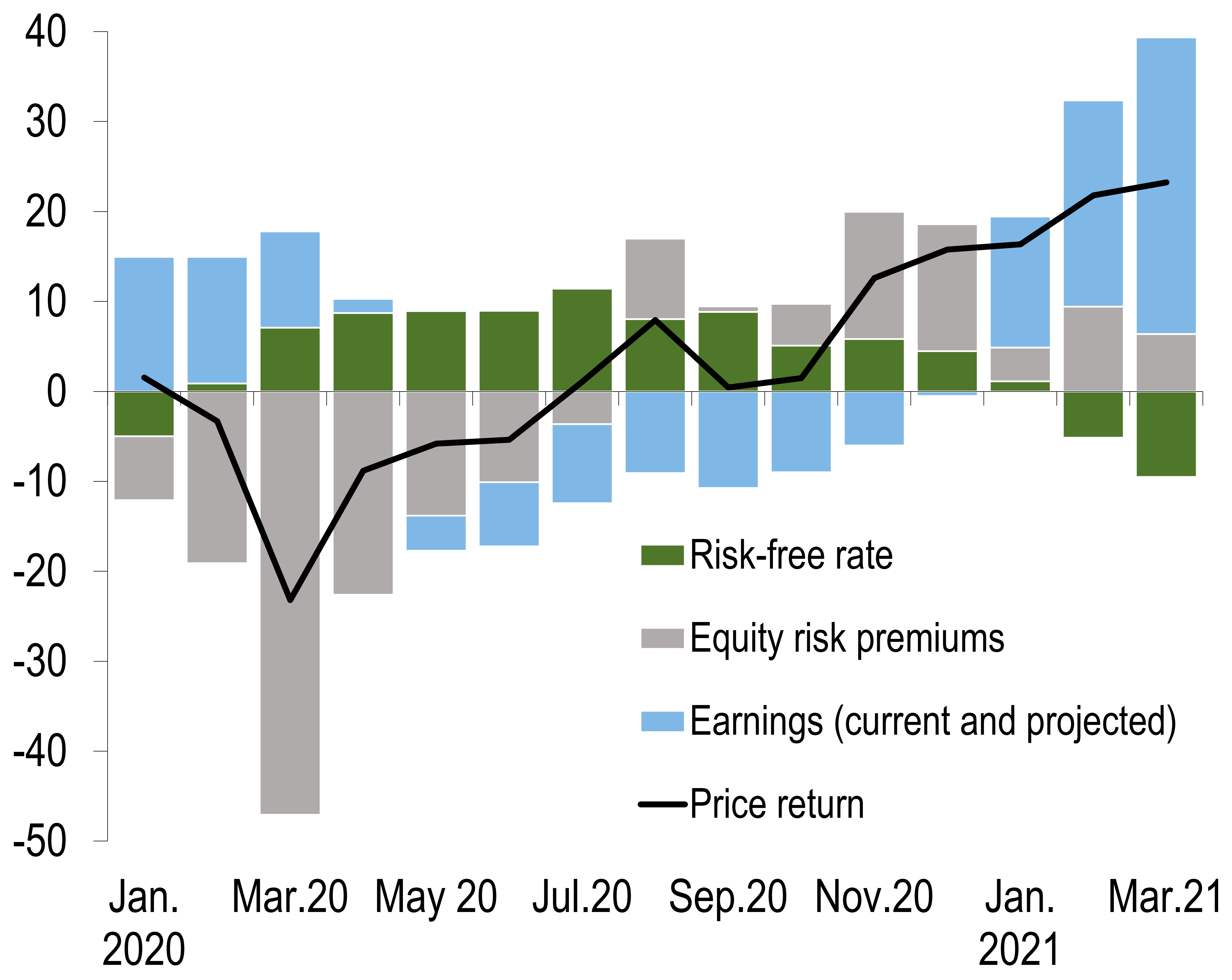


Risk Asset Prices Under Pressure

Global Equities
(Indexed to Jan 1, 2021)

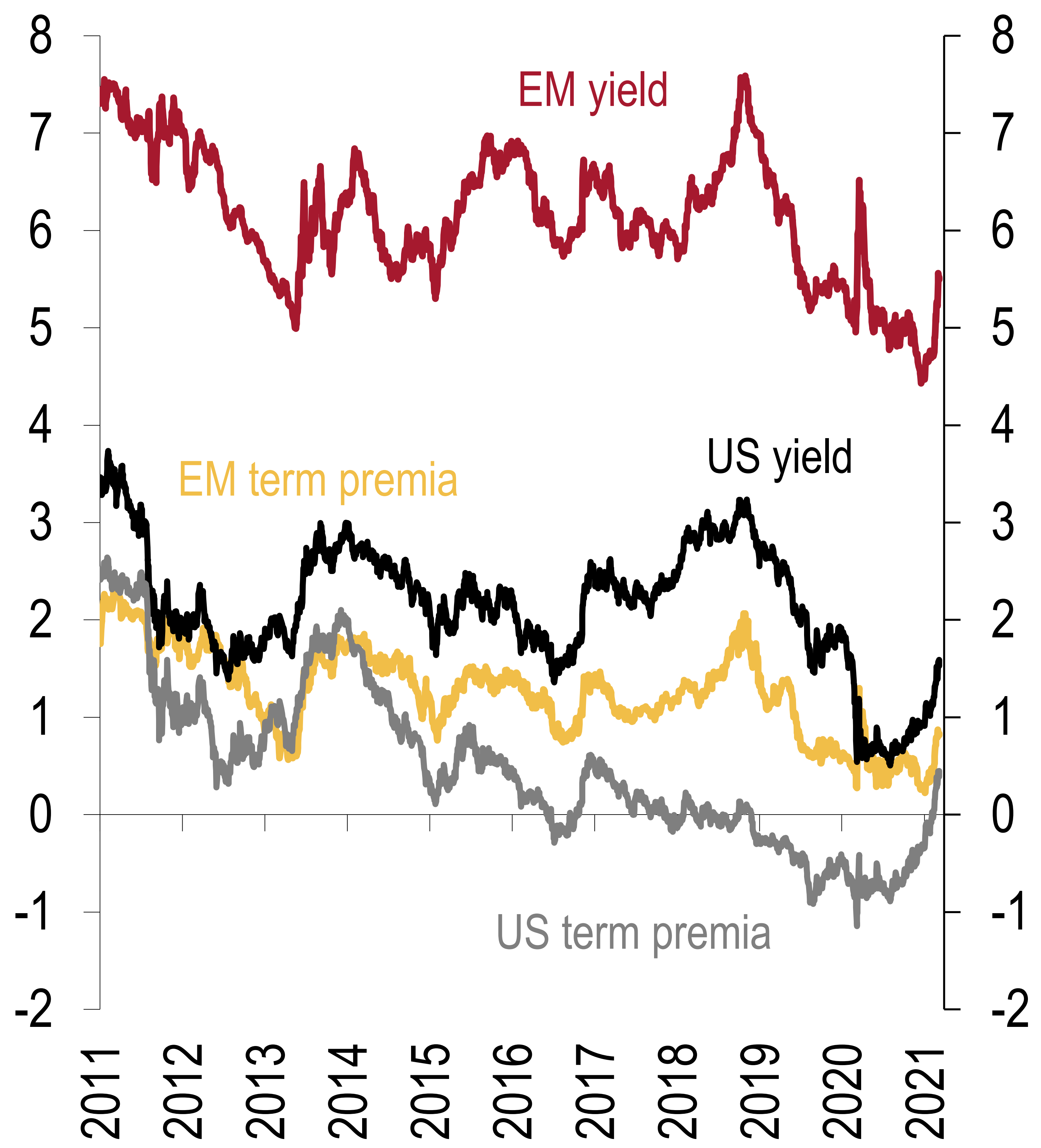


Decomposition of Cumulative S&P 500 Returns
(Since Jan 2020; percent)

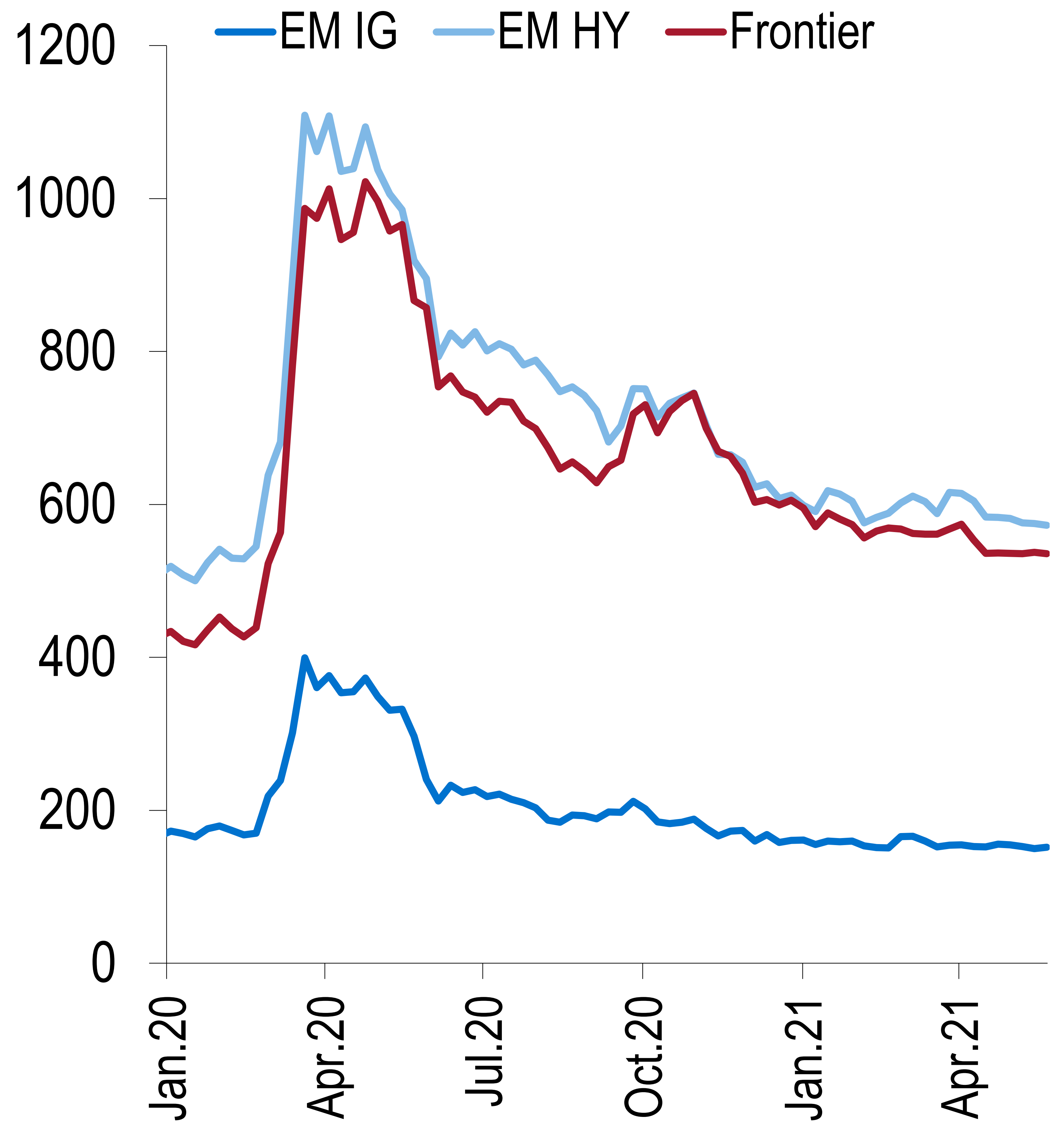


EM LC Rates Most Directly Affected By The US Rates; Credit Resilient So Far

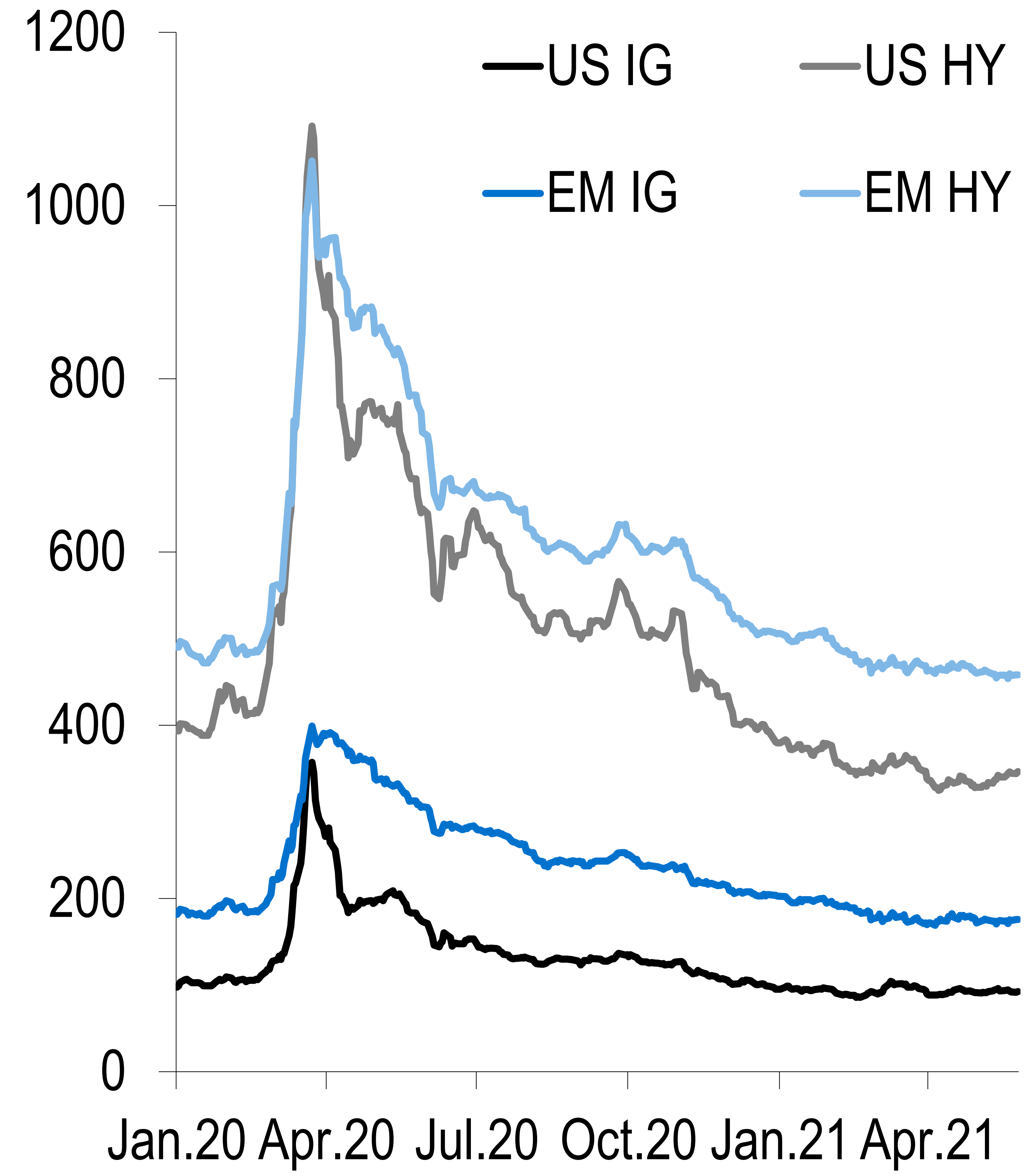
US and Median EM 10-year Yields and Term Premia
(Percent)



EM and Frontier Hard Currency Sovereign Credit Spreads
(Basis points)

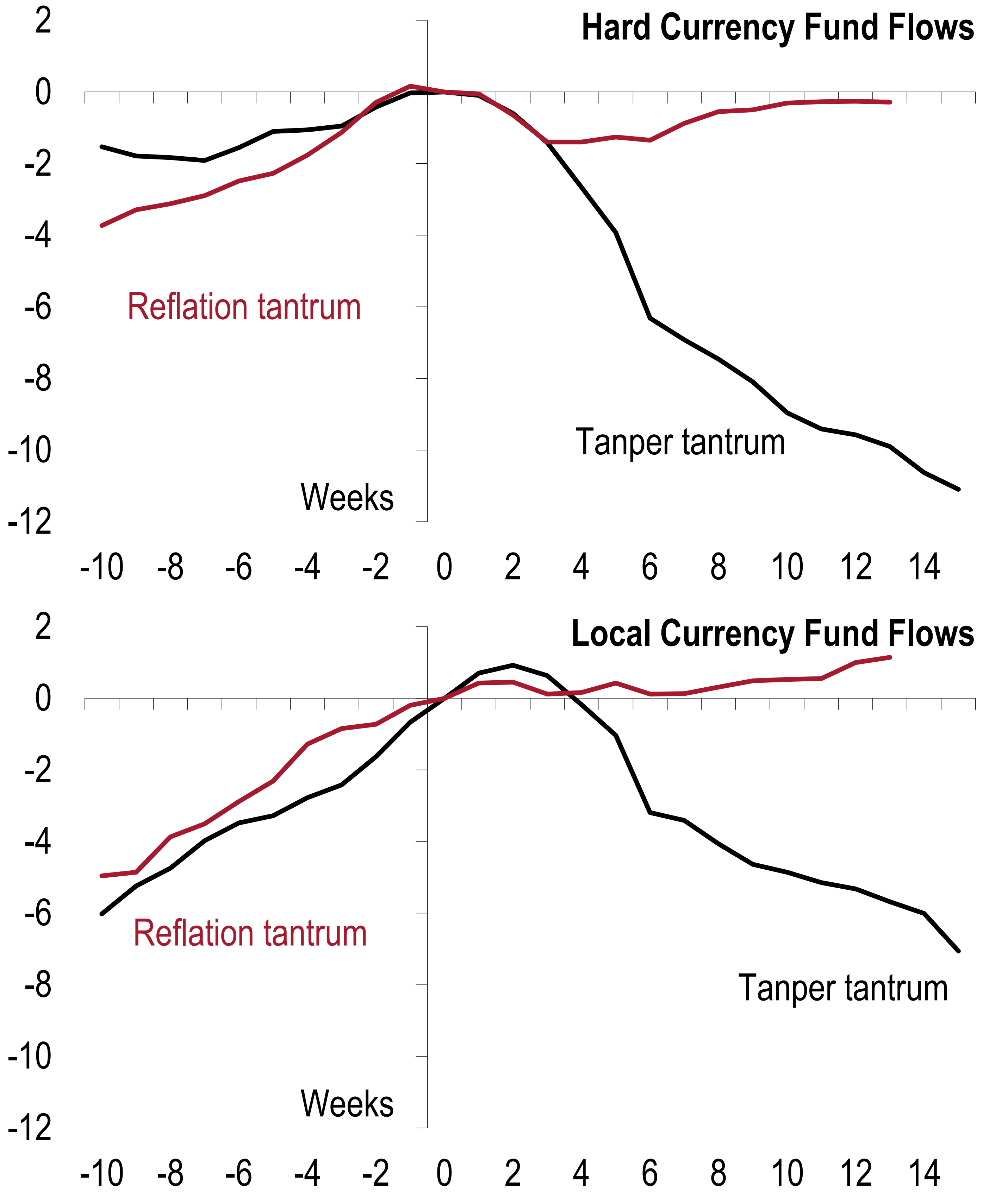


US and EM Hard Currency Corporate Credit Spreads
(Basis points)

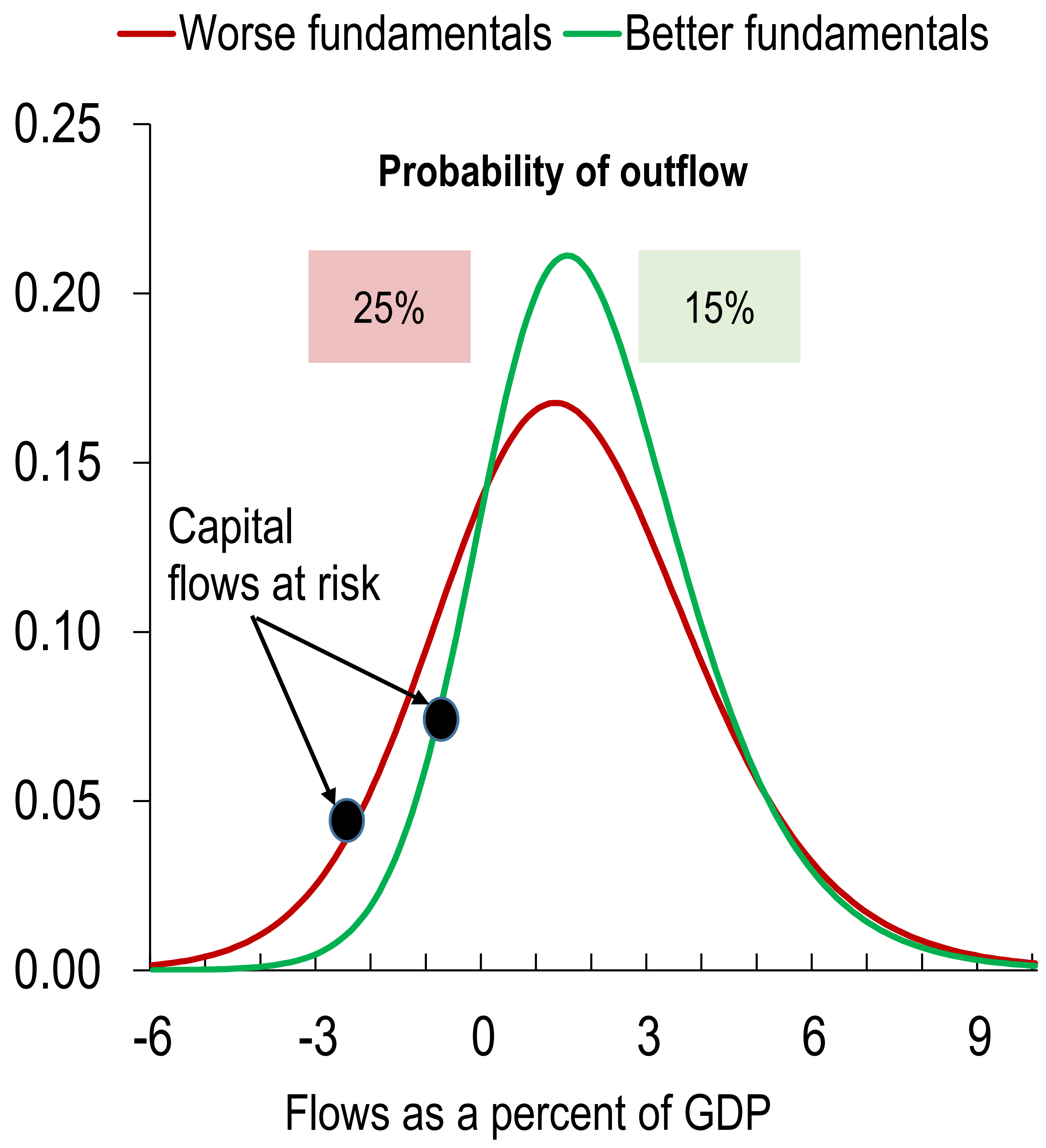


Portfolio Flows Can Help EM Financing Needs

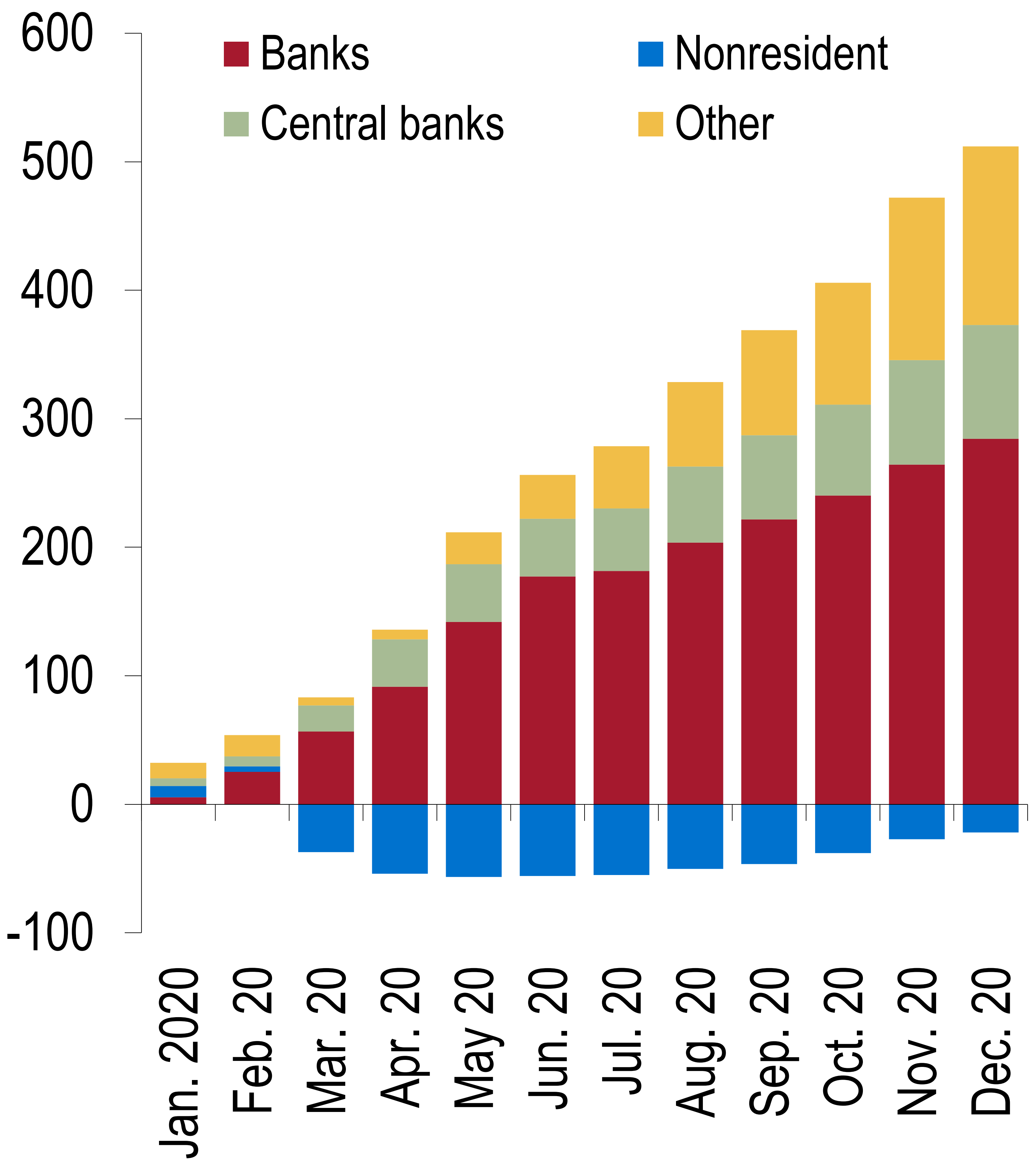
Portfolio Flows
(Percent of asset under management)



Portfolio Flows-at-Risk
(Probability density function)

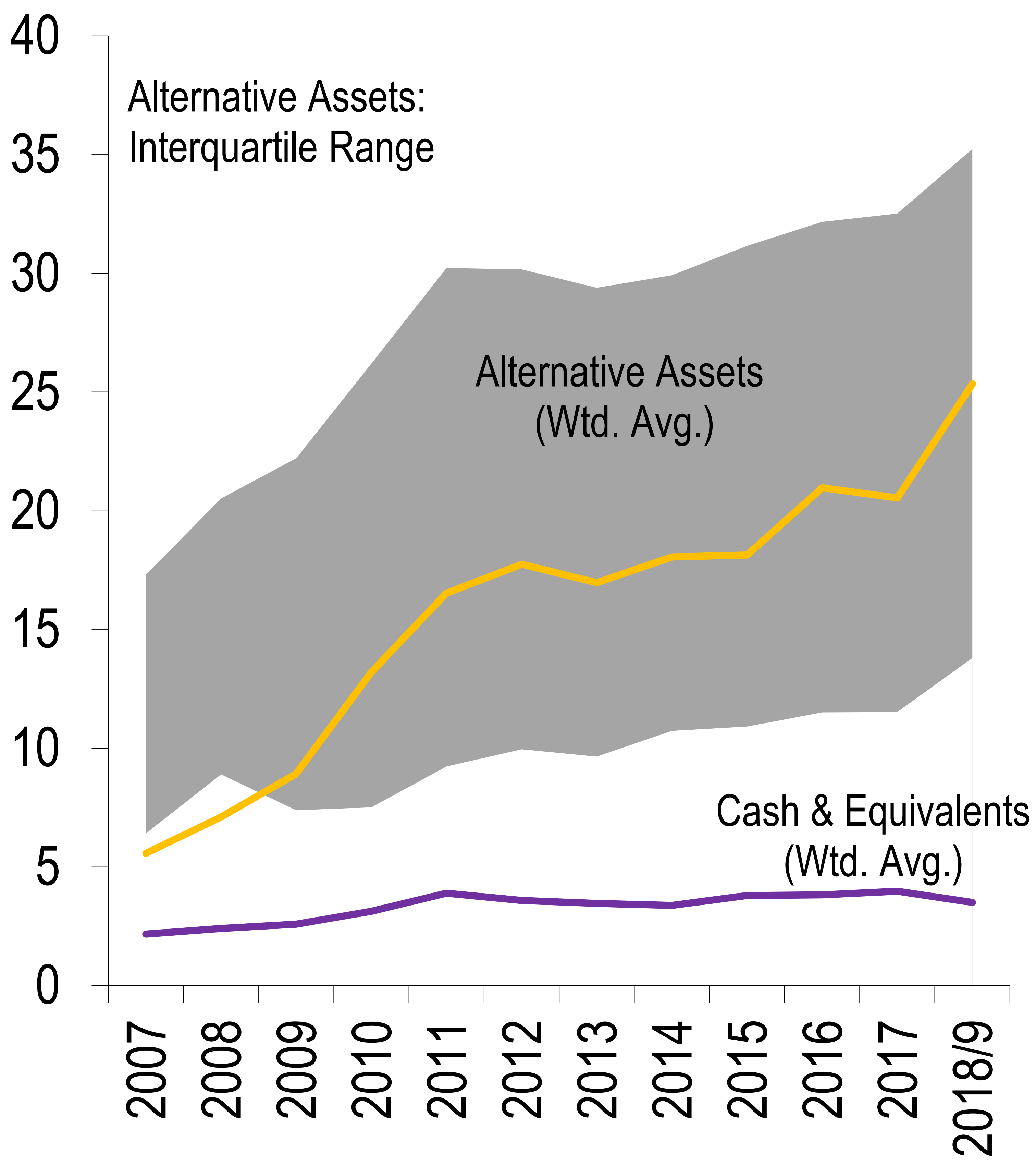


Change in Domestic Sovereign Bond Holdings
(Cumulative, billions of US dollars)

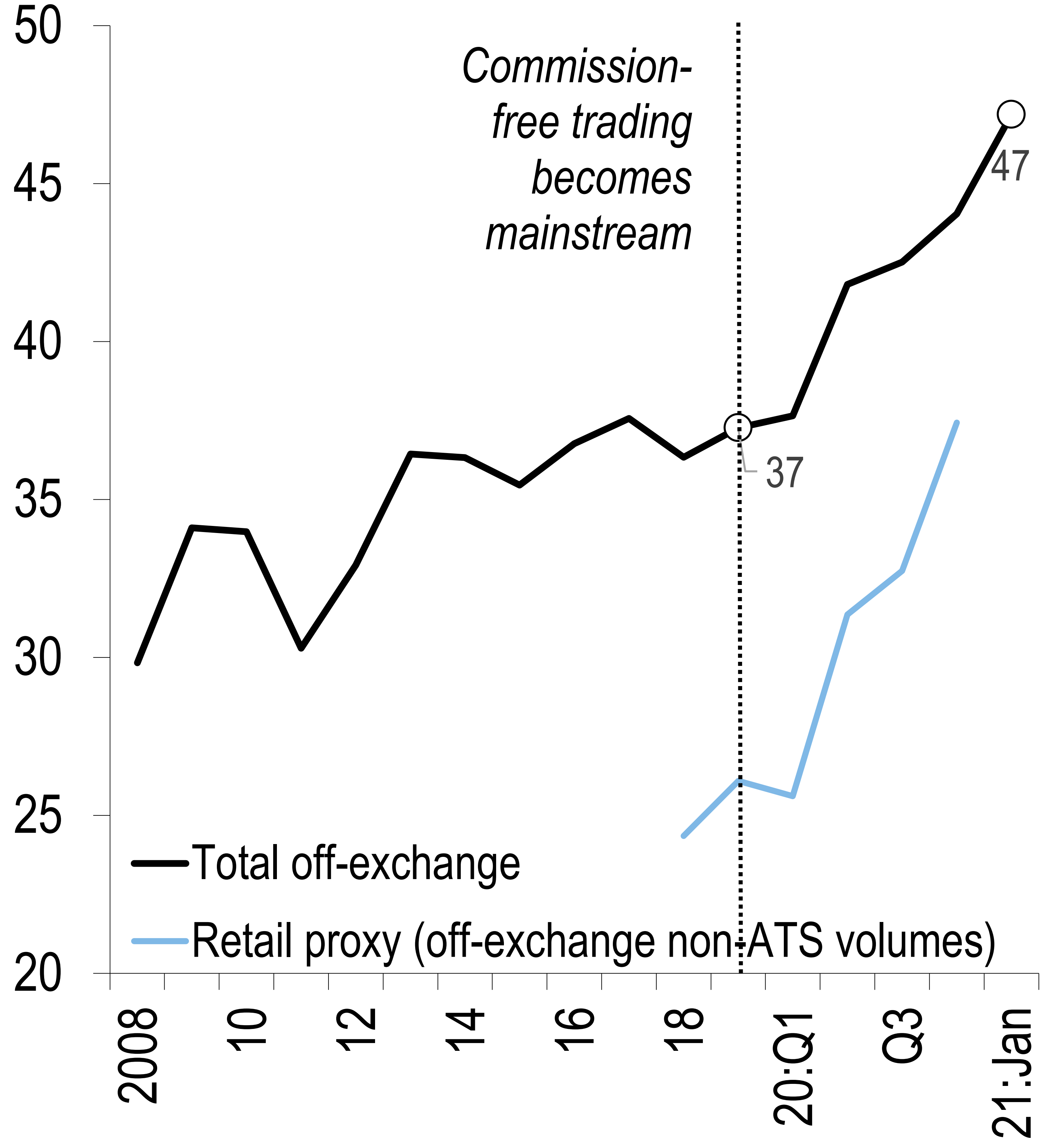


Search For Yield Continues Amid Stretched Valuations

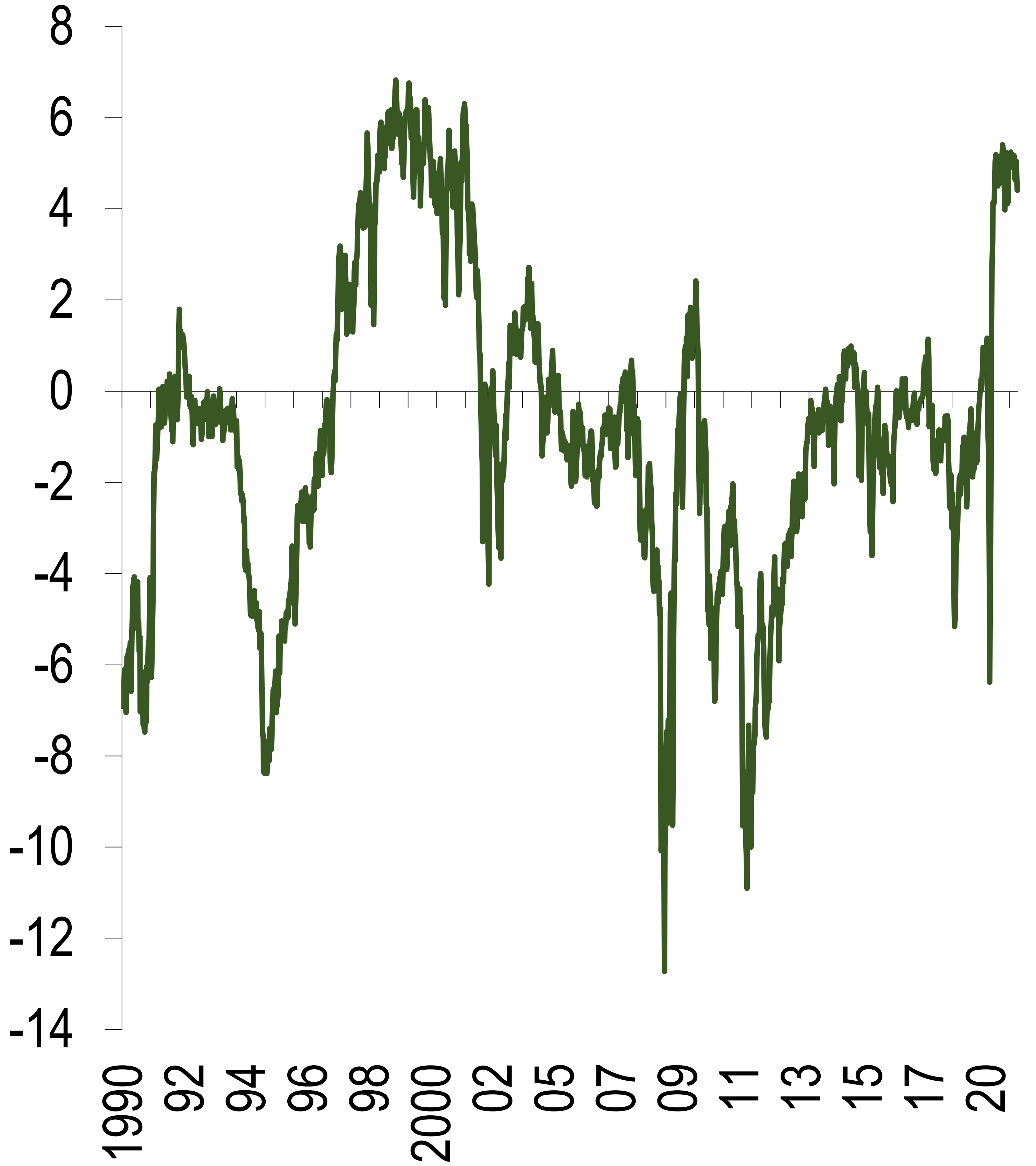
Pension Allocations to Alternative Assets and Cash
(Percent)



Proxy for Retail Trading Activities
(Off-exchange volume as % of total US equity trading volume)

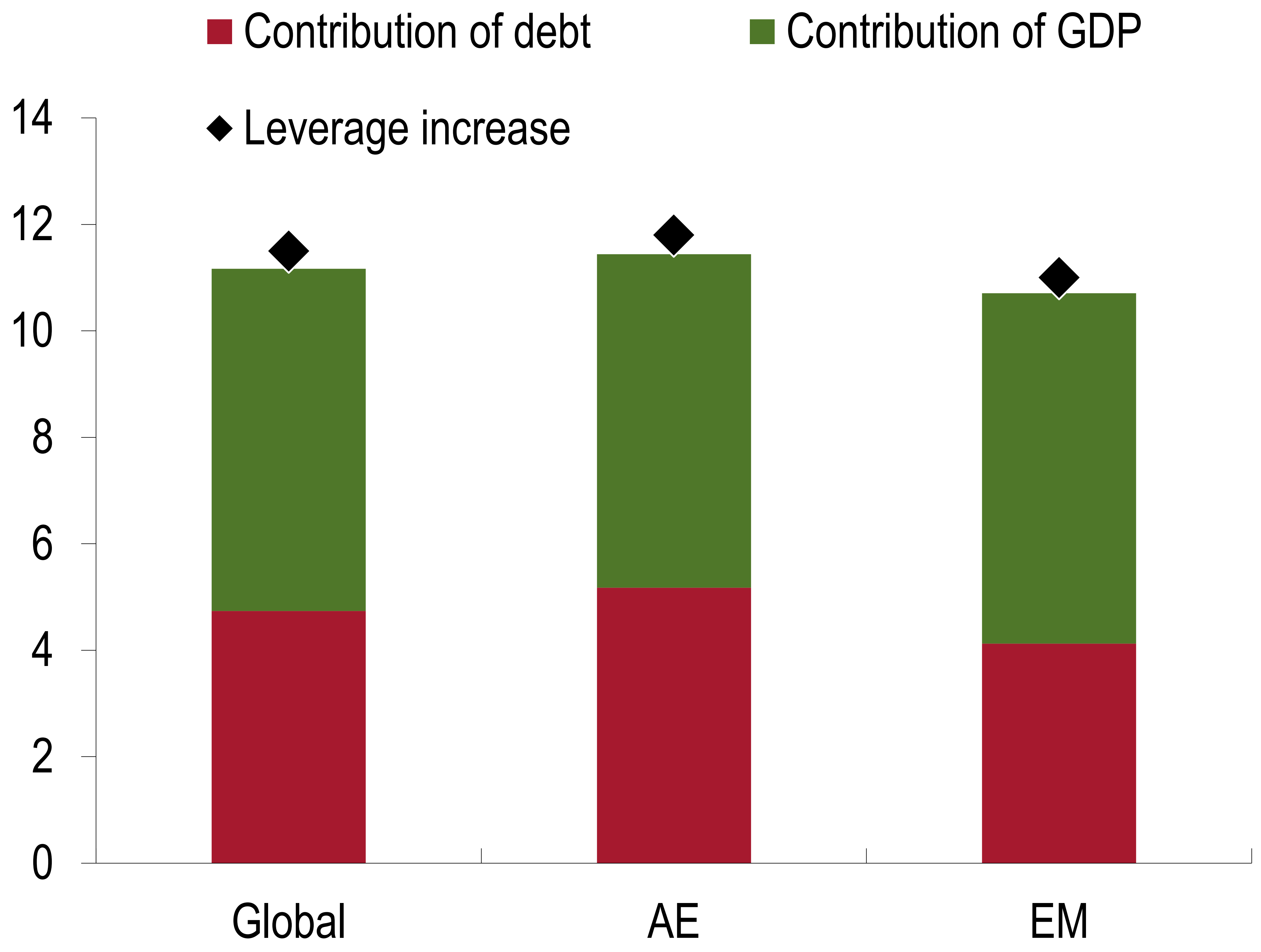


US Equity Market Misalignment
(Deviation from fair value per unit of risk)

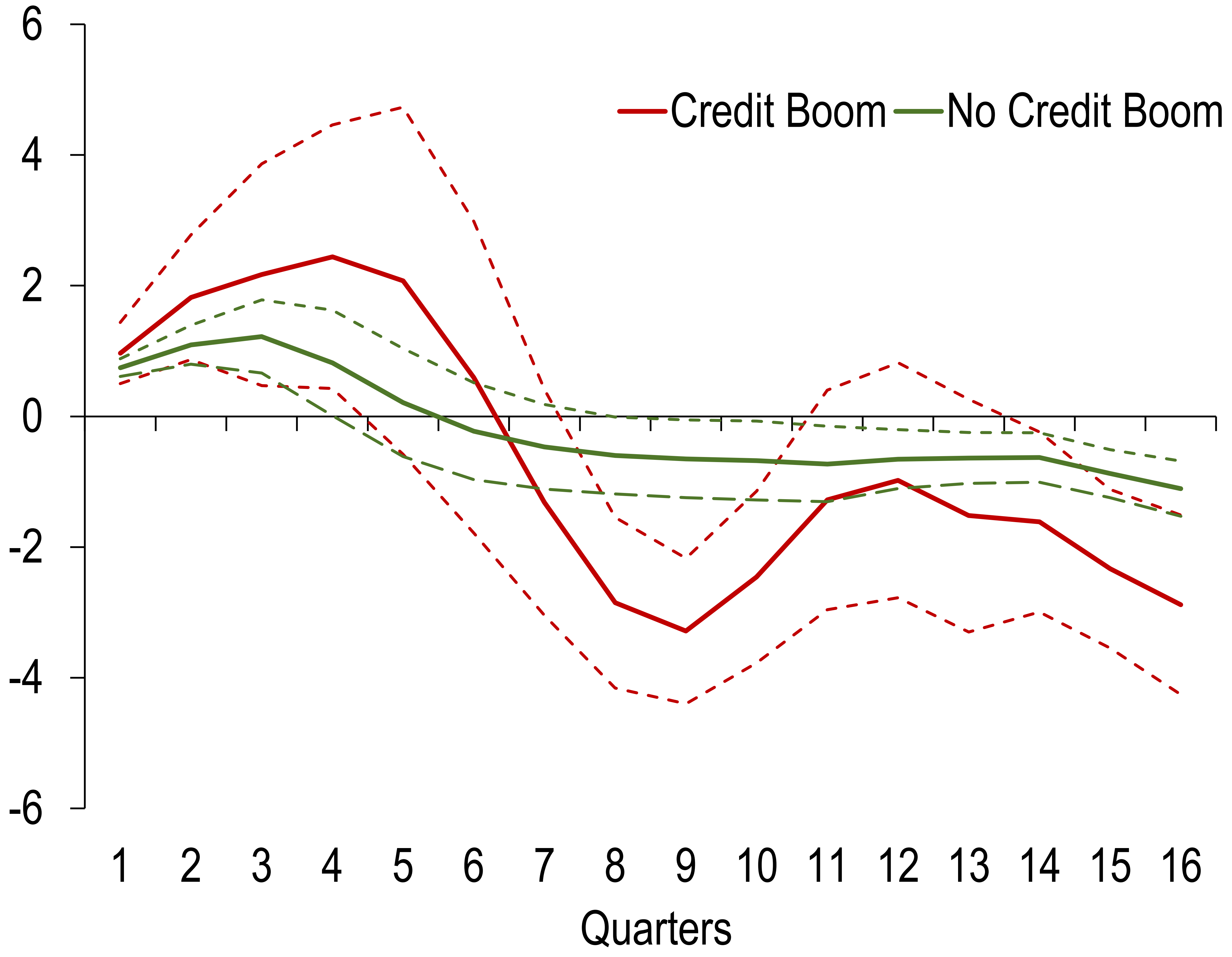


High Leverage Amplifies The Intertemporal Policy Tradeoff

Increase in Non-financial Corporate Leverage, 2019Q4 – 2020Q3
(Debt-to-GDP, percentage points)



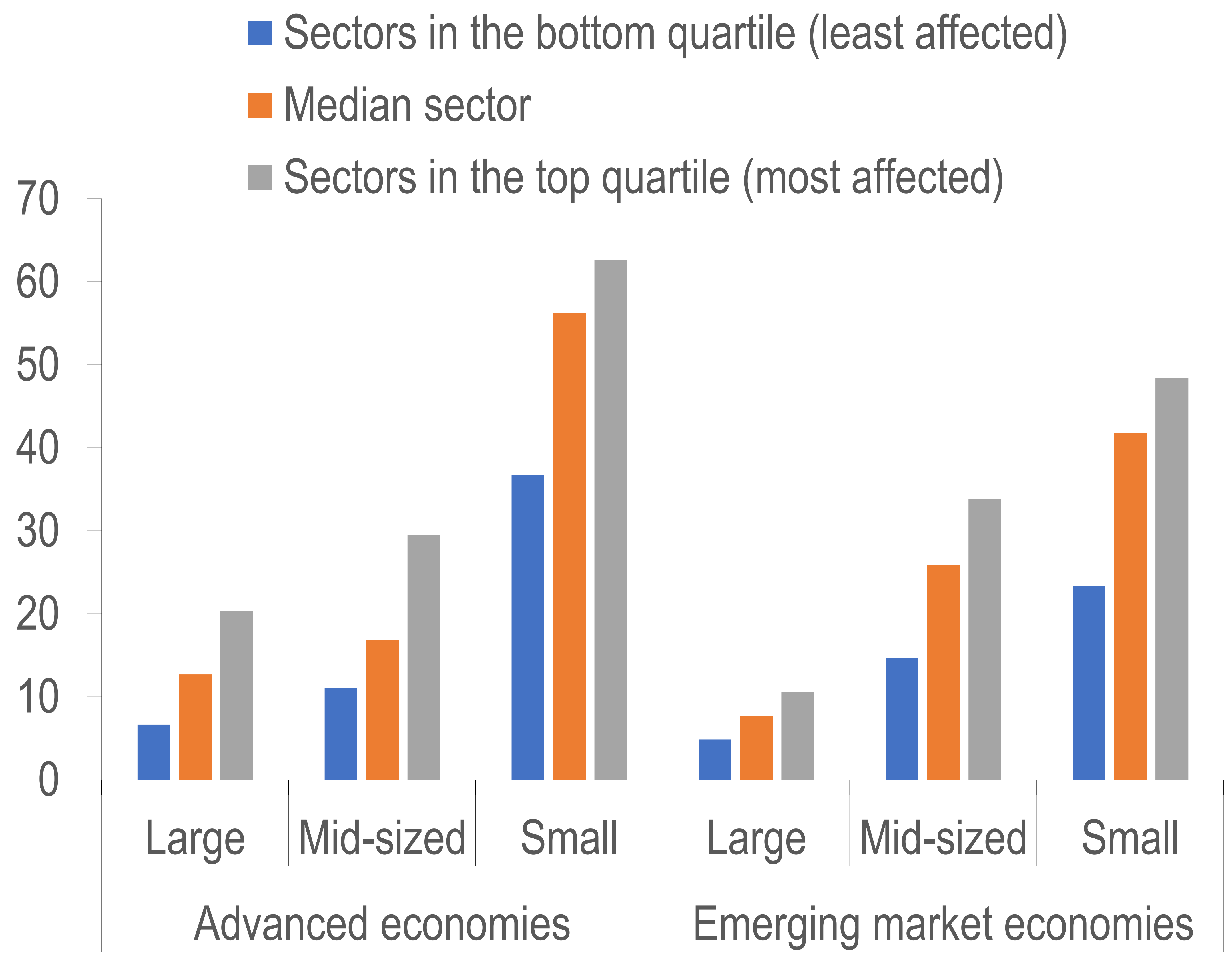
Effect of Easing Financial Conditions on GDP Growth at the 10th Percentile
(Percentage points)



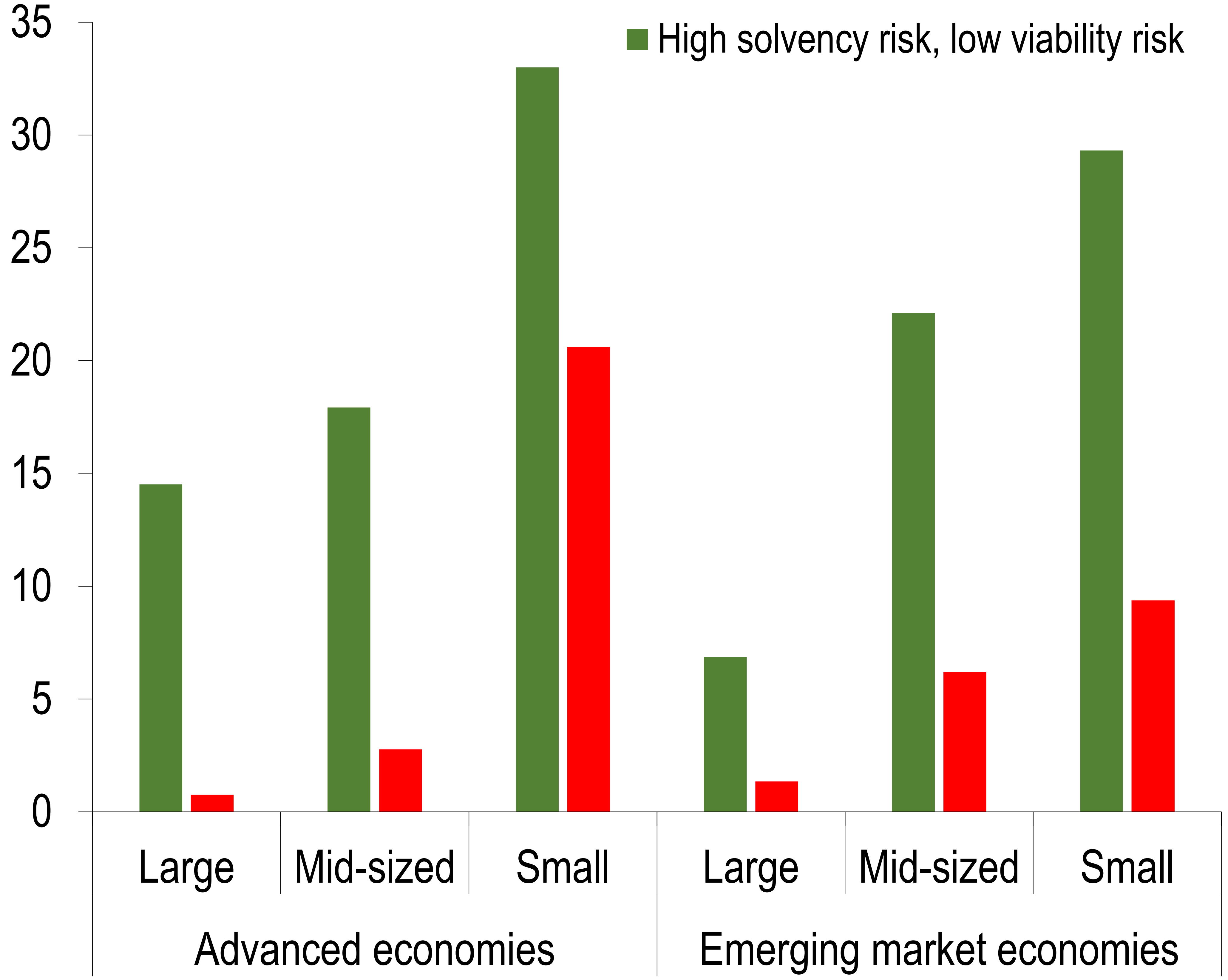
Note: Includes 19 Advanced Economies (AE) and 10 Emerging Markets (EM).

Corporate Solvency Risk Are Still Elevated

Share of Debt at Firms with High Solvency Risk
(Percent of total debt at all firms in these segments)

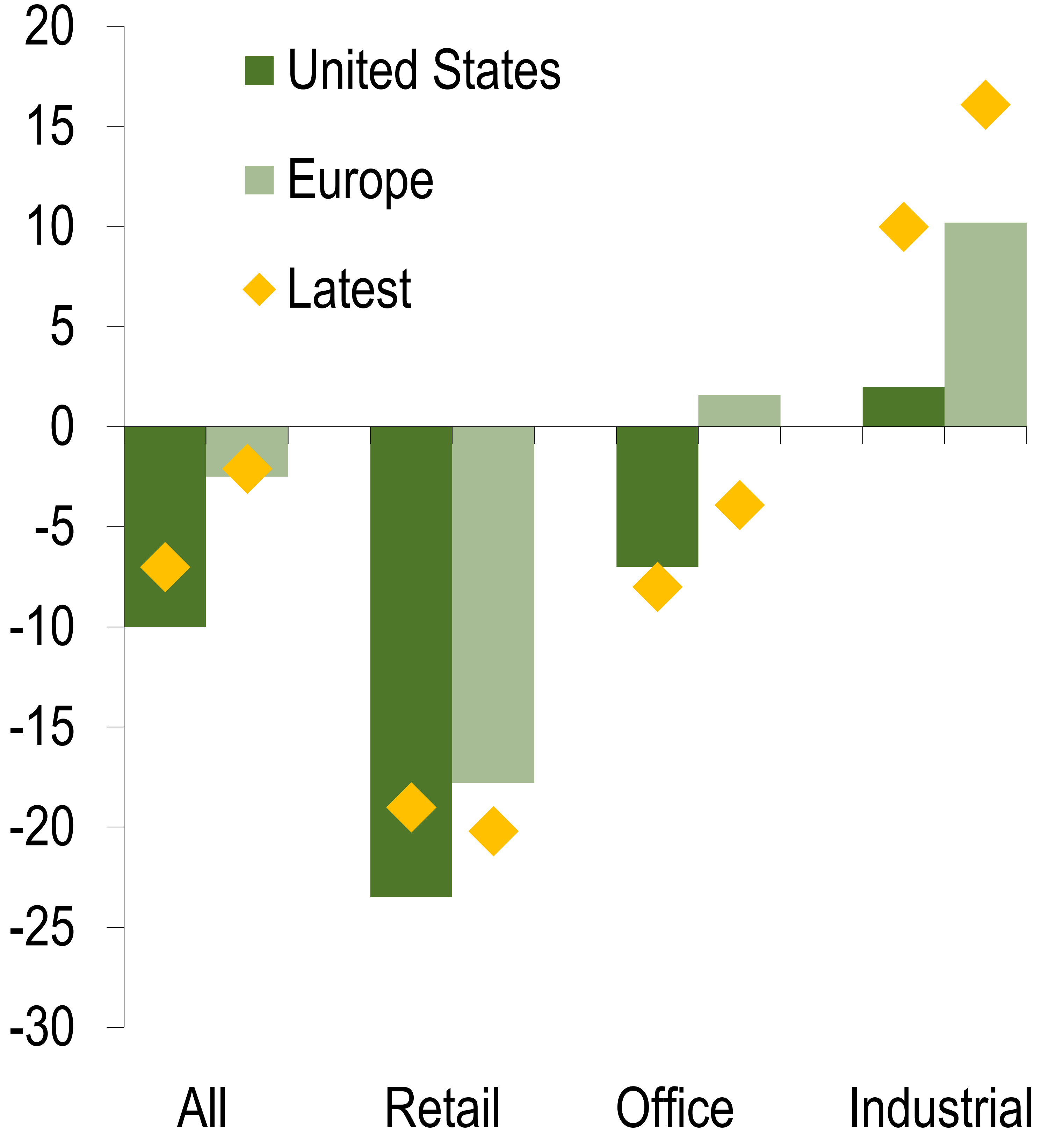


Share of Debt at Firms with High Solvency Risk, by Size and Viability
(Percent of total debt at all firms in these segments; averages across all sectors)

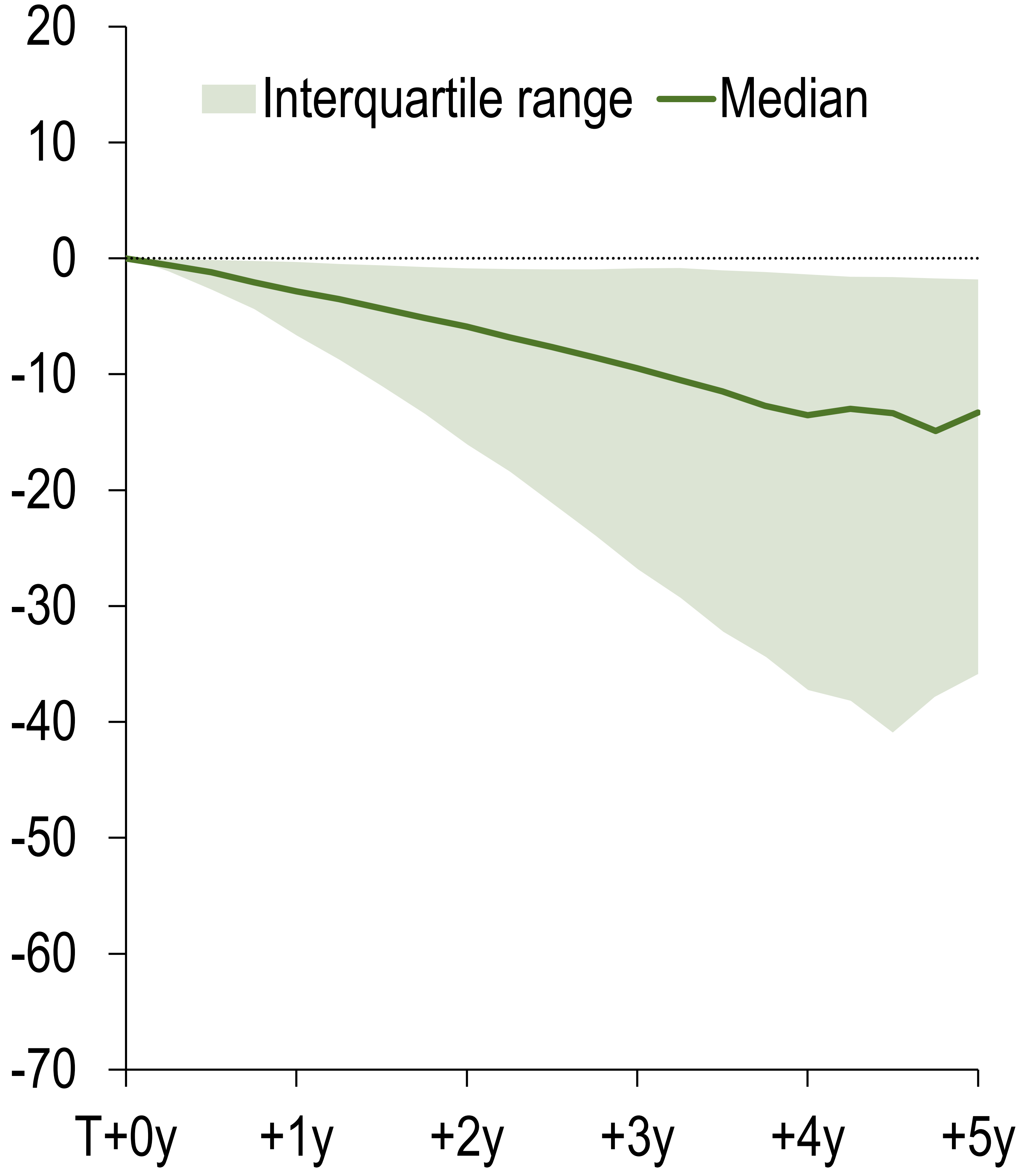


Commercial Real Estate Sector Hit Hard in COVID

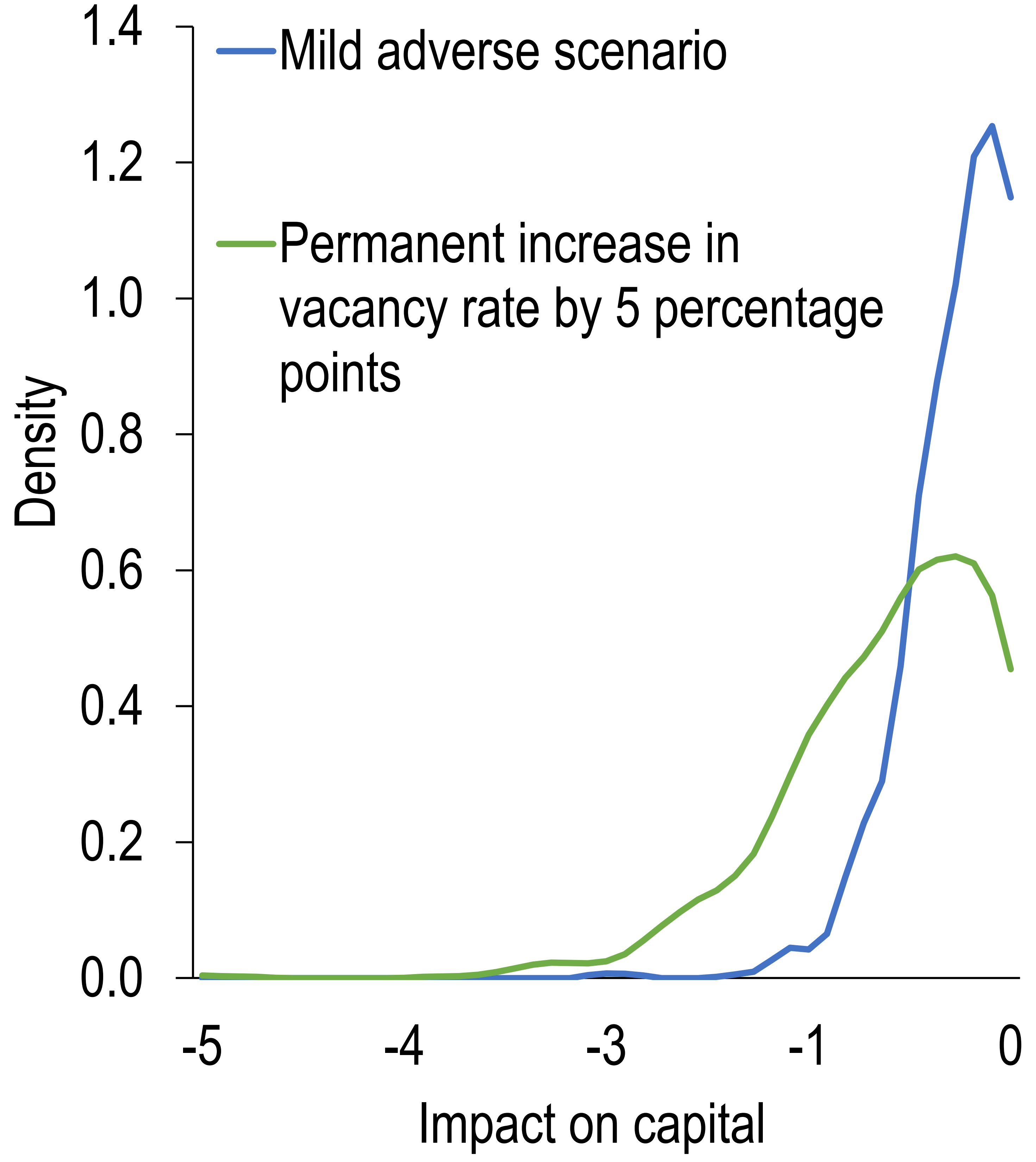
Growth in CRE Price
(Percent yoy, 2020:Q2 and latest)



Response of CRE Prices to a Permanent Shock to the Vacancy Rate
(Percent)

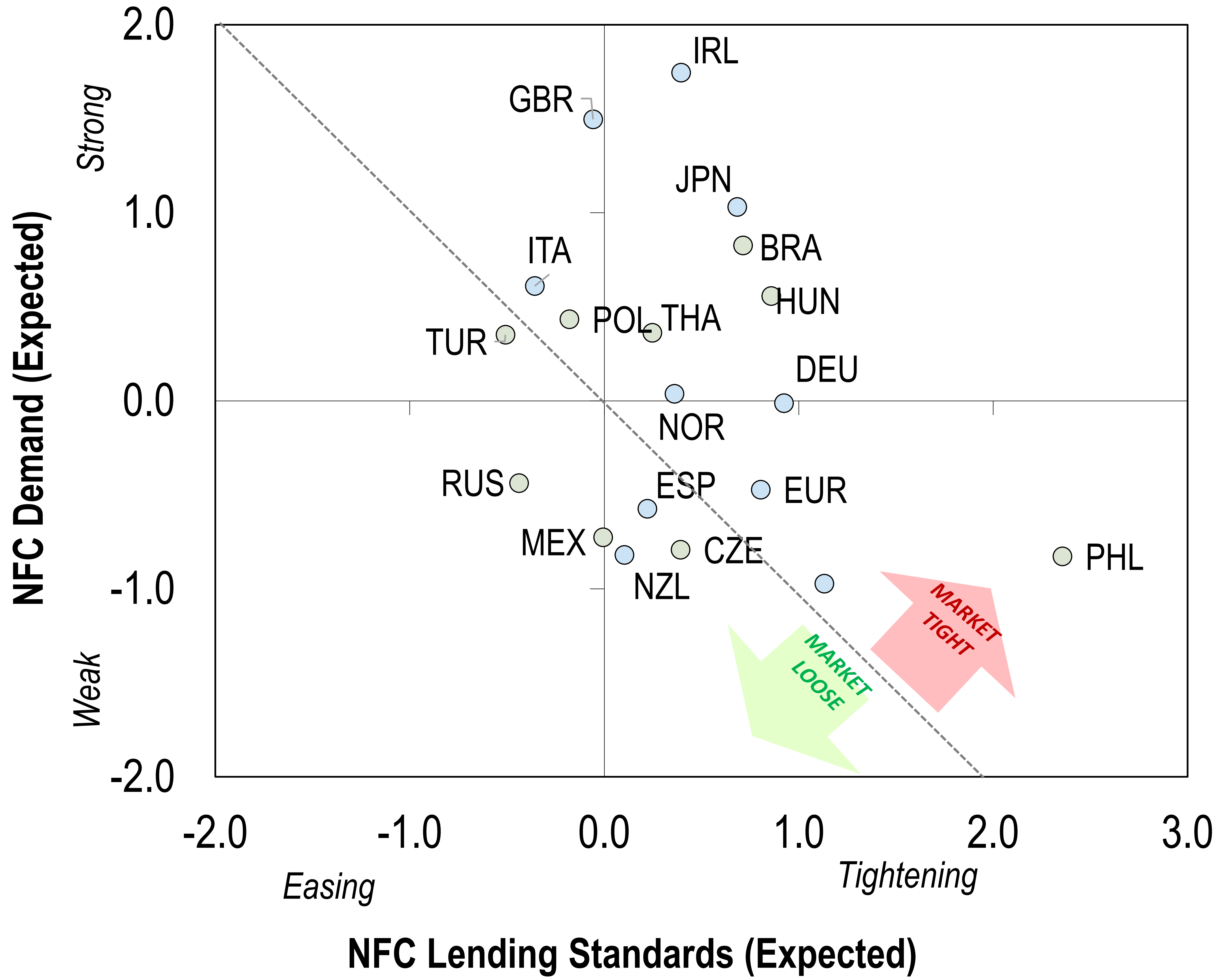


Distribution of Projected Bank Capital Losses with a Permanent Shocks to Vacancy Rates
(Percent of risk-weighted assets)

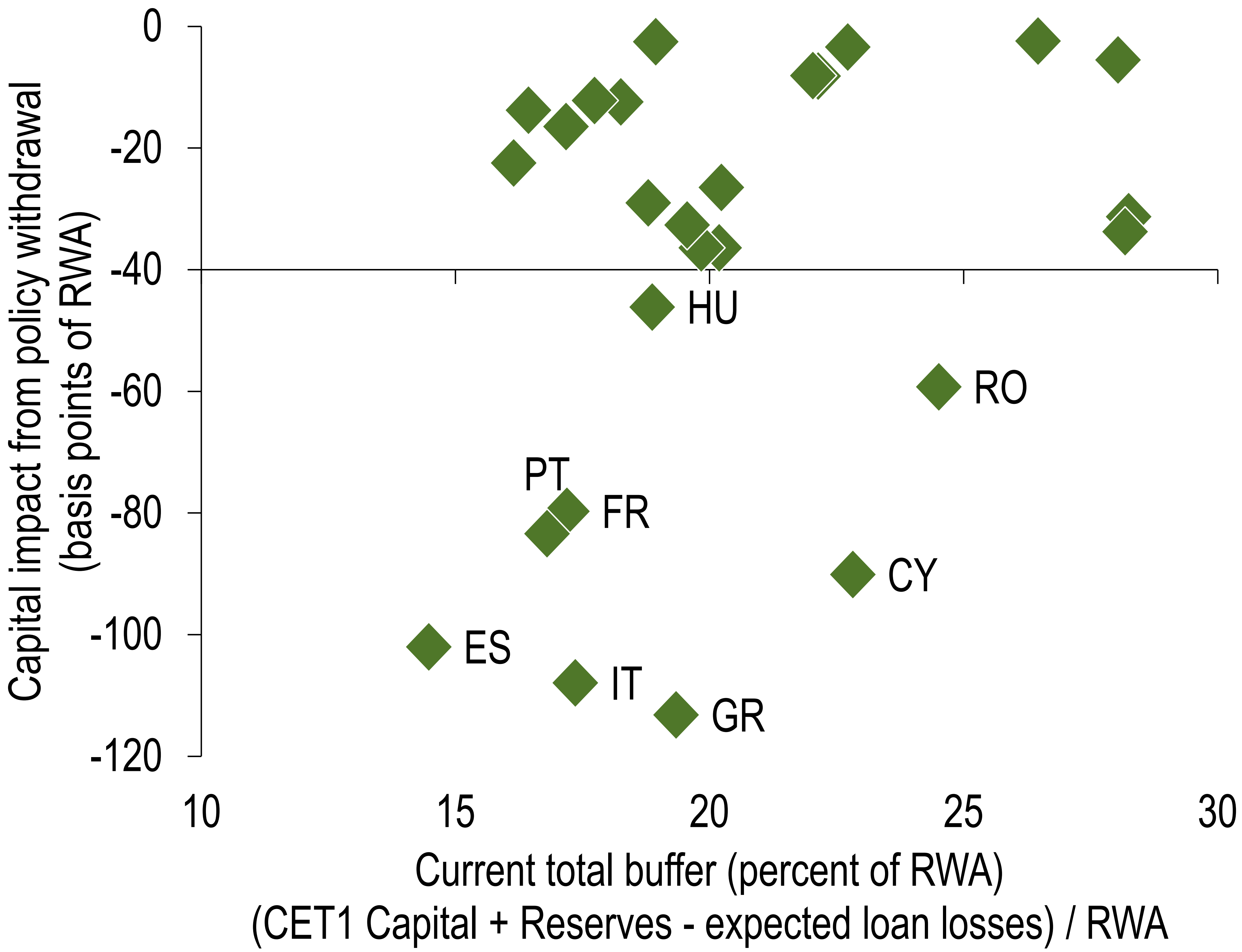


Weak Lending Appetite on Concerns about Asset Quality and Policy Withdrawal

Expected Lending Standards and Loan Demand for SME
(Standard deviation)

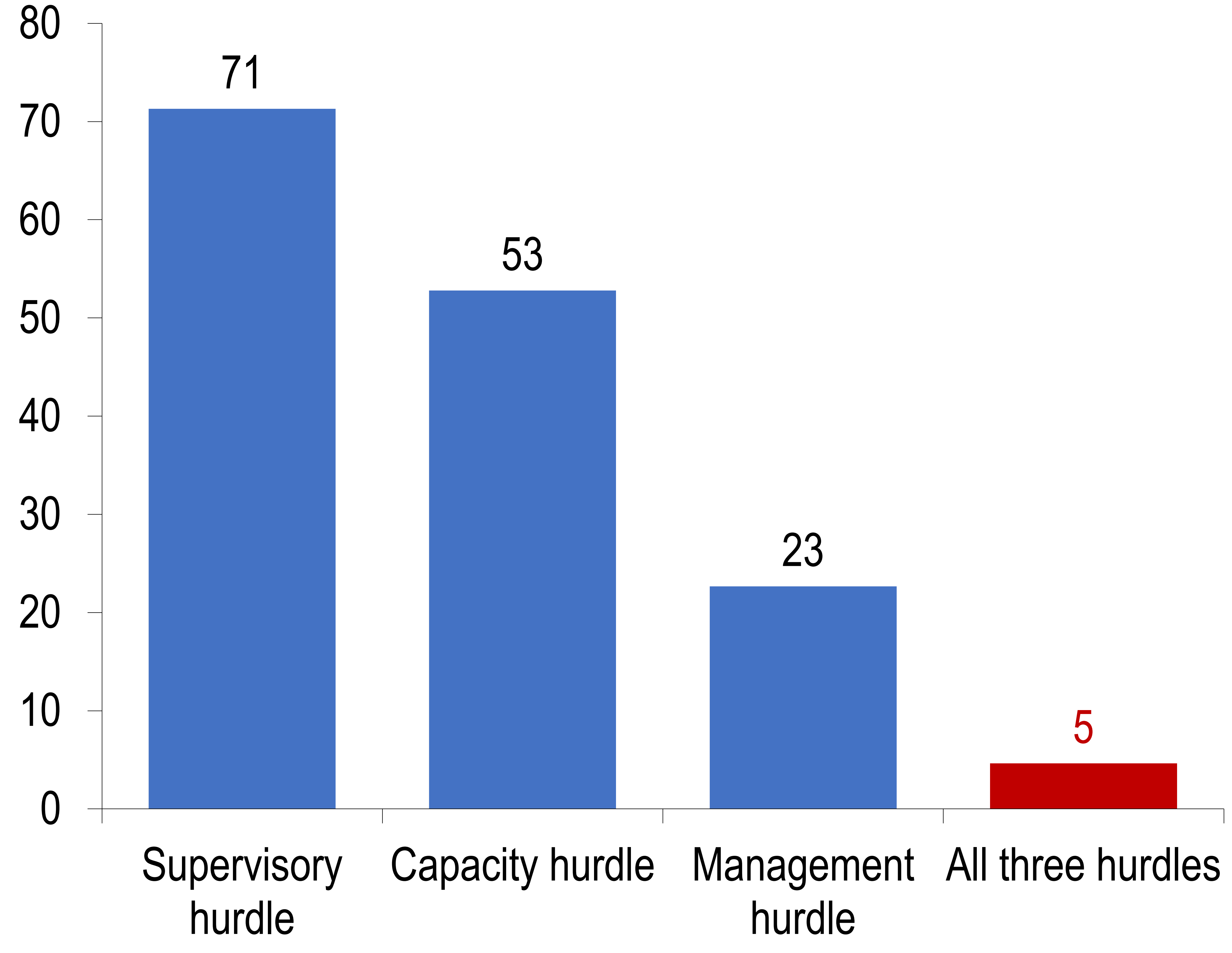


Capital Impact of Withdrawal of Policy Support
(Basis point of RWA)



Bank Capital Buffers Are Ample but Unlikely to be Used

Share of Banks Clearing Different Levels of Hurdles to Use Buffers
(Percent of bank market capitalization)



How do banks think about buffer usability?

Capacity hurdle:
is capital buffer sufficiently large enough?

Supervisory hurdle:
ability to rebuild the buffer organically & within a reasonable time (otherwise supervisors may not allow buffer draw-down).

Management hurdle:
generate sufficient return by using the buffers