Department of Economics and the Centre for Macroeconomics

Assessing Global Financial Stability: where do we stand?

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A Framework for Assessing Global Financial Stability

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Outline

- The GFSR
  - The IMF’s assessment of risks to global financial stability
- Growth-at-Risk
  - Mapping financial stability risks into macroeconomic performance
- Going forward
  - Strengthening the analytical framework for financial stability
Near term global financial stability risks are improving

Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite
Too much money chasing too few yielding assets

Fewer Yielding Assets…
(Global Investment-Grade Fixed Income Instruments)

… Compressing Premiums
As Credit Quality Worssens
(Market Risk Premium, Share of IG BBB Bonds)
The volatility paradox: low volatility breeds complacency

Low Volatility and Rising Valuations…
(AE Assets, Percentile Rank)

Volatilities
Govt bond
Corp bond
Housing
Equities


Model-based probability of default (left scale)
Financing conditions (left scale)
Credit gap (right scale)

00 02 04 06 08 10 12 14 16

-4 -3 -2 -1 0 1 2 3 4

Credit Gap (percentage points)
Higher leverage and debt service challenges

Debt Continues To Rise…
(Average Debt-to-GDP Ratios for G20 Economies, Percent)

... Increasing Debt Service Burdens
(Deviation From Mean, Percentage Points, 2016)

Debt service ratio

Debt-to-GDP
Benign external conditions; EM vulnerabilities remain

Risk Premiums Have Compressed
(Market Risk + Term Premium, Basis Points)

Portfolio Flows Have Rebounded
(Billions of USD, Four-quarter Rolling Sum)

Corporate Leverage Remains High
(Total Debt to EBITDA, Multiple)
China: A delicate balancing act

Regulatory Tightening of Small and Medium Sized Banks...
(Monthly Change, Three Month Average, Billions of RMB)

On-balance sheet shadow credit

Unsecured interbank borrowing

... Could Impact Credit Growth
(Credit Growth Under Shadow Credit Growth Assumption; Percent)

Zero shadow credit growth

2014 2015 2016 2017E
Rising Leverage Foresees a Riskier Outlook
(Probability Density Forecasts for GDP Growth Made One Year Earlier)
Rising household debt could challenge growth

**Short Term Expansions May Pose Future Risks to Growth**
(Growth Effect of a 1 Percent Increase in HH Debt to GDP, Percent)

**Effective Policies & Institutions Could Mitigate These Risks**
(Growth Effect at t+3 of a 1 Percent Increase in HH Debt to GDP, Percent)

**Macroprudential Policies Can Curb Household Credit Growth**
(Impact of a Tightening on Real Household Credit Growth, Percentage Points)
Monetary policy support: Still needed

Gradual Central Bank Balance Sheet Reduction
(Central Bank Outstanding Assets, Trillions of USD)

Prolonged Low Policy Rates
(Market Implied Policy Rates, Percent)
Growth at Risk

A CONCEPTUAL FRAMEWORK FOR FINANCIAL STABILITY RISKS AND MACROECONOMIC PERFORMANCE
Thinking through financial stability

- Defining financial stability
- Measuring financial stability
Rising leverage signals higher downside growth risks at longer time horizons

Advanced economies: three years ahead

Emerging market economies: three years ahead
Tighter financial conditions forecast greater downside tail risk to global growth

Downside and upside risks (5th and 95th percentiles)

Median

FCI (RHS)

Lower growth and tighter financial conditions

-14.5
One-period-ahead GDP and financial conditions

Increasing risk premia signal a more pessimistic growth outlook ….

… as does elevated leverage

Source: IMF staff estimates.
Note: Values are normalized with steady state = 1.
Simple debt tax ameliorates risk of leverage-induced recessions

Source: IMF staff estimates.
Note: Values are normalized with steady state = 1, except for inflation (in percent).
Thank you
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