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

LONDON SCHOOL OF ECONOMICS

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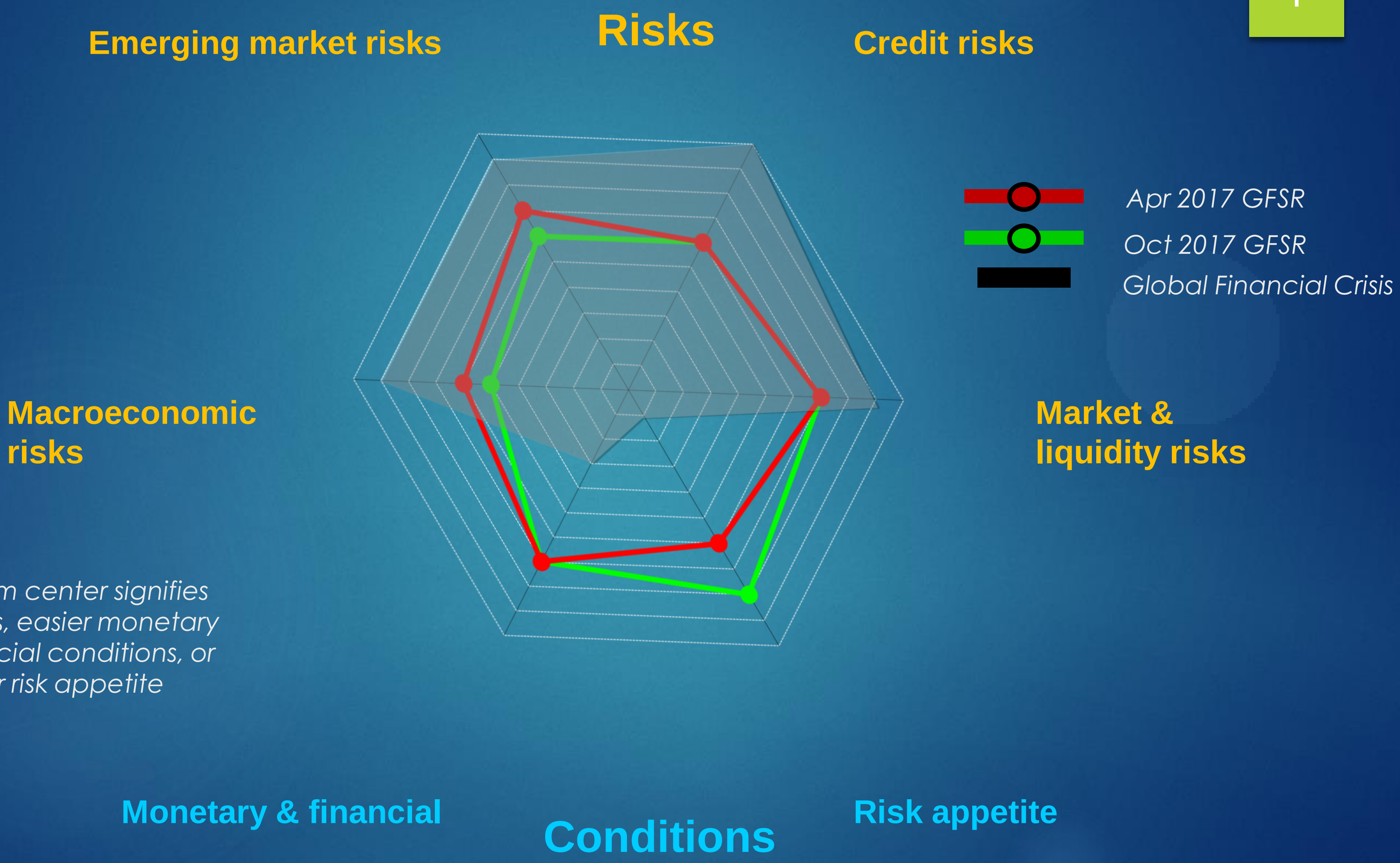
Outline

- 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

Fall 2017 GFSR

IS GROWTH AT RISK?

Near term global financial stability risks are improving

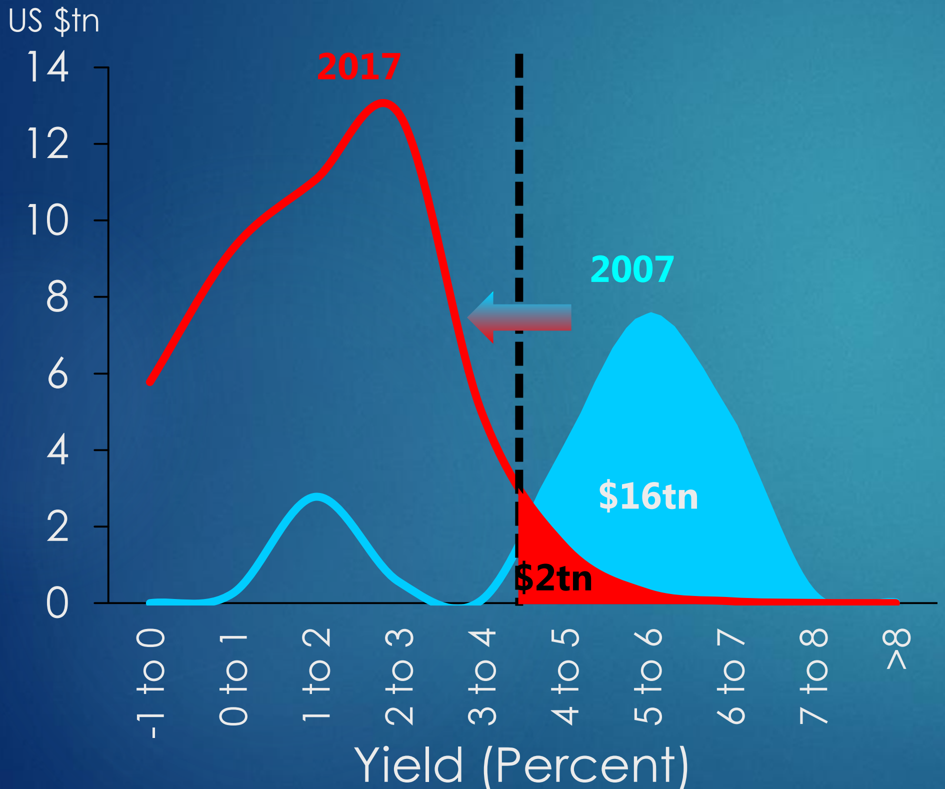


Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite

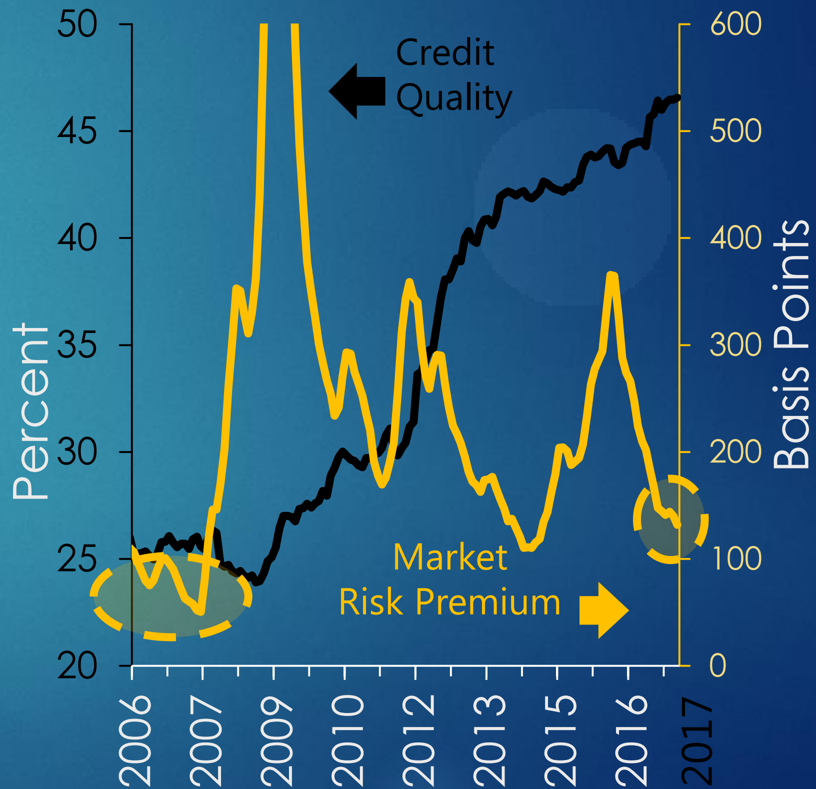
Too much money chasing too few yielding assets

2

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



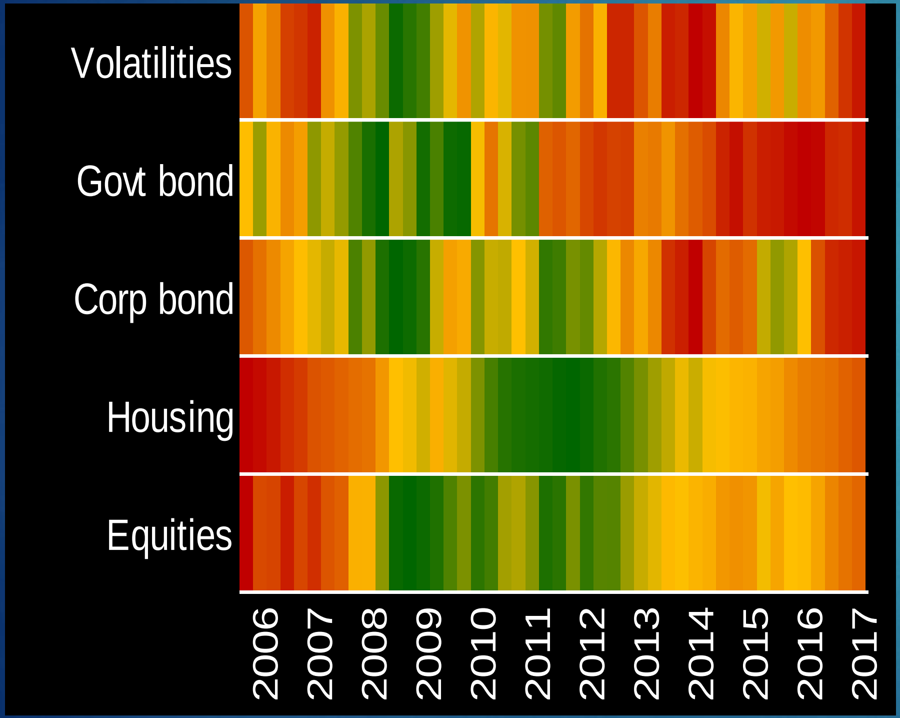
… Compressing Premiums As Credit Quality Worsens
(Market Risk Premium, Share of IG BBB Bonds)



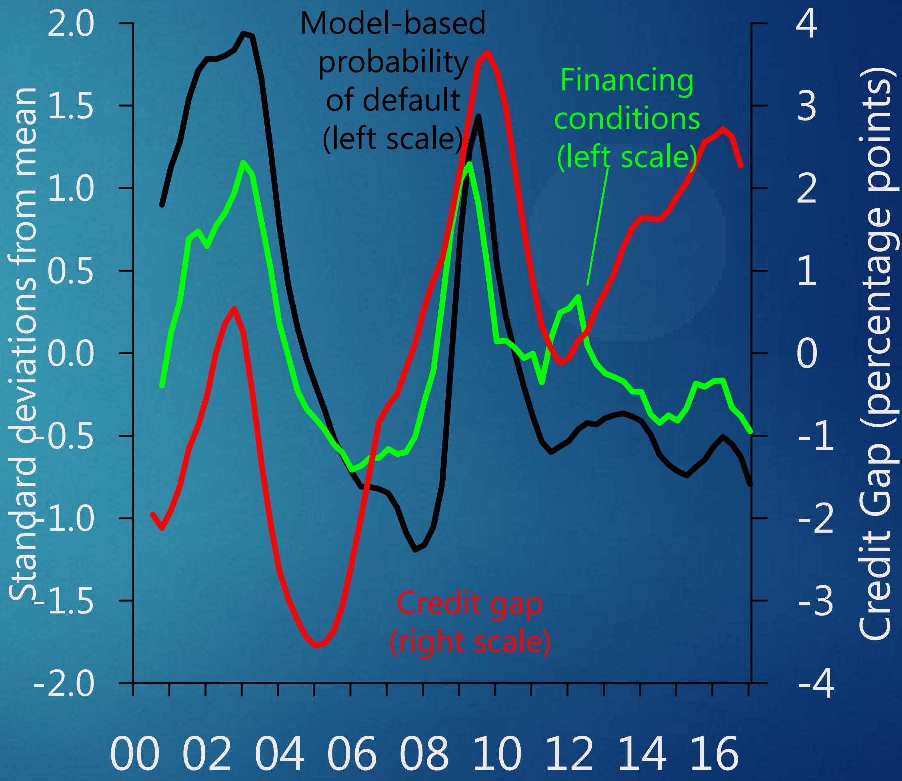
The volatility paradox: low volatility breeds complacency

3

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



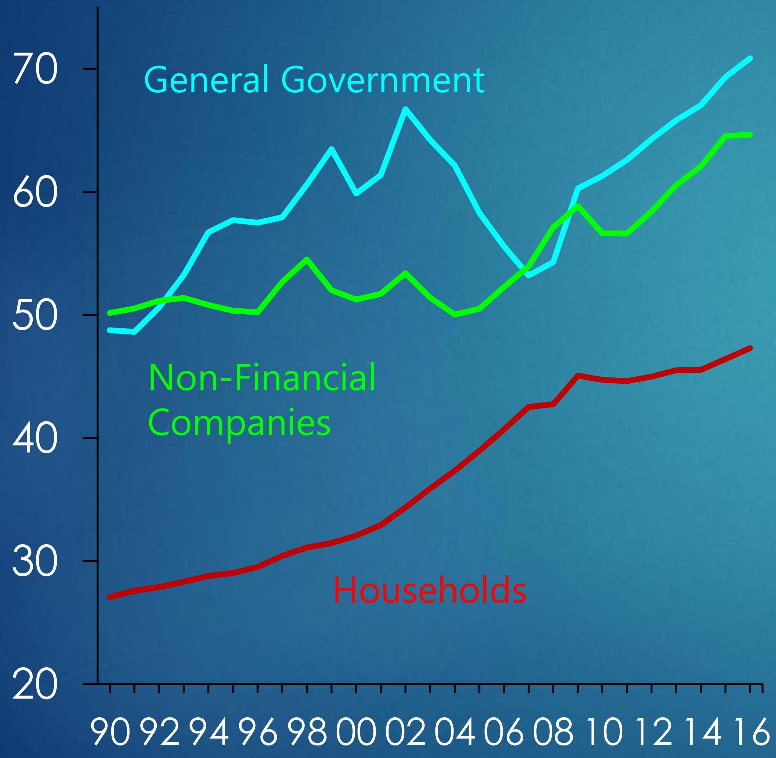
… Leading to Rising Leverage And Complacency



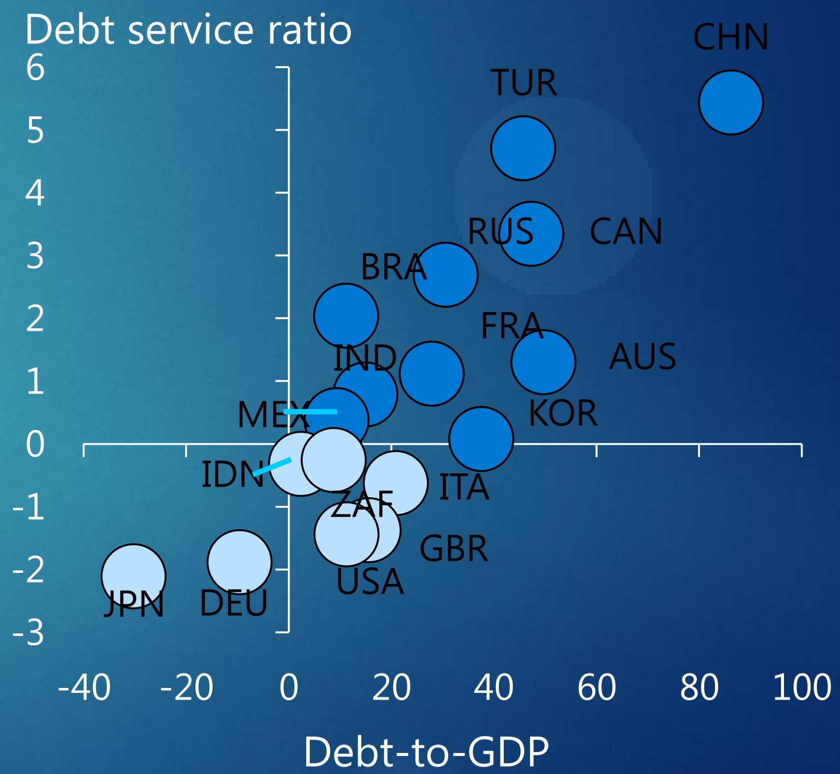
Higher leverage and debt service challenges

4

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



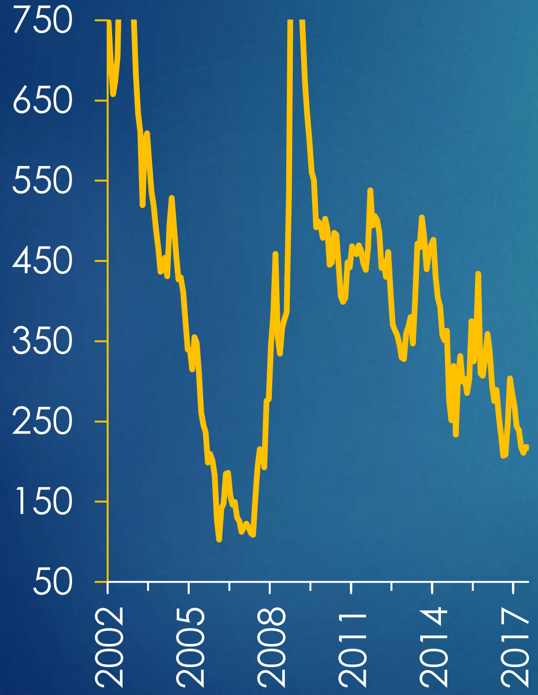
.. Increasing Debt Service Burdens
(Deviation From Mean, Percentage Points, 2016)



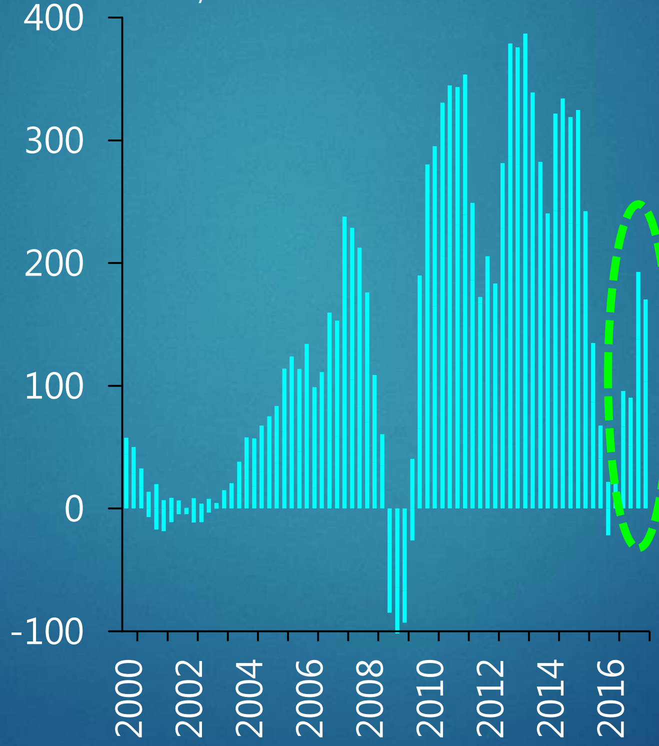
Benign external conditions; EM vulnerabilities remain

5

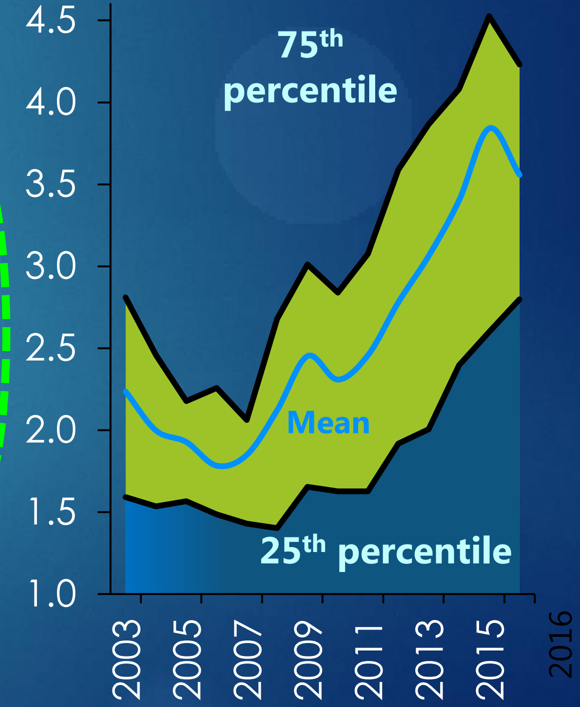
Risk Premiums Have Compressed
(Market Risk + Term Premium, Basis Points)



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

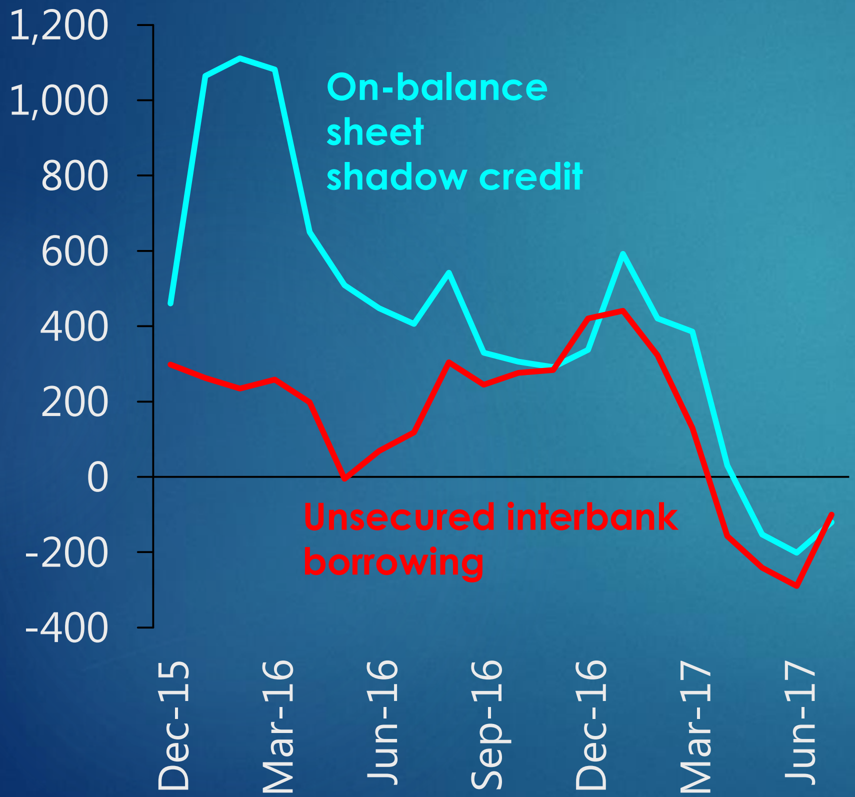


Corporate Leverage Remains High
(Total Debt to EBITDA, Multiple)

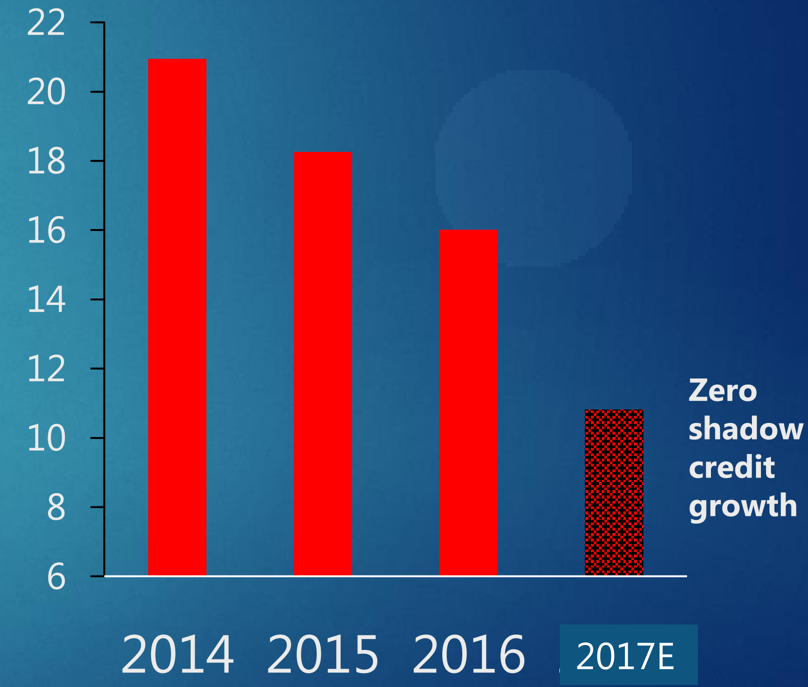


China: A delicate balancing act

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

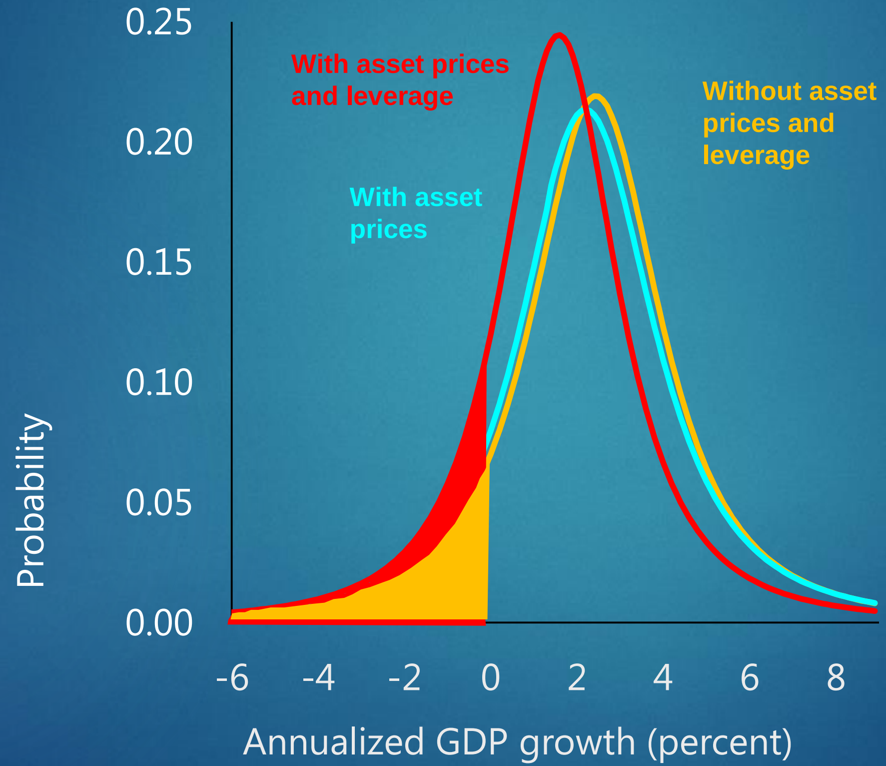


… Could Impact Credit Growth
(Credit Growth Under Shadow Credit Growth Assumption; Percent)



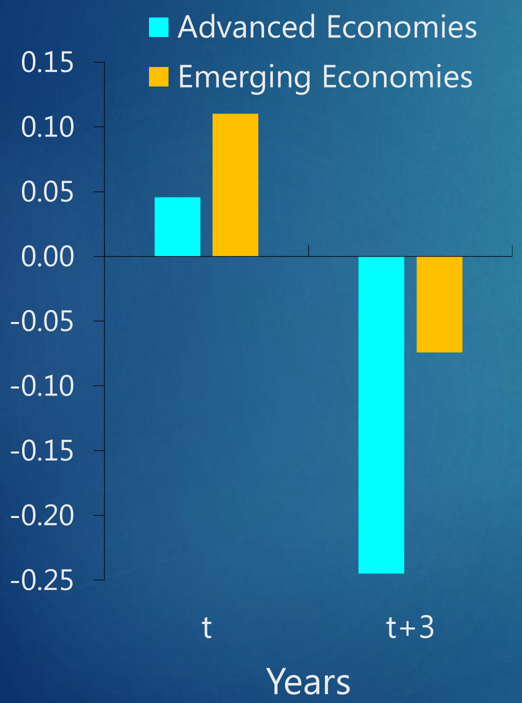
Growth-at-Risk

Rising Leverage Foresees a Riskier Outlook
(Probability Density Forecasts for GDP Growth Made One Year Earlier)

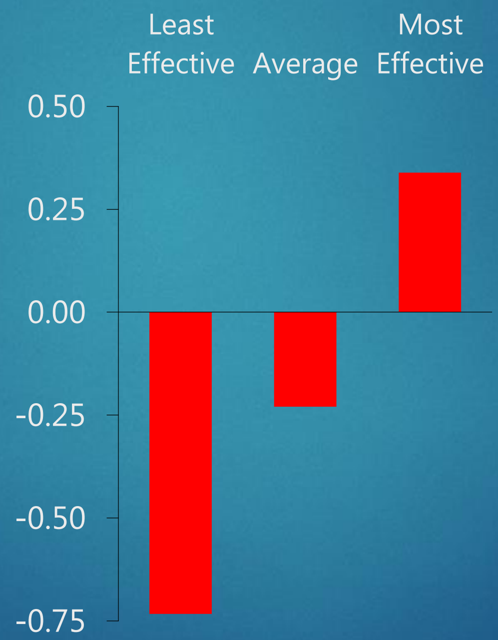


Rising household debt could challenge growth

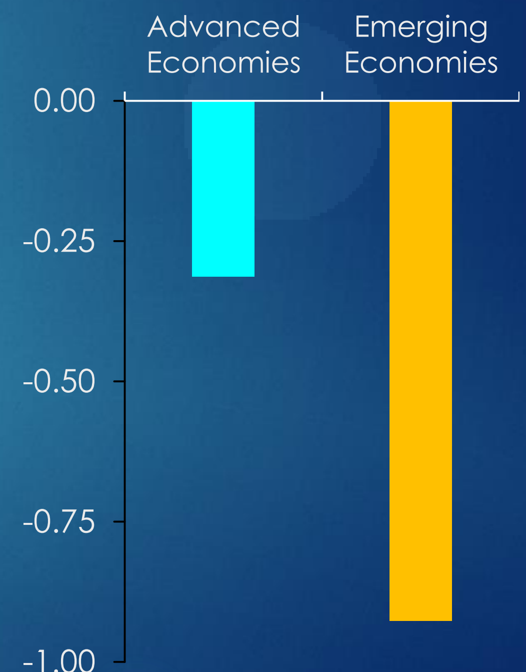
Short Term Expansions May Pose Future Risks to Growth
(Growth Effect of a 1 Percent Increase in HH Debt to GDP, Percent)



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

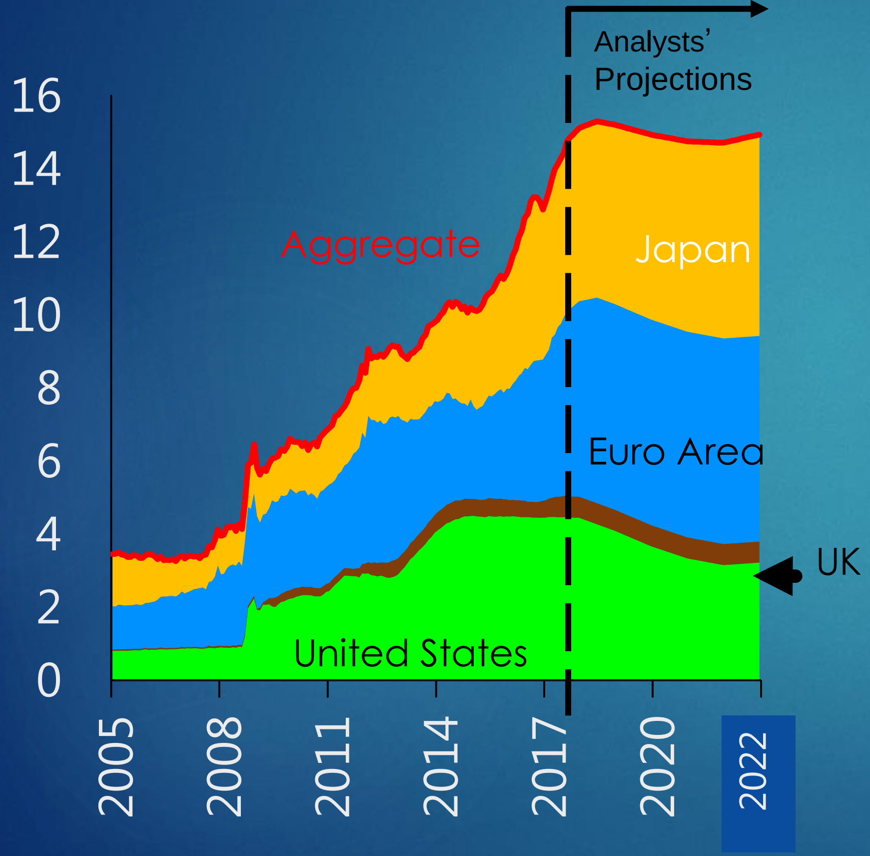


Macroprudential Policies Can Curb Household Credit Growth
(Impact of a Tightening on Real Household Credit Growth, Percentage Points)

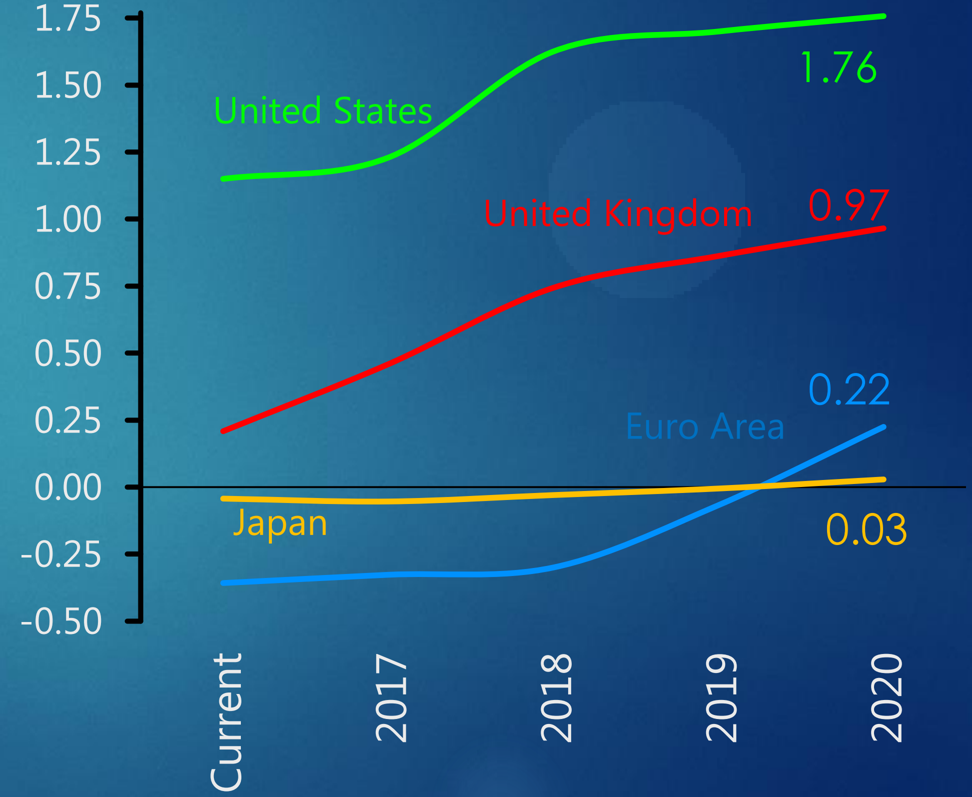


Monetary policy support: Still needed

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



Prolonged Low Policy Rates
(Market Implied Policy Rates, Percent)



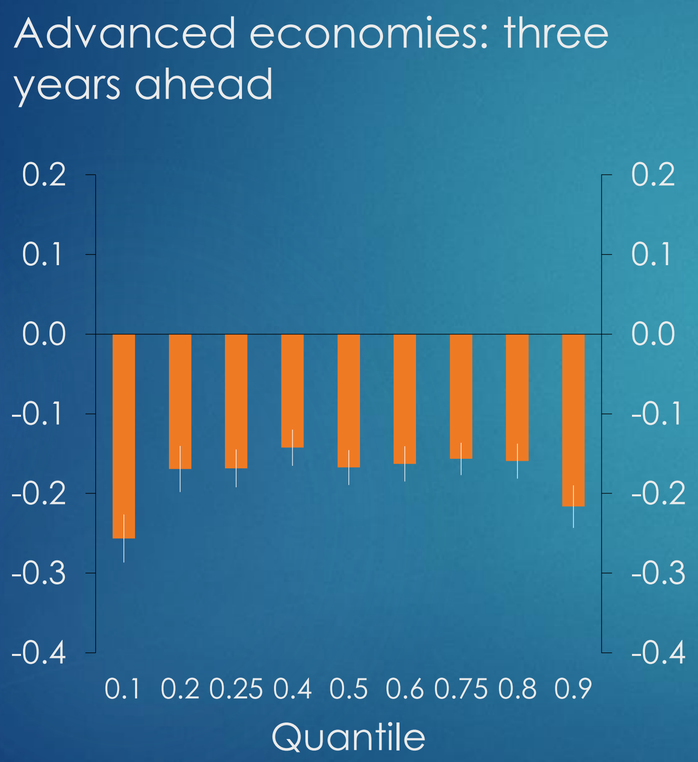
Growth at Risk

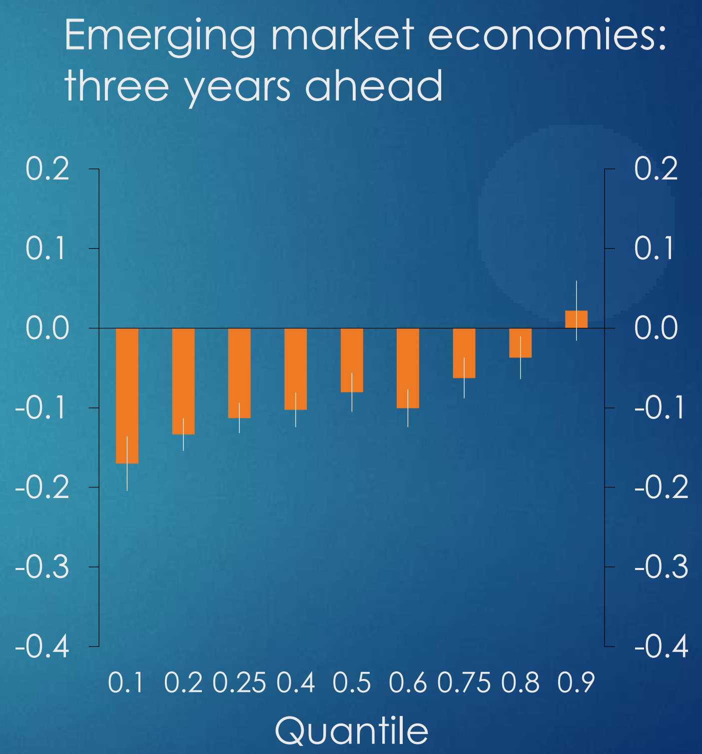
A CONCEPTUAL FRAMEWORK FOR FINANCIAL STABILITY RISKS AND MACROECONOMIC PERFORMANCE

Thinking through financial stability

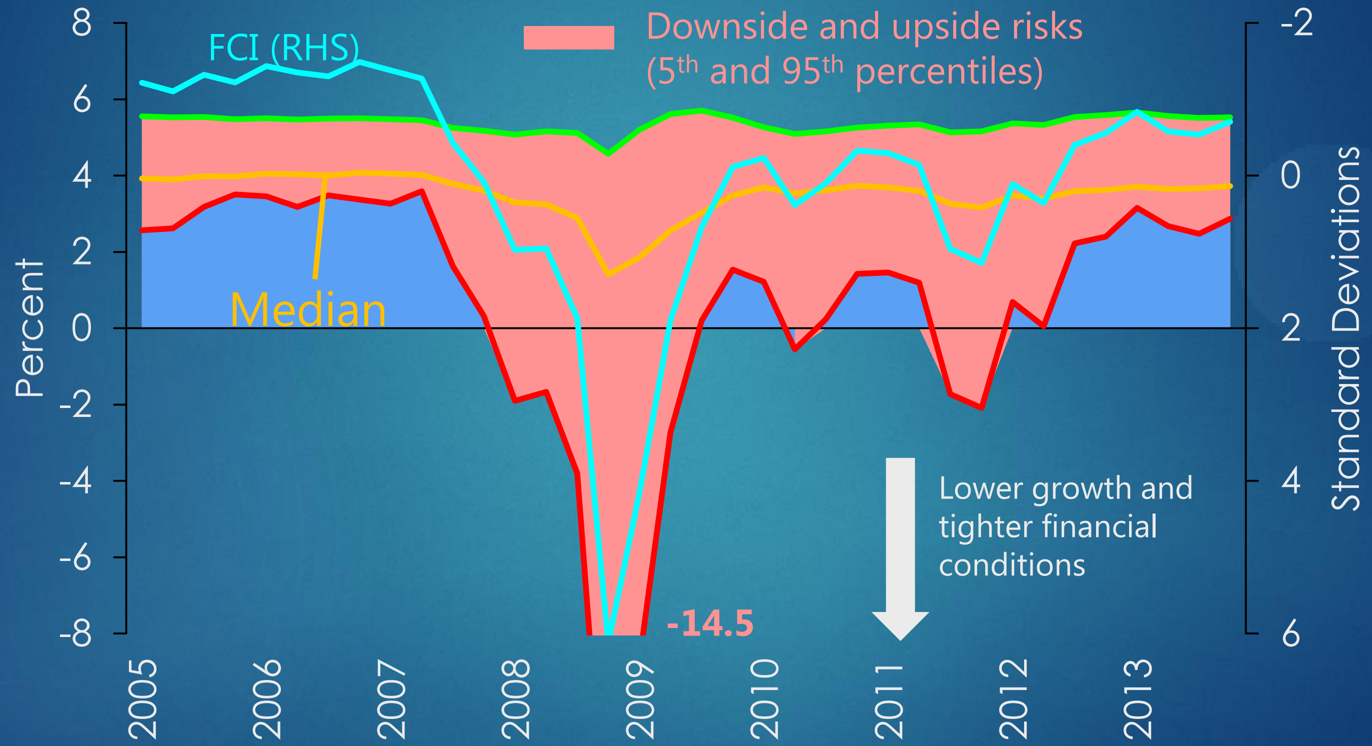
- Defining financial stability
- Measuring financial stability

Rising leverage signals higher downside growth risks at longer time horizons



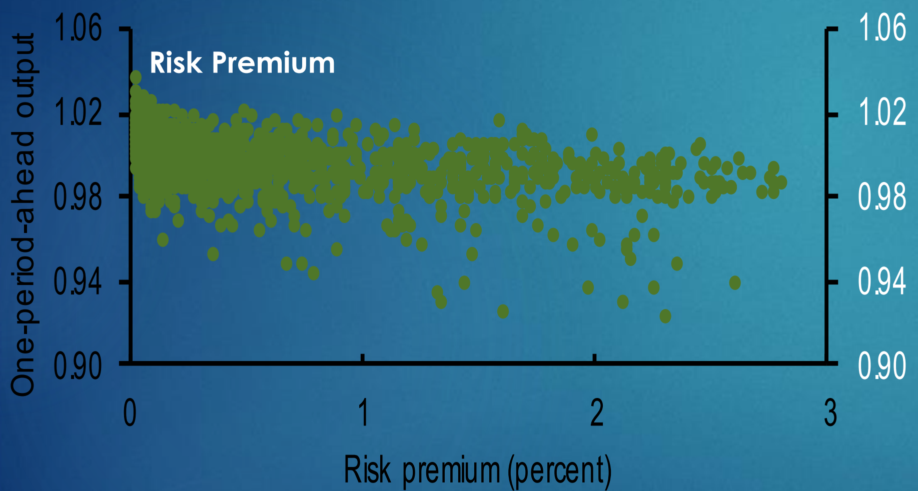


Tighter financial conditions forecast greater downside tail risk to global growth

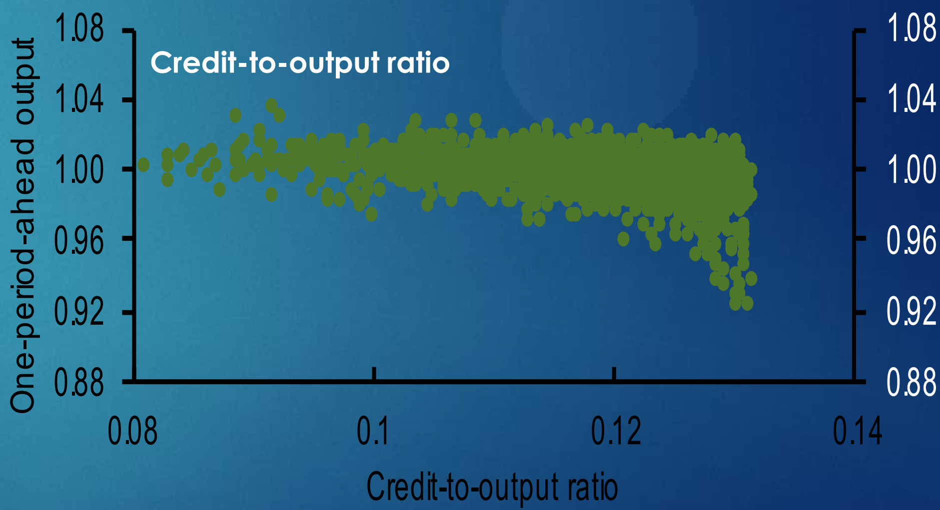


One-period-ahead GDP and financial conditions

Increasing risk premia signal a more pessimistic growth outlook ….

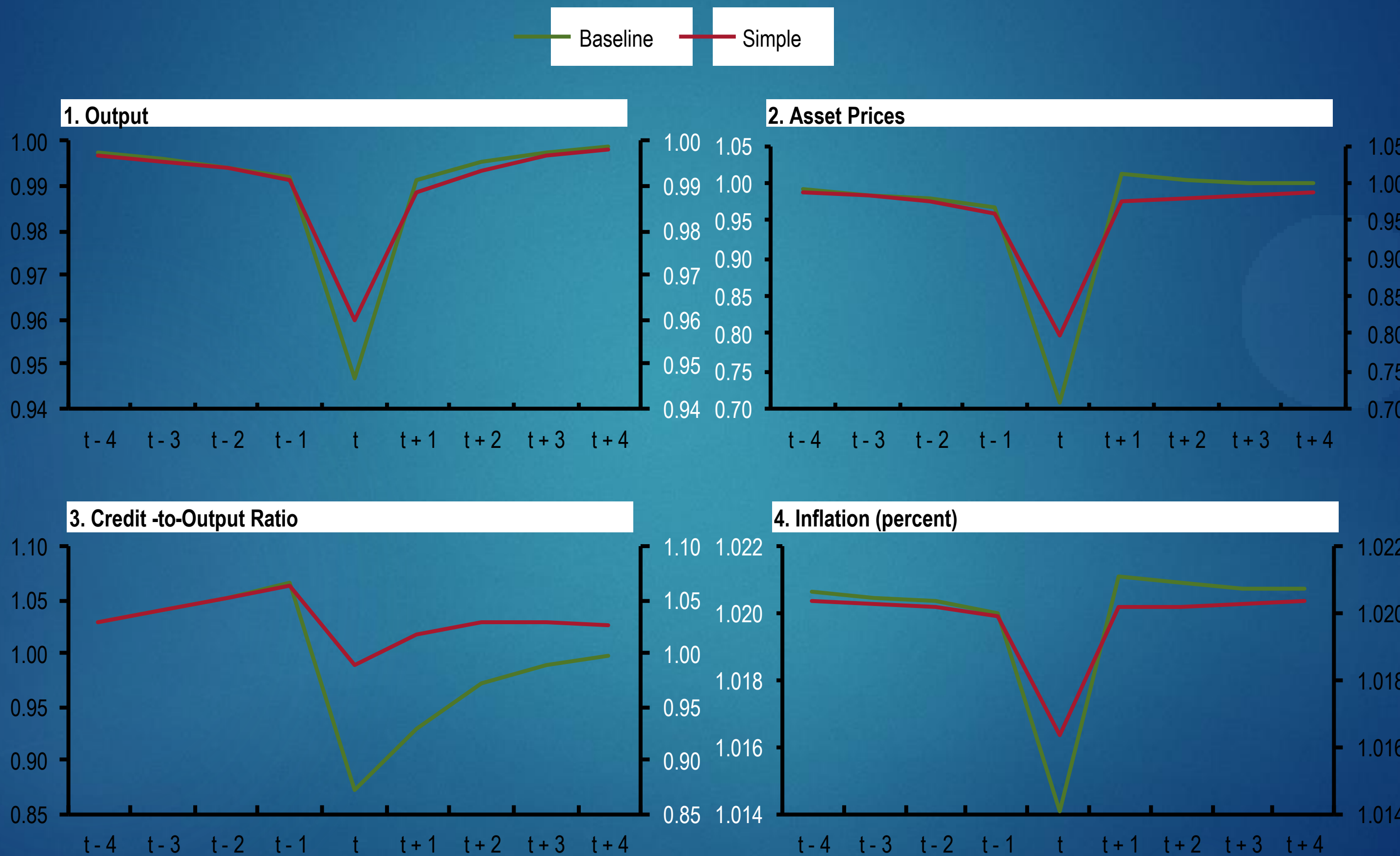


… as does elevated leverage



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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