Discussant at SUERF- Bocconi Webinar - The European Money and Finance Forum

Ranjit Singh
Assistant Director
Monetary and Capital Markets Department
Financial stability risks have risen and the balance of risks to growth has tilted to the downside.

Inflationary pressures have increased sharply across the board…

… calling for decisive monetary action,

Greater differentiation across EMDEs put further pressure on portfolio flows.

Financial vulnerabilities remain elevated in China amid growth slowdown

Against of a backdrop of higher commodity prices, it’s crucial to intensify efforts toward the climate transition while addressing energy security concerns
Tightening of Financial Conditions and Downside Risks to Growth

Financial conditions have tightened, especially for countries with close ties to Russia.

Downside risk to growth have increased meaningfully.

Financial Conditions
(Standard deviations from the mean)

- US
- Euro area
- Latin America
- Central, Eastern, and Southern Europe
- Middle East and Africa

Near-Term Growth-at-Risk Densities
(Percentile rank)

Note: AE = advanced economy; EM = emerging market; GFSR = Global Financial Stability Report.
Equities sold off in the immediate aftermath of the war, particularly in sectors affected by commodity prices and supply chain disruptions concerns…

US equities entered a bear market amid high uncertainty about MP tightening and growth prospects

Credit spreads have widened the most in low-rated corporates

Global Equity Price Change in 2022 (Percent)

Equity chart performance (1/1/2022=100)

Credit Spread levels (Basis points)

Pre-pandemic

Present

January-late February

War period

US S&P500

US Nasdaq

EA

JP

China

Energy

Airlines

Health care

Financials

Food & staples retail

Communication

IT

Consumer discretionary

Japan

Europe

EMs excluding China

US

China

Basic

Energy

Communications

Transportation

Consumer Cyclical

Consumer Noncyclical

Capital Goods

US S&P500

US Nasdaq

EA

JP

China

EMs excluding China

US

Credit Spread levels (Basis points)
Nominal yields have increased, mainly driven by rising breakeven, particularly in Europe.

Inflation expectations have risen sharply on the medium-term but remain mostly anchored on the long-term.

CPI prints continue to surprise on the upside and are expected to stay above target for many EMs.

Inflation Pressures Have Continued to Build Up Across the Board...

Year-to-date change in Advanced Economies yields (Percent)

Inflation Expectations (Percent)

Sum of Inflation Gaps (Ppt)

Note: CPI forecasts by Bloomberg analysts vs. Upper Band of Target
Expected Fed hikes have moved forward

ECB expectations have shifted higher

EMs expected to continue hiking for next year.

Calling for Decisive Monetary Policy Action
Potential for risk repricing as the effects of QT on the path of rates remains uncertain

Impact of QT on real rates, decompression of liquidity premia
(Percent)

Higher inflation along with higher rates may make a soft landing more difficult

Effective Fed Funds rate, Treasury curve slope; recession episodes shaded
(Percent)

-1.50
-1.00
-0.50
0.00
0.50
1.00
1.50
Jan-14
Jul-14
Jan-15
Jul-15
Jan-16
Jul-16
Jan-17
Jul-17
Jan-18
Jul-18
Jan-19
Jul-19
Jan-20
Jul-20
Jan-21
Jul-21
10-year Real Yield (TIPS-implied)
Scenario: No Quantitative Easing (targeting TIPS market)
50-60 basis point compression due to QE

-3
0
3
6
9
12
15
18
21
24
70 75 80 85 90 95 00 05 10 15 20
10y-3m spread Fed funds rate
19 20
US recession
High inflation episodes
US: Trying to Manage a Soft Landing
Southern sovereign yields have exceeded pre-pandemic levels and spreads have widened.

**Euro Area 10-Year Peripheral Spreads**
Basis points; against German bunds

- Greece
- Italy
- Portugal
- Spain

Borrowing needs remain larger compared to pre-pandemic levels and vary across countries.

**European Central Bank Net Sovereign Purchases and Deficits (Percent of GDP)**

- France
- Germany
- Italy
- Spain
- Sum of other countries
- ECB government bond purchases

Forecast
Foreign Bank and Corporate Exposures to Russia and Ukraine

Direct exposures to Russia/Ukraine are modest in aggregate

Indirect exposures are harder to measure but may be significant

European corporates are more exposed to Russia and Ukraine

**Foreign Banks’ Gross Claims on Russia and Ukraine**
(Billions of US dollars)

- **FX Swaps and outright forwards**
  (Billions of US dollars, gross notional)

Percent of firms with meaningful exposure
(Percent of firms with > 2 percent exposure)

- CEE firms
- Stoxx Europe 600
- US S&P 500
- China S&P 500
- Japanese firms

- Total: Ukraine
- Local claims: Ukraine
- International claims: Ukraine
- Total: Russia
- Local claims: Russia
- International claims: Russia

- RUB
- USD
- EUR
- CNY
- Other
- Total

- Right scale
The number of emerging markets with spreads in distressed territory has risen.

Commodity importers have seen the largest increase in spreads.

Credit spreads
(Basis points; change in spreads since Feb 1)

Capital flows-at-risk worsened significantly as a result of the decline in investor risk sentiment.
Developments and Financial Vulnerabilities in China

Rising defaults can spill over to credit channels and other private sector balance sheets

Liabilities and Financing of Real Estate Firms
(Percent of GDP)
Climate Challenge: Energy Security Vs. Energy Transition

Europe’s reliance on Russia for key commodities is leading to decisive trade-offs in energy policy.

Share of Russia in respective import volumes in the European Union (Percent)

Performance of renewable energy indices has deteriorated amidst energy security concerns.

Relative performance of Clean Energy ETF vs (Thermal) Coal and Oil and Gas Index (Ratio)

Renewable energy generation capacity should more than double by 2026 in order to reach Net-zero emissions by 2050.

Renewable energy capacity actual and IEA forecasts (Gigawatt hours)
Policy recommendations

• **Central banks should act decisively to prevent inflation pressure from becoming entrenched** and avoid an unmooring of inflation expectations, while avoiding a disorderly tightening of financial conditions that would jeopardize the post-pandemic economic recovery. Communication remains essential to ensure orderly market reaction.

• **Policy normalization in emerging markets should continue based on country-specific assessments of inflation, economic outlook.**

• **Regulators should assess the implications of the elevated volatility in commodity markets on market functioning** and risk management.

• **Policymakers should intensify their efforts to implement the 2021 United Nations Climate Change Conference (COP26) road map** while taking appropriate steps to address energy security concerns.