



International Monetary Fund

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Complicated Trade-offs Amid Uncertain Geopolitics

- **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 a backdrop of higher commodity prices, it's crucial to intensify efforts toward the climate transition while addressing energy security concerns**

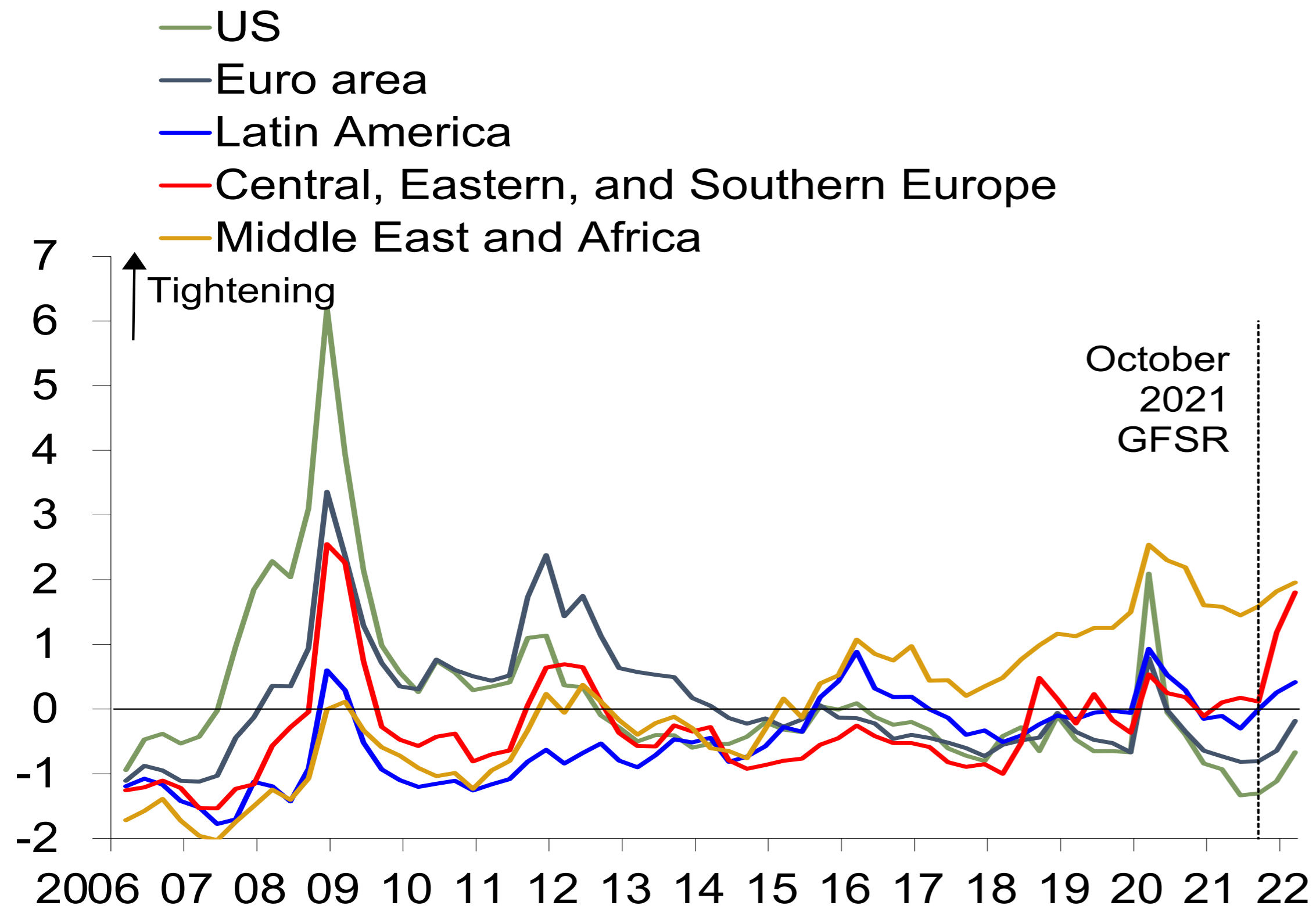
Tightening of Financial Conditions and Downside Risks to Growth

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

Downside risk to growth have increased meaningfully

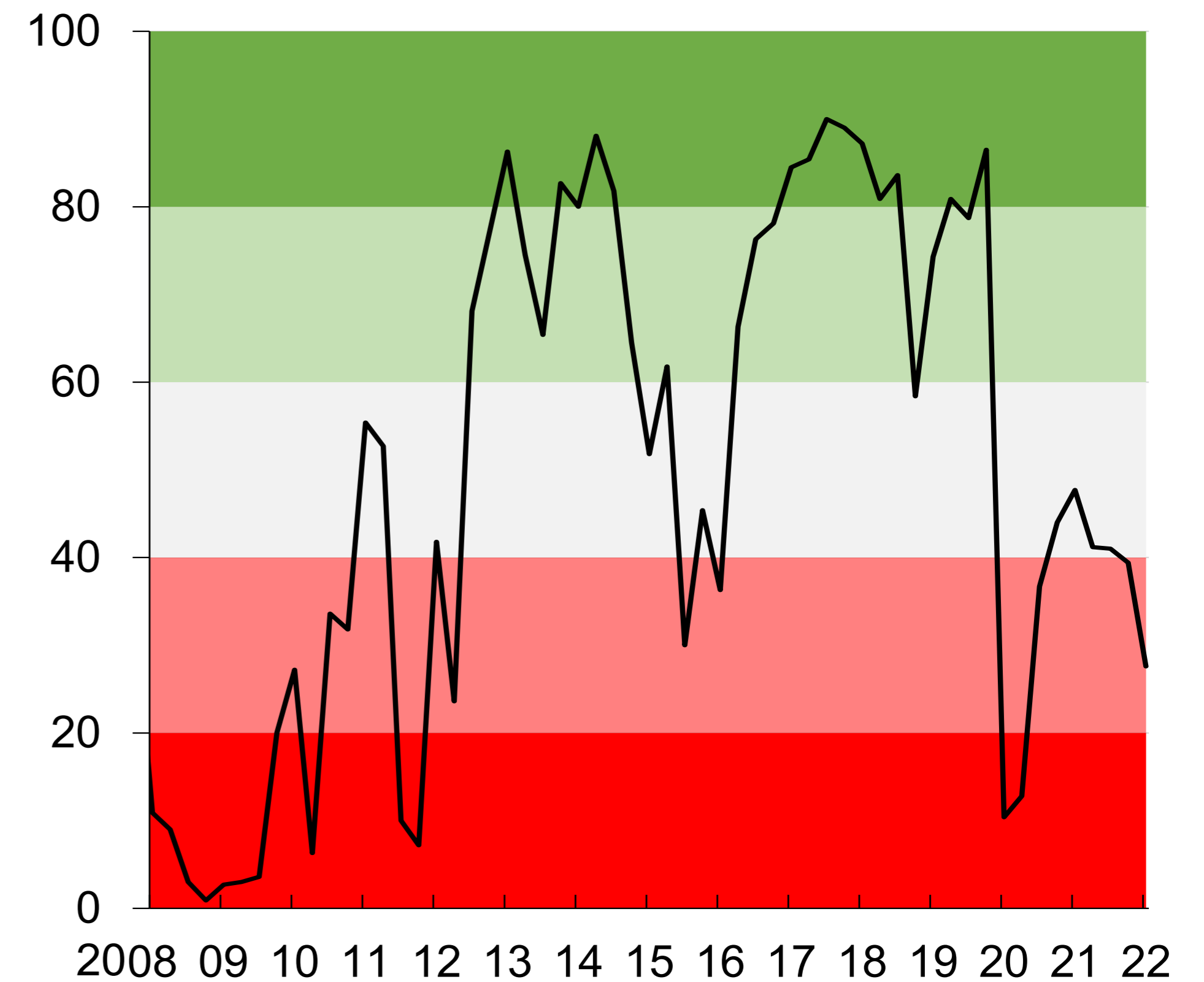
Financial Conditions

(Standard deviations from the mean)



Near-Term Growth-at-Risk Densities

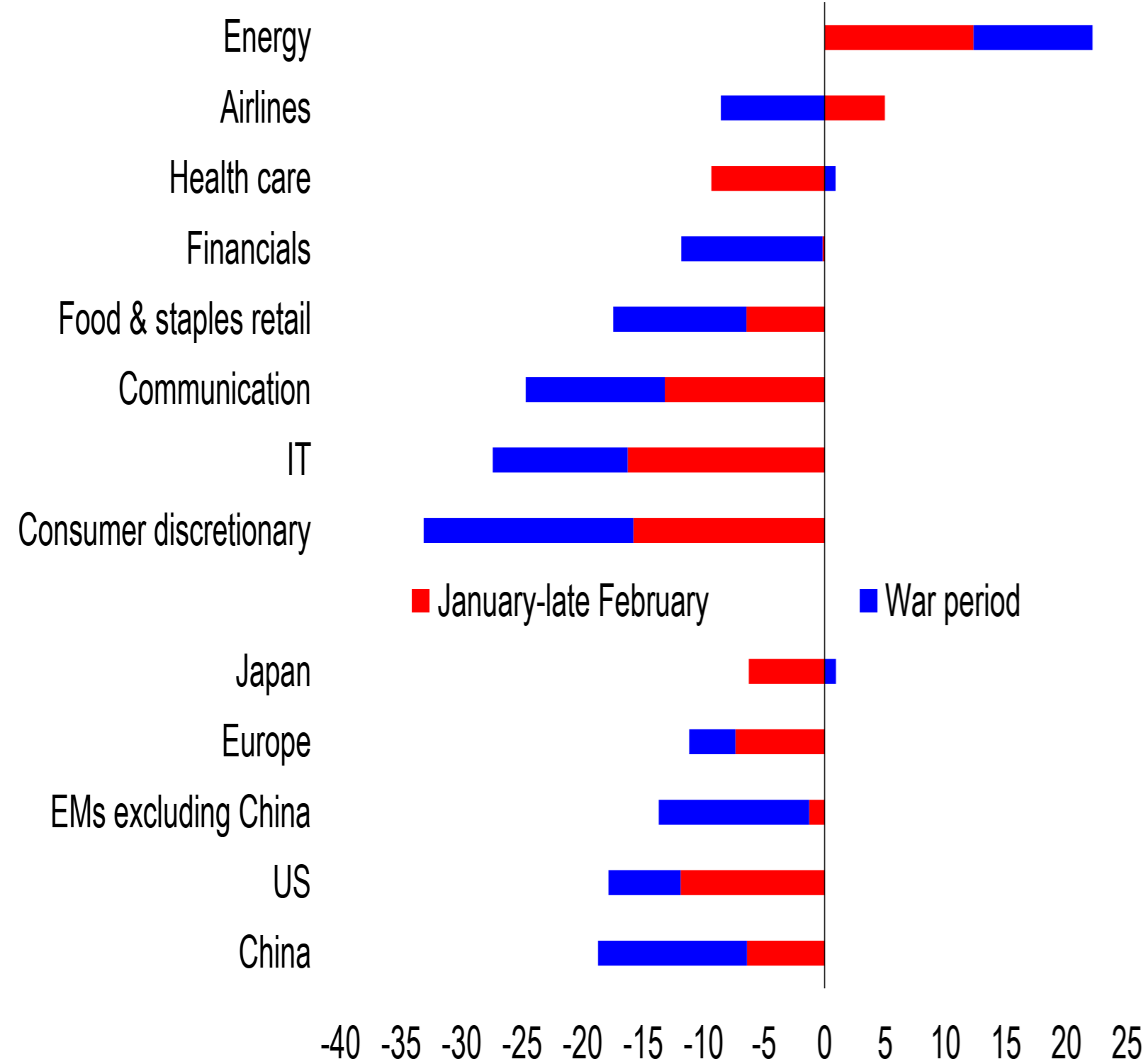
(Percentile rank)



Risk Assets: Navigating Geopolitics and Stagflation Fears

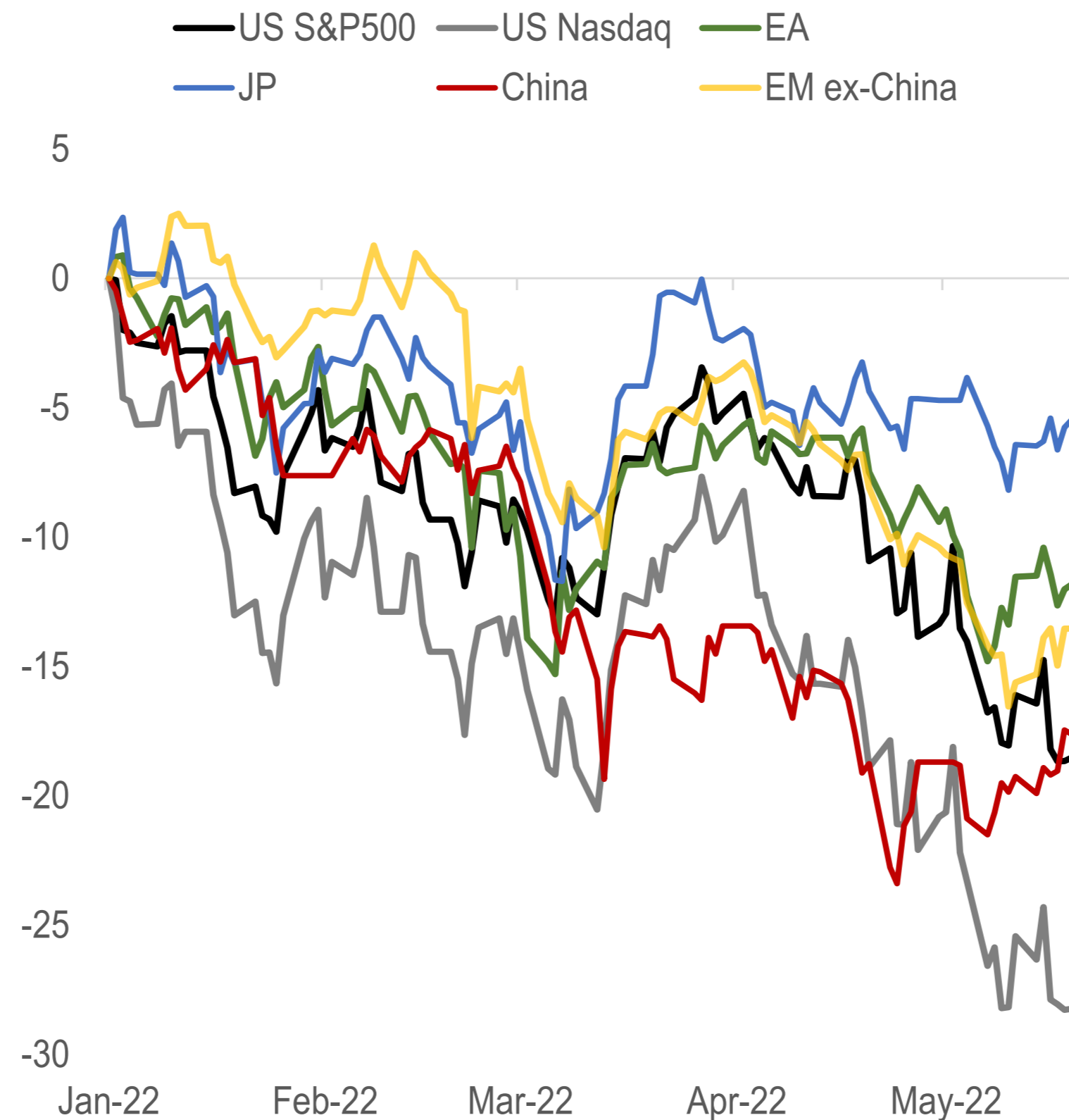
Equities sold off in the immediate aftermath of the war, particularly in sectors affected by commodity prices and supply chain disruptions concerns...

Global Equity Price Change in 2022
(Percent)



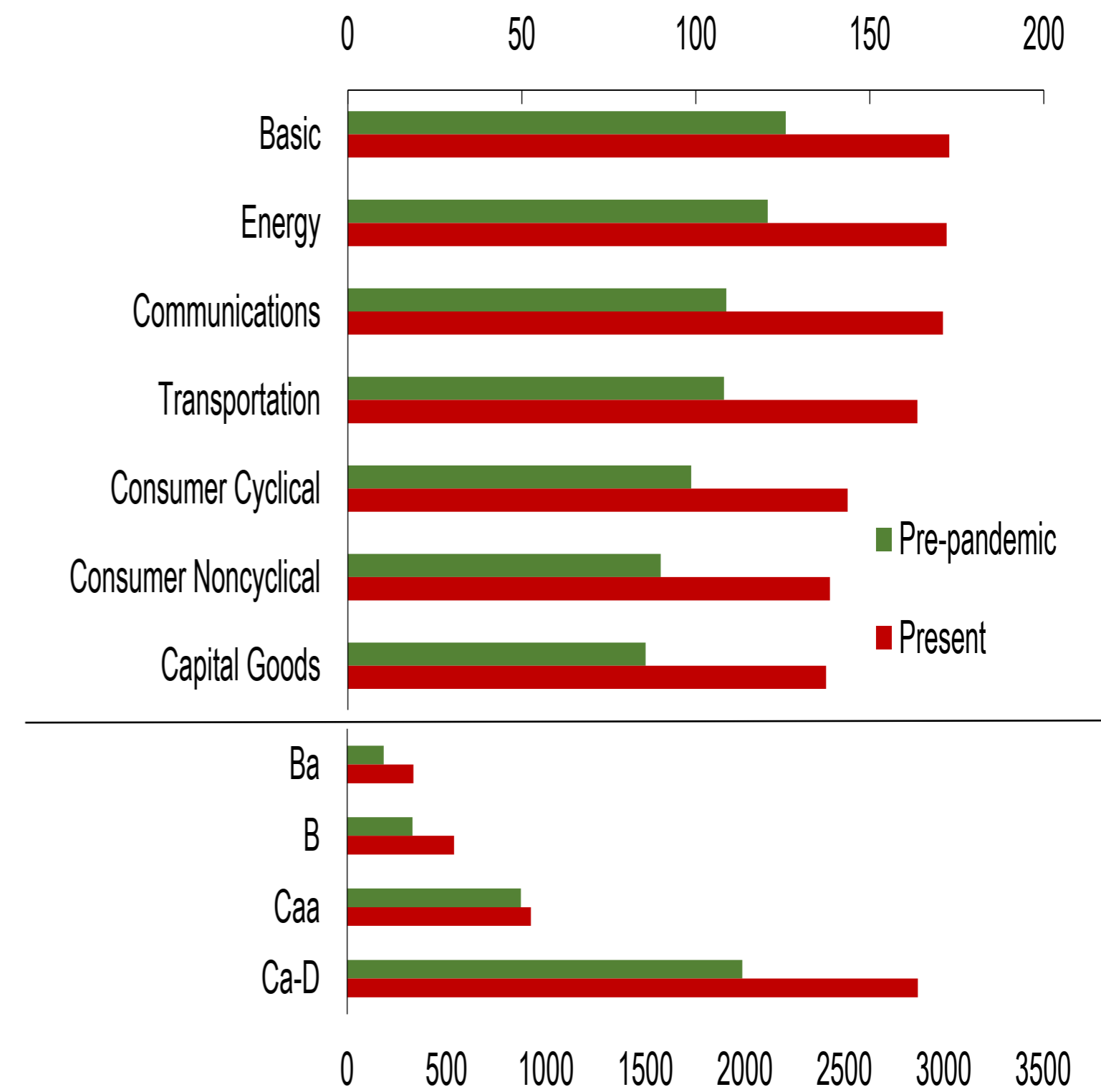
US equities entered a bear market amid high uncertainty about MP tightening and growth prospects

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



Credit spreads have widened the most in low-rated corporates

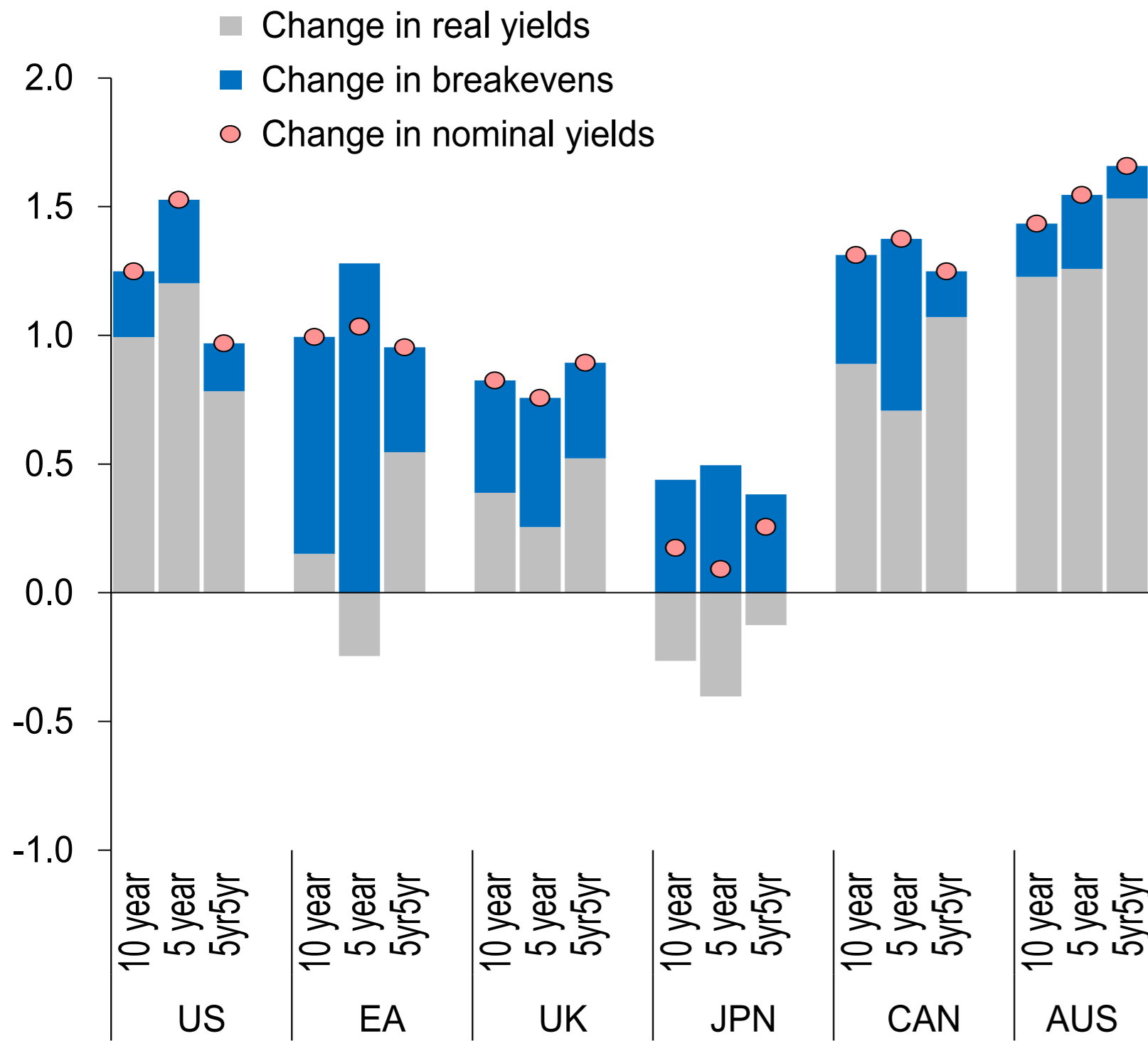
Credit Spread levels
(Basis points)



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

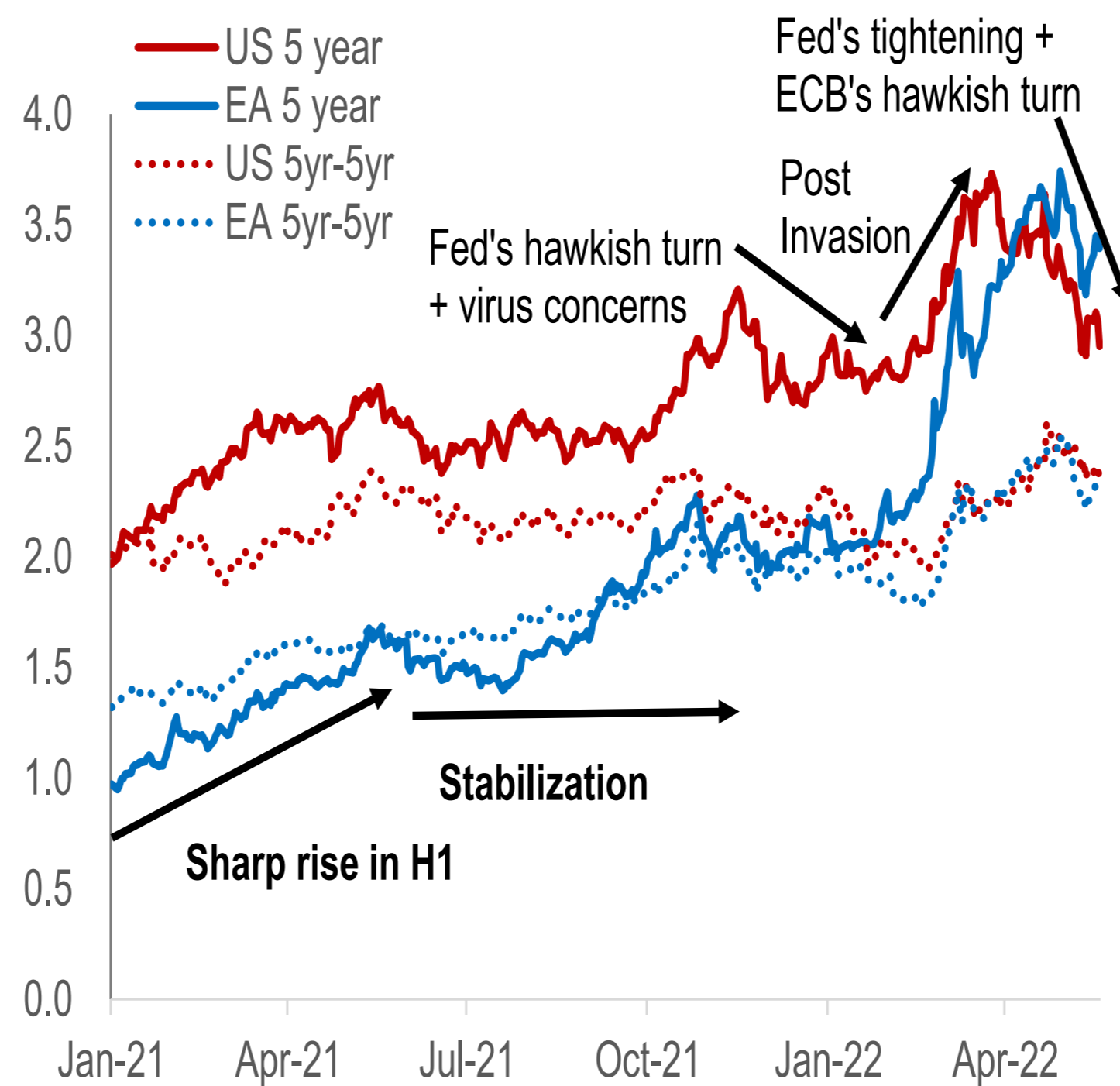
Nominal yields have increased, mainly driven by rising breakevens, particularly in Europe

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



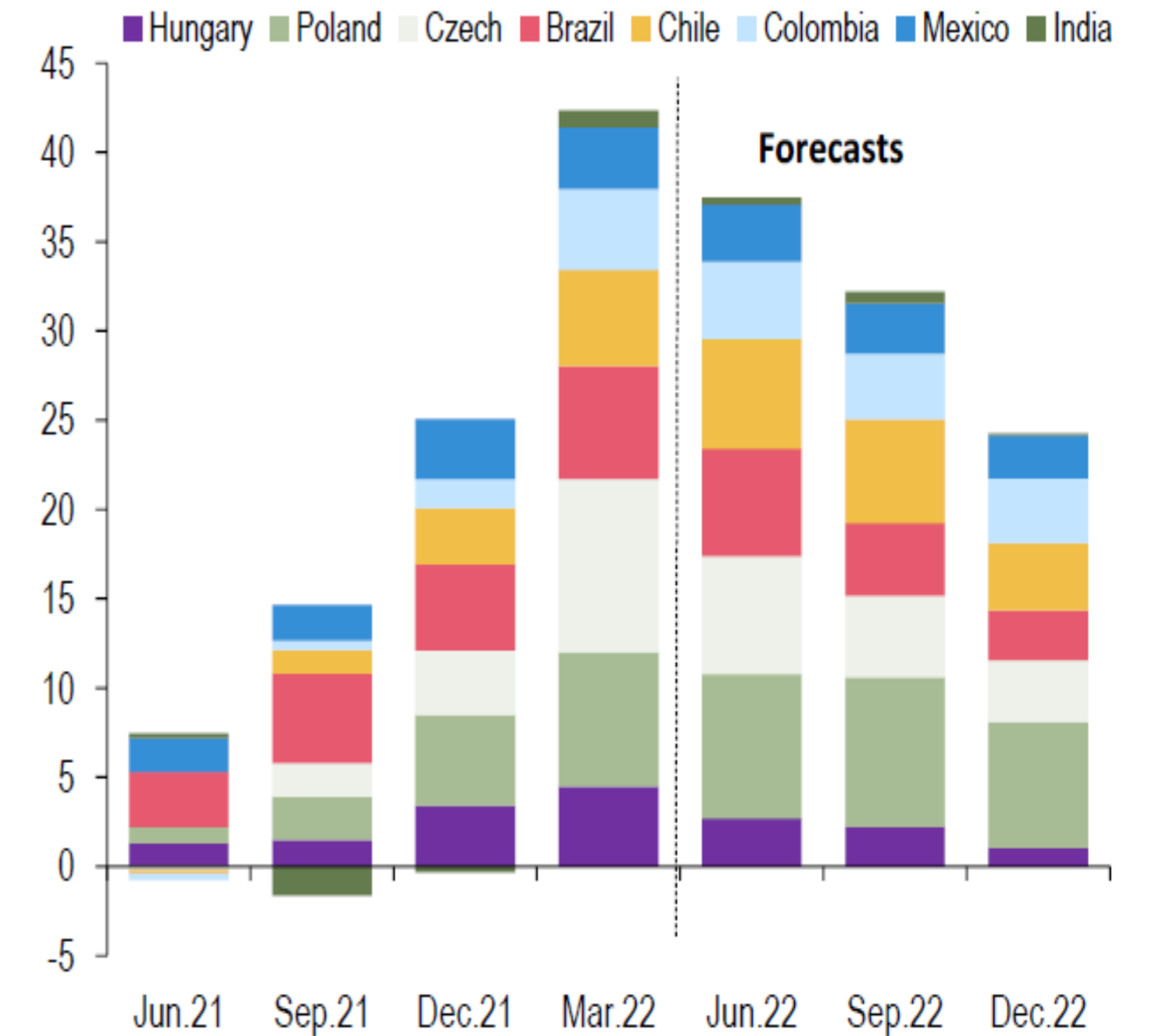
Inflation expectations have risen sharply on the medium-term but remain mostly anchored on the long-term.

Inflation Expectations (Percent)



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

Sum of Inflation Gaps (Ppt)

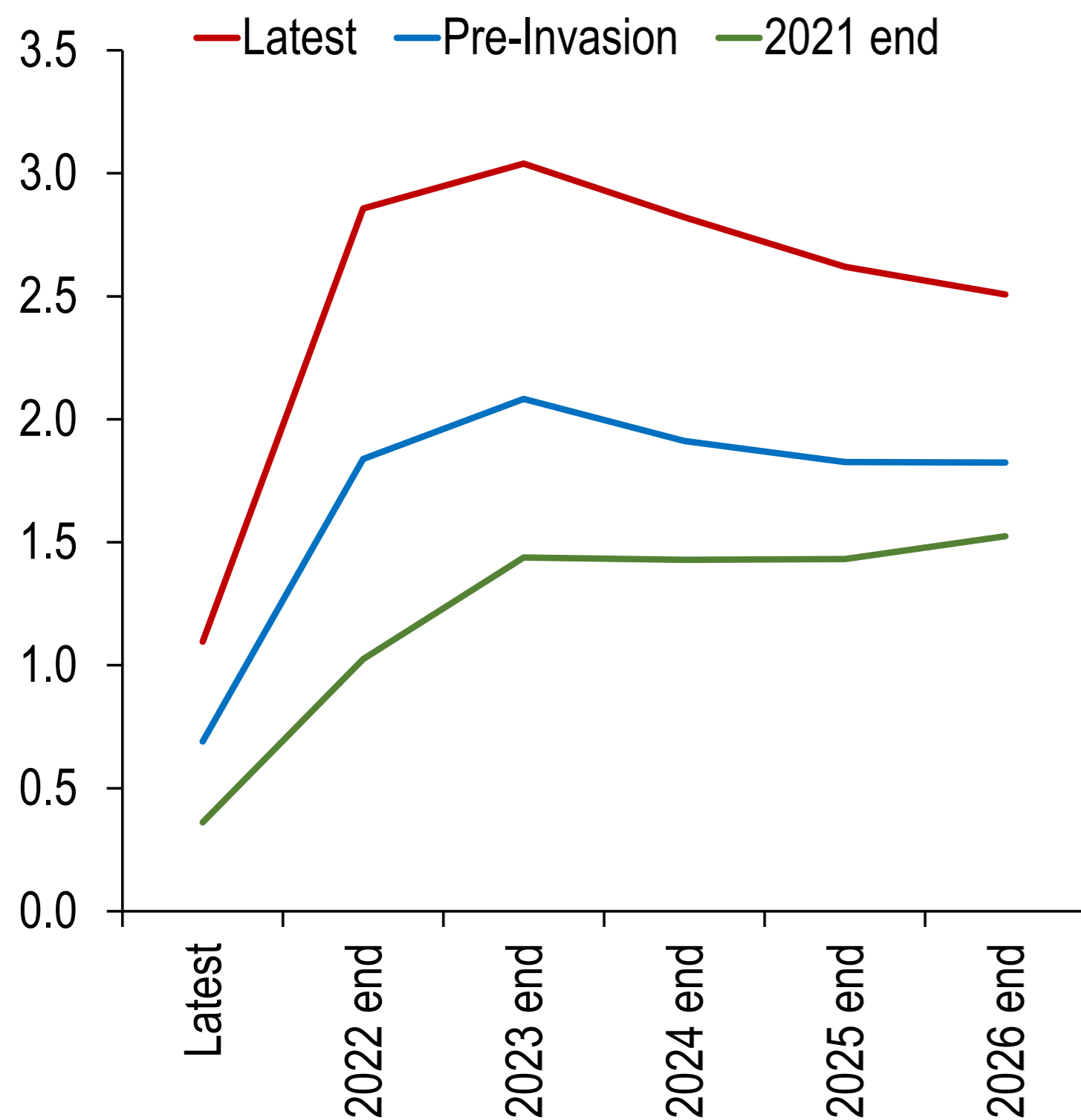


Note: CPI forecasts by Bloomberg analyst's vs Upper Band of Target

...Calling for Decisive Monetary Policy Action

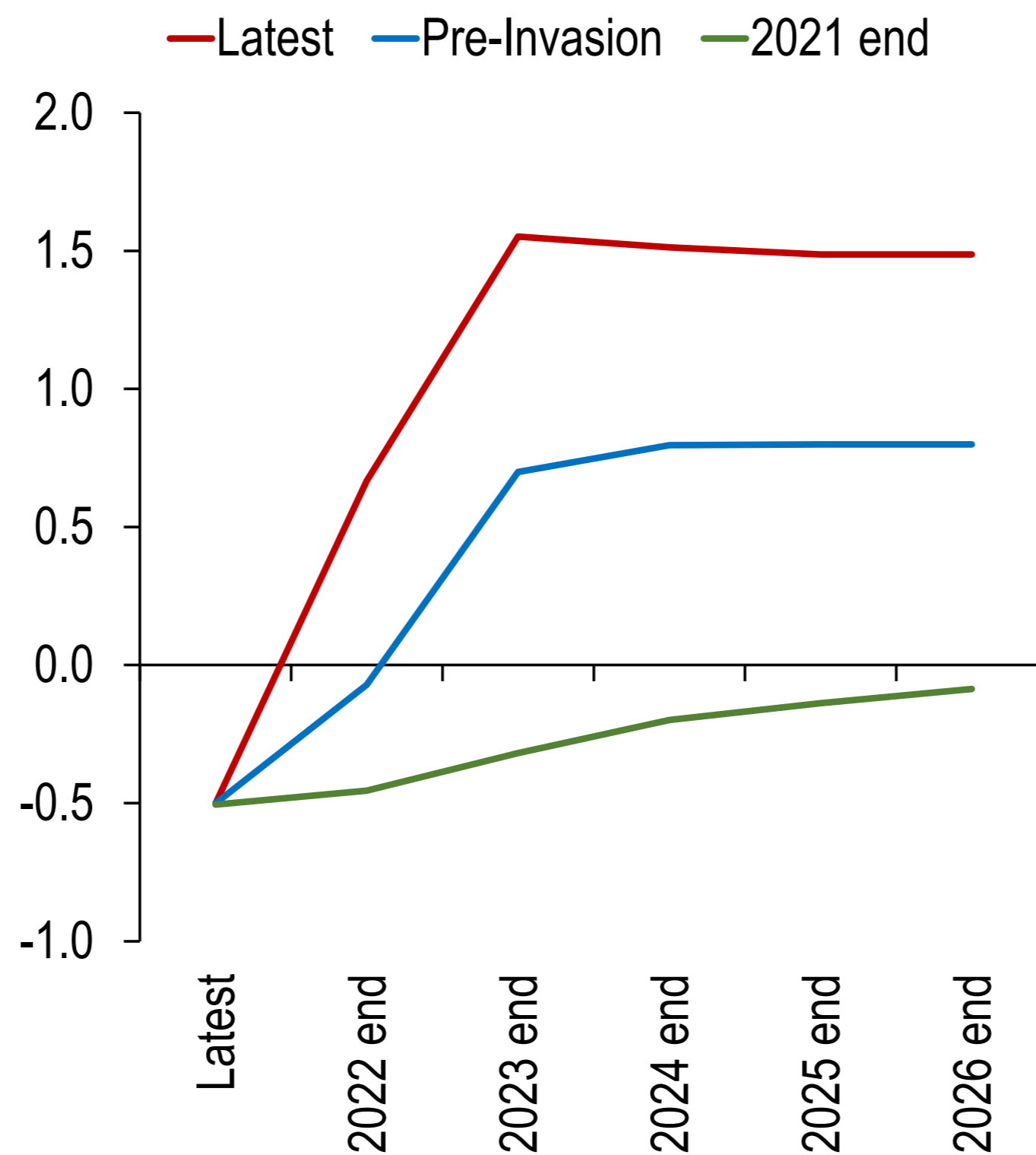
Expected Fed hikes have moved forward

Market implied policy rate
(Percent)



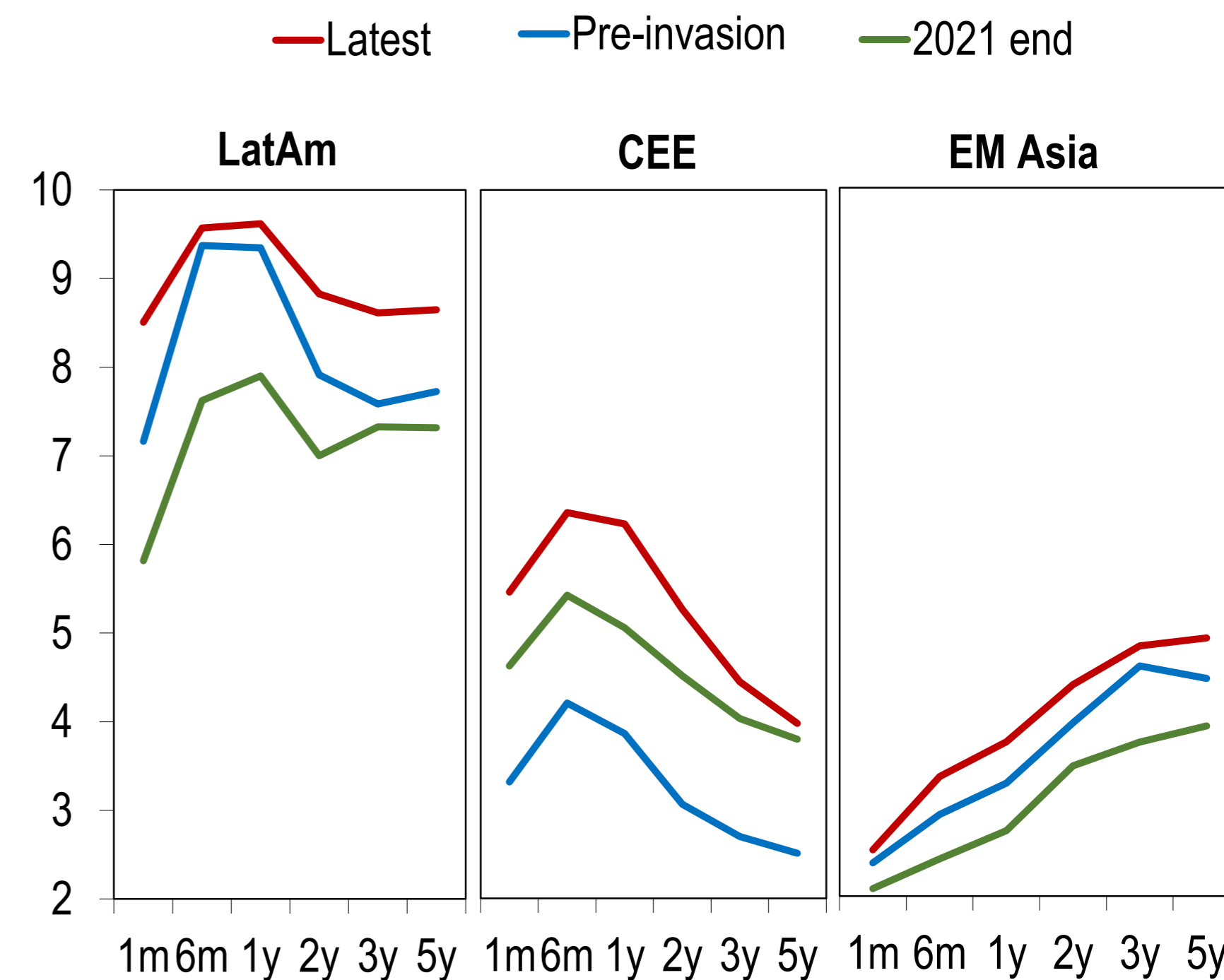
ECB expectations have shifted higher

Market implied policy rate
(Percent)



EMs expected to continue hiking for next year.

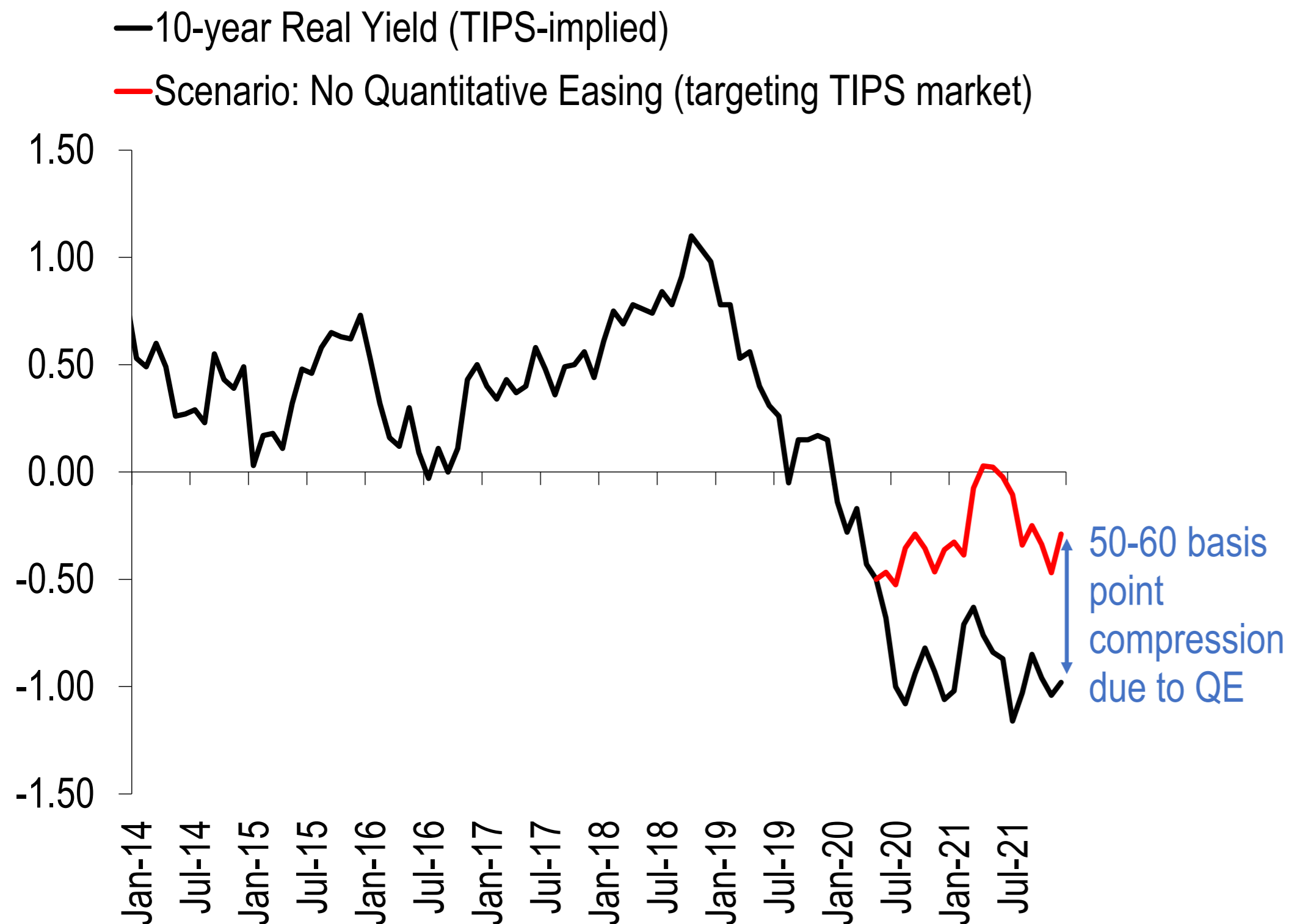
Market implied policy rates
(Percent, average)



US: Trying to Manage a Soft Landing

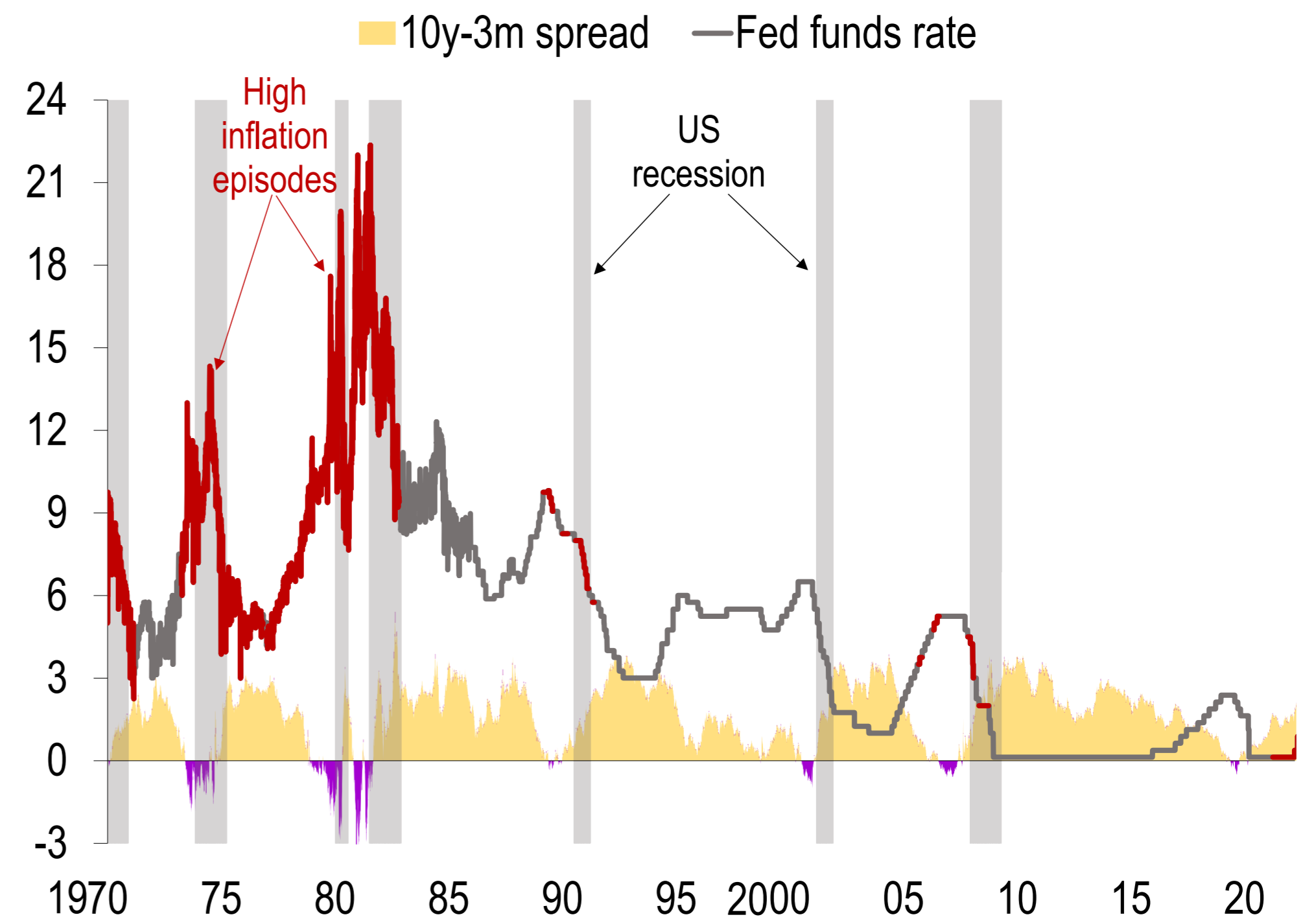
Potential for risk repricing as the effects of QT on the path of rates remains uncertain

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)

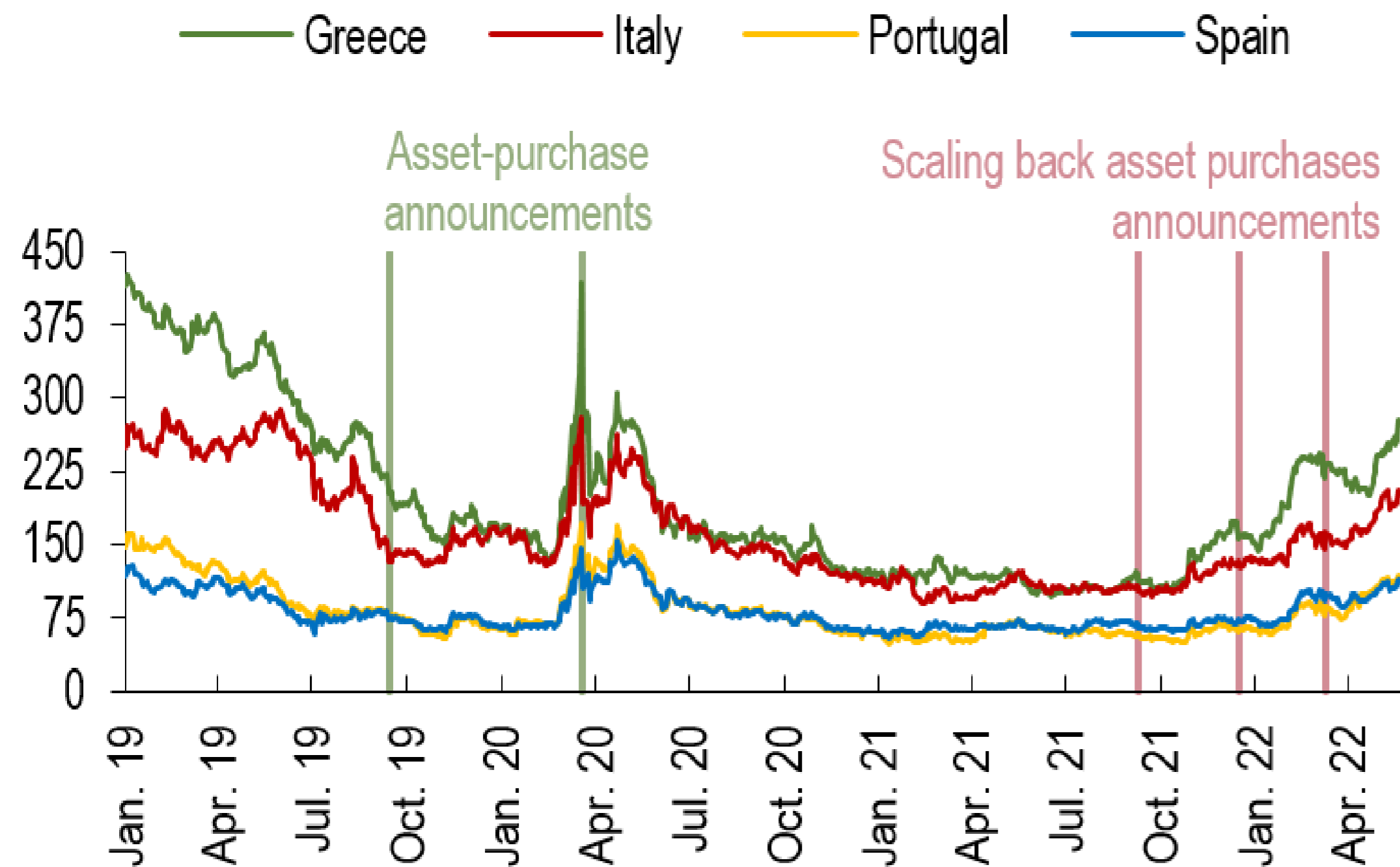


Euro Area: Fragmentation Risk Back in Focus

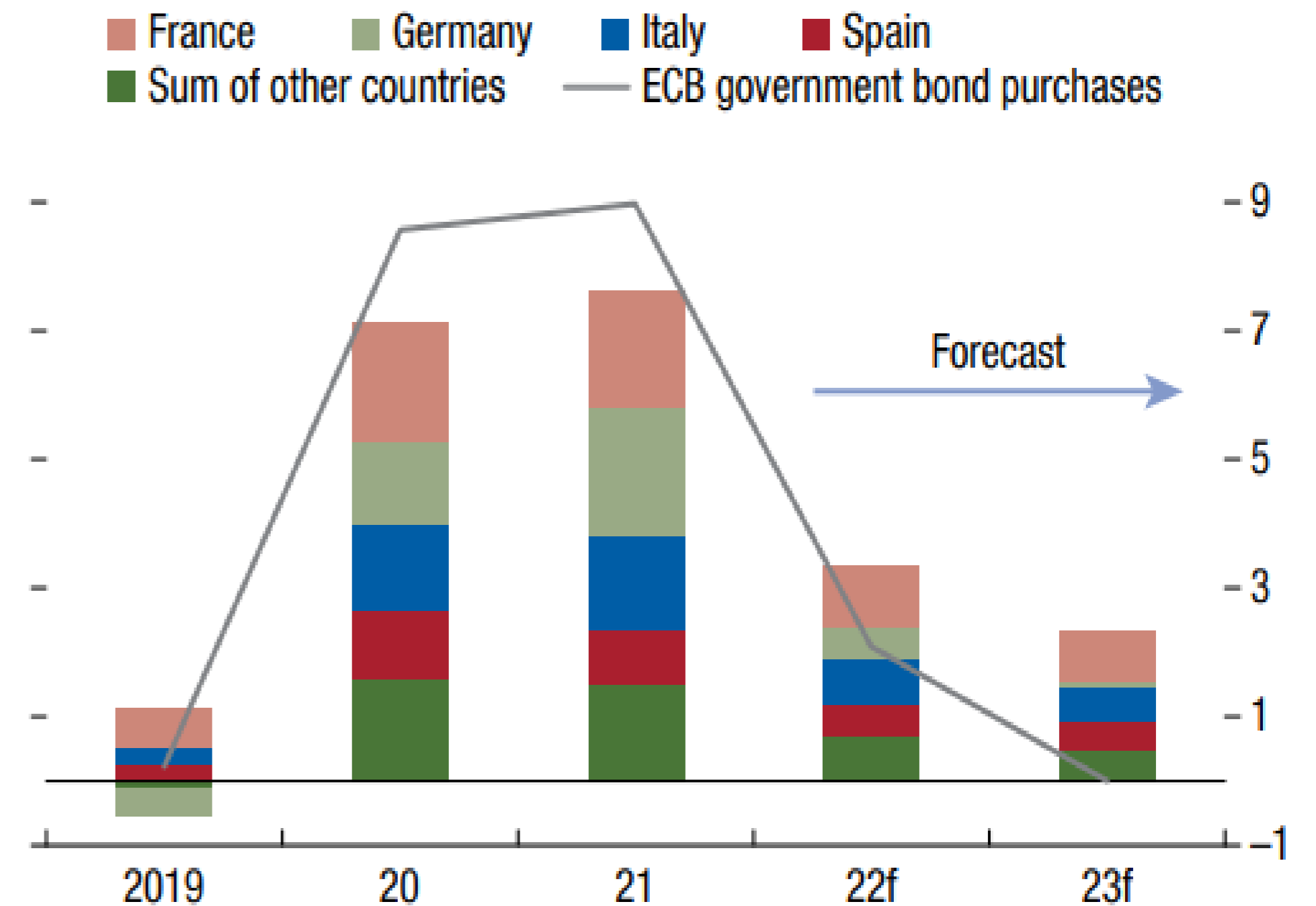
Southern sovereign yields have exceeded pre-pandemic levels and spreads have widened

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

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



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



Foreign Bank and Corporate Exposures to Russia and Ukraine

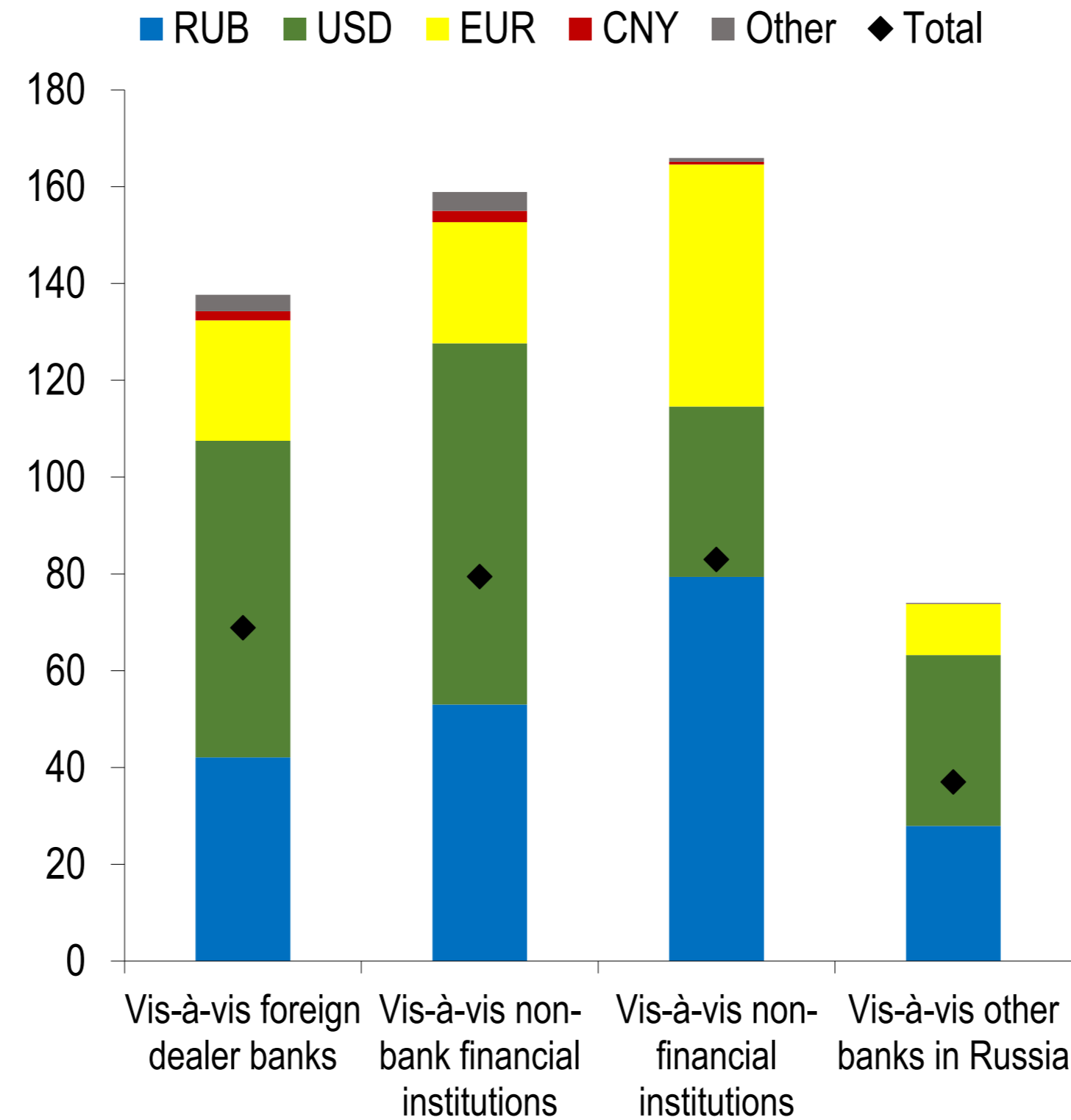
Direct exposures to Russia/Ukraine are modest in aggregate

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



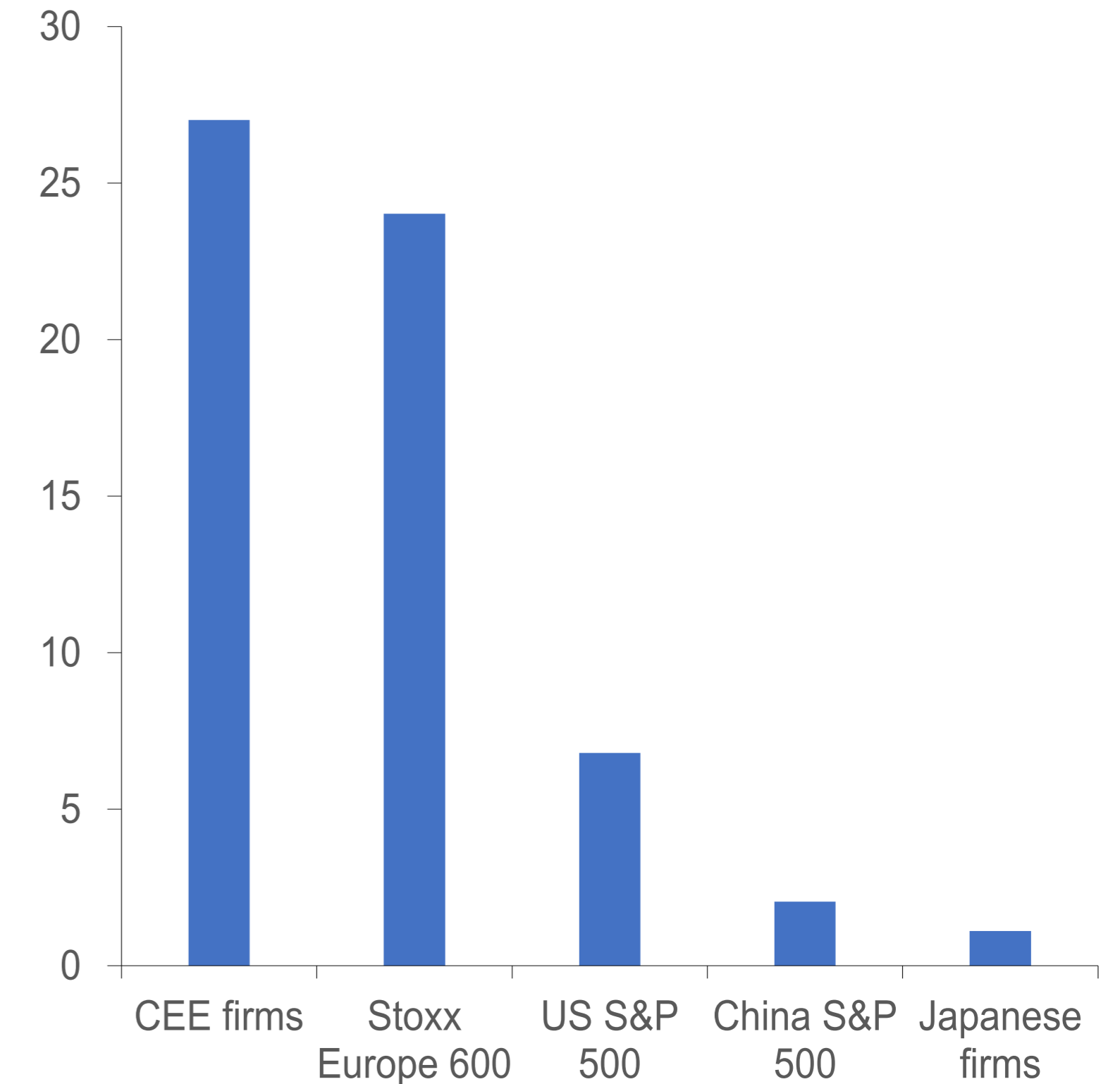
Indirect exposures are harder to measure but may be significant

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



European corporates are more exposed to Russia and Ukraine

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



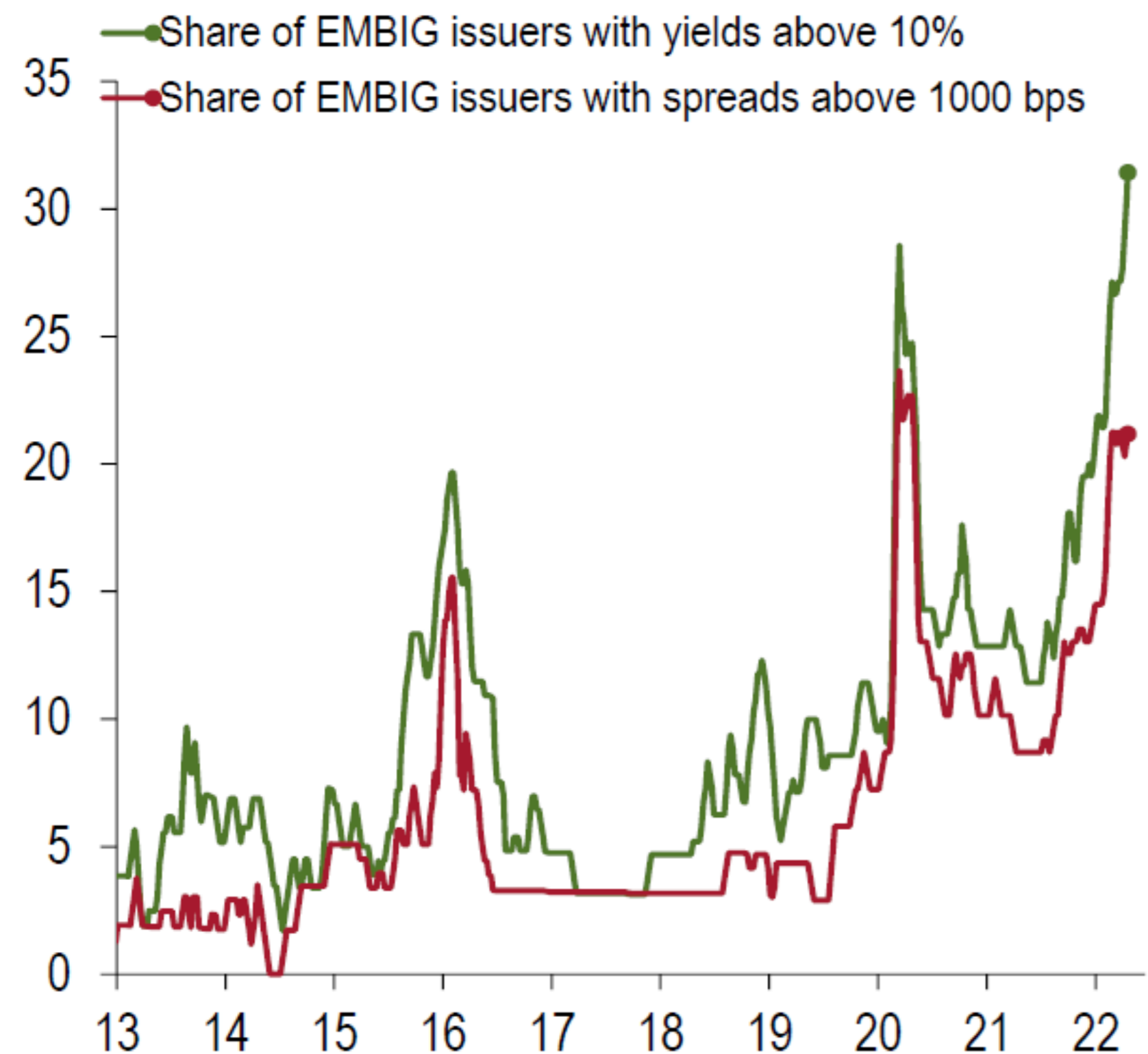
EM: Heightened Differentiation leading to Higher Risk of Capital Outflows

The number of emerging markets with spreads in distressed territory has risen

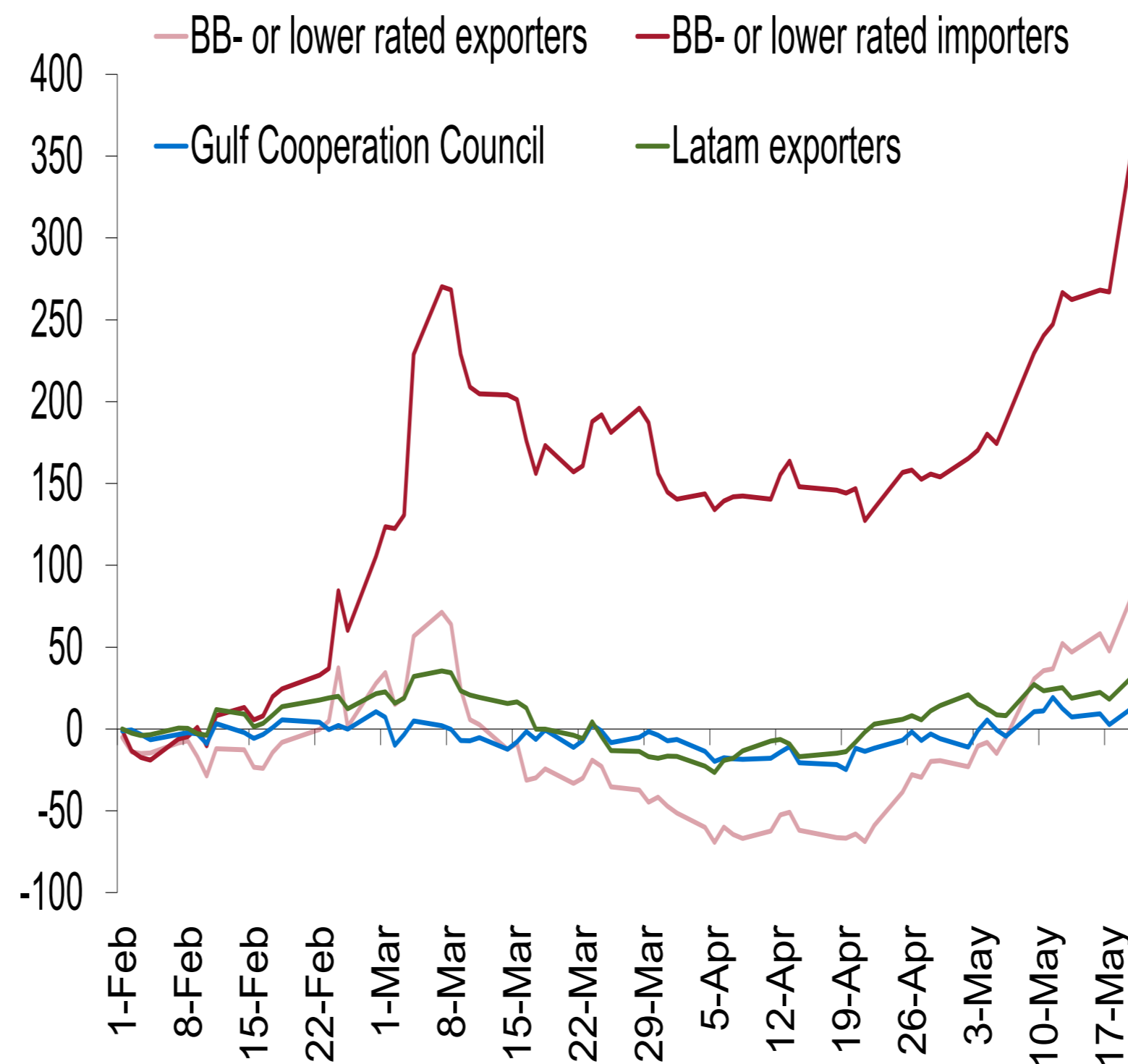
Commodity importers have seen the largest increase in spreads

Capital flows-at-risk worsened significantly as a result of the decline in investor risk sentiment.

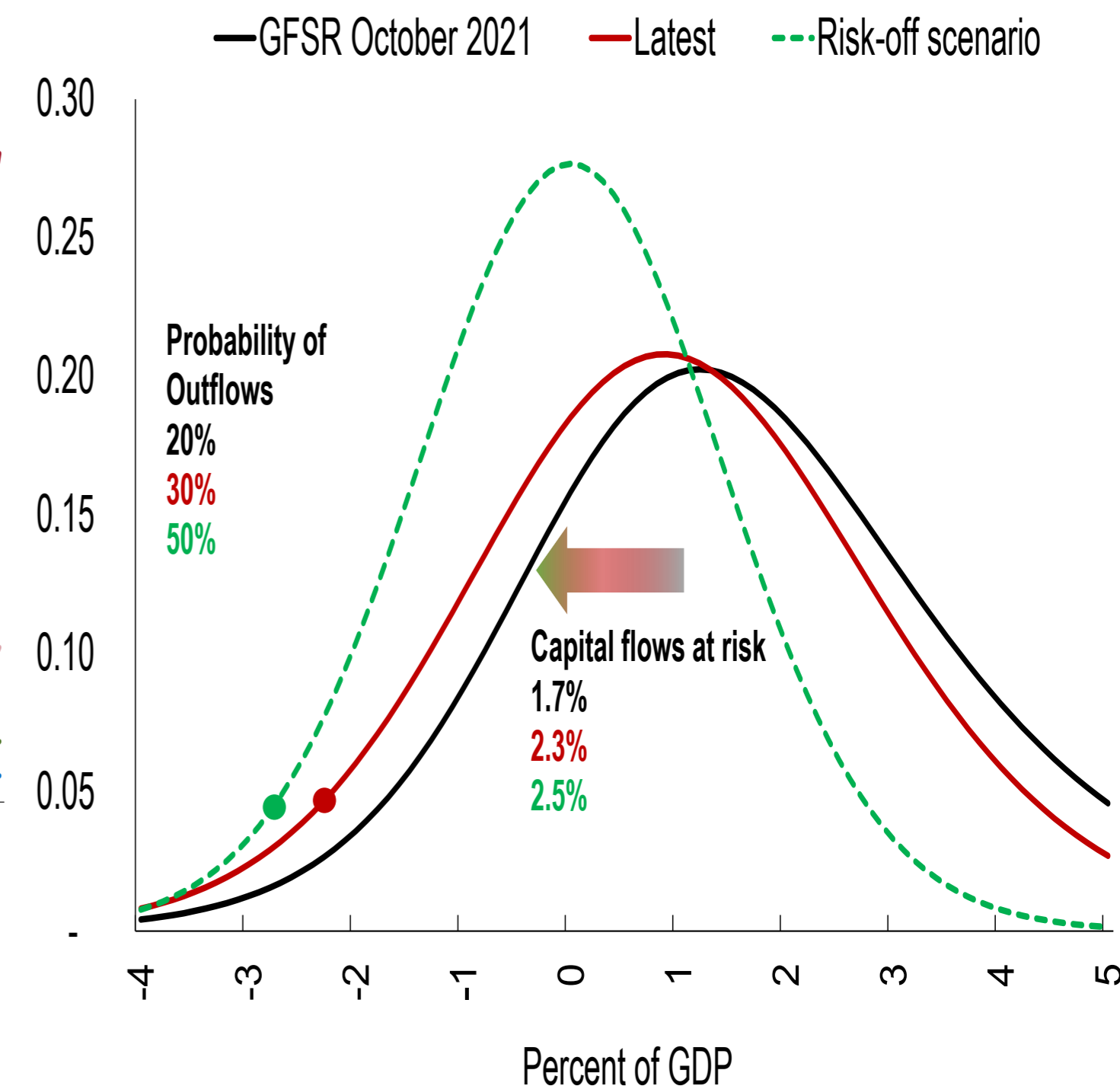
Share of EMBIG countries with Spread > 1000 bps or Yield > 10%
(Percent)



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



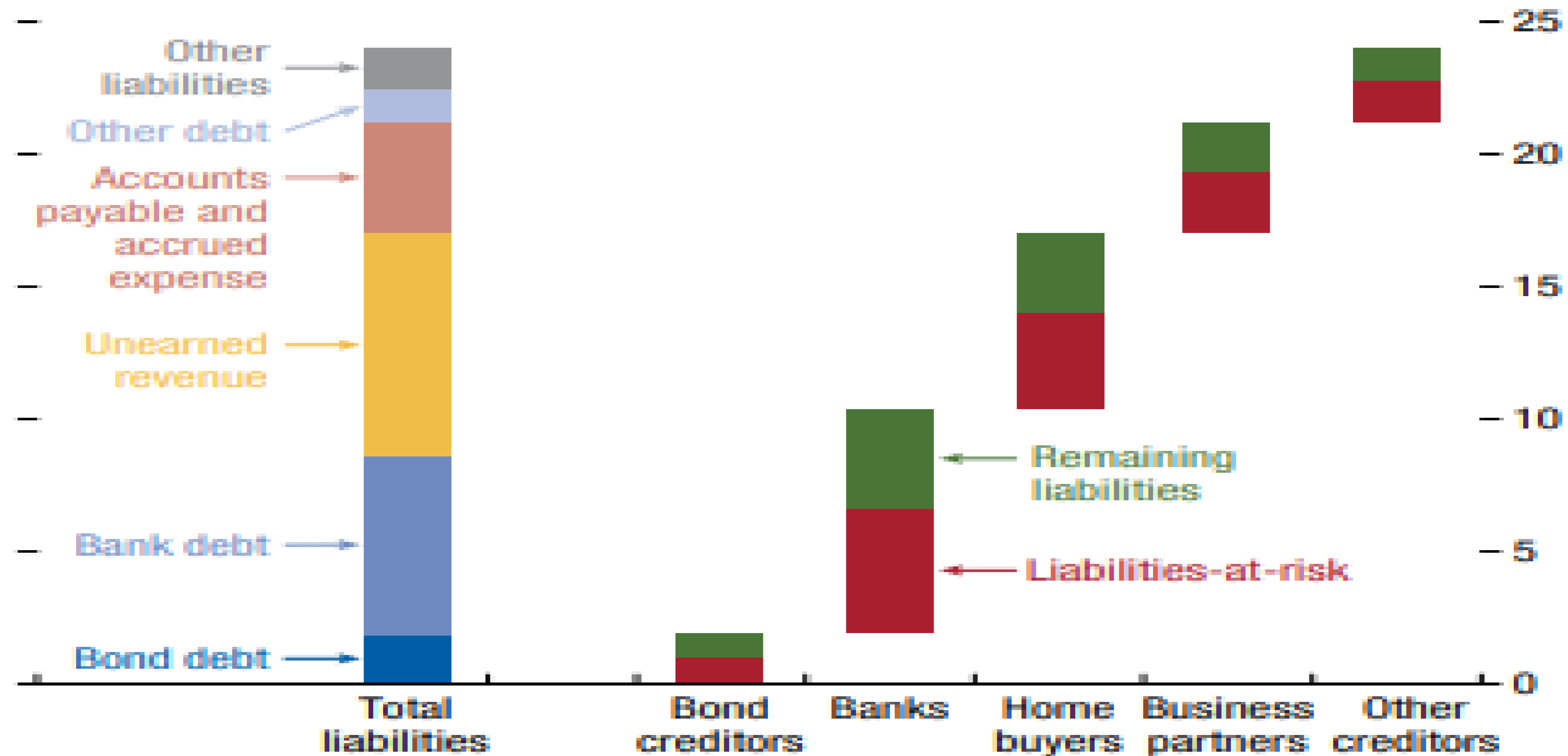
Capital Flows-at-Risk
(Density function)



Developments and Financial Vulnerabilities in China

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

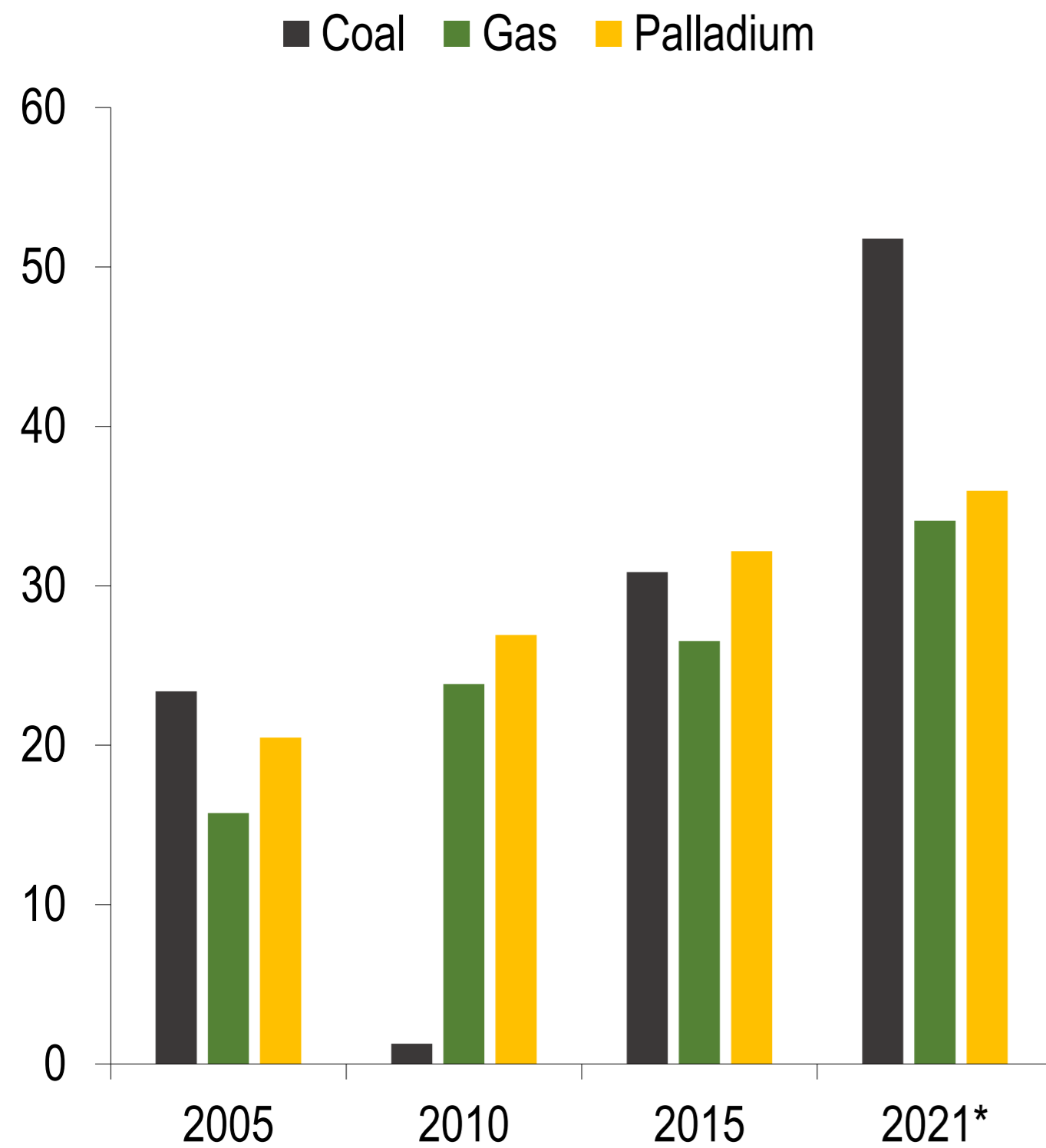
Liabilities and Financing of Real Estate Firms
(Percent of GDP)



Climate Challenge: Energy Security Vs. Energy Transition

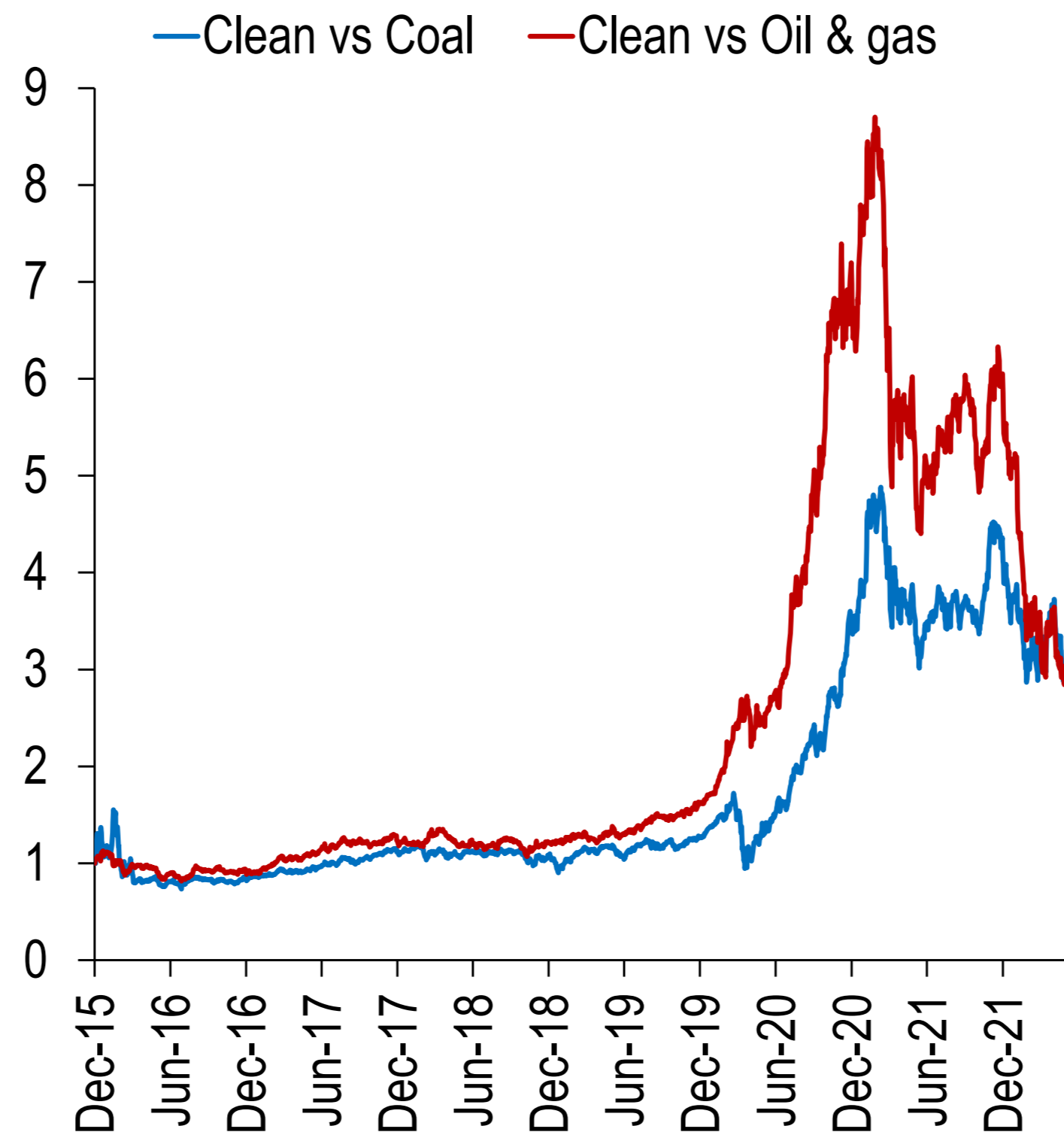
Europe's reliance on Russia for key commodities is leading to decisive trade-offs in energy policy

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



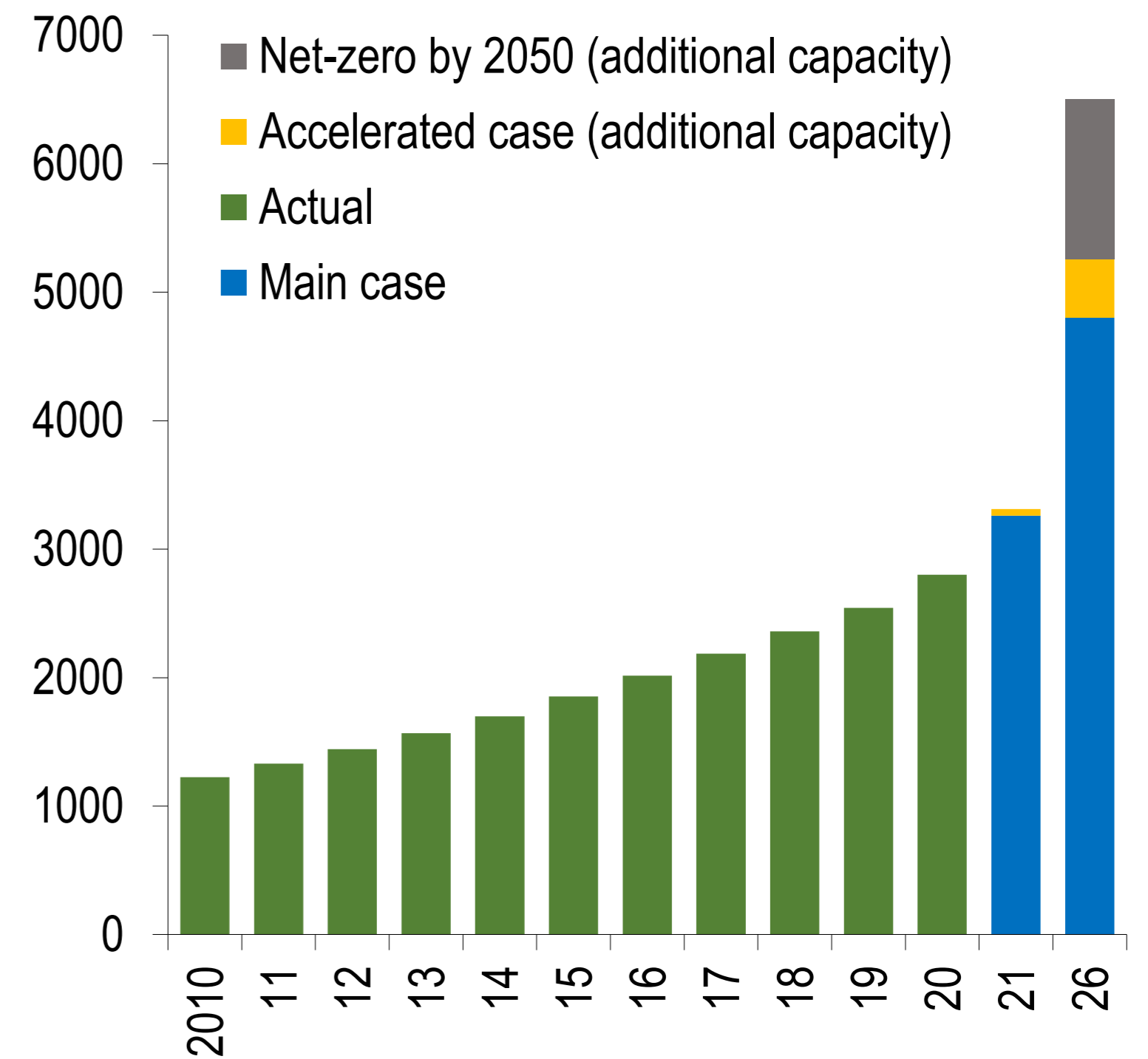
Performance of renewable energy indices has deteriorated amidst energy security concerns

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.