Financial stability risks remain elevated

Acute stress in banking has subsided but the weak tail of banks is still large

Despite the declines in equity prices since September due to rising long-term yields, there still is a risk of further re-pricing

Large emerging markets remain resilient but frontiers and LICs continue to face challenges

The global credit cycle has started to turn as borrowers’ debt repayment capacity diminishes
Markets remain optimistic about inflation in Advanced Economies

**US Inflation and Policy Rate Expectations**

(Percents)

**Euro Area Inflation and Policy Rate Expectations**

(Percents)

**UK Inflation and Policy Rate Expectations**

(Percents)

**Canada Inflation and Policy Rate Expectations**

(Percents)

Note: Dotted lines indicate economists' consensus expectations for the inflation charts and expectations of the future path of interest rates in the policy rate charts.
Markets remain optimistic about inflation in Emerging Markets

Brazil Inflation and Policy Rate Expectations (Percent)

Mexico Inflation and Policy Rate Expectations (Percent)

India Inflation and Policy Rate Expectations (Percent)

Poland Inflation and Policy Rate Expectations (Percent)

Note: Dotted lines indicate economists’ consensus expectations for the inflation charts and expectations of the future path of interest rates in the policy rate charts.
Rise in bond yields has been driven by term premia.

### Change in 10-Year Government Bond Yields and Its Decompositions Since the April GFSR (Basis points)

<table>
<thead>
<tr>
<th>Country</th>
<th>Change from April GFSR to Latest</th>
<th>Change from end of September to Latest</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>5-year 10-year</td>
<td>5-year 10-year</td>
</tr>
<tr>
<td>Germany</td>
<td></td>
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<td>UK</td>
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<td>Japan</td>
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<td>Brazil</td>
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<tr>
<td>Mexico</td>
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<tr>
<td>Poland</td>
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<tr>
<td>Indonesia</td>
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</tr>
</tbody>
</table>

### Change in Term Structure of US Government Bond Yields and Its Decomposition (Basis points)

- **Expected Inflation**
- **Inflation Risk Premium**
- **Real Expected Short-Rate**
- **Real Term Premia**
- **Total Change**

### Market Implied Real Borrowing Cost Forward and Market Implied r* (Percent)

Note: Latest data as of October 17th close.
**Market-implied r* Hasn’t Moved Much While Real Term Premiums Spiked...**

**SEP Range**

**SEP Central Tendency**

-5y5y Expected Real Short Rate (Neutral Proxy)

10y Real Term Premium

---

**Long-Dated Bond Yields Driven By Fiscal Concerns and Other Factors**

**... Amid a Sizeable Increase of Treasury Supply Across All Tenors**

**Treasury Auction Sizes**

(USD bn)

**Long-Term Real Fed Fund Dots, Market-Implied Real Neutral and Real Term Premia**

(Percent)

Source: Bloomberg L.P., Federal Reserve Board, Haver, IMF Staff Calculations

Note: Real short rate and real term premia based on Abrahams et. al (2016)

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**Retail Investors Bought T-Bills**

**Individual Auction Take-Down vs. Bond Mutual Fund Beta to Benchmark Index**

(USD bn, percent)

Source: Bloomberg L.P., Apollo, IMF Staff Calculations

Source: Bloomberg L.P., Federal Reserve Board, Haver, IMF Staff Calculations

Note: Real short rate and real term premia based on Abrahams et. al (2016)
Risks to global growth are forecasted to remain skewed to the downside next year.

Growth Forecast Densities
(Probability density)

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

Goldman Sachs Financial Conditions Index
(Z-Score since 2017)

Note: The global conditional forecast density model employed here augments information on current quarter growth and financial conditions (see April 2018 Global Financial Stability Report) with a proxy for global credit growth (see Adrian et al, 2022 AEJ Macro). This credit growth variable is constructed as a PPP-GDP weighted aggregate of country-specific quarterly growth rates in total credit to the private non-financial (household and non-financial corporates) sector, provided by domestic banks and all other sectors of the economy. Credit data are sourced from the Bank for International Settlements. Goldman Sachs Financial Conditions is sourced from Goldman Sachs Global Investment Research.
The global banking sector has a notable tail of weak banks (Chapter 2)

In a stagflation scenario, some banks could fail to meet minimum capital requirements

Both AE and EM banks could be vulnerable

Geographical Distribution of Banks with Low Post-stress Capital
(Share of Total Assets By Region; Number of Banks Shown on Top of Bars)

Baseline: banks below CET1 of 7 percent (plus GSIB buffer)
Baseline: banks below CET1 of 7 percent (plus GSIB buffer) or CET1 failing by 5pp or more
Adverse: banks below CET1 of 7 percent (plus GSIB buffer)
Adverse: banks below CET1 of 7 percent (plus GSIB buffer) or CET1 failing by 5pp or more
Bank capital is affected through bond valuation losses

Some banking systems hold large securities portfolios

Exposure size, hedging, and duration are key drivers of valuation impact

Share of Securities to Total Assets, 2022
(Percent)

Valuation Impact on HFT and AFS securities, 2023
(Percent of RWA)

Source: IMF Staff Calculations
Price of risk assets have been driven by increasing investor risk appetite.
Geopolitical Uncertainty Could Weigh on Markets

Geopolitical Risk Index
(Caldara and Iacoviello, index points)

Peak response (within 12 quarters)
GPR rises by 4 s.d.

Two weeks after Israel-Hamas conflict (Oct 6 - Oct 23)

<table>
<thead>
<tr>
<th>Index</th>
<th>Base Case</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>Around -10%</td>
<td>-1.8%</td>
</tr>
<tr>
<td>Two-year</td>
<td>Around -25bps</td>
<td>-4.1bps</td>
</tr>
<tr>
<td>VIX</td>
<td>Around +2pts</td>
<td>+3.9pts</td>
</tr>
<tr>
<td>Broad dollar (DXY)</td>
<td>N/A</td>
<td>-0.5%</td>
</tr>
</tbody>
</table>

Note: Based on vector autoregression results of Caldara and Iacoviello (2022).
Investors continue to differentiate among EMs based on fundamentals

**EM IG spreads remain compressed while EM HY spreads (especially lower-rated) are very wide**

**Emerging Markets Bond Index Global (EMBIG) Diversified Spreads**
(Basis points)

**Access to primary markets remains challenging, particularly for frontiers and low-income EM sovereigns**

**Distribution of Historical High-Yield Sovereign Issuance and Treasury Yields**
(Percent)

- **Primary Spreads When UST 10-Year ≥ 3%**
- **Current Distribution of Secondary Spreads for HY Issuers**
The credit cycle is turning as corporate buffers deplete

Interest coverage ratios have declined, but they remain higher than historical averages

Non-financial Corporates Interest Coverage Ratio
(Ratio, US S&P 500 and S&P Europe 350 firms)

The number of firms that do not have enough cash to cover their interest expenses is growing

Firms with less cash than interest expenses
(Percent)

Advanced economies
Emerging markets excluding China

Small Firms
Large Firms

1Q19
1Q21
1Q23
1Q19
1Q21
1Q23
Higher interest rates are putting real estate under pressure

A high interest rate environment has weighed on real house prices

Declining demand and higher borrowing costs increase risk of default of CRE borrowers

Real House Price Growth By Country
(Year-on-year, percent)

One-year Ahead Expected Default Frequency of REITs and CMBS Default Rates
(Percent)
Concerns about financial stability have rattled markets in China

The housing market weakened again with poor sales performance

Macro-financial spillovers could be amplified through the banking-sovereign-corporates nexus

The suspension of redemptions by a major asset manager has raised concerns

Property Developers’ Sales Volumes (Average of 2021H1 = 100; 3-month moving average)

China’s Provinces: Funding Costs of LGFVs and Local Banks, Mid-August 2023 (Percent)

Trust Assets (Trillions of Renminbi)
Ex post central bank tools can improve trade-offs…
  - liquidity provision

…but they have shortcomings
  - liquidity vs solvency, NBFIs, political economy, fiscal space

Macropudential policy can also help…
  - stronger capital buffers reduce likelihood of stress

…but can’t simply lean on stronger macroprudential leg
  - fiscal space rebuilding, rethink monetary policy actions potentially leading to overheating
A broad policy mix is needed to support climate financing in EMDEs (Chapter 3)

Private capital will have to support a larger share of climate investment needs

Projected Private Financing Share in Climate Investments
(Percents)

- Current share of private climate finance
- Required share of private sector by 2030

The share of funds dedicated to climate impact remains very small

Assets Under Management of Sustainable Investment Funds, by Fund Label
(Billions of US Dollars)