Global Financial Stability: How stable are we?

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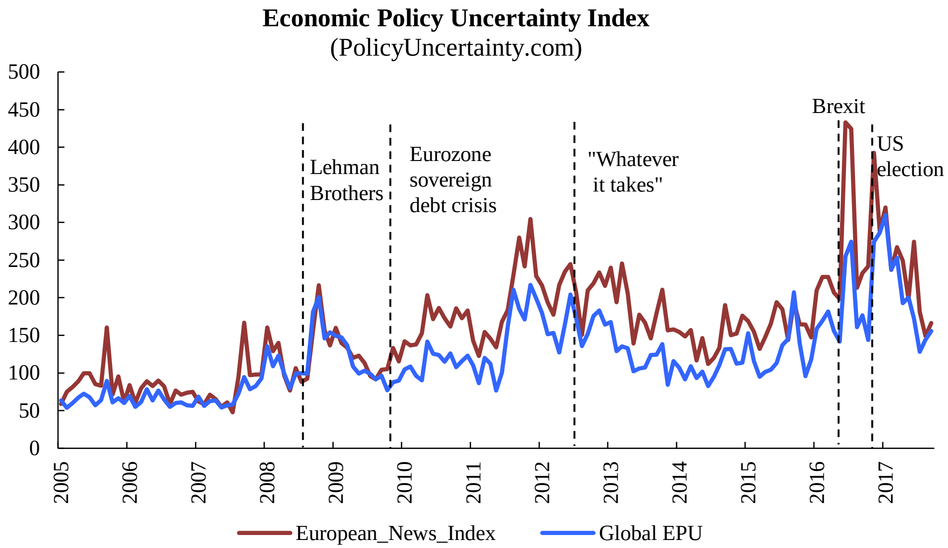
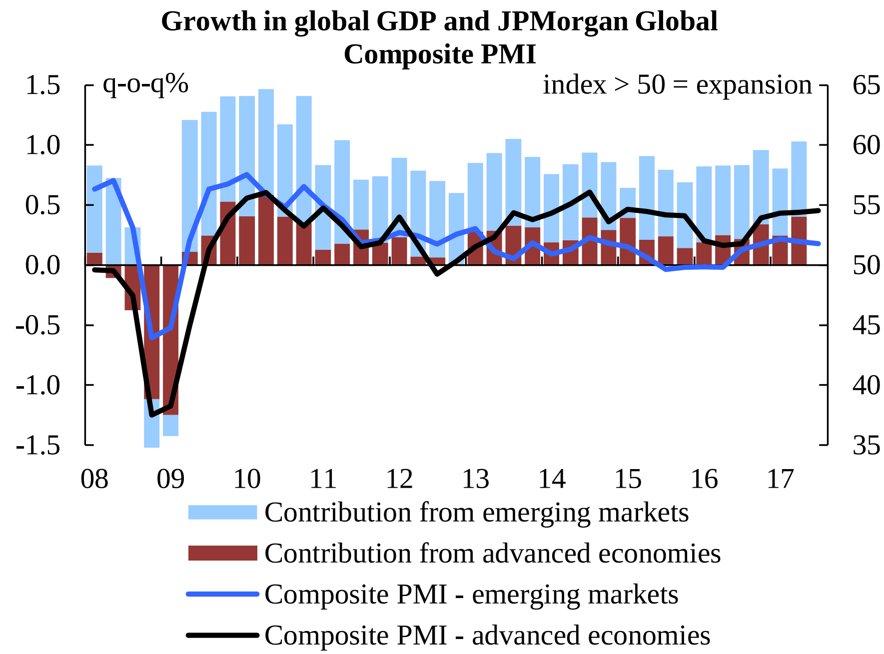
1. Key messages
2. Vulnerabilities in China, US and Europe
3. Our fundamental policy dilemma
4. Some reflections about the new IMF approach

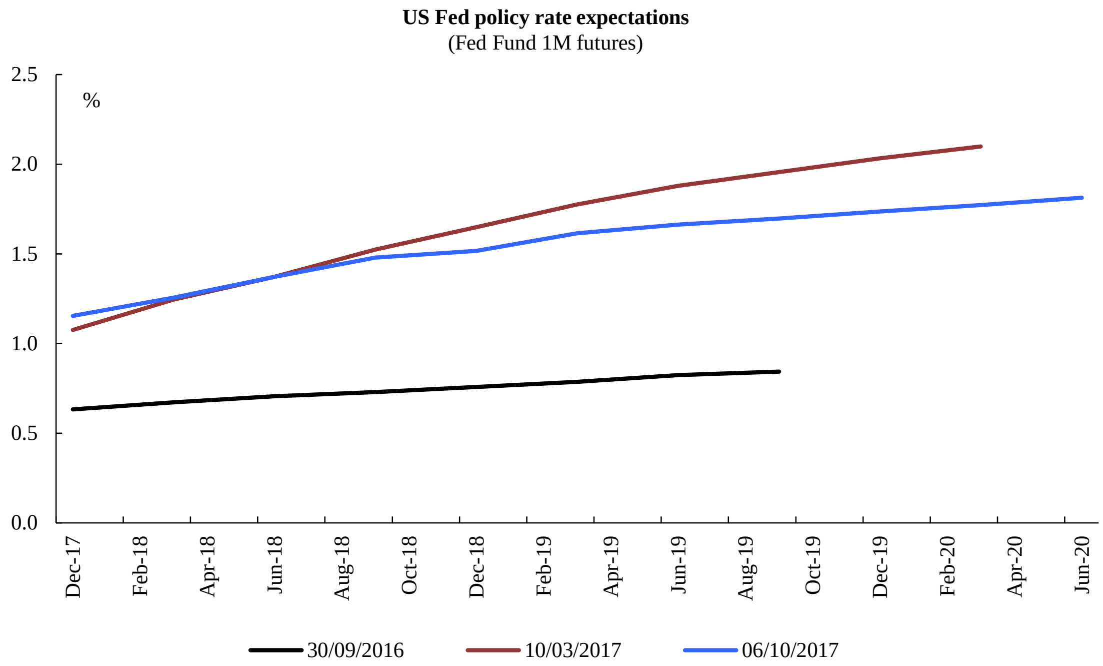
Global equity valuations driven by reduced uncertainty and stronger growth…



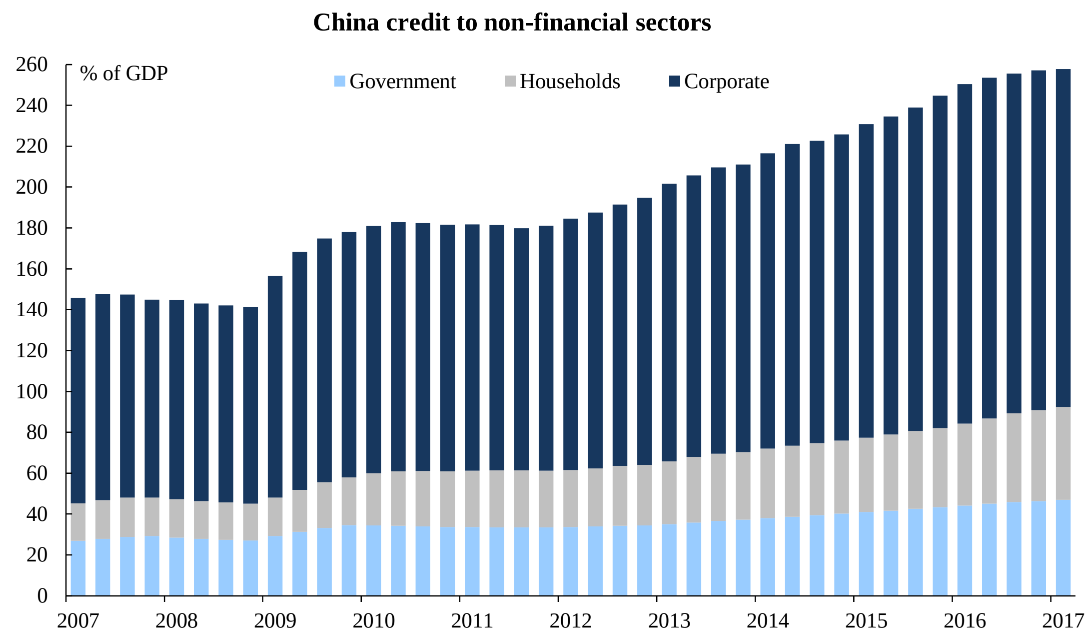


Source: Data Insight, IMF and national statistical institutes for GDP, JPMorgan/Markit for PMI.

… But higher global interest rates challenge market valuations

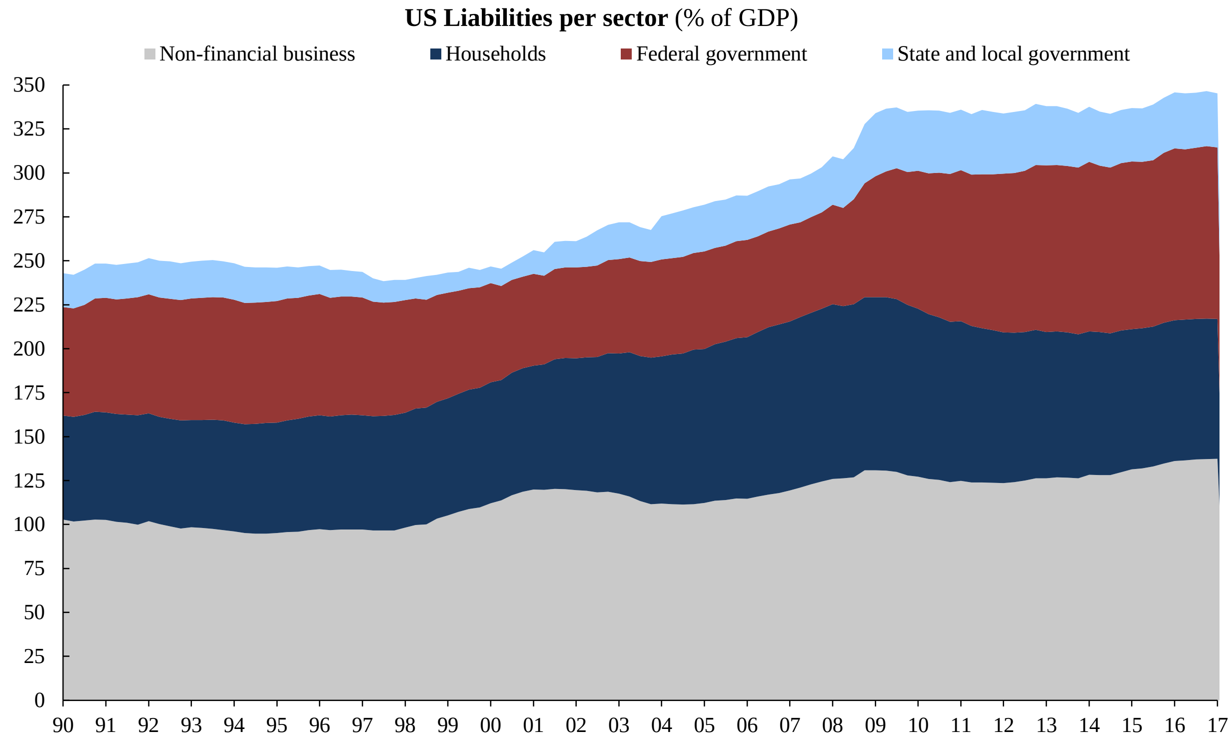


Leverage in China (risk only in medium term?)

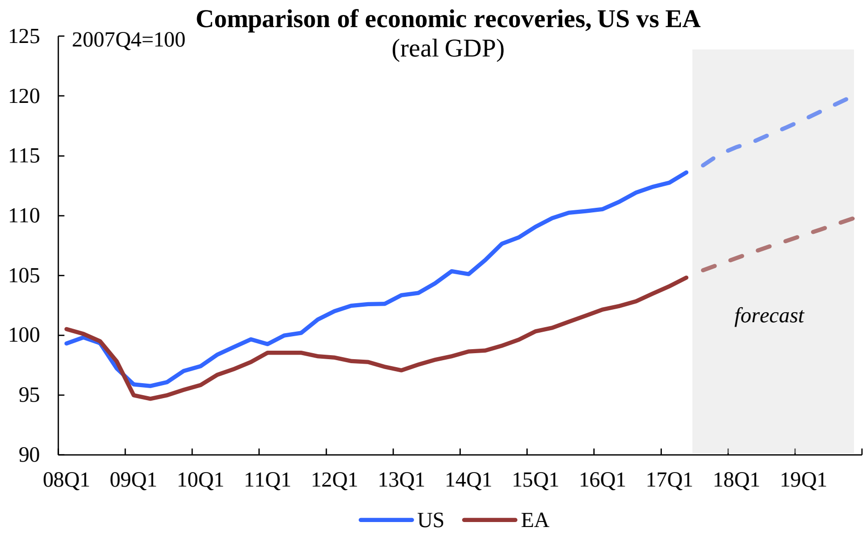


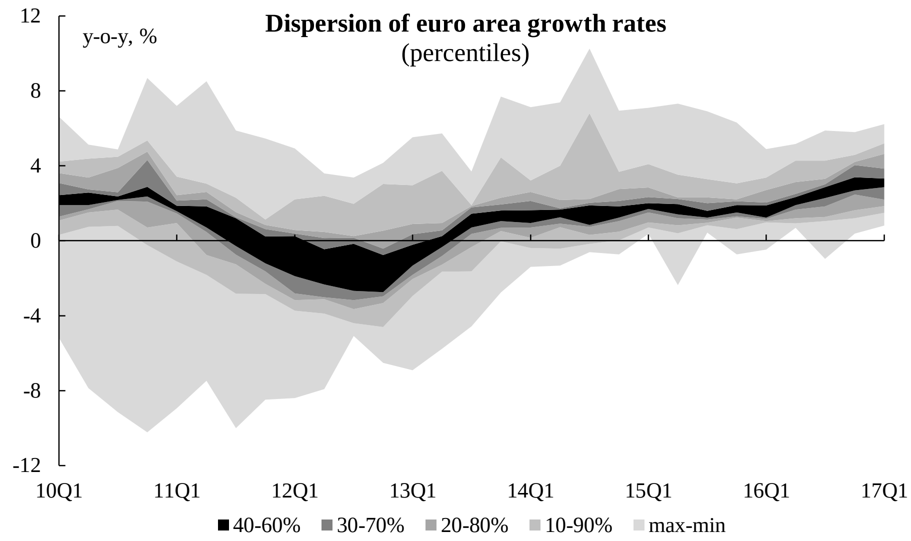
Source: BIS, PBoC

Corporate debt in the US trending up

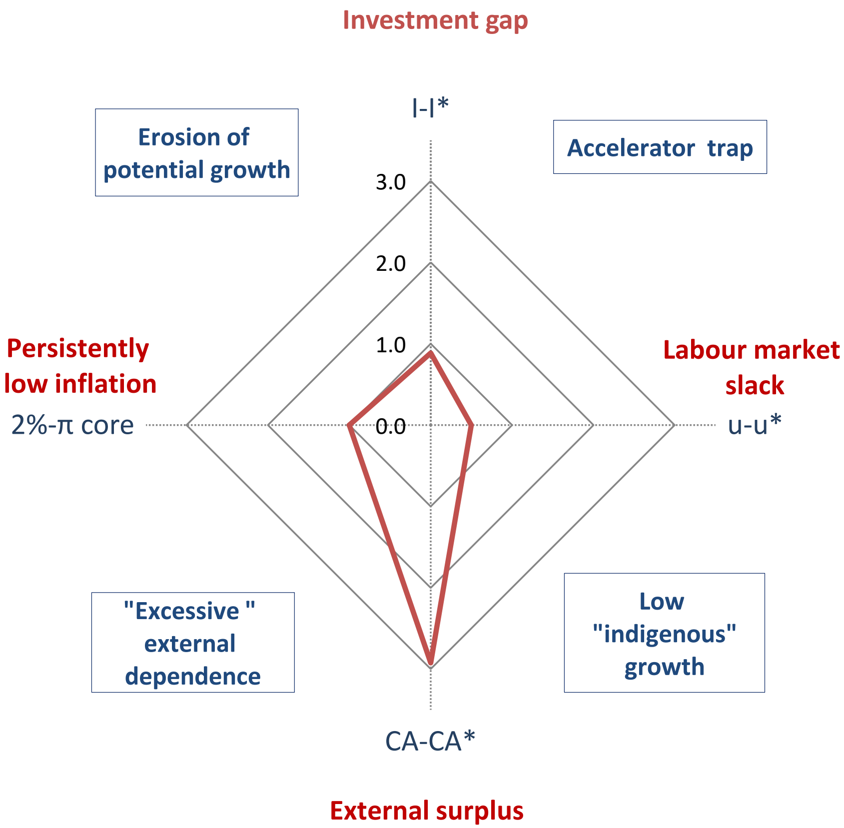


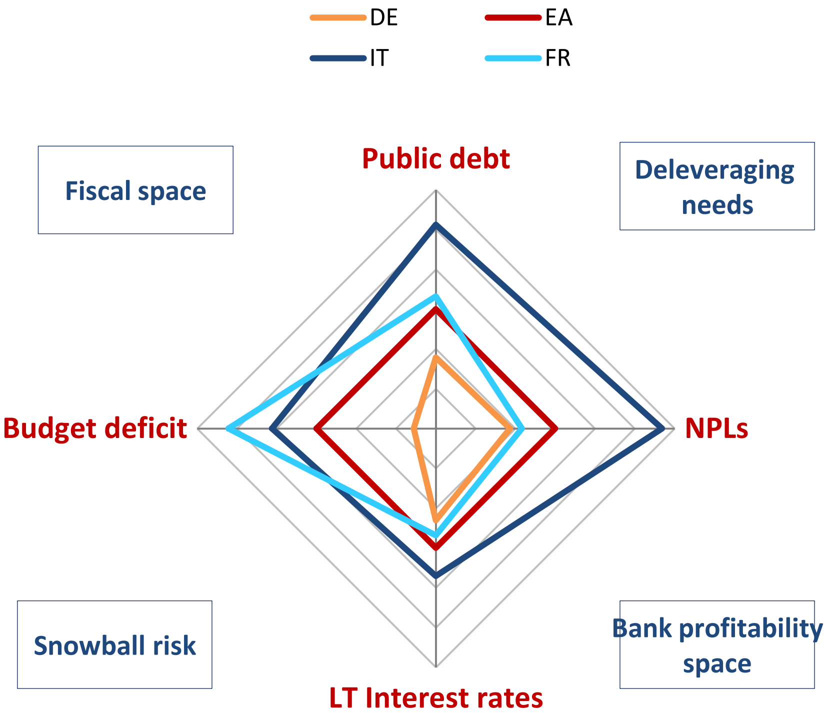
Euro area recovery 'two years behind US' but increasingly broad-based...





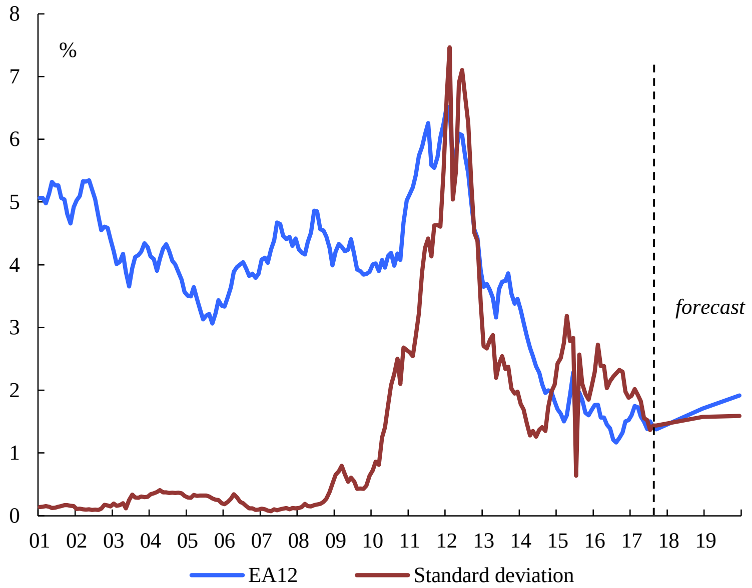
… yet recovery is still incomplete





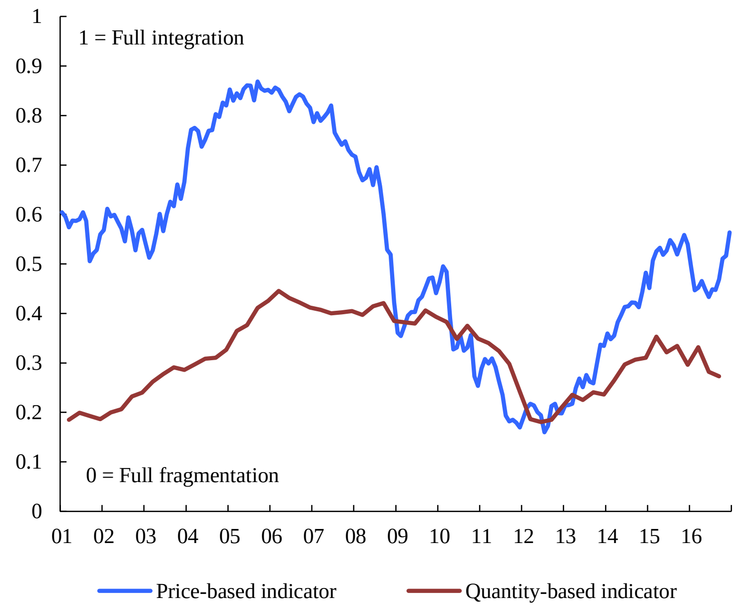
Declining financial fragmentation, but more in prices than quantities

Government interest rates and dispersion, euro area



Note: 10-year government bonds denominated in national currencies. Unweighted simple average and standard error.

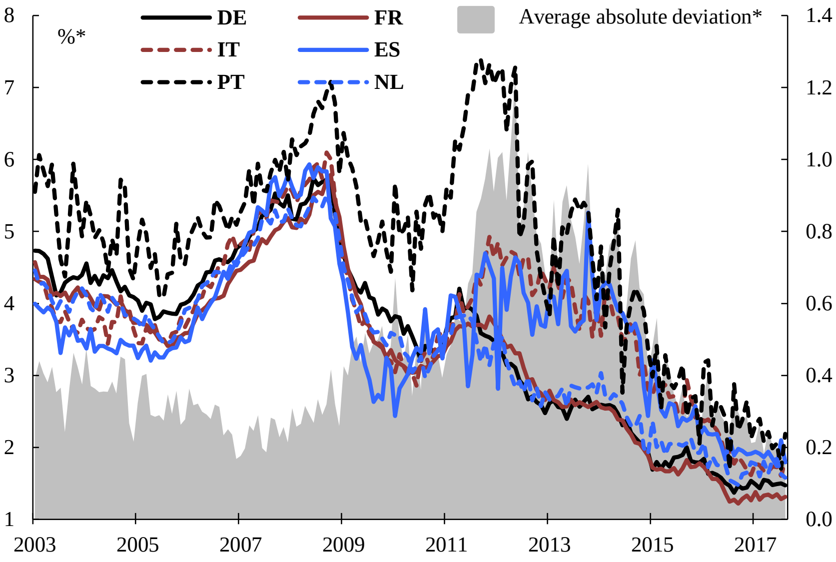
Composite indicators of financial integration



Source: ECB, May 2017.

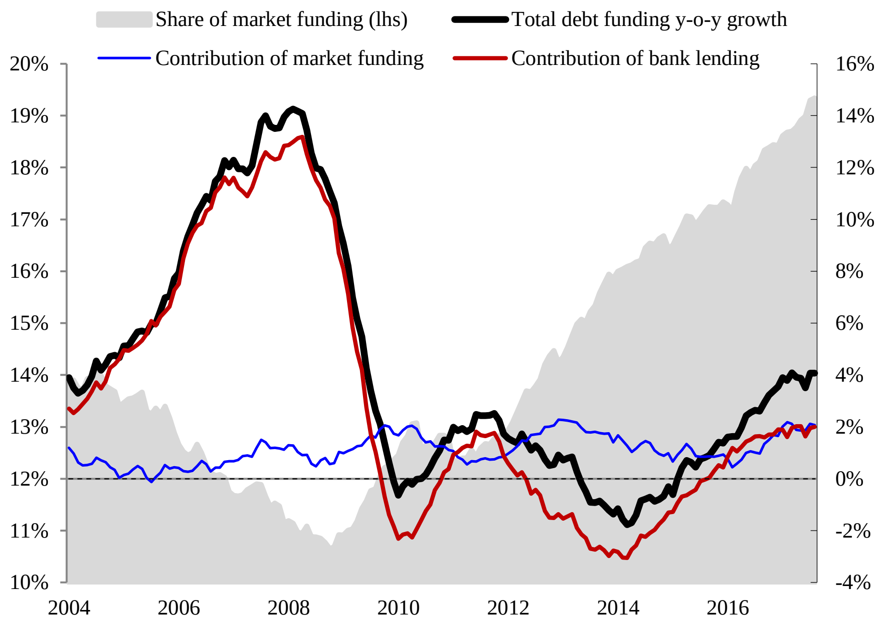
Low credit costs and better balanced financing channels

Country-specific CCCIs for NFCs



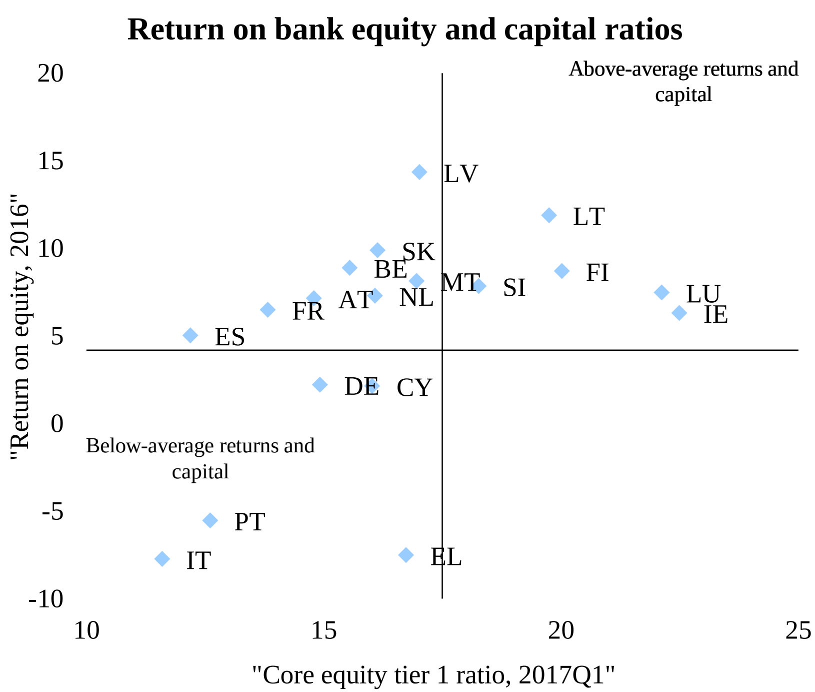
Note: * Based on available data for 9 EA Member States
Source: ECB, Bloomberg, BofA ML, DG ECFIN calculations

NFC's debt funding structure, euro area

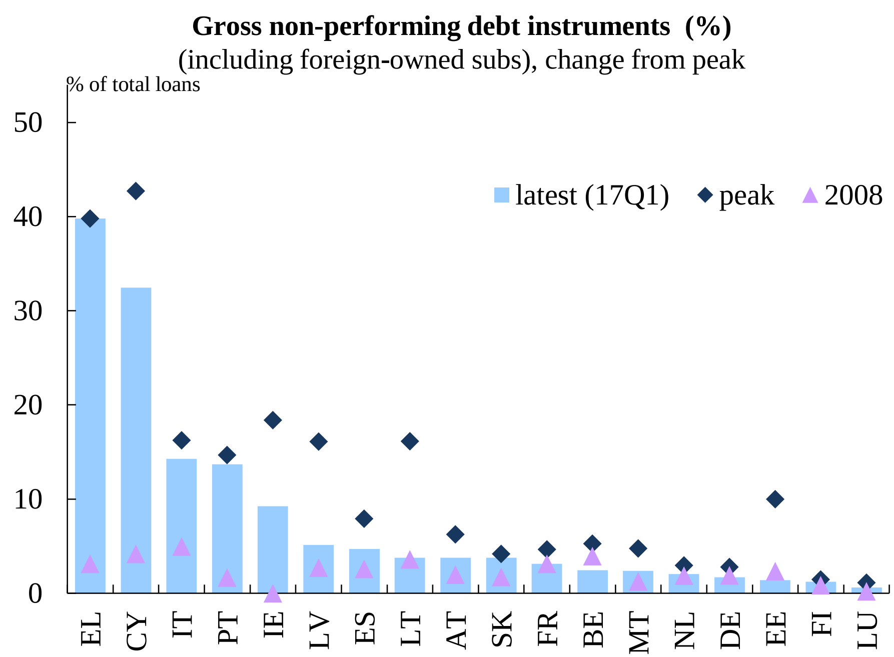


Source: ECB

Need to address remaining bank vulnerabilities

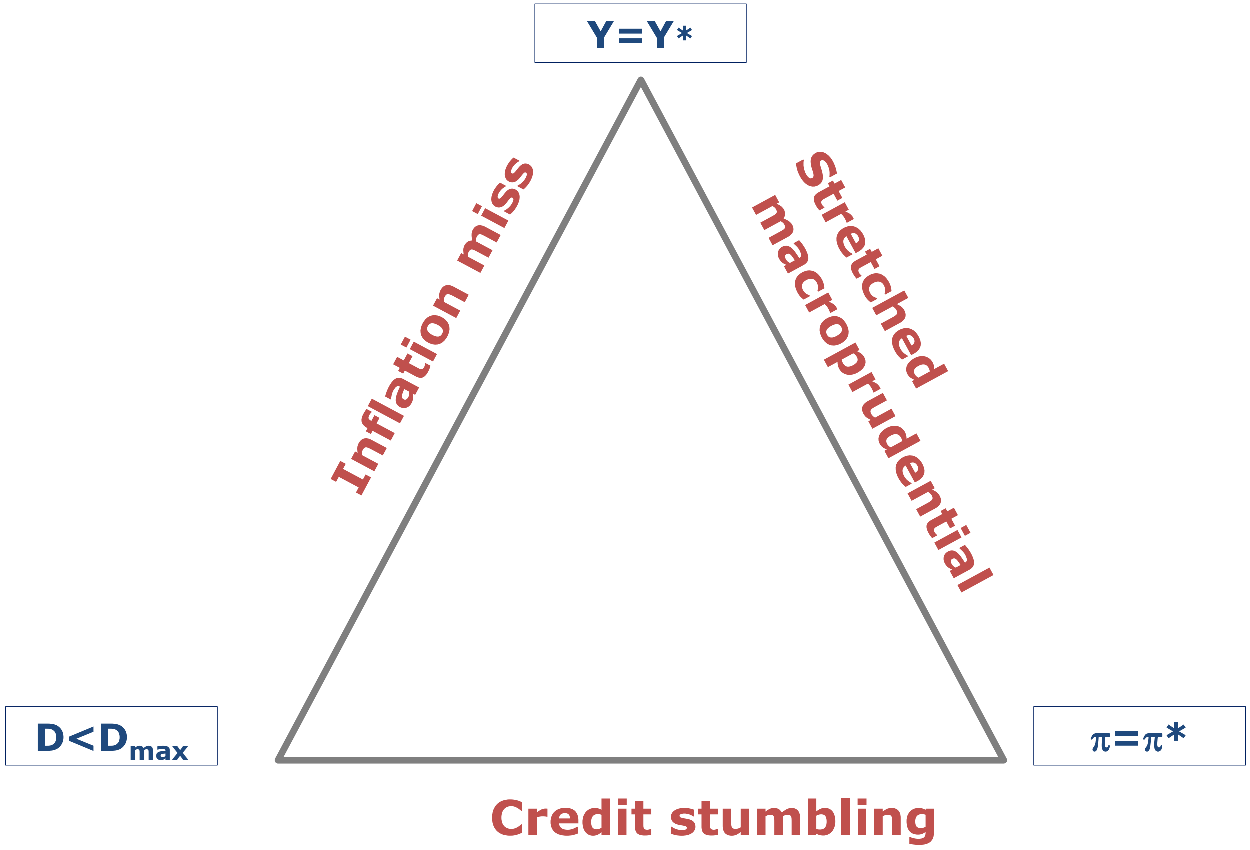


Source: ECB



Source: ECB

Our fundamental policy dilemma



Reflections on the new IMF approach (I)

The new IMF approach is a welcome (and brave) complement to the existing framework

But some caveats:

- Non-linear relationship between financial conditions and growth
- Composite indices are relevant, but can't replace looking in detail from different angles
- Assessing financial conditions and risks in AEs and EMEs should rely on different approaches
- For AEs, financial stress indicators could be added. They also have strong predictive value.
- Overall, data availability, cross-country comparability and consistency limit the emergence of a comprehensive and broadly accepted analytical framework for integrating the financial side.

Reflections on the new IMF approach (II)

GFSR suggests use of the new framework to calibrate crisis prevention policies

But prudence needed:

- Remain humble about our ability to forecast the next financial crisis.
- Indicators do not provide sufficient lead time to activate macroprudential responses. Poorly timed interventions could prove counter-productive.
- The new IMF approach is a good complement for what already exists, not a substitute.
- Public policy and debate is mostly based on the baseline growth outlook. How signals given by FCIs could be used to calibrate baseline scenarios?