



RACE IAS

GLOBAL FINANCIAL STABILITY REPORT

ABOUT THE REPORT:

- **Aim:** It provides an assessment of the global financial system and markets, and addresses emerging market financing in a global context.
- **Release:** It is released twice per year, in April and October.
- **Objectives:** It focuses on current market conditions, highlighting systemic issues that could pose a risk to financial stability and sustained market access by emerging market borrowers. o The Report draws out the financial ramifications of economic imbalances highlighted by the IMF's World Economic Outlook.
- It contains, as special features, analytical chapters or essays on structural or systemic issues relevant to international financial stability.
- In addition to assessing the condition of worldwide markets, the GSFR also issues recommendations for central banks, policymakers, and others who supervise global financial markets.
- **Published by:** The International Monetary Fund (IMF) released its Global Financial Stability Report 2021 recently.
- **Replaced by:** The Global Financial Stability Report (GFSR) replaced two previous reports by the IMF, the annual International Capital Markets Report and the quarterly Emerging Market Financing Report.

GLOBAL FINANCIAL STABILITY REPORT OCTOBER, 2021

Topic: COVID-19, CRYPTO AND CLIMATE:

Highlights:

Global: COVID-19:

- Financial conditions in advanced economies have eased further, on net, since the April 2021 Global Financial Stability Report, buoyed by expectations that monetary policy will remain accommodative.
- Financial conditions in emerging and frontier market economies are little changed, but the rapid spread of virus mutations and uneven access to vaccines pose a threat to the economic recovery. Credit conditions have improved in the corporate sector, albeit unevenly. Corporate balance sheets have generally strengthened, and profitability has improved.
- Advanced Economies: Central bank balance sheets in advanced economies have grown considerably during the COVID-19 pandemic in an effort to ease financial conditions and maintain the flow of credit to households and firms. Monetary authorities have increased the assets held on their balance sheets to close to 60 percent of GDP, almost double the level prevailing before the pandemic.



Crypto Ecosystem:

- In India: India has seen a massive spurt in crypto users of late. The number of blockchain start-ups surpassed 300 in 2021, with the daily crypto trading volume peaking between \$300 - \$500 million.
- Global Consumer Survey in 2020: As per the survey, 99 per cent of its respondents responded that they did trade in crypto currencies. India ranks higher than China, United States, Germany and Japan in crypto adoption. Nigeria, Vietnam and Philippines topped the mentioned survey.
- Challenges: Challenges posed by the crypto ecosystem include operational and financial integrity risks from crypto asset providers, investor protection risks for crypto-assets and Defi, and inadequate reserves and disclosure for some stable coins.
- Cryptoization: IMF in its GFSR 2021 pointed out that for emerging market and developing economies, adoption of cryptocurrency might be luring but they also come with a set of potential macro-financial risks, especially with respect to asset and currency substitution. IMF referred to this phenomenon as 'cryptoization'.
- Bitcoin: It remains the dominant Crypto asset. However, its market share fell sharply in 2021 from 70 per cent to less than 45 per cent. The interest has shifted towards newer blockchains that use smart contracts that replace the earlier ones by enhancing scalability, interoperability, and sustainability.
- Stablecoin trading volumes: have outpaced all other crypto assets. This is primarily because of their high usability for on-spot settlements and derivatives trades on exchanges.
- Popularity of crypto-ecosystem: The crypto-ecosystem is free of intermediaries and match credit platforms match borrowers and lenders without any credit-risk evaluation. They operate directly on blockchains without any customer identification requirements. As per the report, IMF said the deregulated finance made possible by the crypto ecosystem has particularly helped its popularity and intake.

Why Cryptos are vulnerable?

- IMF pointed out that cryptos are particularly vulnerable and are bundled with a set of operational, cyber and governance risks.
- High periods of transaction activity and poorly designed systems and controls make it particularly vulnerable to such risks.
- Thirdly, governance risks because these platforms lack transparency

pertaining to how cryptos are issued and distributed. This could again pave the way for huge losses.

- Monitoring the activity of crypto-asset service providers is complicated by limited, fragmented, and, in some cases, unreliable data. Public data sharing by crypto asset providers is currently mostly voluntary and lacking standardization.

Suggestions by IMF:

- Enact de-dollarization policies, including enhancing monetary policy credibility; a sound fiscal position; effective legal and regulatory measures; and the implementation of central bank digital currencies.
- Prioritizing the adoption of global standards and deeper regulations in areas of systematic importance would help in easing out pressures.

Climate: Fostering the transition to a green economy:

- Total assets under management of sustainable investment funds are small but growing rapidly, more than doubling over the past four years to reach \$3.6 trillion in 2020. However, climate-oriented funds accounted for only \$130 billion of that total.
- Flows into sustainable funds appear to support climate stewardship and encourage the issuance of securities by firms with a more favorable sustainability rating.
- Sustainable investors could also bring financial stability benefits as they are less sensitive to short-term returns.

Financial Stability Report (FSR) by RBI, 2022:

Highlights:

- The global economic recovery has been losing momentum in the second half of 2021 in the face of resurfacing COVID-19 infections, supply disruptions and bottlenecks, elevated inflationary levels and shifts in monetary policy stances and actions across advanced economies and emerging market economies.
- On the domestic front, progress in vaccination has enabled the recovery to regain traction after the debilitating second wave of the pandemic, notwithstanding signs of slowing pace more recently; the corporate sector is

gaining strength and bank credit growth is improving.

- The capital to risk-weighted assets ratio (CRAR) of scheduled commercial banks (SCBs) rose to a new peak of 16.6 per cent and their provisioning coverage ratio (PCR) stood at 68.1 per cent in September 2021.
- Macro stress tests for credit risk indicate that the gross non-performing asset (GNPA) ratio of SCBs may increase from 6.9 per cent in September 2021 to 8.1 per cent by September 2022 under the baseline scenario and to 9.5 per cent under a severe stress scenario. SCBs would, however, have sufficient capital, both at the aggregate and individual levels, even under stress conditions.
- Emerging signs of stress in micro, small and medium enterprises (MSME) as also in the micro finance segment call for close monitoring of these portfolios going forward.

Table 1.2 : General Government Fiscal Balance, 2019–26: Overall Balance

	(per cent of GDP)							
	Actuals		Projections					
	2019	2020	2021	2022	2023	2024	2025	2026
World	-3.6	-10.2	-7.9	-5.2	-4.2	-3.8	-3.6	-3.5
Advanced G-20	-3.6	-11.7	-9.6	-5.4	-4.0	-3.6	-3.5	-3.5
Euro Area	-0.6	-7.2	-7.7	-3.4	-2.4	-2.0	-1.7	-1.6
France	-3.1	-9.2	-8.9	-4.7	-3.9	-3.6	-3.4	-3.4
Germany	1.5	-4.3	-5.8	-1.8	-0.4	0.0	0.5	0.5
Italy	-1.6	-9.5	-10.2	-4.7	-3.5	-2.9	-2.6	-2.4
Japan	-3.1	-10.3	-9.0	-3.9	-2.1	-2.1	-2.1	-2.2
United Kingdom	-2.3	-12.5	-11.9	-5.6	-3.6	-3.2	-3.1	-2.9
United States	-5.7	-14.9	-10.8	-6.9	-5.7	-5.2	-5.3	-5.3
Others	-0.2	-5.2	-4.2	-2.3	-1.4	-1.0	-0.7	-0.6
EMEs	-4.7	-9.6	-5.6	-5.8	-5.2	-4.8	-4.4	-4.1
Emerging G-20	-5.4	-10.3	-7.0	-6.3	-5.7	-5.2	-4.8	-4.4
Asia	-5.9	-10.8	-7.9	-7.0	-6.2	-5.7	-5.2	-4.8
China	-6.3	-11.2	-7.5	-6.8	-6.2	-5.6	-5.0	-4.5
India	-7.4	-12.8	-11.3	-9.7	-8.8	-8.3	-8.1	-7.8
Low-Income Developing Countries	-3.9	-5.2	-5.4	-5.0	-4.5	-4.3	-4.1	-3.9
World Output (per cent)	2.8	-3.1	5.9	4.9	3.6	3.4	3.3	3.3

Note: Overall Fiscal Balance refers to net lending (+) / net borrowing (-) of the government.
Source: IMF Fiscal Monitor, October 2021.

Table 1.1 : Growth Projections for 2021-2023

	2020	2021*	2022*	2023*
				(per cent)
IMF				
Advanced Economies	-4.5	5.2	4.5	2.2
Emerging Markets and Developing Economies	-2.1	6.4	5.1	4.6
World	-3.1	5.9	4.9	3.6
OECD				
World	-3.4	5.6	4.5	3.2

Note *: Projections.
 Source: IMF's World Economic Outlook Database (October 2021), OECD Economic Outlook, Volume 2021 Issue 2 (December).

WAY AHEAD:

- Extraordinary policy measures have eased financial conditions and supported the economy, helping to contain financial stability risks. There is a pressing need to act to avoid a legacy of vulnerabilities while avoiding a broad tightening of financial conditions. Actions taken during the pandemic may have unintended consequences such as stretched valuations and rising financial vulnerabilities. The recovery is also expected to be asynchronous and divergent between advanced and emerging market economies.