

FOREWORD

As the world continues to navigate the exit from the global pandemic, an accelerating trend of digitalization and the existential threat from climate change pose both opportunities and challenges ahead. These 3Cs—COVID-19, Crypto, and Climate—offer opportunities for sustaining the ongoing recovery; facilitating more efficient, accessible, and inclusive financial service provision; and greening the economy. But they also require a global concerted effort to counter risks and vulnerabilities, which if left unchecked, could put growth at risk in the medium term or test the resilience of the global financial system.

Financial stability risks have been contained so far thanks to ongoing policy support that has fueled the global rebound. Investors, however, have become increasingly concerned about the economic outlook amid rising virus infections and greater uncertainty about the strength of the recovery. After declining notably through the summer, global long-term yields have risen in late September, in some countries entirely reversing their earlier moves, on concerns that price pressures may be more persistent than initially anticipated.

While such pressures are expected to moderate and gradually subside, risks to the inflation outlook appear to be skewed to the upside in many countries. In emerging markets, inflation pressures have led many central banks to hike policy rates. The pace of domestic emerging market tightening, combined with the potential for sudden tightening of global financial conditions, could hit emerging markets hard. Already, we see higher financing costs for domestic debt in emerging markets (except China) since last year.

Financial conditions eased further in advanced economies and remained easy on balance in emerging markets. At the same time, a prolonged period of extremely easy financial conditions may result in overly stretched asset valuations and fuel financial vulnerabilities. A sudden repricing of risk in markets, should investors reassess the economic and policy outlook, could interact with such vulnerabilities, leading to tighter financial conditions and putting

growth at risk in the medium term. Credit conditions have improved in the corporate sector, though they remain uneven across sectors and countries. With the gradual removal of fiscal and regulatory support measures, insolvency may rise in some countries. With the exception of a weak tail of banks in some countries, banks have remained resilient so far through the pandemic. However, banks remain cautious about the credit outlook in most countries. In the non-bank financial intermediary sector, the pandemic has unmasked vulnerabilities that need to be urgently addressed.

Monetary and fiscal policy support continues to be essential in much of the world. Central banks should provide clear guidance about the future stance of monetary policy to avoid an unwarranted tightening of financial conditions and minimize the risk of market volatility. Monetary authorities should remain vigilant and—if price pressures turn out to be more persistent than anticipated—act swiftly to counter any possible unmooring of inflation expectations.

Crypto asset markets are growing rapidly. Crypto asset prices remain highly volatile. Furthermore, the volume of crypto asset transactions has reached macro critical levels in some emerging markets, often as high as those of domestic equities. A sound regulatory framework for crypto assets, and decentralized finance markets more generally, must be a priority on the global policy agenda. This is particularly pressing for stablecoins, for which some business models have been subject to the risk of sudden and severe liquidity pressures. A regulatory level playing field is a key priority.

The forthcoming 26th United Nations Climate Change Conference of the Parties (COP26) presents a pivotal opportunity to speed up the transition and much-needed global climate actions to avoid catastrophic climate change. Achieving net-zero carbon emissions by 2050 requires substantial additional global investment by both the public and private sectors. The global financial sector can play a crucial role in catalyzing private finance and accelerating the transition.

Climate finance is growing rapidly, particularly among asset managers. While assets under management in climate-themed investment funds remain relatively small, inflows have surged, and there is a promise of cheaper funding costs for climate-friendly firms as well as greater climate stewardship by funds. Sustainable fund flows also appear more resilient to adverse shocks, suggesting that climate-friendly

investors might be relatively stickier. Further improvements in data, disclosure, and sustainable finance classifications remain the key policy objectives in this area to facilitate the assessment of transition-related risks and prevent greenwashing.

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