Global financial stability risks are rising amid historically high inflation and heightened uncertainty

MACRO-FINANCIAL BACKGROUND

Central banks are aggressively hiking rates to contain high inflation

Stock and bond prices have fallen

Interest rate volatility has risen exacerbated by low liquidity

The US dollar has appreciated sharply

Lower-rated emerging markets are facing high borrowing costs

Financial conditions have tightened in most economies

KEY FINANCIAL STABILITY RISKS AHEAD

Investors expect inflation to remain elevated

Spreads in certain euro area countries are rising

Global stress test points to bank vulnerabilities in emerging markets

Housing markets are at risk of declines in many economies

China’s housing risks could spill over to its banking sector

Emerging market bond funds have seen large outflows

Policies

Price stability is crucial for maintaining macro-financial stability

A tightening in financial conditions is necessary to restore price stability

Central banks should act resolutely to credibly bring inflation back to target and avoid a more painful and disruptive subsequent tightening

Policymakers need to communicate clearly their policy function, their commitment to achieving their objectives, and the need to further normalize policy

Policymakers should contain further buildup of financial vulnerabilities and adjust selected macroprudential tools as needed

Authorities in emerging and frontier markets should reduce risks from high debt vulnerabilities and ensure adequate bank capital buffers

Authorities should facilitate the efficient and orderly restructuring of distressed property developers in China

Sources: Bloomberg Finance L.P.; CEIC, EPFR; Fitch Connect; Haver Analytics; national data sources; S&P Capital IQ; and IMF staff calculations.