EXECUTIVE BOARD MEETING

SM/20/84

CONFIDENTIAL

April 3, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **April 2020 Global Financial Stability Report—Executive Summary and Chapter 1**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Tuesday, April 7, 2020**
Publication:	Yes, it is intended that the Global Financial Stability Report documents will be released to the public at the time of the Global Financial Stability Report press conference, tentatively scheduled for **Tuesday, April 14, 2020**.
Questions:	Mr. Natalucci, MCM (ext. 37108) Ms. Ilyina, MCM (ext. 35351) Mr. Kerry, MCM (ext. 37204) Mr. Papageorgiou, MCM (ext. 34261)
Additional Information:	The paper will be revised for publication in light of the Executive Board discussion. If Executive Directors have additional comments, they should notify Mr. Natalucci and Ms. Ilyina by **5:30 p.m. on Tuesday, April 7, 2020.**

EXECUTIVE SUMMARY

The April 2020 Global Financial Stability Report at a Glance

- The outbreak of COVID-19 has dealt an unprecedented blow to global financial markets.
- Risk asset prices have plummeted and borrowing costs have soared, especially in risky credit markets.
- Emerging and frontier markets have experienced the sharpest portfolio flow reversal on record.
- The priority is to save lives and to support the people and companies most affected by COVID-19.
- Fiscal, monetary, and financial policies should be used to support economies stricken by the pandemic.
- International cooperation is essential to tackle this extraordinary global crisis.

1. The coronavirus disease (COVID-19) presents a historic challenge. Since mid-February, when market participants started to fear that the outbreak would become a global pandemic, the prices of equities have fallen sharply, from previously overstretched levels. In credit markets, spreads have skyrocketed, especially in risky segments such as high-yield bonds, leveraged loans, and private debt, where issuance has come to a halt. Oil prices have plummeted in the face of weakening global demand and the failure of the OPEC+ countries to reach an agreement on output cuts, adding a further leg to the deterioration in risk appetite. These volatile market conditions have led to a flight to quality, with yields on safe-haven bonds declining abruptly.

2. A number of factors have amplified asset price moves, contributing to a sharp tightening of financial conditions at unprecedented speed. Signs of strain have emerged in major short-term funding markets, including the global market for US dollars—a development reminiscent of dynamics last seen during the financial crisis a decade ago. Market liquidity has deteriorated considerably, including in markets traditionally seen as very deep. In addition, leveraged investors have come under pressure, and some have reportedly been forced to close out some of their positions in order to meet margin calls and re-balance their portfolios.

3. Emerging and frontier market economies are facing the perfect storm. They have experienced the sharpest reversal in portfolio flows on record, both in dollar terms and as a share of emerging and frontier market GDP. Portfolio outflows from equity markets were larger than outflows from bond markets, underscoring investor concerns about the economic outlook. However, the loss of external debt financing is likely to put pressure on more leveraged and less creditworthy borrowers. This may lead to a rise in debt restructurings, which could test existing debt resolution frameworks.

4. While there are signs of stabilization in some markets, strains remain in other sectors and there is a risk of a further tightening in financial conditions. Elevated vulnerabilities, which have been highlighted repeatedly in *Global Financial Stability Reports*, are being exposed and may further amplify stresses in financial markets. For example, asset managers are facing large outflows and may be forced to sell assets into falling markets, potentially exacerbating price moves. High levels of borrowing by companies and households may lead to debt distress as the economy comes to a sudden stop. The resilience of banks may be tested further in the face of large market and credit losses. This may cause them to cut back their lending to the economy, amplifying the slowdown in activity.

5. This historic challenge necessitates a forceful policy response. The priority is to save lives and to implement appropriate containment measures to avoid overwhelming health systems. Country authorities need to support people and companies that have been most affected by the virus outbreak, as discussed in the *World Economic Outlook*.

6. To that end, authorities across the globe have already implemented wide-ranging policies. The *Fiscal Monitor* describes the fiscal support packages that have been announced by governments across the globe. Large, timely, temporary, and targeted fiscal measures are necessary to ensure that a temporary shutdown of activity does not lead to a more permanent damage to the productive capacity of the economy and to society as a whole.

7. Central banks globally have taken bold and decisive actions by easing monetary policy, purchasing a range of assets, and providing liquidity to the financial system in an effort to lean against the tightening in financial conditions and maintain the flow of credit to the economy. As policy rates are now near or below zero in many major advanced economies, unconventional measures and forward-guidance about the expected policy path are becoming the main tools for these central banks' going forward. Central banks may also consider further measures to support the economy during these challenging times.

8. Policymakers need to maintain a balance between safeguarding financial stability and supporting economic activity.

- *Banks.* In the first instance, banks' existing capital and liquidity buffers should be used to absorb losses and funding pressures. In cases where the impact is sizable or longer lasting and bank capital adequacy is affected, supervisors should take targeted actions, including asking banks to submit credible capital restoration plans. National authorities may also need to step in with fiscal support—either direct subsidies or tax relief—to help borrowers to repay their loans and finance their operations, or provide credit guarantees to banks. Supervisors should also encourage banks to negotiate, in a prudent manner, temporary adjustments to loan terms for companies and households struggling to service their debts.
- *Asset managers.* To prudently manage liquidity risks associated with large outflows, regulators should encourage fund managers to make full use of the available liquidity tools where it would be in the interests of unitholders to do so.
- *Financial markets.* Market resilience should be promoted through well calibrated, clearly defined, and appropriately communicated measures, such as circuit breakers.

9. Emerging market economies should manage external pressures by allowing their exchange rate to depreciate. If exchange rate movements become disorderly, authorities should consider intervening in foreign exchange markets. Temporary capital flow management measures may also have to be used in the face of substantial outflow pressures. Sovereign debt managers should prepare for longer-term funding disruptions by putting contingency plans in place to deal with limited access to external financing.

10. Multilateral cooperation is essential to help reduce the intensity of the COVID-19 shock and its damage to the global economy and financial system. Countries confronting the twin crises of health and external funding shocks—for example, those reliant on external financing or commodity exporters dealing with the plunge in commodity prices—may additionally need bilateral or multilateral assistance to ensure that health spending is not compromised in their difficult adjustment process. Official bilateral creditors have been called upon by the IMF Managing Director and the World Bank President to suspend debt payments from countries below the International Development Association's operational threshold that request forbearance while they battle the pandemic. The IMF, with $1 trillion in available resources, is actively supporting member countries.

GLOBAL FINANCIAL STABILITY OVERVIEW

Approved By
Tobias Adrian

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CONTENTS

Markets in the Time of Coronavirus

Chapter 1 at a glance

- Global financial conditions have tightened abruptly with the onset of the COVID-19 pandemic.
- Risk asset prices have dropped sharply as investors have rushed for safety and liquidity.
- Emerging and frontier markets have experienced the largest portfolio flow reversal on record.
- A further tightening of financial conditions may expose financial vulnerabilities:
    - asset managers may become distressed sellers, exacerbating asset price declines
    - leveraged firms may lose market access and defaults may spike.
- Banks' resilience may be tested as economic and financial market stress rise.
- Strong policy response and international cooperation are needed to tackle these challenges.

The COVID-19 Pandemic Triggered A Sharp Market Correction

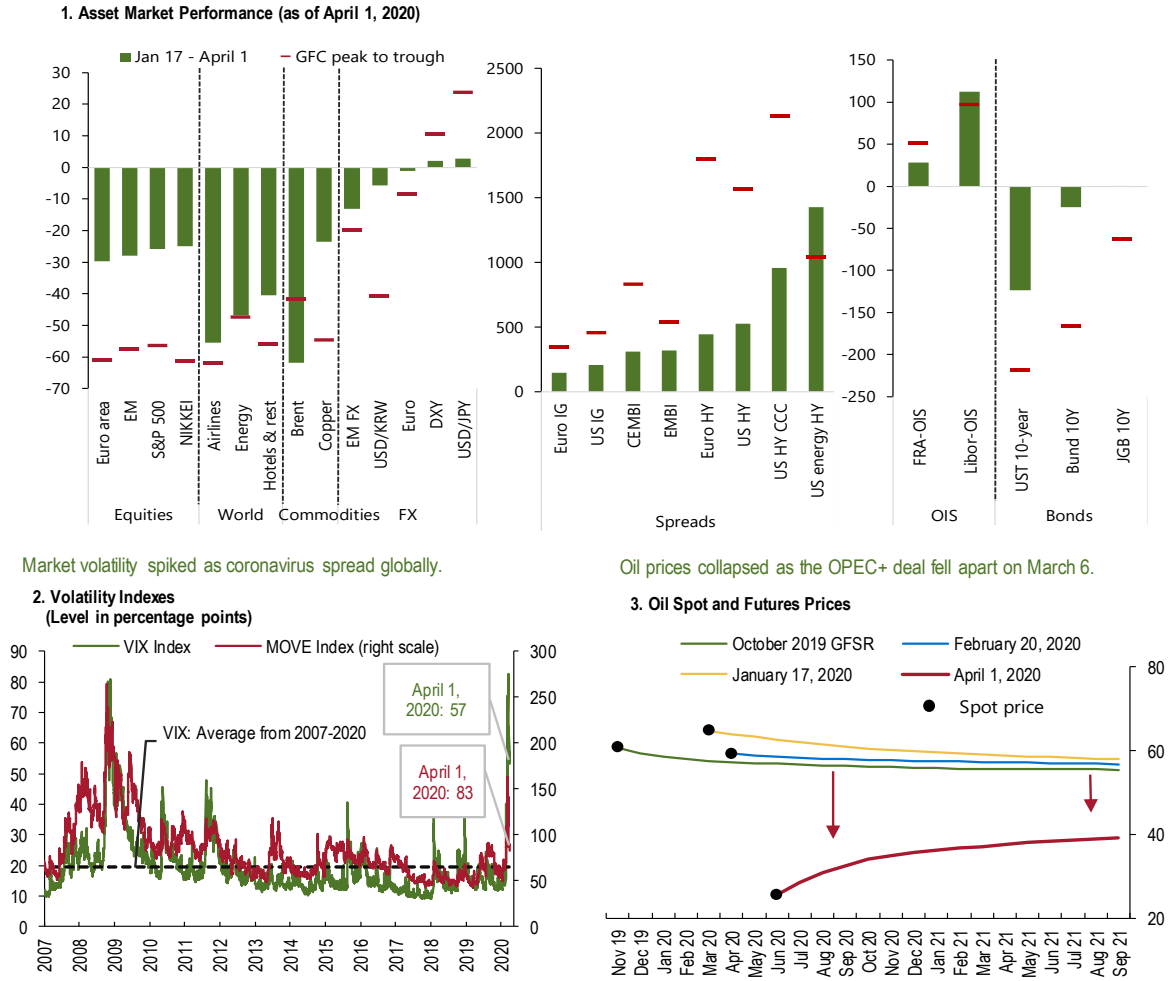
1. The COVID-19 global pandemic is a historic challenge. The necessary measures imposed by country authorities to slow the spread of the virus and to bolster the capacity of health systems have led to a sudden stop in economic activity and a sharp deterioration of the economic outlook. Global growth is now expected to decline by [3.0] percent in 2020, which is worse than during the global financial crisis (see the April 2020 *World Economic Outlook* (WEO)). The timing and the shape of future recovery remain highly uncertain.

2. Early in the year, financial markets were buoyed by a widespread sense of optimism on the back of supportive monetary policies, reduced trade tensions, and tentative signs of stabilization in the global economy. However, as COVID-19 spread globally, the prices of risk assets and commodities started to fall at unprecedented speed while the prices of safe-haven assets, such as gold and US Treasuries gained, as investors reassessed the economic impact of COVID-19 and rushed for safety and liquidity (Figure 1.1, panel 1). Equity markets experienced the fastest drop in history with the S&P 500 falling 20 percent from its peak in just 16 trading sessions, though broad asset price declines have not reached the magnitudes seen in 2008–09. Implied volatility spiked across asset classes, in some cases reaching levels last seen during the global financial crisis (Figure 1.1, panel 2).

3. The failure of the OPEC+ countries to reach an agreement on output cuts to maintain stable oil prices in the face of weakening global demand added fuel to the fire. While spot prices fell the most, the entire oil futures curve shifted down, suggesting that investors expect oil prices to remain low for a long time (Figure 1.1, panel 3). While the sell-off was broad-based, sectors most exposed to the impact of the virus containment measures—such as airlines, transportation, hotels and restaurants—or to the energy market came under severe pressure (Figure 1.1, panel 1).

Figure 1.1. Financial Market Developments: Adding Oil to the Fire

Investors fled risk assets for safe-haven assets, with some risk asset prices falling by more than 25 percent …



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: MOVE = Merrill Option Volatility Estimate; VIX = Chicago Board Options Exchange Volatility Index.

4. These volatile market conditions sparked a flight to safety and liquidity among investors. Government bond yields in Germany and the United States fell sharply, reflecting both declines in term premia and a lower expected path of monetary policy (Figure 1.2, panel 1). Implied interest-rate volatility spiked, as liquidity conditions in the US Treasury markets worsened. The market-implied probability of inflation falling below 1 percent over the next five years spiked in Europe and in the United States on concerns about the economic impact of COVID-19 and the fall in oil prices (Figure 1.2, panel 2).

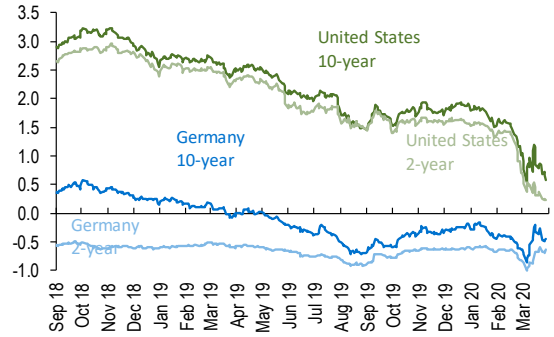
5. Central banks responded with decisive monetary policy easing. Policy rates in several advanced economies came down close to zero (Figure 1.2, panel 3), and government bond yields are now expected to stay low for even longer. The stock of government bonds with yields of

below 1 percent (shown in light and dark blue in Figure 1.2, panel 4) doubled from around 40 percent of bonds outstanding at the end of 2019 to about 80 percent in March 2020.

Figure 1.2. Advanced Economy Government Bond Markets: Lower for Even Longer

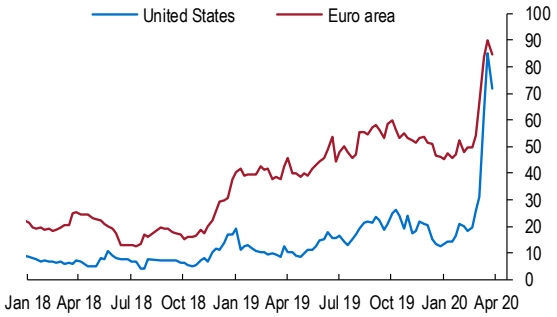
Yields collapsed initially on the back of lower term premiums and expectations of central bank response …

1. Advanced Economy Government Bond Yields



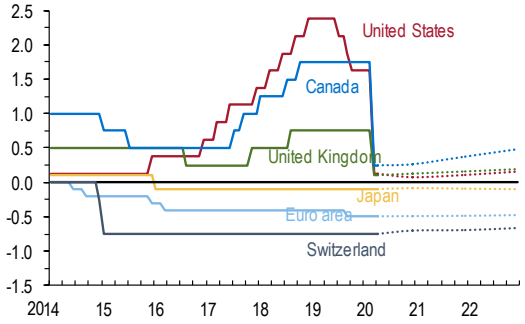
… as the inflation outlook deteriorated on expectations of sustained economic weakness.

2. Probability of Inflation Below 1% Over 5 Year Period (Percent)



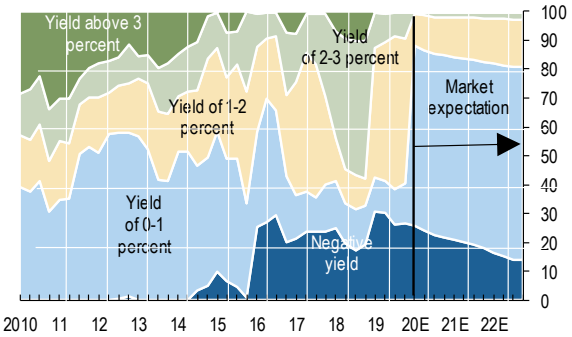
Central banks are expected to cut rates further …

3. Actual and Expected Policy Rates (Basis points)



…pushing down yields on government bonds even lower.

4. Advanced Economy Government Bonds (Percent of bonds outstanding, by yield)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.

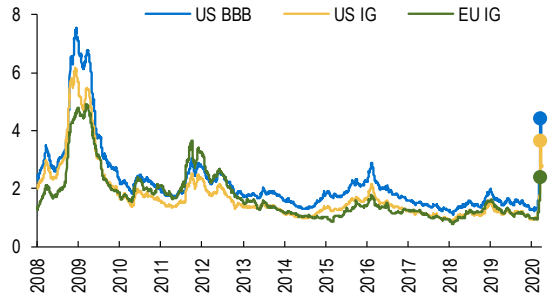
Stress in Credit Markets Was Amplified by Borrowers' Leverage and the Oil Price Collapse

6. Conditions in the *corporate credit markets* have deteriorated sharply since early March on the back of rising credit and liquidity risks. *Investment grade bond* spreads widened (Figure 1.3, panel 1), as investors started to focus on a large share of BBB credits that are at risk of downgrades and elevated leverage in this market segment (see the April 2019 GFSR). In the primary market, European issuance declined, while US issuance picked up pace because of increased need for cash (only partly met by bank credit lines) and strains in the commercial paper market (Figure 1.3, panel 2) (see below). In response to pressures in the corporate bond markets, several central banks, including the US Federal Reserve, the ECB and the Bank of Japan, rolled out new facilities and expanded existing programs to support issuance and liquidity in corporate debt and commercial paper markets (see the policy section).

Figure 1.3. Corporate Credit Markets: Pricing Higher Default Risk

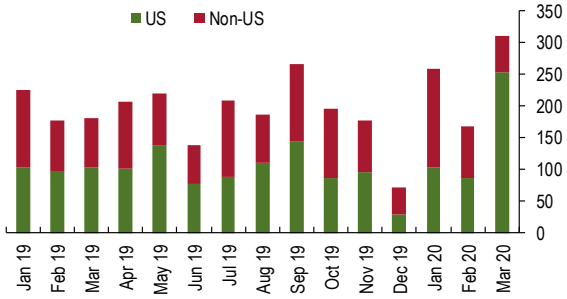
Global investment grade corporate spreads sharply widened, with US spreads now at their highest levels since the global financial crisis (GFC).

1. Global Investment Grade (IG) Corporate Spreads (Percent)



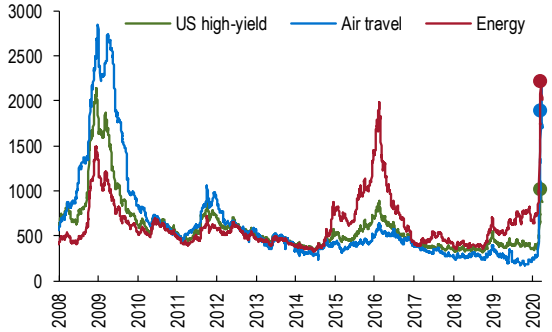
US investment grade firms continued to issue in March—in contrast to European firms—because of increased need for cash and strains in the commercial paper market.

2. Global Investment Grade Bond Issuance (Billions of US dollars)



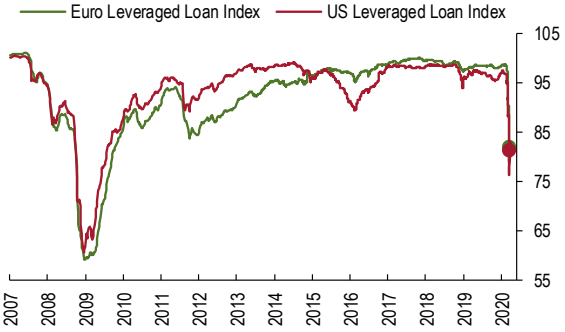
High-yield spreads rose to post-GFC highs, driven by energy and transportation sectors

3. US High-Yield Corporate Spreads



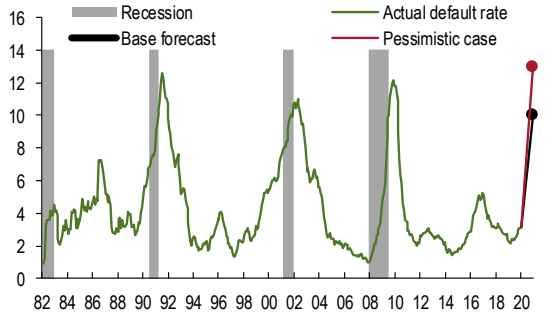
Leveraged loan prices experienced a decline of about half the drop seen in the global financial crisis.

4. Global Leveraged Loan Market Prices



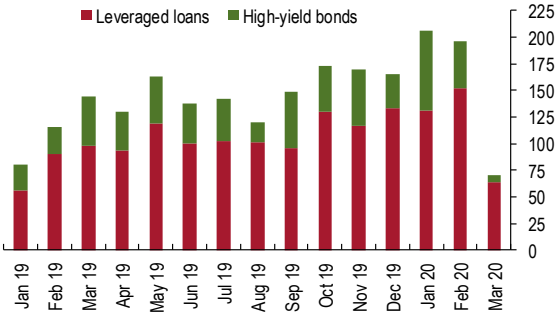
With credit risk rising, rating agencies revised up default forecasts to

5. S&P US Speculative-Grade Default Rate



The primary market for high-yield bonds and leveraged loans dried up

6. Global High Yield Bond and Leveraged Loan New Issuance



Sources: Bloomberg Finance L.P.; S&P Global Ratings; S&P LCD; and IMF staff calculations.

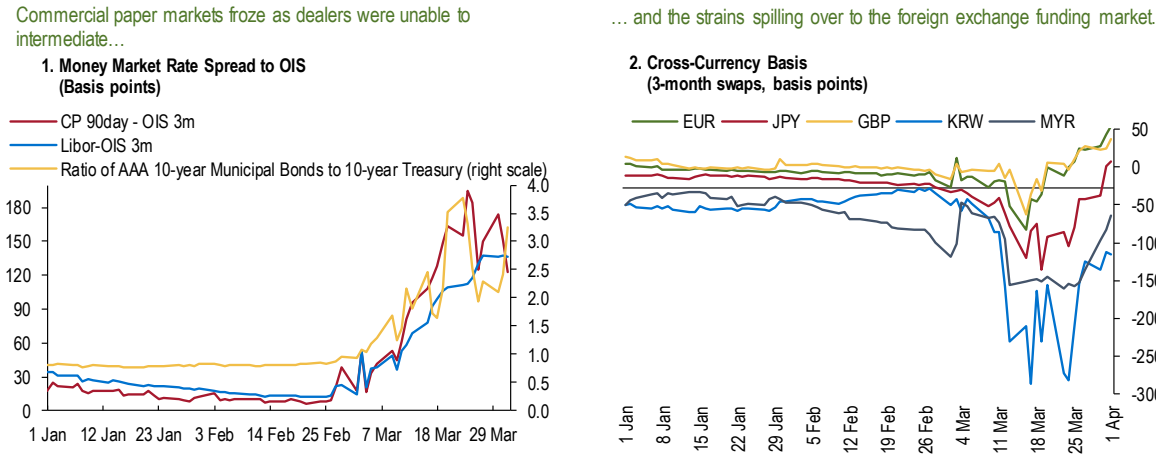
7. By contrast, strains remained unaddressed in the *risky credit market segments*—high-yield bonds, leveraged loans, and private debt. These markets expanded rapidly after the global financial crisis, reaching $9 trillion globally, while borrowers' credit quality, underwriting standards, and investor protections weakened (see the forthcoming Chapter 2 of this report). Since early March, *high-yield bond* spreads have widened dramatically, particularly in the energy

sector and in sectors most affected by the COVID-19 outbreak, such as transportation (Figure 1.3, panel 3). *Leveraged loan prices* have experienced sharp decline, approximately half the drop seen during the global financial crisis (Figure 1.3, panel 4). Against a backdrop of already elevated leverage and expected declines in earnings, rating agencies revised up their speculative-grade default forecasts from benign to recessionary level of around 10 percent (Figure 1.3, panel 5). Market-implied US high-yield defaults also rose to 8-10 percent. The issuance of high yield bonds came to a halt and issuance of leveraged loans fell considerably (Figure 1.3, panel 6).

Pressures in Short-term Funding Markets Were Exacerbated by Dealers' Clogged Balance Sheets

8. The US *commercial paper* market, which is typically tapped by firms to meet their working capital needs, froze. Two factors contributed to this development. First, prime money market funds sought to reduce their commercial paper holdings to raise cash and build liquidity buffers in response to actual and expected investor outflows. And second, dealer banks were reportedly less able or willing to intermediate these flows as they faced balance sheet and risk limits constraints. As a result, commercial paper spreads widened dramatically (Figure 1.4, panel 1). A similar dynamic occurred in the US municipal bond market, as dealers could not warehouse the surge in supply resulting from outflows from municipal bond funds. Short-term funding markets in Australia, Canada, and the United Kingdom experienced similar pressures. In response, central banks launched several emergency facilities (see the policy section) that have provided some relief to the commercial paper markets.

Figure 1.4. Short-term Funding Markets: Under Stress



Sources: Bloomberg Finance L.P.; and JP. Morgan & Chase CO; IMF staff calculations.
Note: In panel 1, CP 90day yield is a composite of offered levels for A1/P1/F1 fated US commercial paper programs. In panel 2, EUR = euro; GBP = British pound; JPY = Japanese yen; KRW = Korean won; MYR = Malaysian ringgit. LIBOR = London interbank offered rate; OIS = overnight index swap.

9. Conditions in global *US dollar funding markets* tightened as well. The spread between Libor—the floating rate at which banks lend to each other—and a risk-free rate widened sharply (Figure 1.4, panel 1). The cross-currency basis—a premium paid on the US dollar funding in exchange for local currency—widened for most currencies (Figure 1.4, panel 2). The extent of initial tightening was more severe in economies with large dollar funding demand but with no swap lines with the US Federal Reserve. In response to these pressures, several central banks agreed to augment the provision of US dollar liquidity through an enhancement to existing swap lines or though new temporary swap lines, including with a few emerging market economies (see the policy section for details). Since the end of March, pressures appeared to have abated somewhat in a number of markets.

Financial Deleveraging and Strained Market Liquidity Aggravated Selling Pressures

10. The sharp tightening in financial conditions in March put pressure on *leveraged investors* to close out some of their positions in order to meet margin calls and to re-balance their portfolios—a dynamic that likely amplified asset price declines. For example, as volatility and correlations across asset classes shot up, *volatility-targeting investors* were apparently forced to liquidate some of their asset holdings, contributing to the sell-off [1]. The two-fold increase in the balances of *central counterparty clearing houses* with the US Federal Reserve in only two weeks is another evidence that leveraged investors faced significant margin calls.

11. As Treasury yields fell sharply and intra-day volatility increased, leveraged investors who had engaged in the so-called *basis trades* in the US Treasury market were forced to unwind their positions[2]. This led to a substantial increase in dealers' holdings of Treasury bonds. With volatility surging, dealers' risk management practices and limits likely constrained their ability to intermediate markets, adding to stress (see the online annex for a discussion of dealers' balance sheet constraints and other market fragilities). As a result, liquidity conditions in the US Treasury market deteriorated sharply (Figure 1.5, panel 1). In response to these developments, the US Federal Reserve took a number of steps aimed at preventing market disruptions and mitigating upward pressure on Treasury yields, such as increasing the scale of asset purchases, introducing additional large open-market operations to inject liquidity, allowing foreign central banks to repo their Treasury holdings in exchange for dollars, and temporarily excluding U.S. Treasury

[1] Volatility-targeting investors - such as variable annuities, commodity trading advisors and risk parity funds - seek to keep expected portfolio volatility at a specific target level. When market volatility is low, greater financial leverage is typically employed to meet volatility targets. However, as volatility and correlations spike, strategies that are less flexible to deviate from targets (such as variable annuities) may be more likely to shed assets to ensure that they maintain their target volatility.

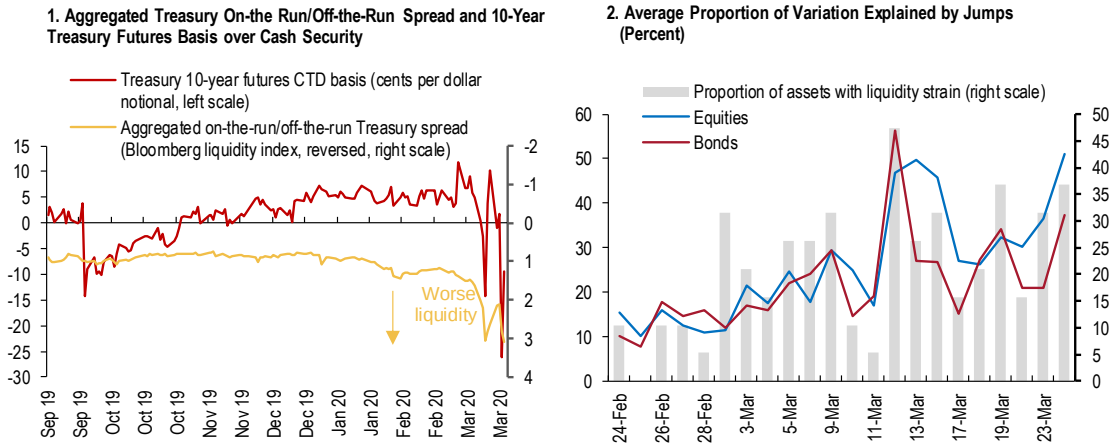
[2] Before the COVID-19 induced sell-off, some leveraged investors had built up sizable short positions in Treasury futures and long positions in off-the-run cash Treasuries in order to profit from the implied yield differential. Following decisive central bank easing, Treasury yields collapsed to a record low level, but less than the Treasury futures-implied yield. This price action forced many of these leveraged investors to unwind their basis trade positions to stop losses, to meet margin calls, or to keep their risk exposures below targets.

securities and reserves from the calculation of the supplementary leverage ratio for bank holding companies (see the policy section for details).

Figure 1.5. Market Liquidity Conditions: Under Strain

Treasury market liquidity has been impaired, partly due to constrained dealer balance sheets.

Liquidity conditions have deteriorated across a broad range of markets.



Sources: Bloomberg Finance LP; J.P. Morgan; and IMF staff calculations.
Note: In panel 2, the analysis includes equity markets in the United States, United Kingdom, Euro Area, Spain, Korea, Mexico, China, Brazil and India. Treasury markets in the United States, United Kingdom, Germany, Spain, France, Italy, Portugal, Mexico, Brazil and India.

12. With markets moving deeper into correction territory, *market liquidity* has continued to deteriorate across a broad range of markets. According to the IMF staff's high-frequency jump analysis, liquidity conditions have deteriorated meaningfully since end-February (Figure 1.5, panel 2).[3]

Stretched Asset Valuations Magnified the Speed of Asset Price Declines

13. In addition to the financial fragilities and amplifiers discussed above, the unwinding of stretched asset valuations (highlighted in previous GFSRs) likely exacerbated the sell-off. Deviations from fair value had reached extreme levels across multiple countries and sectors, before adjusting sharply in late February-March.

14. In *equity markets*, price-earnings ratios had reached the highest levels since the global financial crisis prior to the COVID-19 induced sell-off (as indicated by the percentiles in Figure 1.6, panel 1). This was partly supported by optimistic 2020 earnings-per-share (EPS) growth forecasts. The IMF staff's fundamentals-based assessment of equity price misalignments suggests that equity valuations had become increasingly stretched since the October 2019 GFSR,

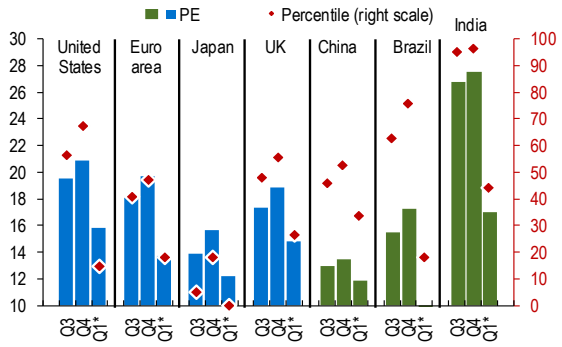
[3] The analytical framework employed here to detect liquidity stress –introduced in GFSR, October 2018 (Box 1.4 and Online Annex 1.1.) – relies on examining jumps (or discontinuities) in intraday price evolution. Price jumps can be categorized into two types: 'large' (finite activity) jumps that are linked to significant news events; or episodic series of 'small' (infinite activity) jumps. Since the virus outbreak, an increasingly larger proportion of price variation in global equity and sovereign bond markets has been attributable to discontinuities, or jumps, which are indicative of liquidity stress. See also GFSR, April 2019 (Special Feature: 'Liquidity risks in capital markets').

with the extent of overvaluation approaching historically high levels in several countries in the last quarter of 2019 (Figure 1.6, panel 3). However, after the COVID-19 shock, equity prices collapsed, wiping out a significant portion of overvaluation in many markets and sectors. Despite recent downward revisions, the latest available consensus EPS growth forecasts (Figure 1.6, panel 2) likely do not fully reflect the speed of downward adjustments, with analysts' latest forecasts, as well as the IMF staff's estimates based on market price declines, pointing to negative earnings growth in major markets in 2020.[4]

Figure 1.6. Asset Valuations: Wild Swings

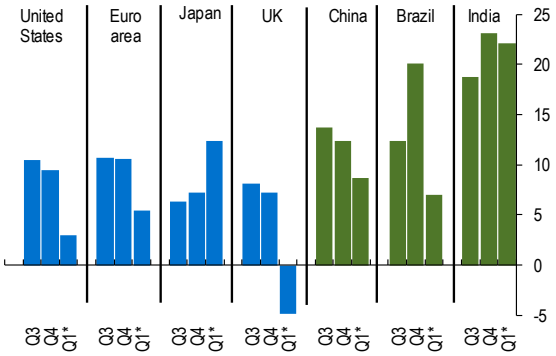
Global equity valuations adjusted as share prices collapsed …

1. Equity Markets: Price-to-Earnings Ratios
(Percent, quarterly averages, left scale; percentiles based on 2010-2020 period, right scale; Q1* = March 19)



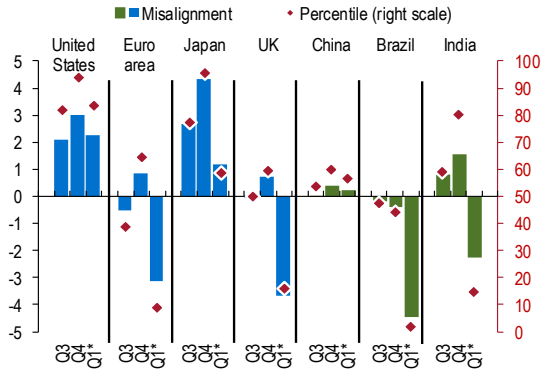
… and earnings growth prospects were downgraded.

2. 2020 Earnings per share (EPS) Growth Forecast
(Percent; Q1* = March 19)



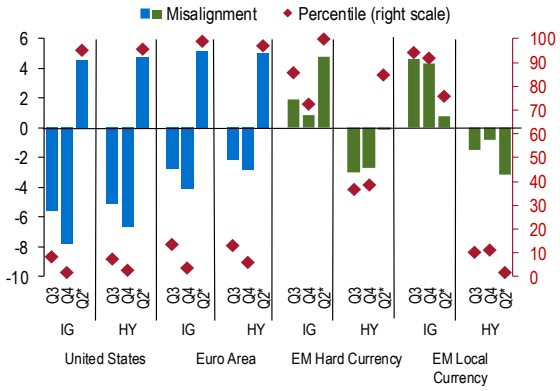
The declines in equity prices wiped out overvaluations across most equity markets …

3. Equity Markets Misalignments
(Deviation from fair value per unit of risk, quarterly averages, left scale; percentiles based on 1995–2020 period, right scale; Q1* = March 19)



…and most bond markets.

4. Bond Spread Misalignments
(Deviation from fair value per unit of risk, quarterly averages, left scale; percentiles based on 1995–2020 period, right scale; Q1* = March 19)



Sources: Bloomberg Finance L.P.; and IMF Staff Calculations.
Note: PE refers to cyclically adjusted price-earnigns ratios. In panel 3, misalignment is the difference between market and model-based values scaled by the standard deviation of monthly returns. Positive values indicate overvaluation. Intuitively, this measure indicates how many standard deviations of monthly returns (or "units of risk") it would take to get back to fair value. In panel 4, misalignment is the difference between market spread and model-based spread scaled by the standard deviation of monthly spread changes. Negative values indicate overvaluation. Intuitively, this measure indicates how many standard deviations of monthly spread changes (or "units of risk") it would take to get back to fair value.

[4] For the United States, such estimates range from -8 percent to -33 percent. The IMF staff's market-implied estimate of 12-month forward EPS growth is based on the October 2019 GFSR equity valuation model using current levels of equity prices and interest rates, the latest data on the IBES EPS earnings dispersion, and the assumption of neutral valuations.

15. In *credit markets*, corporate spreads had continued to tighten between the October 2019 GFSR and early 2020. In fact, the extent of spread misalignment—the difference between market- and fundamentals-based spreads—had increased in the US and in the euro area, as well as in high-yield corporate bond markets in emerging markets in the last quarter of 2019 (Figure 1.6, panel 4), with spreads tightening well below the levels justified by fundamentals (as shown by percentiles at the lowest end of the ranges). After the COVID-19 outbreak, most spreads have widened dramatically, wiping out most of prior overvaluations.

Emerging and Frontier Markets are Facing the Perfect Storm

16. An unprecedented combination of external shocks (COVID-19 pandemic, oil price decline, increased global risk aversion and a prospect of global recession) led to a broad-based *sell-off in emerging and frontier markets*. Emerging market equity prices have fallen by more than 30 percent since mid-January (Figure 1.7, panel 1). Currencies of commodity-producing economies (such as Brazil, Colombia, Mexico, Russia, and South Africa) tumbled by more than 15 percent against the US dollar in the first quarter of 2020 (Figure 1.7, panel 2). Currencies of other emerging markets have been relatively less affected, likely due to stronger currency interventions, as well as lower external vulnerabilities. Spreads of dollar-denominated emerging market sovereign bonds rose to nearly 700 basis points by the end of March—the highest level since the global financial crisis. But for some weaker economies, the current shock was particularly severe as the number of distressed sovereign issuers (those with spreads over 1,000 basis points) rose to record levels (Figure 1.7, panels 3 and 4). Oil-importing economies have generally fared better, but lower remittances, reduced external funding availability, and lower external demand may outweigh the positive impact of lower oil prices.

17. *Portfolio flows to emerging markets* have experienced a reversal of unprecedented scale. Nonresident portfolio outflows from emerging markets reached a record level in dollar terms (more than $95 billion since January 21), and the highest ever relative to their aggregate GDP in the first quarter of 2020 (Figure 1.8, panels 1 and 2). Outflows from equity markets were particularly strong, given their sensitivity to the growth outlook (see the forthcoming Chapter 3 in this report), as well as from Asia and Brazil (Figure 1.8, panel 2, left). But even outflows from bond markets were significant: cumulative debt outflows from emerging market bond funds in the first three weeks of March reversed all the inflows of the previous thirteen months (Figure 1.8, panel 2b, right).

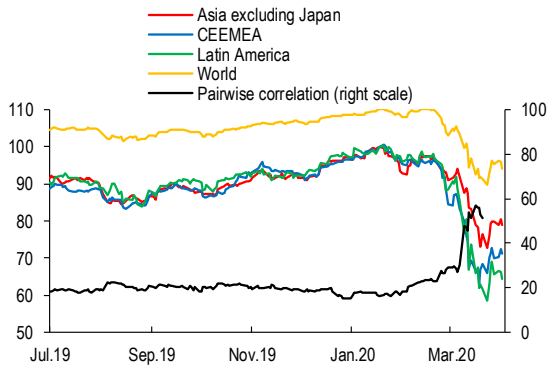
18. The *breadth of outflows*—in terms of the number of affected counties – was the largest since the global financial crisis. The depth of outflows was significant for many countries, with South Africa and Thailand witnessing outflows of more than 1 percent of GDP, in just two months. Moody's downgraded South Africa's local currency rating to sub-investment grade, raising the specter of further outflows by benchmark driven investors (see April 2019, GFSR). Retail outflows surged (Figure 1.8, panel 3), but institutional investors reportedly also had to reduce positions because of redemptions or risk limits given heightened volatility. The reversal of bond portfolio fund flows was broad-based, but relatively worse for hard currency bond funds

(Figure 1.8, panel 4). To mitigate the impact of outflows on domestic economies, country authorities have stepped up currency interventions, provided liquidity support to the bond market and to the banking system, and sought to establish swap lines with the US Federal Reserve and the ECB (see the policy section for details).

Figure 1.7. Emerging Equity and Bond Markets: Facing the Perfect Storm

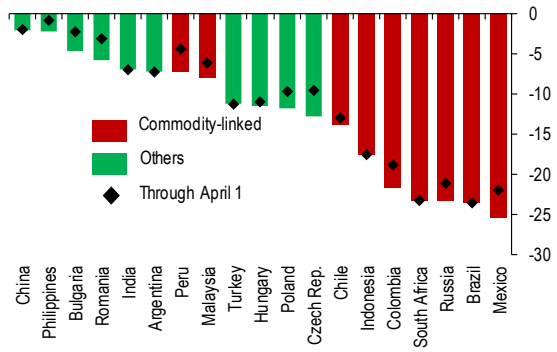
Equity markets sold off in anticipation of a sizable growth contraction …

1. Emerging Market Equity Market Performance
(Index Jan 17, 2020 = 100, and percent)



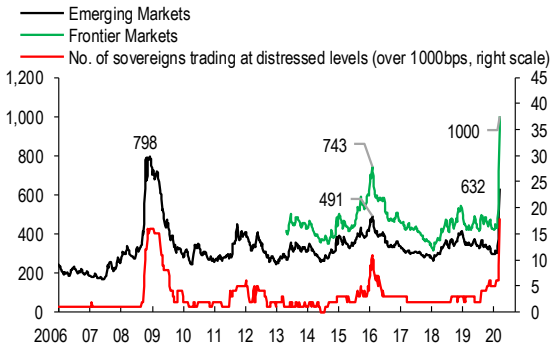
… and currencies depreciated against the US dollar, particularly for the commodity producing economies.

2. Currency Performance
(Versus dollar; percent; bars are max drawdown in Q1:2020, points are change through April 1)



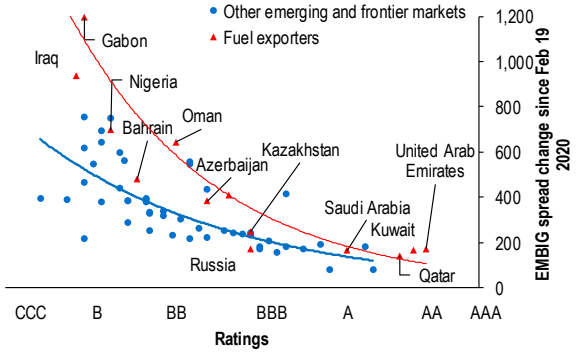
Dollar debt spreads widened to distressed levels in a record number of countries…

3. Spreads of Dollar-Denominated Debt
(Basis points, left scale; number of countries, right scale)



… and bond spreads spiked for lower-rate and oil-producing economies.

4. Spreads of Dollar-Denominated Debt and Ratings
(Basis points, sovereign ratings)

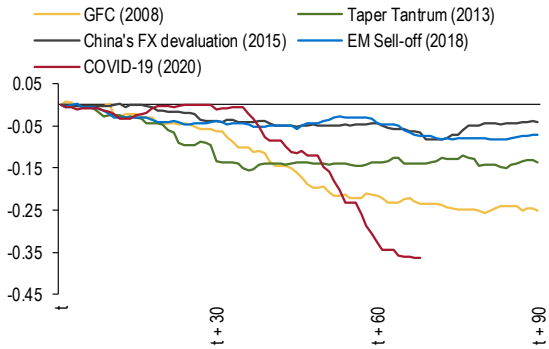


Sources: Bloomberg Finance L.P.; JPMorgan Chase & Co; and IMF staff calculations.
Note: CEEMEA = Central and Eastern Europe and the Middle East; EMBIG = JP Morgan Emerging Market Bond Index Global.

Figure 1.8. Portfolio Flows to Emerging Markets: A Big Reversal

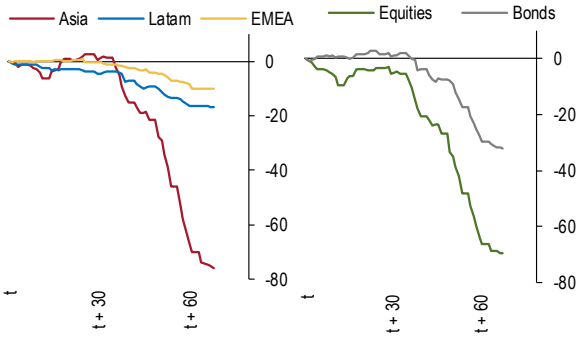
During the COVID-19 sell-off, emerging markets saw the strongest reversal since 2008 both in USD terms and relative to GDP.

1. Cumulative Nonresident Portfolio Flows to Emerging Markets (Percent of GDP, based on daily observations)



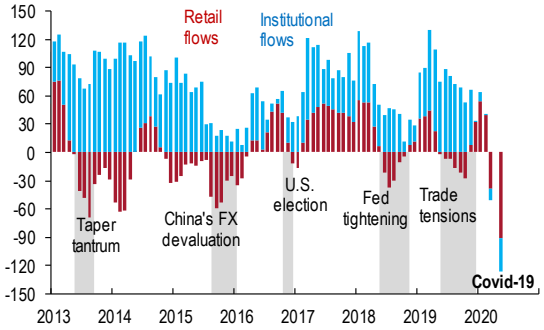
The strongest outflows were out of Emerging Asia and equity markets; debt portfolio outflows accelerated recently.

2. Cumulative Nonresident Portfolio Flows to Emerging Markets, Aggregated by Regions and Asset Classes (Billions of US dollars, based on daily observations)



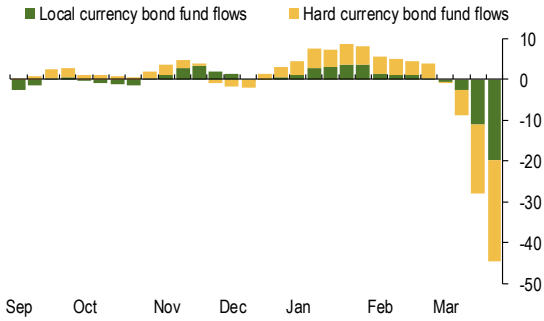
Retail fund outflows were particularly strong, while institutional investor flows also turned negative recently.

3. Estimates of Retail vs Institutional Flows (Billions of US dollars; 3-month rolling sum)



Outflows have been significant for both local and hard currency bond funds.

4. Bond Fund Flows across Categories (Billions of US dollars; 4-week rolling sum)



Sources: Bloomberg Finance L.P.; EPFR Global; Haver Analytics; Institute of International Finance; and IMF staff calculations.
Note: In panel 3, retail flows are estimated using EPFR Global data. The last bar is for February and March, adjusted for the full quarter. Economies included in panels 1 are: China, Brazil, Hungary, India, Indonesia, Korea, Mexico, Pakistan, Philippines, Qatar, Sri Lanka, South Africa, Taiwan POC, Thailand, Ukraine and Vietnam. EMEA = Europe, the Middle East, and Africa; FX = foreign exchange; GFC = global financial crisis; Taiwan POC = Taiwan Province of China.

The Sharp Tightening of Global Financial Conditions Significantly Increased Risks to Financial Stability…

19. Overall, global financial conditions, which had been easing steadily over the course of 2019 and into the beginning of 2020, tightened sharply in March 2020 (Figure 1.9, panel 1)[5]. Not only was the tightening very pronounced, but the speed was unprecedented, even compared to the global financial crisis. Falling equity prices and widening corporate spreads were only marginally offset by declines in interest rates across most advanced and emerging market economies (Figure 1.9, panel 2). Other *emerging markets* (not including China) also experienced a

[5] The values of the Financial Conditions Indices (FCIs) for Q1:2020 are based on March 2020 average.

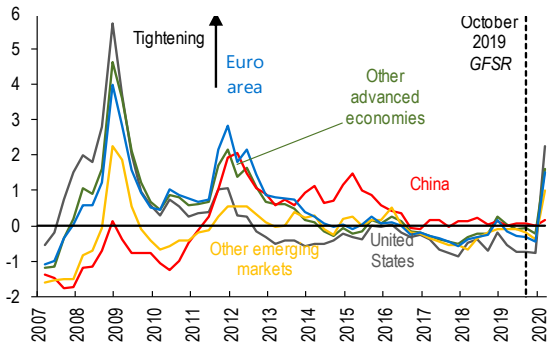
significant tightening of financial conditions mainly driven by a sharp increase in their external funding costs (Figure 1.9, panels 1 and 2).

20. *China* was the first to experience the COVID-19 outbreak. However, financial conditions in China have been broadly stable so far, in contrast with other countries (Figure 1.9, panels 1 and 2). This may have reflected, among other things, still limited external financial linkages, a strong role of government-owned financial institutions and firms, and early proactive efforts by the authorities which helped stabilize market conditions and sentiment. The central bank maintained highly accommodative interbank liquidity, directed banks to maintain corporate credit growth, and reduced policy rates. Equity markets reversed initial declines on reports about government intervention. That said, financial conditions for specific weaker segments may be worse than headline numbers suggest.

Figure 1.9. Global Financial Conditions: Getting Tighter

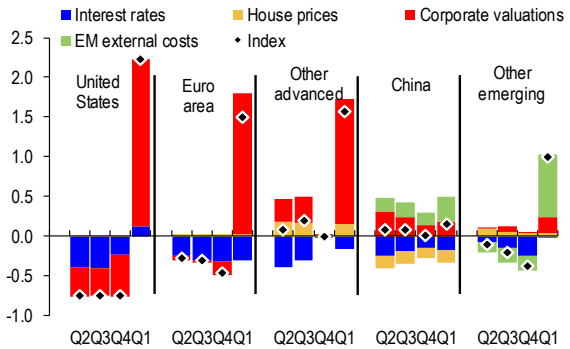
Financial conditions tightened sharply in March 2020…

1. Global Financial Conditions Indices (Standard deviations from mean)



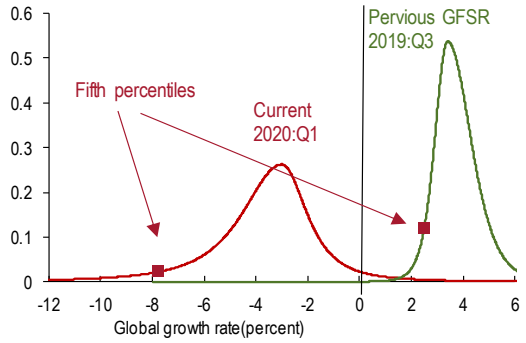
…largely driven by a very significant deterioration in corporate valuations.

2. Key Drivers of Global Financial Conditions Indices (Standard deviations from mean)



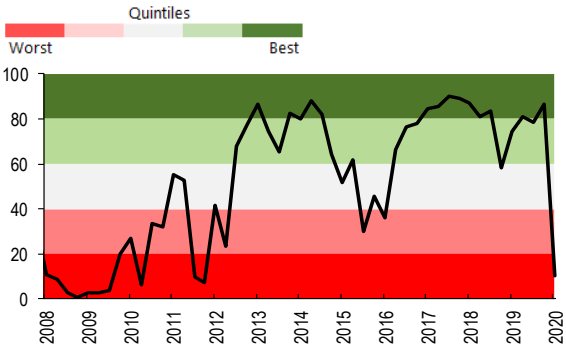
Near-term downside risks have increased sharply…

3. Near-term (2020) Growth Forecast Density (Probability density)



… approaching the levels last seen in 2008

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



Source: Bank for International Settlements; Bloomberg Finance L.P.; Haver Analytics; IMF, International Financial Statistics database; and IMF staff calculations.
Note: In panels 1–2, the 2020:Q1 = average values for March 2020. In panel 2, the interest rates component contains real short-term interest rates, term spreads or medium term interest rates, and interbank spreads. In panel 3, near-term refers to the year 2020. Forecast density estimates are centered around the WEO forecasts for 2020. In panel 4, the color of the shading depicts the percentile rank for the 5th percentile threshold (growth-at-risk) of near-term growth forecast densities from 1991 onward. See the April 2018 GFSR for details. EM = emerging market.

21. All in all, the sharp tightening of global financial conditions since the COVID-19 outbreak, together with the significant downward revision of the 2020 global growth forecast from 3.3 percent in the January 2020 WEO update to [-3.0] percent in the April 2020 WEO, shifted the near-term distribution of global growth to the left. This shift implies a significant increase in downside risks to growth and financial stability. More specifically, the one-year-ahead forecast distribution based on economic and financial conditions as of March 2020 (Figure 1.9, panel 3) indicates that there is a 5 percent probability (an event that happens once every 20 years) that global growth could fall below [-7.4] percent. For comparison, this threshold was above 2 percent in October 2019. In addition, the balance of risks is now skewed to the downside, with the odds of global growth exceeding zero this year close to only 4 percent. Compared to historical norms, the near-term growth-at-risk metric is approaching levels last seen during the global financial crisis (Figure 1.9, panel 4).[6]

22. The continued spread of COVID-19 globally may require imposition of tougher and longer-lasting containment measures, which might lead to a further tightening of global financial conditions (see the Scenario analysis box in the April 2020 WEO). Furthermore, as the policy space becomes more limited, investors may start doubting policymakers' ability to deal with the crisis. For emerging and frontier markets, authorities may find it challenging to contain destabilizing effects of a sharp reversal of portfolio flows on domestic financial markets. A widespread distress of banks and other financial institutions could lead to a permanent scarring of balance sheets, which may further delay the recovery.

A Further Tightening of Financial Conditions May Expose Financial Vulnerabilities in Banks and Other Financial Institutions

23. While events are still unfolding, both the extent and the speed of tightening in financial conditions have exposed some "cracks" in global financial markets. Although there have been no runs on banks or failures of nonbank financial institutions so far, a prolonged period of dislocation in financial markets may result in distress among asset managers, banks, or other financial institutions to an extent that could lead to a credit crunch for nonfinancial borrowers.

24. Financial vulnerabilities have been elevated in some systemically important economies before the outbreak of COVID-19 (Figure 1.10)[7], and they may become exposed should financial conditions continue to tighten:

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[6] The growth-at-risk (GaR) framework assesses the downside risks to financial stability by gauging how the range of severely adverse growth outcomes (5th percentile of the growth distribution) shifts in response to changes in financial conditions and vulnerabilities (see Chapter 3 of the October 2017 GFSR for details). Assumptions pertaining to policy responses or macroeconomic shocks are captured in the GaR framework to the extent that they affect the current economic and financial conditions, or the baseline growth forecast.

[7] This assessment is based on the methodology introduced in the April 2019 GFSR, which covers 29 jurisdictions with systemically important financial sectors. In this GFSR, other nonbank financials have been split into asset managers and other financial institutions to help better track

- Vulnerabilities are elevated in *sovereigns* and *nonfinancial firms*, reflecting high levels of debt. Nonfinancial corporate sector vulnerabilities are significantly higher now than in 2008-09, implying that a prolonged period of negative growth and elevated cost of funding could lead to a large-scale corporate distress (see the corporate debt-at-risk analysis in Chapter 2 of the October 2019 GFSR).
- Vulnerabilities remain high among *asset managers*, and close to the levels seen during the global financial crisis, as discussed in the October 2019 GFSR. Asset managers in several countries (notably, the United States and China) entered the COVID-19 crisis with higher leverage, maturity and liquidity mismatches. In the euro area and other advanced economies, vulnerabilities are somewhat lower, on aggregate, than in other regions.
- *Bank* vulnerabilities continue to be high in China and other emerging market economies, as well as in the euro area. While banks have more capital now than in 2008, their balance sheets could be strained by market and credit losses. This is reflected in market pricing, which suggests there is a risk of sizable depletion of bank capital.
- In the *global insurance sector*, vulnerabilities appear to be less pronounced in aggregate than in other sectors but are still high in some countries and regions. In the United States, insurers face elevated liquidity mismatches and credit risk, while in other advanced economies insurers also tend to have currency mismatches. In the euro area, vulnerabilities in the insurance sector are relatively moderate overall, but leverage and credit risks are elevated. Chinese insurers operate with high liquidity mismatches.

Pressures on Asset Managers May Lead to Fire Sales

25. *Asset managers* may be forced to sell assets, thus amplifying asset price declines. Since the virus outbreak, investment funds have faced massive portfolio losses (Figure 1.11, panel 1). This led to concerns about actual and anticipated redemptions, especially in the case of fixed-income funds (Figure 1.11, panels 2). Cash buffers, which typically serve as a first line of defense against redemptions, are estimated at about 7 percent of assets for an average open-ended fixed-income fund (see October 2019 GFSR), and even lower for some riskier credit funds (see the forthcoming Chapter 2 of this report). Outflows, while on aggregate still smaller than cash buffers, could, if they continue or accelerate, exhaust these buffers and force the sale of other high-quality liquid assets. The latter would reinforce price declines in investment grade bond markets. These pressures, however, may be partly mitigated by liquidity management

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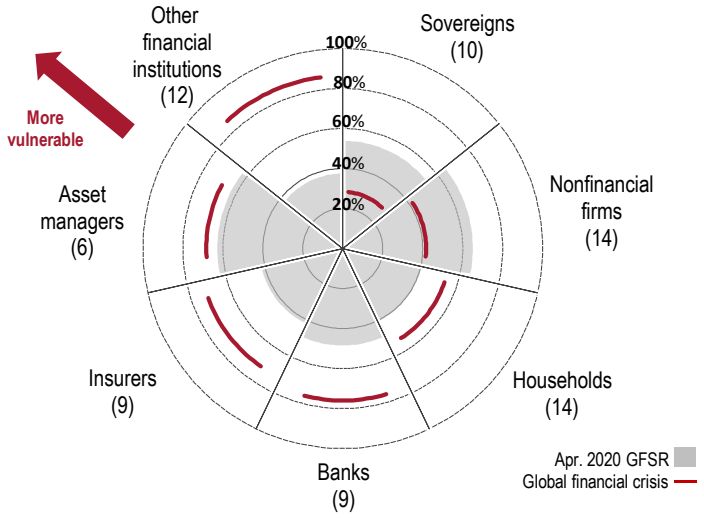
the evolution of vulnerabilities in different parts of this large and diverse sector. Asset managers include all collective investment schemes for which sectoral data are publicly available. For Brazil fund-level data have been aggregated for this purpose. For China the category includes investment funds, trusts and the off-balance sheet wealth management products of banks, securities companies and insurers. The other financial institutions category can include broker dealers, merchant banks, securitization vehicles, finance companies, holding companies, funding companies, credit guarantors, multipurpose nonbank financial corporations, custodians, and different forms of nonbank lending institutions and/or residual aggregates for non-bank financial companies excluding investment funds, pension funds and insurers.

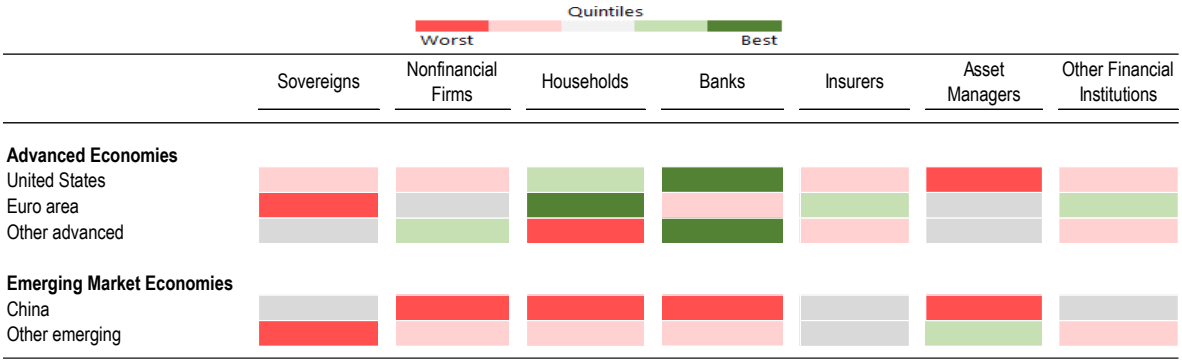
Figure 1.10. Global Financial Vulnerabilities: Pre-Existing Conditions

Vulnerabilities are elevated in the corporate and sovereign sectors as global nonfinancial debt has reached new highs, while asset managers have taken on more risks in the low-yield environment.

1. Proportion of Systemically Important Countries with Elevated Vulnerabilities, by Sector (Percent of countries with high and medium-high vulnerabilities, by GDP [assets for banks, asset managers, other financial institutions and insurers]; number of vulnerable countries in parentheses)



2. Financial Vulnerabilities by Sector and Region



Sources: Banco de Mexico; Bank for International Settlements; Bank of Japan; Bloomberg Finance L.P.; China Insurance Regulatory Commission; European Central Bank; Haver Analytics; IMF, Financial Soundness Indicators database; Reserve Bank of India; Securities and Exchange Commission of Brazil; S&P Global Market Intelligence; S&P Leveraged Commentary and Data; WIND Information Co.; and IMF staff calculations.

Note: In panel 1, global financial crisis reflects the maximum vulnerability value from 2007–08. In panel 2, dark red shading indicates a value in the top 20 percent of pooled samples (advanced and emerging market economies pooled separately) for each sector from 2000–18 (or longest sample available), and dark green shading indicates values in the bottom 20 percent. In panels 1 and 2, for households, the debt service ratio for emerging market economies is based on all private nonfinancial firms. Other systemically important advanced economies comprise Australia, Canada, Denmark, Hong Kong Special Administrative Region, Japan, Korea, Norway, Singapore, Sweden, Switzerland, and the United Kingdom. Other systemically important emerging market economies comprises Brazil, India, Mexico, Poland, Russia, and Turkey.

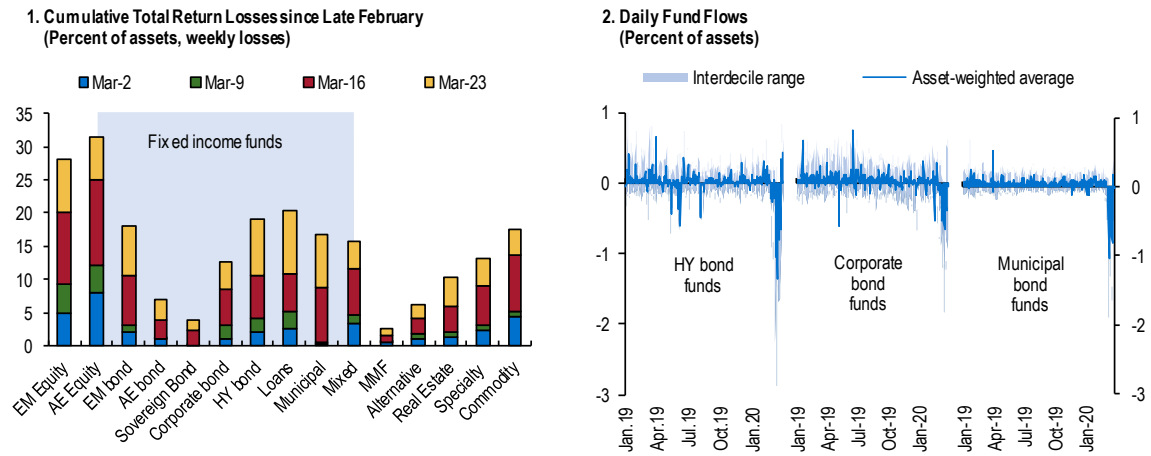
A number of methodological changes have been introduced in this GFSR for *the other nonbank financial sector*: (1) country-specific data series for 10 individual euro area countries have been added to the dataset for other financial institutions and asset managers, complementing respective euro area aggregate data; (2) country-level data are aggregated to regional totals using asset based weights, rather than GDP; (3) the euro area dataset has been expanded to include data on nonbank financial institutions beyond securitization vehicles; and (4) a new indicator measuring the gross derivative exposures has also been added. For *insurers*, the country-specific data series for 10 individual euro area countries (Austria, Belgium, France, Finland, Germany, Ireland, Italy, Luxembourg, Netherlands, Spain) were added to the dataset for insurers. Previously, the assessment of the euro area insurers was based on the data at the euro area level. A new indicator of profitability was also added. In the computation of the regional and global aggregates, the GDP-based weights were replaced by total assets-based weights.

mechanisms used by investment funds (including the tapping of credit lines), as well as by central bank purchases of corporate bonds and by liquidity facilities offering relief for money market funds (see the policy section).

Figure 1.11. Investment Funds: Worries About Losses and Redemptions

As asset prices declined, investment funds' losses began to mount

Fixed income funds – especially those exposed to risky credit market segments – faced rapidly growing outflows



Sources: Bloomberg Finance L.P.; Morningstar; and IMF staff calculations.
Note: Panel 2 reports estimated daily net flows for a sample of fixed income funds with assets over $700 million. Flow rates have been winsorized at an absolute value of 50 percent.

26. Anticipation of weaker liquidity conditions may have led some funds to de-risk portfolios early by selling less liquid and lower rated credit assets with the aim of strengthening the liquidity of their remaining portfolios. These actions may have initially exacerbated price declines in riskier markets. A further deterioration in market conditions could in turn lead to more redemption pressures, especially for funds with low liquidity buffers or a particularly price-sensitive investor base. So far, there have been very few suspensions of investor redemptions. In the United Kingdom, several property funds were gated, locking in at least $10.5 billion in assets, while one of the country's bigger property funds has been gated since December 2019. Market reports suggest that some smaller European bond funds were suspended as well, but most of these suspensions were lifted within days.[8]

[8] Bloomberg Finance L.P. reported on March 20, 2020 on redemptions halts for Swedish funds and the FT reported on March 22 on suspensions of Nordic funds.

Banks Could Act as an Amplifier Should the Crisis Deepen Further

27. In 2007-08, a sharp cut back in bank lending, due to liquidity strains and losses at banks, exacerbated the impact of the global financial crisis on the economy. There is a danger that this could be repeated. Banks are already facing sharply rising wholesale funding costs, despite the steps taken by central banks to provide liquidity (Figure 1.12, panel 1). Some large companies are drawing on lines of credit from banks, adding to pressures on banks' balance sheets. Total undrawn lines of credit amounted to $1.8 trillion at the end of 2019 for a sample of almost 400 banks headquartered in G7 economies—some 35 percent of risk-weighted assets (Figure 1.12, panel 2). The prospect of large draws on lines of credit may impair banks' ability or willingness to maintain the flow of credit to the economy. Reports from market contacts suggest that this is leading some banks to hoard liquidity rather than provide it to other institutions in the market.

28. Investors appear to be increasingly concerned about both mark-to-market and credit losses at banks:

- The declines in asset prices are expected to lead to losses on banks' portfolios of risky securities, though this could be partly offset by gains on their holdings of safe-haven assets. For example, strains are already emerging in the commercial real estate sector, with US commercial mortgage-backed security spreads widening by about 300 basis points since mid-February (Figure 1.13, panel 1). Furthermore, increases in bond yields for some highly indebted governments may lead to a reemergence of the sovereign-financial sector nexus in some jurisdictions[9].
- The longer the sudden stop in economic activity continues, the more likely it is that banks will see credit losses on their lending to households and companies. Bank credit accounts for a significant portion of lending to commercial real estate, ranging from about 50 percent to 70 percent of debt in this sector (Figure 1.13, panel 2). The fall in the oil price has put energy companies under additional pressure, and banks could also see credit losses on loans to these firms. Finally, banks may also face losses on indirect exposures, through their lending to households that are employed in vulnerable sectors.

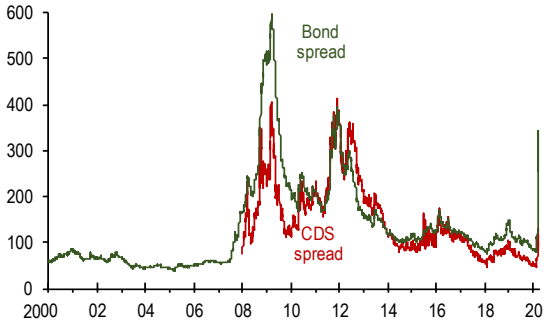
29. The higher levels of capital buffers built since the global financial crisis will help banks to absorb losses. Average Tier 1 capital ratios across economies with large financial systems are more than 400 basis points higher than they were at the end of 2007 (Figure 1.12, panel 3). In addition, greater holdings of liquid assets should also enable banks facing funding problems to raise cash. The substantial and coordinated action by central banks to provide liquidity to banks in many economies, including in repo (repurchase) operations and dollars via central bank swap lines, should also help alleviate liquidity strains (see the policy section). However, the low level of bank profitability in some advanced economies (as discussed in the forthcoming Chapter 4 of this report) means that banks will have less income available to offset losses than in the past.

[9] See the April 2019 GFSR for a discussion of the sovereign-bank nexus in the euro area.

Figure 1.12. Banks in Large Economies: Resilience Tested

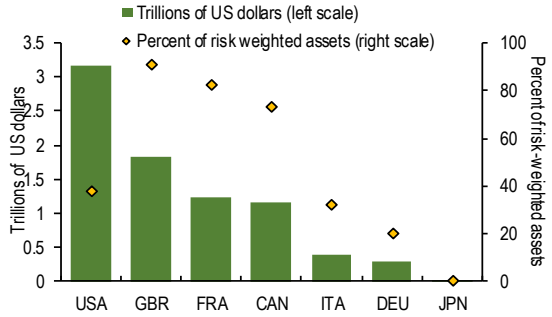
Banks are facing a sharply higher wholesale funding costs …

1. Global Bank Funding Spreads (Basis points)



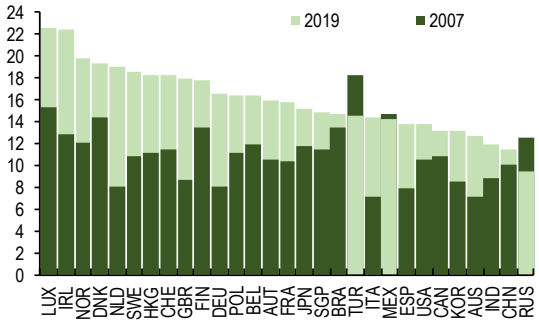
… and calls on lines of credit are adding to liquidity strains.

2. Bank Loan Commitments, End-2019



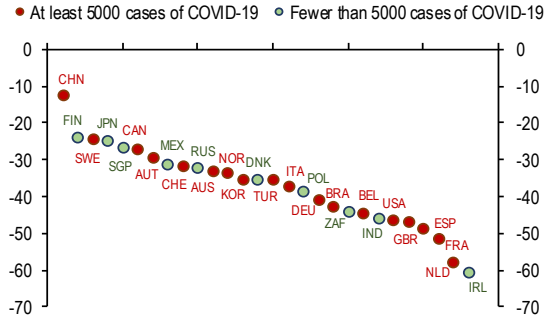
Banks now have more capital to absorb losses …

3. Banking System Tier 1 Capital Ratios (Percent)



… but sharp falls in bank equity prices …

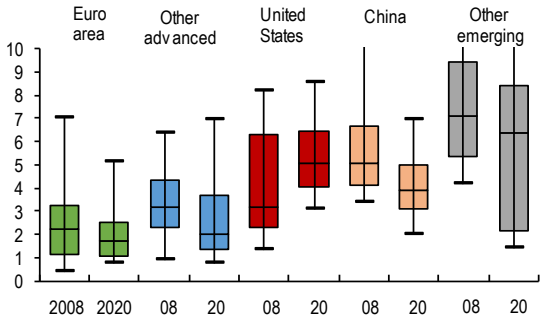
4. Change in Bank Equity Prices (Percent change since January 17)



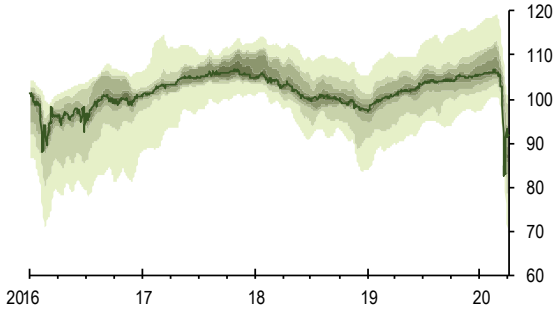
… low market valuations in some economies …

… and falls in contingent convertible bonds suggest that investors remain concerned about banks' prospects.

5. Market-Adjusted Bank Capitalization (Percent)



6. Bank Contingent Convertible Bond Prices (Cents on the dollar)



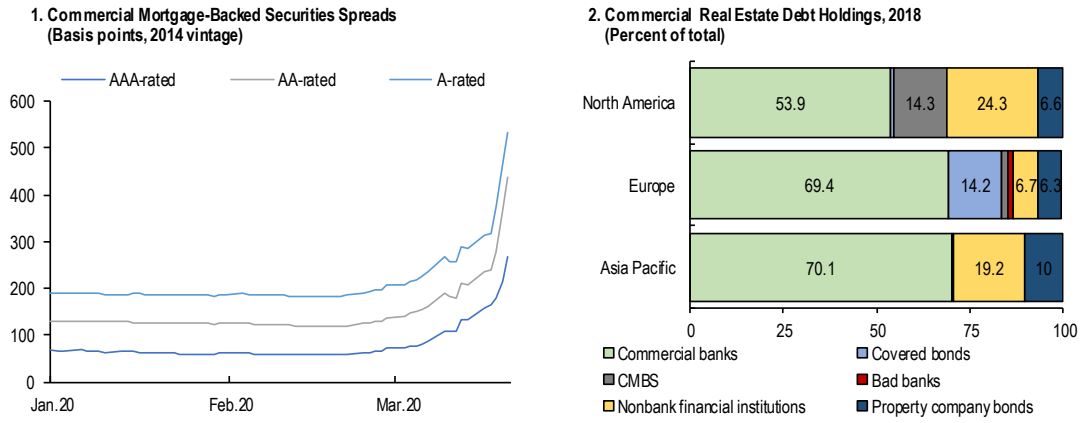
Sources: Bloomberg Finance L.P; Datastream; Haver Analytics; S&P Global Market Intelligence; SNL Financial; IMF Financial Soundness Indicators database; and IMF staff calculations.

Note: In panel 1, the global credit default swap (CDS) spread is the average of indices for Asia, Europe, North America, and the United Kingdom. Panel 2 is based on a sample of about 400 banks from the seven economies shown in the panel. Commitments include only irrevocable commitments where disclosed, and total reported commitments otherwise. Most banks either distinguish between revocable and irrevocable commitments, or include only revocable commitments. Panel 4 shows the average change in equity prices of bank in each country. Panel 5 shows the range of market-adjusted capitalization of individual banks in each economy. Market-adjusted capitalization is calculated as the product of tangible common equity and the minimum of the price-to-book ratio and 1, all as a percentage of tangible assets (which are adjusted for derivatives netting at US banks). The box shows the 25th to 75th percentile, the vertical lines show the 5th to 95th percentile, while the horizontal lines shows the 50th percentile. The vertical axis in panel 5 has been set to a maximum of 10 percent to aid presentation. Panel 6 shows the 5th to 95th percentile of prices across indices for banks in economies with large financial systems, where data are available. In panels 2, 3, and 4, data labels use International Organization for Standardization (ISO) country codes. Cocos = contingent convertible bonds.

Figure 1.13. Commercial Real Estate and Commercial Mortgage-Backed Securities: Widening Spreads and Increased Exposure to Real Estate Debt

Spreads of commercial mortgage-backed securities have widened significantly over the past two months …

… and banks have significant exposures to commercial real estate debt.



Sources: Bloomberg Finance L.P; Cushman & Wakefield (Money Into Property report); and IMF staff estimates.
Note: In panel 2, no number labels are included for amounts less than 2 percent. Totals do not add up to 100 due to rounding. CMBS = commercial mortgage-backed securities.

30. The large declines in bank equity prices since mid-January suggest that investors are still concerned about bank resilience. Equity prices fell by about 35 percent on average over this period and by up to 60 percent in some countries (Figure 1.12, panel 4). If market valuations were used to calculate capital ratios at banks, instead of book values, many banks would appear to have weak capitalization—similar to levels during the global financial crisis (Figure 1.12, panel 5). Median market-adjusted capitalization is now higher than in 2008 only in the United States. Declines in the prices of contingent convertible bonds (cocos) also suggest some concerns among investors about pressures on bank balance sheets and potential fear about solvency issues (Figure 1.12, panel 6).[10] These considerations underscore the need for decisive policy action to prevent problems at banks leading to a sharp reduction in lending at a time when economic activity is already weak.

Insurance Companies May Suffer Losses

31. Pressures have also been rising for *insurance companies*, limiting their ability to play their traditional countercyclical role. The shares of insurers in major jurisdictions have been hit hard, with most experiencing declines of over 30 percent so far in 2020 (Figure 1.14, panel 1).[11] Their credit default swap spreads also widened alongside those of other financial corporations.

[10] Contingent convertible instruments are bonds that convert into equities if bank indicators, such as capital ratios, breach certain triggers.

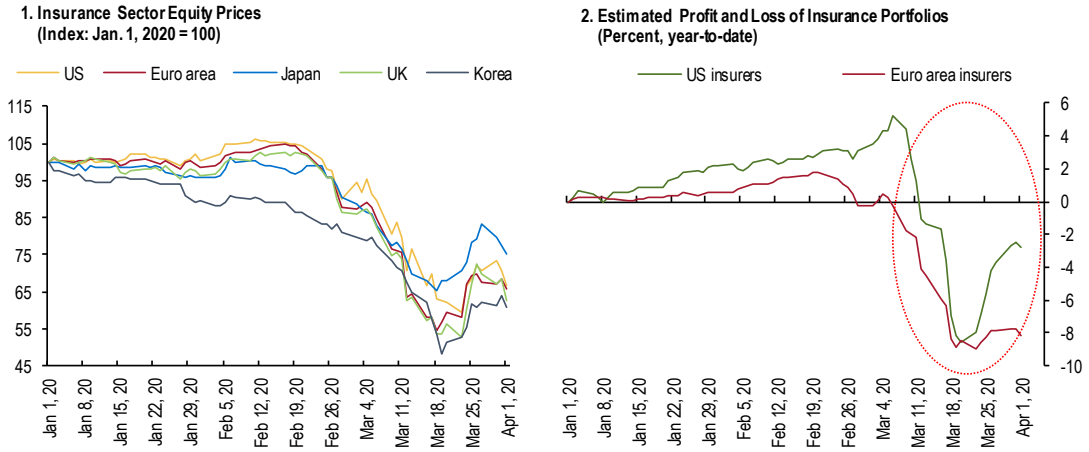
[11] The United States, euro area, Japan, the United Kingdom and Korea are five of the largest insurance jurisdictions, accounting for about two-thirds of life premium volumes globally.

32. The shares of insurance companies have underperformed broader equity indices since the second week of March, when the widening of corporate credit spreads accelerated, and government bond yields started to rise (particularly in the euro area and emerging markets). Because the portfolios of insurance companies are heavily skewed towards long term sovereign and corporate bonds, heavy losses on fixed income investments have weighed on their portfolio returns, particularly for euro-area insurers (Figure 1.14, panel 2).[12]

Figure 1.14. Insurance Companies: Falling Equity Prices and Lower Returns

The shares of global insurers have been hit hard …

…with insurance investment portfolios suffering large losses across fixed income and equity exposures



Sources: Bloomberg Finance L.P.; Haver Analytics ; European Insurance and Occupational Pensions Authority; National Association of Insurance Commissioners; and IMF staff calculations.
Note: The estimated year-to-date performance of US and Euro-area insurance portfolios in Panel 2 is meant to serve as an illustration of gross portfolio returns, and does not reflect accurately the performance of the portfolios of each insurance company. The estimation uses broad aggregate data for the exposures of insurance portfolios in both jurisdictions as of Q3 2019. For simplification, it excludes all non-fixed income and equity investments. It also assumes that all euro-area insurers are invested in the broad Bloomberg Barclays indices for each sector (sovereigns and credit) in the euro-area and the Euro Stoxx 50 index. For the US, Bloomberg Barclays indices and the S&P 500 index are used as proxy.

33. In addition, insurers' bond holdings may be subject to credit downgrades. For example, US insurers are estimated to have over $40 billion of BBB credits at risk of downgrade to sub-investment grade.[13] While this is less than 2 percent of their corporate bond investments, further increases in corporate bond downgrades could increase losses as well as capital requirements for insurers.[14] Some supervisors have already made use of available flexibility in the current framework to mitigate the impact of these shocks on insurers to preserve their operational viability (see the policy section).

[12] This refers to the estimated mark-to-market losses on the investment portfolios of insurers. The ultimate impact of these shocks on insurers will, however, be alleviated somewhat by regulatory mechanisms that can be activated in periods of market stress (see the policy section).

[13] As of March 17, 2020 (Source: CreditSights).

[14] Derivative exposures could also come under pressure and subject insurers to further losses. For example, large life insurers can hold derivatives to hedge the guarantees provided by their variable annuity businesses.

Prolonged External Pressures Will be A Test for Emerging and Frontier Markets

34. The sudden stop in economic activity and portfolio outflows, together with the oil price shock, represent a severe stress test for many emerging and frontier market economies, especially as many of them entered the COVID-19 crisis with weaker initial conditions than in 2008:

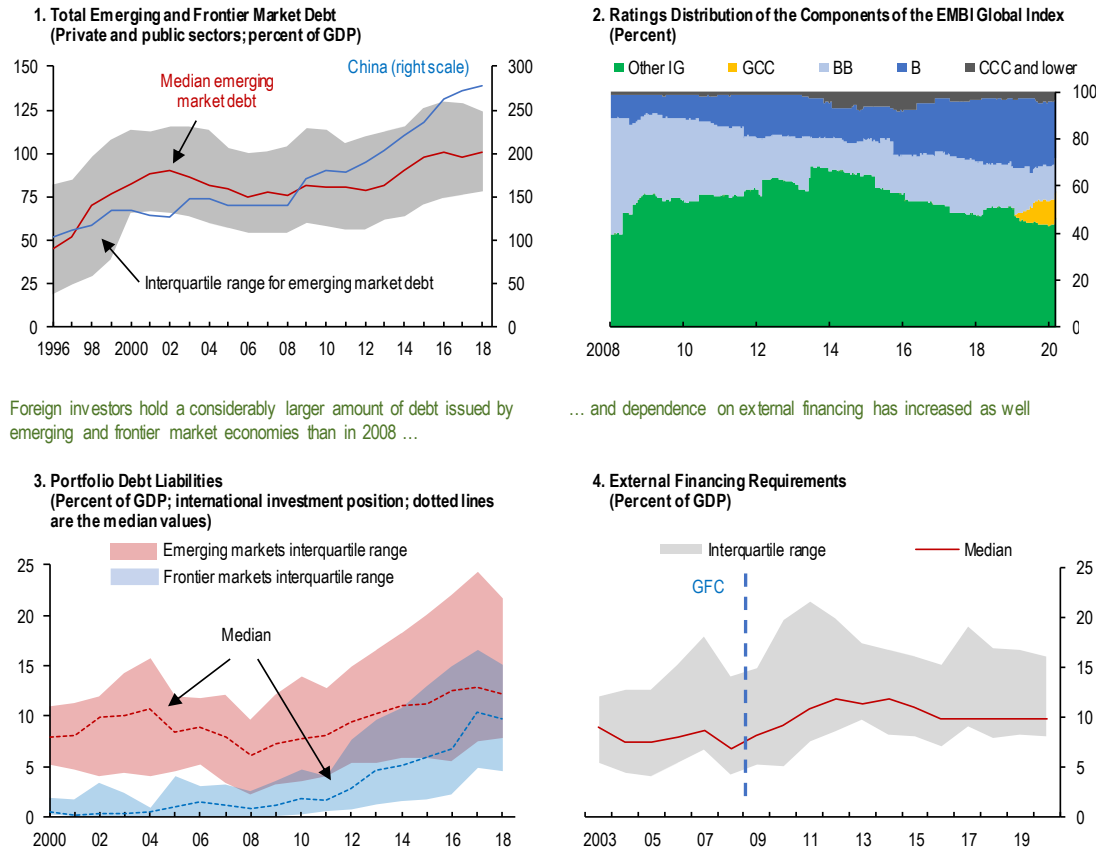
- First, emerging market bond issuers are much more levered now than they were in 2008 (see Figure 1.15, panel 1), and they include new issuers with a larger dependence on oil and other commodities (Gulf Cooperating Council member countries), as well as lower-rated issuers (such as frontier markets—see Figure 1.15, panel 2).

- Second, many major emerging market economies have less policy space. Real policy rates in most emerging market economies are now lower than before 2008, especially for those with traditionally much higher interest rates (such as Brazil). Fiscal policy space is generally more constrained as well, with debt at significantly higher levels (as in China, South Africa and Brazil) and wider structural budget deficits.

- Third, many of the emerging market and frontier economies are now much more reliant on foreign portfolio investors and external funding more generally than in 2008-09 (Figure 1.15, panel 3 and 4; also see the forthcoming Chapter 3 of this report for details).

35. The *key vulnerabilities* of major emerging and frontier market economies, given the current constellation of shocks, are highlighted in Figure 1.16, panel 1. The sharp decline in economic output and sudden increase in borrowing costs could hurt economies with limited fiscal space, high financing needs or external financing vulnerabilities, which include Brazil, Chile, Colombia, Egypt, Hungary, India, South Africa, and Turkey. Additionally, economic output decline is also likely to be meaningful for Mexico, Thailand and Russia. Oil exporters are at risk, given the nearly 60 percent price collapse in the first quarter of 2020, with Colombia, Nigeria, Russia, and Saudi Arabia being most exposed. In response, Colombia, Mexico, South Africa, and several Middle Eastern Economies were downgraded or put on negative outlook by rating agencies. However, some economies have large foreign currency reserves and other buffers, that can be used to absorb these shocks. In addition, some of the systemic state-owned enterprises have become more vulnerable due to lower oil prices (e.g. Mexico's Pemex) or to weaker electricity demand (e.g. South Africa's Eskom) as well as higher funding costs (also see October 2019 GFSR).

Figure 1.15. Emerging and Frontier Markets: 2008 versus 2020



Sources: Bloomberg Finance L.P.; JPMorgan Chase & Co; and IMF staff calculations.
Note: Panel 1 is based on 59 emerging market countries. In panel 3, frontier and emerging market samples include 30 countries each. Panel 4 is based on 20 large emerging market countries.

36. Countries where banks have high non-performing loans, significant exposures to state-owned enterprises, and large holdings of government bonds are vulnerable to an intensification of the sovereign-financial sector feedback loop. For example, in *India*, where non-bank financial institutions had already been under intense funding pressure, following two defaults before the COVID-19 shock, state-owned banks have sizable stock of bad loans and significant links to non-bank financial institutions. Other countries, notably African economies, may be vulnerable to disruptions in trade financing that can also arise if cross-border funding and correspondent banking relations become affected.

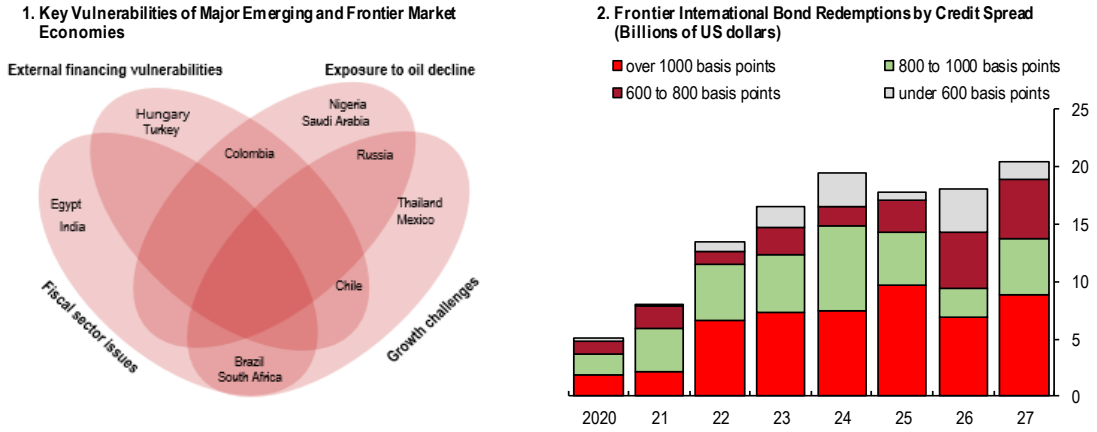
37. In *China*, vulnerabilities are particularly elevated in the corporate, banking and shadow-banking sectors (as discussed in previous GFSRs, and also shown in Figure 1.10). The ongoing health crisis and a significant growth slowdown could increase financial stress through several channels. First, the balance sheets of small and medium-sized banks will likely weaken further as their limited capacity to support their vulnerable small and private borrowers increases distress among these firms. Second, credit and liquidity risks are rising for the large and heavily indebted property developer sector, which is under heightened pressure due to dollar funding strains and the sharp slowdown in sales. Third, outflows from nonbank financial institutions, some of which operate with significant liquidity and maturity mismatches and often high leverage, could be set off by slumping equities prices, rising bond defaults, or further weakening of investor confidence.

38. In *frontier market economies,* the fears of global recession pushed borrowing spreads to their highest levels since 2008, at a time when rollover needs are set to rise in many of these countries (Figure 1.16, panel 2). Debt restructuring is underway in Argentina, Ecuador, Lebanon and Zambia. Frontier markets often lack financial depth and have a shallower domestic investor base which can impair monetary policy transmission and compound market pressures in times of stress (see forthcoming Chapter 3 of this report).

Figure 1.16. Main Vulnerabilities of Emerging and Frontier Market Economies

Emerging market economies show vulnerabilities along critical dimensions.

Frontier market bond spreads are near or at record high levels, with some issuers facing sizable debt rollovers in the coming years.



Sources: Bloomberg Finance L.P.; JPMorgan Chase & Co; and IMF staff calculations.
Note: In Panel 1, the countries with elevated vulnerabilities are identified as the ones which are in the bottom quartile when ranked across the multiple indicators in each category. Indicators in the fiscal sector include central govt balance (share of GDP), public debt (share of GDP) and gross financing needs (share of GDP). Indicators in the external sector include current account balance (share of GDP), short-term debt to remaining maturity (share of GDP), external debt (share of GDP), foreign holdings of government debt (share of total) and IMF's reserve adequacy metric. Exposure to oil decline is based on oil balance as a share of GDP. Growth challenges are highlighted for the countries where GDP is expected to contract by more than 5 percentage points year-on-year in 2020.

Policy Priorities

What has been done so far?

39. The COVID-19 pandemic has required urgent measures to address health concerns, preserve the stability of the global financial system and protect the productive capacity of the economy (also see the *April 2020 WEO*). Country authorities have provided timely, temporary, targeted fiscal measures, including additional support for health agencies, wage subsidies, cash payments to citizens, government-funded paid sick and family leaves, expanded unemployment benefits and deferral of tax payments (see the *April 2020 Fiscal Monitor)*. Country authorities have taken actions to support firms and individuals facing payment difficulties through loan moratoria, restructuring of loan terms or credit guarantees for loans. Several countries have expanded loan programs, including guarantees, for financing small and medium-size enterprises (SMEs)[15] (see Table 1.1).

40. *To preserve the stability of global financial system*, central banks have been the first line of defense in leaning against the tightening in financial conditions. Decisive monetary policy actions have been taken in three main areas (Table 1.1).

- First, central banks have significantly *eased monetary policy*, including by cutting policy rates by 50-150 basis points in 12 jurisdictions as well as by expanding their asset purchase programs to put downward pressure on long-term interest rates and mitigate a rise in long-term borrowing costs for households and firms.
- Second, they have provided *additional liquidity* to banking systems, including by lowering bank reserve requirements, easing collateral terms, upsizing liquidity repo operations and extending the term of such operations.[16] Some country authorities activated or enhanced programs to provide funding support to banks.[17]
- Third, a number of central banks have agreed to *enhance the provision of US dollar liquidity* through swap line arrangements to ameliorate tighter conditions in the global US dollar funding market.[18]

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[15] For example, the Bank of England introduced several loan schemes (such as Coronavirus Business Interruption Loan Scheme ("CBILS") and a new Term Funding Scheme with additional incentives for SMEs ("the TFSME") to support SMEs.

[16] For example, the Federal Reserve is currently offering up to $500 bn in overnight repo twice a day. In addition, they plan to conduct regular term operations offering up to $45 bn in 2-week repo and up to $500 bn each in 1-month and 3-month repo.

[17] For example, the ECB has made the terms of its targeted longer-term refinancing operations (TLTROs) more favorable, raised the borrowing allowance to 50 percent of the stock of a bank's eligible loans, and reduced lending performance threshold to 0 percent. For further details, see https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312_1~39db50b717.en.html. Bank of England has also provided a term funding facility to banks see https://www.bankofengland.co.uk/markets/market-notices/2020/term-funding-scheme-market-notice-mar-2020

[18] On March 15, the Bank of Canada, European Central Bank, the Bank of England, the Bank of Japan, and Swiss National Bank, started offering USD with 84-day term, in addition to the existing 1-week operation. On March 19, the Federal Reserve announced the establishment of temporary US dollar swap lines with nine central banks including four emerging economies.

Table 1.1. Monetary and Financial Policy Responses to COVID-19
(In 29 Jurisdictions with Systemically Important Financial Sectors)

	Advanced Economies																						Emerging market economies						
	Euro area										Other Europe					N. America		Asia-Pacific											
	AUT	BEL	FRA	FIN	DEU	IRL	ITA	LUX	NLD	ESP	DNK	NOR	SWE	CHE	GBR	CAN	USA	AUS	HKG	JPN	KOR	SGP	CHN	BRA	IND	MEX	POL	RUS	TUR
Monetary policies																													
1. Policy rate cuts (basis points)	—	—	—	—	—	-	—	—	—	—	-	125	50	-	65	150	150	50	100	-	50	-	30	50	75	50	50	-	100
2. Central bank liquidity support	—	—	—	—	Y	—	—	—	—	—	Y	Y	Y	Y	Y	Y	Y	Y	-	Y	Y	-	Y	Y	Y	Y	Y	Y	Y
3. Central bank swap lines	—	—	—	—	Y	—	—	—	—	—	Y	Y	Y	Y	Y	Y	Y	Y	-	Y	Y	Y	-	Y	-	Y	-	-	-
4. Central bank asset purchase schemes	—	—	—	—	Y	—	—	—	—	—	-	-	Y	-	Y	Y	Y	Y	-	Y	-	-	-	-	-	-	Y	-	-
External policies																													
1. Foreign currency intervention	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	Y	-	Y	Y	Y	-	Y	Y
2. Capital flow measures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Financial policies for banks																													
1. Easing of the countercyclical capital buffer (basis points)	-	50	25	-	25	100	-	-	-	-	100	150	250	200	100	-	-	-	100	-	-	-	-	-	-	-	-	-	-
2. Easing of systemic risk or capital conservation buffer	-	-	-	Y	-	-	-	-	Y	-	-	-	-	-	-	Y	-	-	-	-	-	-	-	-	-	-	Y	Y	-
3. Use of capital buffers or easing of provisioning requirements	—	—	—	—	Y	—	—	—	—	—	-	Y	-	Y	Y	Y	Y	Y	-	Y	-	-	Y	Y	-	-	-	Y	-
4. Use of liquidity buffers	—	—	—	—	Y	—	—	—	—	—	Y	Y	Y	Y	-	Y	-	-	-	Y	-	-	Y	-	-	-	-	Y	Y
Financial policies for borrowers																													
1. State loans or credit guarantees	Y	Y	Y	Y	Y	-	Y	-	Y	Y	-	Y	-	Y	Y	Y	-	Y	Y	Y	Y	-	Y	-	-	-	-	Y	-
2. Restructuring of loan terms or moratorium on payments	-	Y	Y	Y	-	Y	Y	-	-	Y	-	Y	Y	-	-	Y	Y	Y	Y	-	Y	Y	Y	-	-	-	Y	Y	Y

Source: IMF staff.
Note: The table shows policy measures for 29 economies with systemically important financial sectors. The table does not include details on all of the central bank facilities that have been introduced, but rather groups them under 'central bank liquidity support' or 'central bank asset purchases'.
For more details, see www.IMF.org/COVID19policytracker

41. To enhance the liquidity and functioning of *short-term funding markets* as well as to maintain the *flow of credit to the broader economy,* several central banks launched facilities to support a number of markets, including commercial paper, corporate bonds, and asset-backed securities. By effectively stepping in as "buyers of last resort" in these markets and setting an upper limit on the cost of credit, central banks aim to ensure that households and firms continue to have access to credit at an affordable price. Table 1.2 provides examples of such facilities in G7 countries, but similar measures have been implemented in other countries as well, including in emerging market economies.[19]

42. To counter currency funding pressures and mitigate damage to their economies from *unprecedented capital flow reversals*, a number of central banks in emerging market economies have intervened in foreign currency markets. Some (Brazil, Mexico, Indonesia, Russia and Thailand) have restarted or continued foreign currency intervention programs to mitigate excessive volatility in their domestic currencies, several countries have reduced foreign currency reserve requirements (e.g., Indonesia, Turkey) or increased availability of foreign currency swaps and repos (e.g. Brazil, Russia, Indonesia).

[19] See www.IMF.org/COVID19policytracker

Table 1.2. Selected Central Bank Facilities to Support Funding Markets

	Money markets and government securities	Corporate bond market	Other markets
Bank of Canada	**Bankers' Acceptance Purchase Facility** Purchases of eligible bankers' acceptances to maintain credit to small and medium sized businesses. **Provincial Money Market Purchase Program** Purchases of provincial money market securities in the primary market. **Commercial Paper Purchase Program** Purchases of eligible commercial paper in the primary and secondary markets to maintain the smooth flow of credit to corporations.		
Bank of England	**Asset Purchase Facility** A £200 billion increase in the central bank's holdings of UK government bonds and sterling non-financial investment-grade corporate bonds to a total of £645 billion. **COVID Corporate Financing Facility** For 12 months the central bank and Treasury will purchase commercial paper of maturities up to one year issued by companies making a material contribution to the UK economy.		
Bank of Japan	**Outright purchases of commercial paper and corporate bonds** A temporary (until the end of September 2020) increased in holdings of corporate bonds and commercial paper, moving from reinvesting proceeds of maturing assets into making net purchases. **Policy actions to enhance the liquidity and functioning of short-term funding markets** The BoJ announced funds-supplying operations against pooled collateral and purchases of Japanese government securities (JGSs) with repurchase agreements. In addition, it conducted unscheduled outright purchases of Japanese government bonds and expanded its Securities Lending Facility (SLF).		**Purchase of Exchange Traded Funds and Real Estate Investment Trusts** A doubling in the pace of Exchange Traded Fund purchases.
European Central Bank	**Pandemic Emergency Purchase Programme** Purchases of private and public sector securities, until the end of 2020, up to a total amount of €750 billion.		
US Federal Reserve	**Primary Dealer Credit Facility** Provide credit to primary dealers in exchange for a broad range of collateral for term funding with maturities up to 90 days. **Commercial Paper Funding Facility** Purchases from eligible issuers, via a Special Purpose Vehicle (SPV), of three-month U.S. dollar-denominated commercial paper. **Money Market Mutual Fund Facility** Provision of liquidity to eligible money market mutual funds.	**Primary Market Corporate Credit Facility** Purchase bonds from eligible issuers, via a SPV, and make loans to eligible borrowers. **Secondary Market Corporate Credit Facility** Purchases of investment grade corporate bonds in the secondary market from eligible issuers.	**Term Asset-Backed Securities Loan Facility** Loans to holders of certain AAA-rated asset-backed securities based on newly and recently originated consumer and small business loans.

Sources: National central banks. See hyperlinks for more details

43. *Regulators and supervisory authorities* have implemented a range of financial policy measures:

- To allow *banks* to absorb losses and support the flow of credit to the economy, some countries (see Table 1.1) have released *macroprudential buffers* (such as the countercyclical capital buffers, domestic systemic risk or the capital conservation buffers) and issued supervisory expectations that *capital and liquidity buffers* included in the Basel III framework should be used (enabling banks to operate below normal liquidity requirements). Some countries have also temporarily adjusted *supervisory priorities* and eased certain *regulatory requirements*, including delaying stress tests, introducing flexibility for banks in their treatment of nonperforming exposures or easing other requirements.[20]

- Many *insurance* supervisors have focused on regulatory actions to support business continuity and fair treatment of policyholders, for example by supporting a grace period on premium payment for the affected policyholders and allowing more flexibility on supervisory reporting.[21] A few National Competent Authorities have gone beyond the measures set out in the Solvency II framework. For example, the Italian authority adopted an adjustment aimed at protecting domestic insurers from the effects of heightened market volatility, with a special focus on their domestic government bond investments[22].

- *Asset managers* have been supported by some targeted measures as well. For example, the US Securities and Exchange Commission halted enforcement actions against affiliated parties' purchases of assets from money market funds and temporarily permitted other open-end mutual funds to borrow from affiliated parties and related funds. Supervisors in several jurisdictions have extended deadlines for regulatory filings.

- *Short-sale bans* have been introduced in many countries (for example, France, Italy and Belgium) to reduce the risk of downward price spirals and prevent further deterioration in liquidity conditions which could create systemic risk. *Circuit breakers* have been triggered in many markets over recent weeks to halt trading temporarily to ensure orderly trading conditions. Some exchanges also reparametrized their circuit breakers.

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[20] For example, the U.S. Federal Reserve has temporarily relaxed supplementary leverage ratio (SLR) requirements to exclude on-balance sheet holdings of US treasuries and deposits at the Federal Reserve from ratio's denominator to enhance the ability of large bank holding companies to provide market liquidity. For further details, see https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm.

[21] The European Insurance and Occupational Pensions Authority (EIOPA) issued a statement noting Solvency II provides flexibility in extreme situations in the ladder of supervisory interventions, including measures to extend the recovery period of affected insurers.

[22] On March 16, the Italian government adopted the Directive (EU) 2019/2177—which was passed on December 27, 2019— into national law with immediate effect. Specifically, this approved the adoption of an adjustment that reduced the threshold for Italian government bond spreads on German bunds—from 100bps to 85bps—that triggers the country-specific component of the volatility adjustment under Solvency II.

What are the next steps?

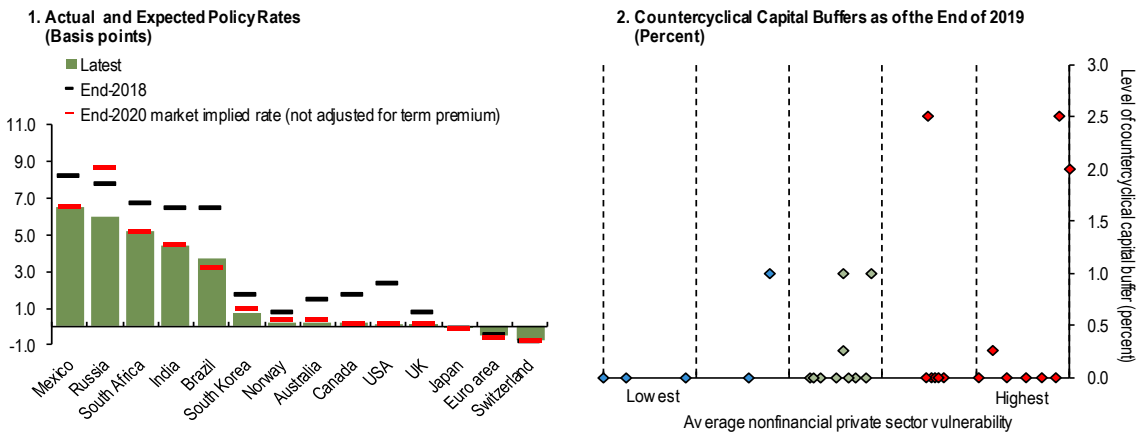
44. Given that events are still unfolding, it is not possible to fully assess the effectiveness of policies implemented so far, although market sentiment has shown signs of improvement in response to policymakers' actions. It is clear that a combination of monetary, fiscal and financial sector policies will continue to be needed going forward to support the stability of the global financial system and to preserve soundness of financial institutions, especially if economic activity remains paralyzed for longer than expected. Some difficult questions, such as maintaining adequate capital at banks, as needed, and providing liquidity support to a broad range of market participants, including nonbank financial institutions, may have to be addressed if the situation evolves according to a more severe scenario.[23]

45. Furthermore, some constraints on policy options may emerge. Given that policy rates in most advanced economies are now close to or below zero (Figure 1.17, panel 1), asset purchases and forward-guidance about the expected policy path will likely be the main tools in the central banks' monetary policy arsenal going forward, but room may be reduced given already very low long-term rates. In terms of macroprudential tools, only about a third of systemically important jurisdictions had the option of releasing the countercyclical capital buffers (CCYB) before the virus outbreak (Figure 1.17, panel 2), though some countries may also be able to ease other macroprudential tools. Given that some countries have limited or no fiscal space, it may be challenging for them to provide credible fiscal backstop.

Figure 1.17. Shrinking Monetary and Macroprudential Policy Space

Policy rates are close to or below zero in many countries, and few additional rate cuts are expected …

Despite rising vulnerabilities, relatively few countries had built up countercyclical capital buffers before the pandemic.



Sources: Bloomberg Finance L.P.; Haver Analytics; Bank for International Settlements; and IMF staff calculations.
Note: Panel 2 shows the latest data on the countercyclical capital buffer (CCYB) levels in 29 systemically important jurisdictions with low (1) to high (5) vulnerabilities in the nonfinancial private sector (average of the household and nonfinancial corporate sectors weighted by the level of debt in each sector), based on the information used to draw Figure 1.5. Green diamonds are used for the lower two quintiles, yellow for the middle quintiles, and red for the upper two quintiles. The CCYB rates are as of February 2020.

[23] For example, the European Commission has introduced the temporary state aid framework, which provides significant flexibility and waives burden-sharing requirements for government support to banks including via precautionary recapitalizations.

- Some facilities have not been implemented yet, and some segments of financial markets are beyond the reach of current central bank facilities, such as local governments in the US (for longer maturity debt), the commercial real estate market, and risky credit markets. In several countries, efforts are under way to close these gaps.[24] Central bank measures to support the *corporate sector* appear to have improved market functioning and eased near-term liquidity stress in certain segments of these markets, as evidenced by some narrowing in investment-grade spreads and the reopening of the primary market. However, because no direct support has been provided to the risky credit markets so far (sub-investment grade corporate debt is not currently eligible at these facilities in the US), credit markets have shown signs of bifurcation, with the gap between investment- and speculative-grade spreads widening and no issuance since February. Should financial conditions deteriorate further, and credit downgrades and defaults rise meaningfully, authorities may consider extending their support to risky credit markets, along with other measures to support the flow of credit to the broader economy.

What should be the guiding principles for financial sector policies?

46. The regulatory and supervisory responses to deal with the impact of pandemic would need to maintain the balance between preserving financial stability, maintaining soundness of financial institutions, and supporting economic activity:

- *Loan-restructuring*: Supervisors should encourage banks to prudently renegotiate loan terms for companies and households struggling to service their debts. This should be done without lowering loan classification and provisioning standards. While a loan restructuring may not automatically lead to increase in credit risk or loan losses, if borrowers remain likely to repay their obligations, banks need to assess their customers' creditworthiness on an ongoing basis and reflect any deterioration in asset quality in a timely manner. In cases where authorities have announced a loan moratorium or repayment holidays, banks may not be able to reliably assess the implications of the crisis on their customers. But they should aim to update their assessments as soon as feasible and reflect any implications in loan classification and expected loan losses.

- *Accounting treatment of credit losses*. Regulators globally have provided guidance on how to apply IFRS 9 Expected Credit Loss (ECL) requirements in light of COVID-19. They have clarified that the requirements should not be applied mechanically and that forward-looking-expected credit loss (ECL) estimates-should be reasonable and supportable, taking into account the expected nature of the shock (likely temporary), the impact of the economic support measures, and the scarcity of available and reliable information.

[24] For example, the US Federal Reserve is working on the modalities of the Main Street Business Lending Program (MSBLP).

- *Banks*: In the first instance, banks' existing capital and liquidity buffers should be used to absorb financial costs of any customer loan restructuring and to relieve pressures on banks' funding and liquidity using full flexibility within the existing regulatory frameworks. In cases where the impact is sizable or longer lasting and bank capital adequacy is affected, supervisors should take targeted actions, including asking banks to submit credible capital restoration plans. In such cases, national authorities may also need to step in with fiscal support—either direct subsidies or tax relief to help borrowers to repay their loans and finance their operations; or provide credit guarantees to banks. Throughout this process, transparent risk disclosure and supervisory expectations on dealing with the implications of the outbreak will be important for market discipline to work effectively. Supervisors should also discuss operational and business continuity plans with banks.

- *Insurance companies*: Insurance solvency frameworks in many jurisdictions include a ladder of supervisory intervention that allows for some flexibility of regulatory actions in cases of extreme market stress, including measures to extend the allowed recovery period of affected insurers. While temporary regulatory accommodation may be necessary, supervisors should not signal a lowering of standards. Supervisors should ask insurers to prepare credible plans to ensure that they can maintain or restore their solvency positions while continuing to provide necessary insurance cover to policyholders. Supervisors should also consider the macroprudential implications so that the actions they take do not incentivize the fire sale of assets through enhanced liquidity risk monitoring and management.

- *Asset managers:* Regulators should ensure that risk management frameworks are being applied in a robust and effective manner. Regulators should support the availability of the widest possible set of liquidity management tools (such as gates/deferred redemptions, swing pricing) and encourage fund managers to make full use of the available tools where it would be in the interests of unitholders to do so. Depending on the asset classes within the portfolio, a fund manager may face difficulties in obtaining timely and reliable valuations. Authorities should monitor developments and seek to provide clarity to fund managers on their expectations, including on the circumstances in which use of liquidity management tools, including a (temporary) suspension of redemptions, may become appropriate.

- *Financial markets:* For circuit breakers, volatility controls and other market resilience measures to be effective, they need to be well calibrated, clearly defined and appropriately communicated. When adopting temporary restrictions, such as on the use of short selling, authorities should consider the potential negative impact on liquidity and price discovery, and ensure that they are justified to support market confidence and financial stability. The restrictions should be temporary and only implemented within a predictable and reliable framework.

- *Liquidity provision by central banks:* Central banks may intervene to prevent impairment in money, securities and foreign exchange markets that could emerge in the wake of financial disruptions, that is when funding or market liquidity deteriorates substantially relative to normal conditions or if dealers are not able to trade assets at reasonable prices and without excessive price fluctuations. The lending operations may involve short- and long-term repo operations (reverse repurchase agreements), discount window (possibly at longer maturities), and foreign exchange swaps. The outright asset purchases, which can take the form of a program to buy securities or foreign exchange, may be appropriate to improve market liquidity. To effectively target the source of the market disruption, central banks may need to expand the range of eligible collateral (for both lending and outright operations) beyond what they accept during normal times while also expanding the range of counterparts with whom they deal. Central banks should also carefully assess which markets are critical to support in order to maintain financial stability, while ensuring the design of the program, as much as possible, minimizes moral hazard and the risks to the central bank.

How should emerging and frontier markets address external pressures?

47. Emerging and developing countries may be particularly hard hit by the virus outbreak given their dependence on external funding, increased leverage and high reliance on commodity production for some economies (as discussed in the upcoming Chapter 3):

- *Manage exchange rate pressures.* Many emerging markets are already facing volatile market conditions due to sharp reversals of portfolio flows. Exchange rate flexibility should be used, where feasible. Multilateral swap lines may be needed to alleviate the US dollar funding pressures. For countries with adequate reserves, exchange rate intervention can lean against market illiquidity and thus play a role in muting excessive volatility. However, interventions should not prevent necessary adjustments in the exchange rate. Interventions should be planned on the basis that the pressures arising from the current crisis might last several months or longer. If macroprudential buffers exist, a relaxation of these tools can reduce the impact of the current shock on market conditions and on the overall economy. For example, foreign currency reserve requirements can be relaxed to mitigate foreign-exchange funding pressures.
- *Managing capital outflows*: In the face of an imminent crisis, introducing outflow capital flow management measure (CFMs) could be part of a broad policy package, but CFMs cannot substitute for warranted macroeconomic adjustment. Considerations to introduce CFMs need to have due regard to the country's international obligations. CFMs generally need to be broad-based and effectively enforced to reduce capital outflows. Such measures should be implemented in a transparent manner, be temporary, and lifted once crisis conditions abate.

- *Prepare for longer-term external funding disruptions.* Sovereign debt managers should put in place contingency plans for dealing with limited access to external funding markets for a prolonged period. From the perspective of the trade-off between cost and risk, reducing rollover risks should take priority over concerns about containing costs when there are large downside risks stemming from potential loss of market access. Using cash buffers may become necessary, and some countries may have to seek bilateral and multilateral assistance (see *April 2020 WEO*). For those countries that are facing rapidly deteriorating debt dynamics, limited market access, high external financing requirements or high volatility, it may become necessary to preemptively and cooperatively seek a debt resolution with their creditors, including official creditors.

What should be the focus of international policy coordination?

48. Multilateral cooperation can help mitigate the health impact of the COVID-19 pandemic and its damage to the global economy and financial system. In the first instance, cooperation is needed to avoid price controls and ease trade restrictions on essential medical supplies. Bilateral and multilateral swap lines should be provided to a broader range of emerging markets. Greater international coordination may also be needed to reduce broader capital flow disruptions.

49. The IMF, with $1 trillion in available resources, is actively supporting member countries through various lending facilities, including rapid-disbursing emergency financing, which could amount to $50 billion for low-income countries and emerging markets. Of this, $10 billion is available at zero interest for the poorest members through the Rapid Credit Facility. In addition, the Catastrophe Containment and Relief Trust can provide up to $380 million—including the United Kingdom's recent pledge of $183 million—in up-front grants to relieve IMF debt service. Official bilateral creditors have been called upon by the IMF Managing Director and the World Bank President to suspend debt repayment from International Development Association countries that request forbearance. This would help with their immediate liquidity needs to address the challenges of the pandemic.

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