

UWTSD MBA (2020 intake)
Global Business Challenges
(HKBM7009_HKMA)
(4-2)

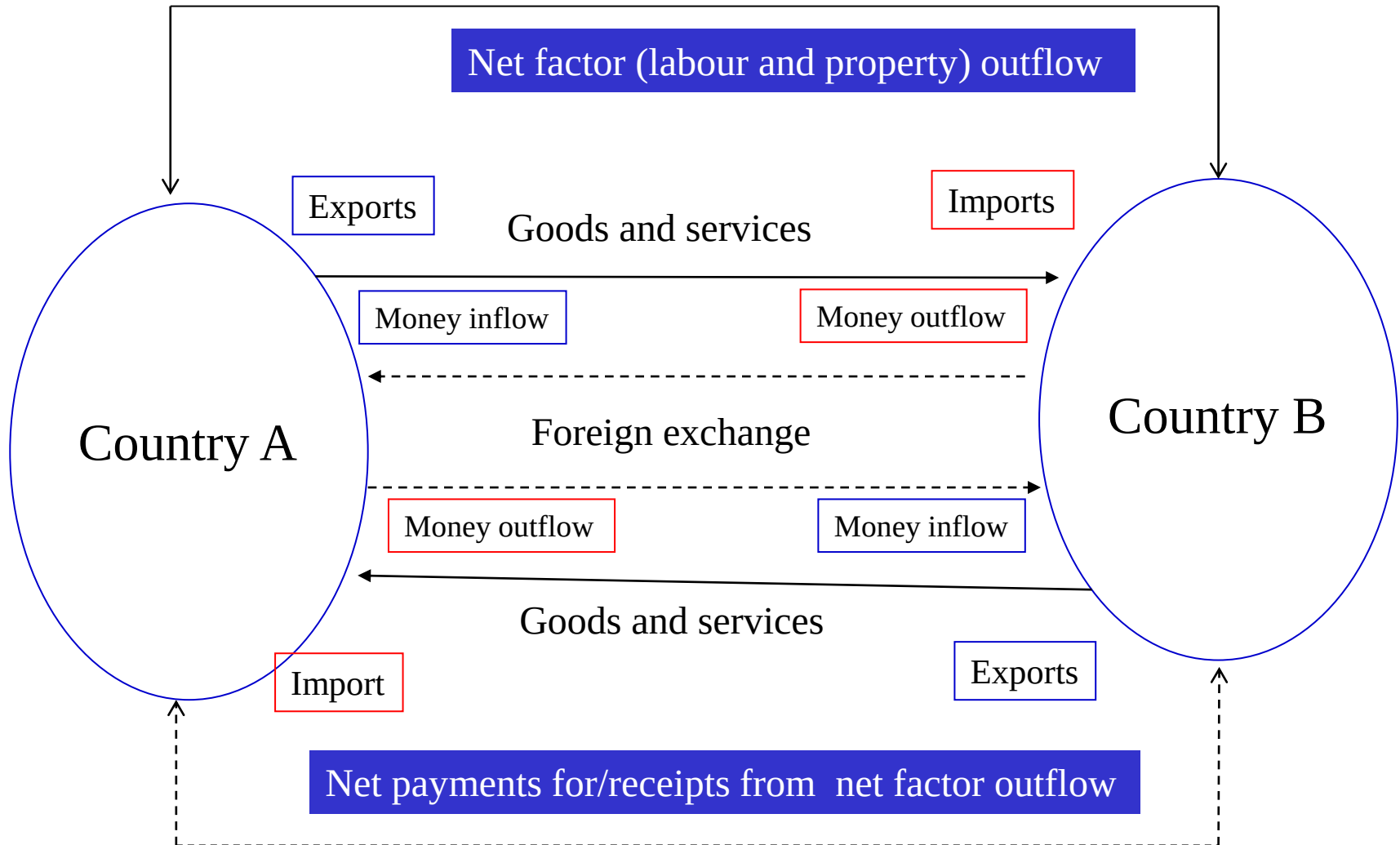
Macroeconomics Foundations II: Global Financial Market

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24 January 2020; 2:00 am to 6:00 pm

Lecture Agenda :

- Some Basics
- Balance-of-Payments Accounting
- Markets for interest rate instruments
- The Foreign Exchange Market
- Global Financial Stability Overview

Some Basics



————→ Physical flow (The scope of international trade)

-----→ Money flow (The scope of international finance)

Dimensions of a global economy

- Global trade
 - a. in goods
 - b. in services
- Global money (Foreign currency exchange rates)
- Global labour
- Global foreign direct investment
 - a. Plant, equipment, or operations
 - b. Financing or purchase in the form of loans, equity shares, or bonds
- Global flows of capital
 - a. Currency exchange
 - b. Settlements of purchases
 - c. Require international financial institutions to manage

Global Financial Integration

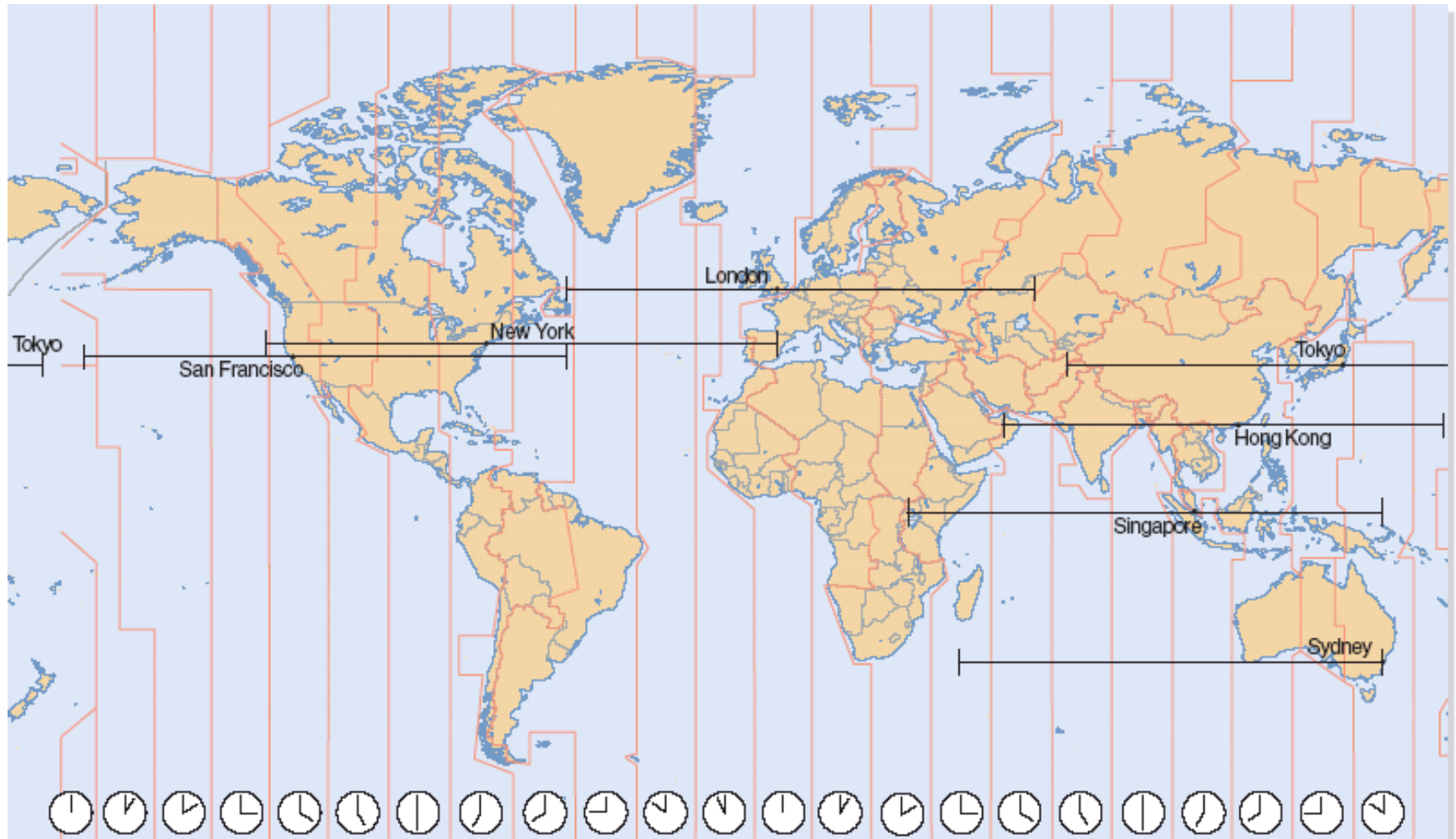
- The world has become increasingly integrated
 - Implying that there is more interdependence
- Problems in one part of the global economic system have ramifications for the entire system
 - Implying that there is more need for global collective action
 - There is greater need for institutions, like the IMF, to regulate the global international financial markets

Classification of Global Financial Market

1. Markets for interest rate instruments;
2. Equity markets;
3. Markets for investment and money market funds' shares/units
4. Foreign exchange markets; and
5. Financial derivatives markets
 - The most relevant types of derivatives are: swaps, options, futures, outright forwards and forward rate agreements.

Since foreign exchange risk and interest rate risk are highly concerned by firms involved in global business, we will focus our discuss on items 1 and 4.

24 Hour Trading



Balance-of-Payments Accounting

IMF data

<imf.org> <Data> <Balance of Payments Statistics (BOPS)> <MORE> <Data Tables>
<BPM6: data Reports by Economy, updated monthly__1. Balance of Payments Analytic
Presentations by country>

Definition

The Balance of Payment is a system statement of all movements of goods and services, financial assets, and reserve assets between one country and the rest of the world over a year and compiled on principles of double-entry bookkeeping.

In Balance-of-Payments Accounting:

A debit entry is any transaction which results in a money outflow or payment to a foreign country (e.g. Imports).

A credit entry is any transaction which results in a money inflow or receipt from a foreign country (e.g. Exports).

A hypothetical Balance-of-Payments

	Credit entry (+)	Debit entry (-)
Current account	Merchandise exports	Merchandise imports
	Export of services	Import of services
	Unilateral transfers from foreigners	Unilateral transfers to foreigners
Current and financial account	Sales of money market assets and financial market assets to foreigners	Purchases of money market assets and financial market assets from foreigners
settlement account	Official sales of gold and foreign currencies reserves	Official purchases of gold and foreign currencies reserves

Balance-of-payments equilibrium and disequilibrium

Two different types of international transactions

Autonomous transactions:

Current account
Short-term capital account
(Financial market assets)

Accommodating transactions:

Official settlement account
Short-term capital account
(Money market assets)

Balance-of-payments equilibrium is a state of balance between Autonomous international payments and receipts over a given period (a several years over a full business cycle)

$$\boxed{\text{Autonomous receipts}} = \boxed{\text{Autonomous payments}}$$

$$F^s = F^d \rightarrow \text{Balance-of-payments equilibrium}$$

$$F^s > F^d \rightarrow \text{Balance-of-payments surplus}$$

Balance-of-payments
disequilibrium



$$F^s < F^d \rightarrow \text{Balance-of-payments deficit}$$

Hong Kong Balance of Payments. 2012-2019

	2012	2013	2014	2015	2016	2017	2018	2019
Current account (excludes reserves and related items)	4,147.2	4,190.8	4,057.3	10,263.9	12,688.0	15,621.1	13,514.4	22,467.2
Goods, credit (exports)	468,39...	506,20...	514,15...	501,72...	501,54...	540,46...	568,13...	547,84...
Goods, debit (imports)	487,31...	534,12...	546,51...	524,59...	518,25...	563,38...	600,40...	563,90...
Balance on goods	-18,912.7	-27,920.9	-32,358.7	-22,870.0	-16,704.5	-22,927.3	-32,271.9	-16,065.8
Services, credit (exports)	98,504.1	104,77...	106,92...	104,35...	98,510.2	104,09...	113,14...	101,17...
Services, debit (imports)	76,618.1	75,197.2	73,964.4	74,092.8	74,478.4	77,739.3	81,643.0	78,891.5
Balance on goods and services	2,973.4	1,658.7	598.6	7,393.3	7,327.3	3,429.6	-765.4	6,221.7
Primary income, credit	140,68...	152,59...	161,82...	164,40...	164,07...	182,51...	207,99...	213,20...
Primary income, debit	136,89...	147,37...	155,81...	158,68...	156,01...	167,68...	190,80...	194,29...
Balance on goods, services, and primary income	6,769.2	6,882.2	6,608.9	13,118.0	15,389.4	18,258.0	16,424.6	25,129.8
Secondary income, credit	905.1	1,042.9	1,135.1	1,245.0	1,345.2	1,579.8	1,631.8	1,382.3
Secondary income, debit	3,527.1	3,734.4	3,686.7	4,099.0	4,046.6	4,216.7	4,542.0	4,044.9
Capital account (excludes reserves and related items)	-184.7	-207.3	-96.5	-27.7	-48.2	-82.7	-200.7	-84.0
Capital account, credit	0.1	0.5	0.3	33.0	0.5	0.5	0.6	0.8
Capital account, debit	184.8	208.1	96.7	61.0	48.6	83.2	201.4	84.6
Balance on current and capital account	3,962.5	3,983.5	3,960.8	10,236.2	12,639.8	15,538.4	13,313.7	22,383.2

	2012	2013	2014	2015	2016	2017	2018	2019
Financial account (excludes reserves and related items)	-15,816.8	3,459.6	-8,516.0	-19,812.7	11,831.6	-22,430.5	21,145.5	32,599.5
Direct investment, assets	88,122.7	83,328.5	140,89...	78,514.9	75,552.1	101,76...	75,012.1	44,052.9
Equity and investment fund shares	69,209.0	82,370.2	122,14...	58,934.0	69,673.7	66,576.3	85,872.4	65,037.3
Debt instruments	18,913.8	958.0	18,746.0	19,581.1	5,878.3	35,185.4	-10,860.4	-20,984.4
Direct investment, liabilities	74,887.1	76,857.5	129,84...	181,04...	133,25...	125,71...	97,036.3	53,171.2
Equity and investment fund shares	67,340.8	78,101.8	114,01...	175,87...	107,39...	98,944.4	104,49...	55,329.9
Debt instruments	7,546.4	-1,244.2	15,827.6	5,172.0	25,865.6	26,772.2	-7,459.9	-2,158.8
Portfolio investment, assets	40,122.0	66,366.4	35,614.4	85,305.6	68,352.2	7,010.8	96,995.5	46,141.8
Equity and investment fund shares	20,592.4	23,125.0	41,034.4	54,211.2	45,697.7	14,100.0	32,711.8	12,791.5
Debt instruments	19,529.7	43,241.3	-5,420.1	31,094.5	22,654.6	-7,089.0	64,283.7	33,350.3
Portfolio investment, liabilities	36,024.5	16,580.9	27,320.2	-39,947.9	7,823.5	41,009.2	18,331.3	5,502.7
Equity and investment fund shares	28,949.6	8,714.2	17,647.9	-42,525.3	2,501.2	10,309.4	-2,397.4	3,508.9
Debt instruments	7,074.9	7,866.7	9,672.6	2,577.2	5,322.6	30,699.6	20,728.4	1,993.6
Financial derivatives (other than reserves) and employee stock ...	-1,960.4	-7,047.8	-15,263.1	-12,793.3	-4,679.7	-7,925.2	-4,232.2	-1,122.3
Fin. derivatives and employee stock options, assets	-39,731.2	-54,784.4	-57,914.8	-72,781.0	-95,108.6	-82,955.3	-78,532.5	-60,529.7
Fin. derivatives and employee stock options, liabilities	-37,770.7	-47,736.3	-42,651.6	-59,987.7	-90,428.7	-75,030.1	-74,300.5	-59,407.6
Other investment, assets	17,042.9	82,431.0	119,29...	-36,780.3	41,529.9	192,86...	72,592.7	-31,649.6
Other equity	...	...	...	...	...	...	...	...
Debt instruments	17,042.9	82,431.0	119,29...	-36,780.3	41,529.9	192,86...	72,592.7	-31,649.6
Other investment, liabilities	48,232.6	128,17...	131,88...	-7,039.7	27,840.3	149,41...	103,85...	-33,850.7
Other equity	...	...	...	...	...	...	...	...
Debt instruments	48,232.6	128,17...	131,88...	-7,039.7	27,840.3	149,41...	103,85...	-33,850.7
Balance on current, capital, and financial account	19,779.3	523.9	12,476.9	30,048.9	808.2	37,968.9	-7,831.9	-10,216.3
Net errors and omissions	4,580.7	6,940.1	5,462.3	6,332.3	332.2	-5,832.4	8,825.4	9,070.5
Reserves and related items	24,360.1	7,463.8	17,939.1	36,381.1	1,140.4	32,136.5	993.4	-1,145.8
Reserve assets	24,360.1	7,463.8	17,939.1	36,381.1	1,140.4	32,136.5	993.4	-1,145.8
Net credit and loans from the IMF (excluding reserve position)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	...	...	...	...	...	...	...	...

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 (-) Indicates that a figure is zero
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Balance of payments performance in selected countries: 2019

Millions of U.S. Dollars

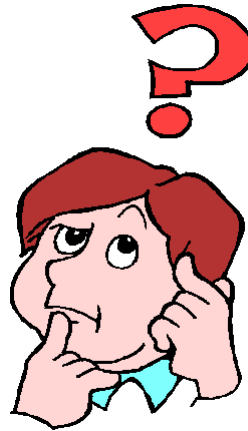
	HK	Macao	China	USA
Current account (excludes reserves and related items)	22,467.16	17,695.80	141,335.50	-480,228.00
Capital account (excludes reserves and related items)	-83.9508	-22	-327.3	-6,244.00
Financial account (excludes reserves and related items)	32,599.55	10,352.30	-37,754.70	-400,205.00
Balance on current, capital, and financial account	-10,216.3	7,321.50	178,762.90	-86,267.00
Net errors and omissions	9,070.504	-5,818.20	-198,050.90	90,927.10
Reserves and related items	-1,145.83	1,503.30	-19,288.10	4,660.10

Markets for Interest Rate Instruments

Transformation of currency denomination in business loans

Hong Kong

HKD
Bank lending
rate = 8%



Japan

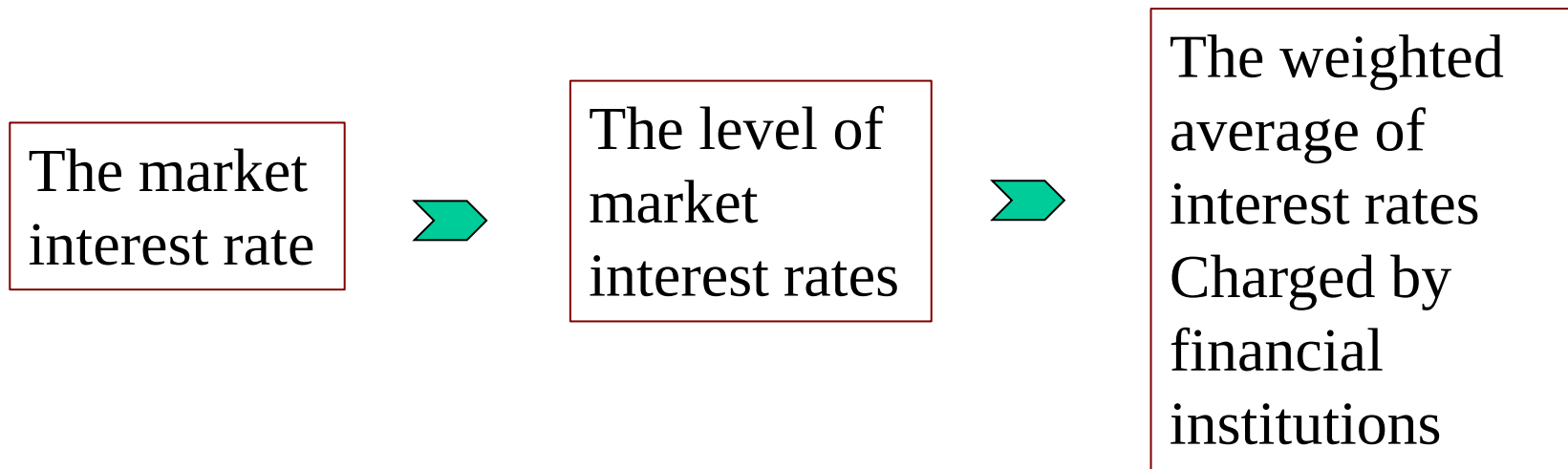
Japanese yen
Bank lending
rate = 5%

- The spread between buying and selling prices
- Service charge
- Transaction cost (service charge or commission)
- Exchange rate Expectations
- Exchange Risk
- Net profit margin

Interest Rate Instruments

Deposits and loans	Short term (up to and including 1 year) Interbank deposits and loans US Federal funds Bank time deposit or transferable deposits Bank business loans
	Long term (over 1 year) Bank mortgage loans Bank long term fixed deposits
Debt securities	Short term (up to and including 1 year) Examples: Treasury bills and commercial papers
	Long term (over 1 year) Examples: Bonds sold by issuing companies, governments and others outside their own countries

The market interest rate



There are different rate of interest applied to different individuals/firms subject different terms to maturity, risk premium (credit risk, country risk, industry risk), and the monetary authority's interest rate target.

BIS Policy rates

- The data set on the monetary policy rates of 38 central banks.
- This is the only data set containing both current and historical data for a large number of countries.
- Central banks informed the BIS on which interest rates to be considered as policy
- The data set presents the target rate, or when this is not available the traded rate, for the central bank's main policy instrument. Several central banks implement their monetary policy based on more than one interest rate.

BIS Policy rates for selected countries

Central bank policy rates, Monthly, -End of period

Per Cent Per Year

Period	China	UK	HK	Japan	USA	Euro Area
31.12.2009	5.31	0.5	0.5	0.1	0.125	1
31.12.2010	5.81	0.5	0.5	0.05	0.125	1
31.12.2011	6.56	0.5	0.5	0.05	0.125	1
31.12.2012	6	0.5	0.5	0.05	0.125	0.75
31.12.2013	6	0.5	0.5	0	0.125	0.25
31.12.2014	5.6	0.5	0.5	0	0.125	0.05
31.12.2015	4.35	0.5	0.75	0	0.375	0.05
31.12.2016	4.35	0.25	1	-0.1	0.625	0
31.12.2017	4.35	0.5	1.75	-0.1	1.375	0
31.12.2018	4.35	0.75	2.75	-0.1	2.375	0
30.09.2019	4.35	0.75	2.25	-0.1	1.875	0
31.12.2020	3.85	0.1	0.5	-0.1	0.125	0

The Foreign Exchange Market

Bilateral Exchange Rates

Exchange rates are expressed as the price of one currency in terms of another.

Quoted currency = numerator
Base currency = denominator

(HKD/USD) = HKD needed to buy one U.S. dollar

HKD is quoted currency, dollar is base currency

$$\text{Direct quote} = \frac{\text{Quoted currency}}{\text{Base currency}} = \frac{7.8}{1} = 7.8$$

$$\text{Indirect quote} = \frac{1}{\text{Direct quote}} = \frac{1}{7.8} = 0.1282$$

Exchange Rate Index

- It is designed to indicate a country's overall external value against a basket of selected currencies.
- The effective exchange rate index ([EERI](#)) for the HKD is an index which measures movements in the weighted average of the exchange rate of the HKD against the currencies of major trading partners of Hong Kong. It serves as an indicator for measuring the overall strength of the HKD relative to selected currencies. A new series of EERI, which includes 15 currencies and is based on January 2010 as 100, has replaced the old series as from 3 January 2012.

Currency Weights of the New Series of Effective Exchange Rate Index

		(%)		
貨幣	Currency	貿易總值加權 Trade-weighted	進口貨值加權 Import-weighted	整體出口貨值加權 Export-weighted
人民幣	Chinese Renminbi	52.45	48.52	56.93
美元	U.S. Dollar	8.68	5.51	12.28
歐元	Euro	7.49	6.06	9.11
日圓	Japanese Yen	7.22	9.43	4.71
新台幣	New Taiwan Dollar	4.86	6.97	2.45
新加坡元	Singapore Dollar	4.67	7.16	1.86
南韓圓	Korean Won	3.09	4.11	1.93
印度盧比	Indian Rupee	2.34	2.17	2.52
馬來西亞元	Malaysian Ringgit	1.83	2.65	0.89
英鎊	Pound Sterling	1.82	1.30	2.40
泰銖	Thai Baht	1.79	2.32	1.19
瑞士法郎	Swiss Franc	1.18	1.63	0.68
澳元	Australian Dollar	0.98	0.54	1.48
菲律賓披索	Philippine Peso	0.97	1.26	0.65
加拿大元	Canadian Dollar	0.63	0.37	0.92
總計	Total	100.00	100.00	100.00

C&S (2011), Hong Kong *Monthly Digest of Statistics*, December 2011, Feature Article: New Series of Effective Exchange Rate Index for the Hong Kong Dollar. pp. 5

表 9.14 外幣兌換率及港匯指數

Table 9.14 Exchange rates and the Effective Exchange Rate Indices

		(每單位外幣兌換港元) (HK Dollar per unit of foreign currency)									
年	月	澳元	加拿大元	印度盧比	日圓	南韓圓	馬來西亞元	新台幣	菲律賓	英鎊	新加坡元
Year	Month	Australian Dollar	Canadian Dollar	Indian Rupee	Japanese Yen	Korean Won	Malaysian Ringgit	New Taiwan Dollar	Philippine Peso	Pound Sterling	Singapore Dollar
2018		5.86	6.05	0.115	0.0709	0.0071	1.94	0.263	0.152	10.46	5.81
2019		5.44	5.91	0.111	0.0719	0.0067	1.89	0.256	0.153	10.00	5.74
2020		5.36	5.79	0.105	0.0727	0.0066	1.85	0.261	0.157	9.96	5.63
2019	10	5.33	5.95	0.110	0.0725	0.0066	1.87	0.258	0.153	9.93	5.73
	11	5.35	5.92	0.110	0.0719	0.0067	1.88	0.258	0.153	10.09	5.75
2020	12	5.37	5.92	0.110	0.0715	0.0066	1.88	0.258	0.153	10.24	5.75
	1	5.35	5.95	0.109	0.0711	0.0067	1.91	0.258	0.154	10.16	5.76
	2	5.18	5.85	0.109	0.0707	0.0065	1.87	0.259	0.156	10.08	5.60
	3	4.84	5.58	0.104	0.0722	0.0064	1.81	0.259	0.156	9.62	5.48
	4	4.88	5.51	0.102	0.0719	0.0063	1.78	0.259	0.156	9.61	5.44
	5	5.05	5.55	0.102	0.0723	0.0063	1.79	0.259	0.156	9.53	5.47
	6	5.34	5.72	0.102	0.0720	0.0064	1.81	0.260	0.156	9.71	5.56
	7	5.45	5.74	0.103	0.0726	0.0065	1.82	0.262	0.156	9.82	5.59
	8	5.58	5.85	0.104	0.0731	0.0065	1.85	0.262	0.156	10.18	5.66
	9	5.61	5.87	0.105	0.0734	0.0066	1.87	0.262	0.156	10.05	5.68
	10	5.52	5.87	0.105	0.0737	0.0068	1.87	0.263	0.160	10.06	5.70
	11	5.64	5.92	0.104	0.0743	0.0070	1.89	0.265	0.164	10.24	5.76
	12	5.84	6.05	0.105	0.0747	0.0071	1.91	0.265	0.164	10.41	5.82

Source: C&S

Source: Hong Kong Monthly Digest of Statistics. January 2021, C&S

		(每單位外幣兌換港元) --- 續 (HK Dollar per unit of foreign currency) --- cont'd						港匯指數 (2010年1月=100) Effective Exchange Rate Indices for HK Dollar (January 2010 = 100)		
年	月	瑞士法郎 Swiss Franc	泰銖 Thai Baht	美元 U.S. Dollar	歐元 Euro	人民幣 Chinese Renminbi	特別 提款權 Special Drawing Right	貿易總值 (進口及整體 出口)加權 Trade (import and export) - weighted	進口貨值 加權 Import- weighted	整體出口 貨值加權 Export- weighted
2018		8.01	0.243	7.839	9.25	1.1855	11.10253	101.8	101.7	101.9
2019		7.89	0.253	7.836	8.77	1.1332	10.82677	105.2	104.9	105.5
2020		8.28	0.249	7.757	8.86	1.1248	10.79899	105.8	105.4	106.2
2019	10	7.90	0.259	7.843	8.67	1.1063	10.76052	106.6	106.2	107.1
	11	7.89	0.259	7.830	8.66	1.1153	10.76742	106.2	105.8	106.6
	12	7.94	0.259	7.807	8.67	1.1131	10.76499	106.3	105.9	106.8
2020	1	8.01	0.256	7.774	8.64	1.1227	10.72618	105.9	105.5	106.4
	2	7.97	0.249	7.776	8.49	1.1103	10.64667	107.1	106.8	107.5
	3	8.12	0.243	7.765	8.60	1.1047	10.65506	107.7	107.3	108.1
	4	7.98	0.238	7.752	8.42	1.0940	10.57032	108.7	108.3	109.1
	5	8.00	0.242	7.753	8.45	1.0878	10.57284	108.9	108.4	109.3
	6	8.14	0.249	7.752	8.73	1.0944	10.69489	107.9	107.5	108.4
	7	8.30	0.247	7.753	8.89	1.1059	10.78884	106.9	106.5	107.3
	8	8.51	0.249	7.752	9.17	1.1187	10.94505	105.7	105.3	106.1
	9	8.48	0.248	7.751	9.14	1.1375	10.94596	104.7	104.4	105.0
	10	8.50	0.249	7.752	9.12	1.1565	10.96086	103.6	103.3	104.0
	11	8.52	0.255	7.754	9.18	1.1754	11.02324	102.3	102.0	102.7
	12	8.72	0.258	7.753	9.43	1.1880	11.14548	101.2	100.9	101.6

註釋：數字是指期內每日收市中間價的平均值。除新台幣及菲律賓披索的數字是現鈔價外，其餘的均為電匯價。

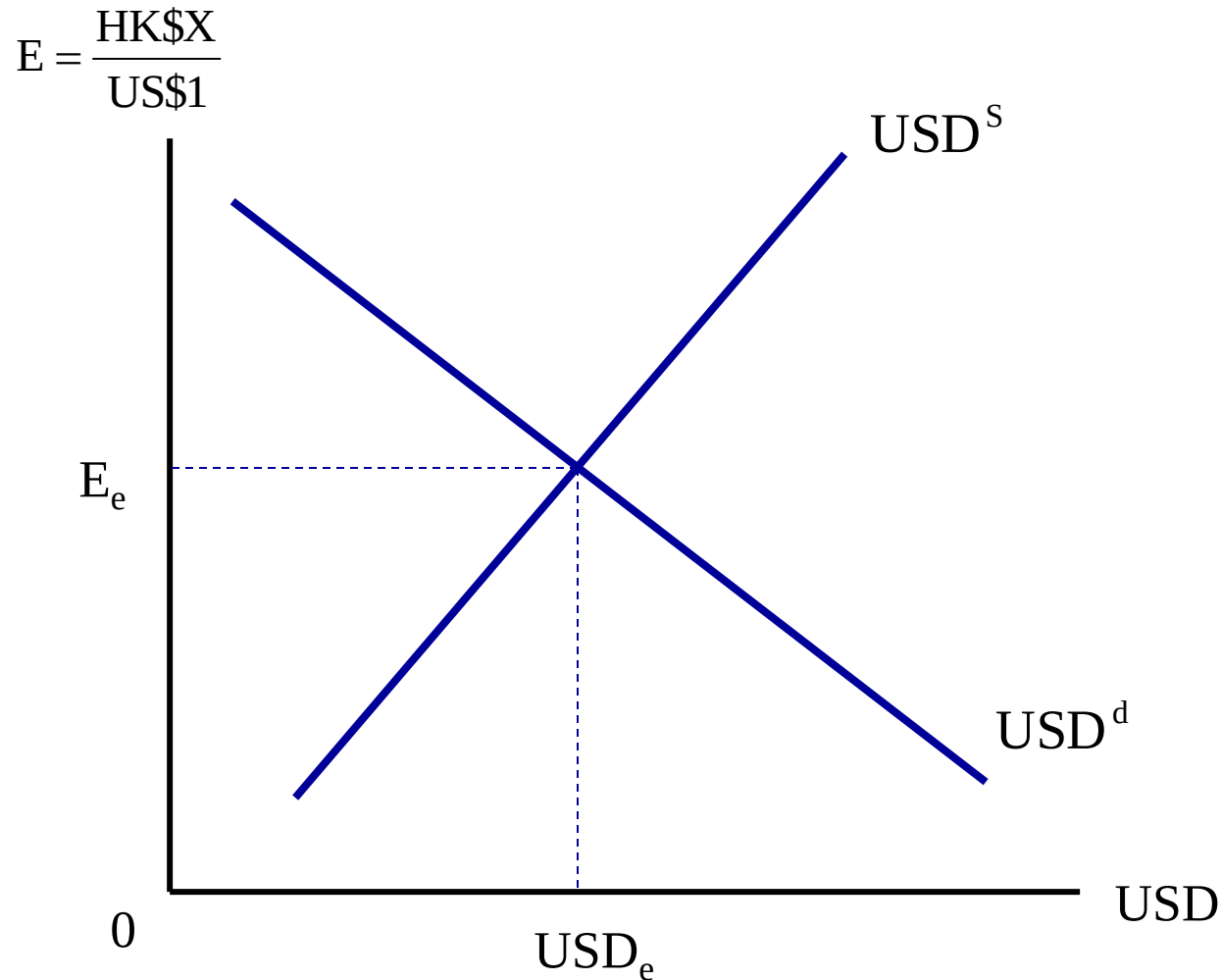
Note: Figures are the averages of the daily closing middle-market rates for the respective period. They are telegraphic transfer rates except those for the New Taiwan Dollar and Philippine Peso which are notes rates.

資料來源：香港金融管理局；
政府統計處貿易資料分析組

Sources: Hong Kong Monetary Authority;
Trade Analysis Section,
Census and Statistics Department

A theoretical model for exchange rate determination

The US Foreign Exchange Market in Hong Kong



Supply of the domestic currency

- A foreign currency is offered in exchange for the domestic currency because holders of the foreign currency wish to make payments in the domestic currency.
- It is derived from the credit items in the BP.
- The supply of curve is slopping upwards from left to right.

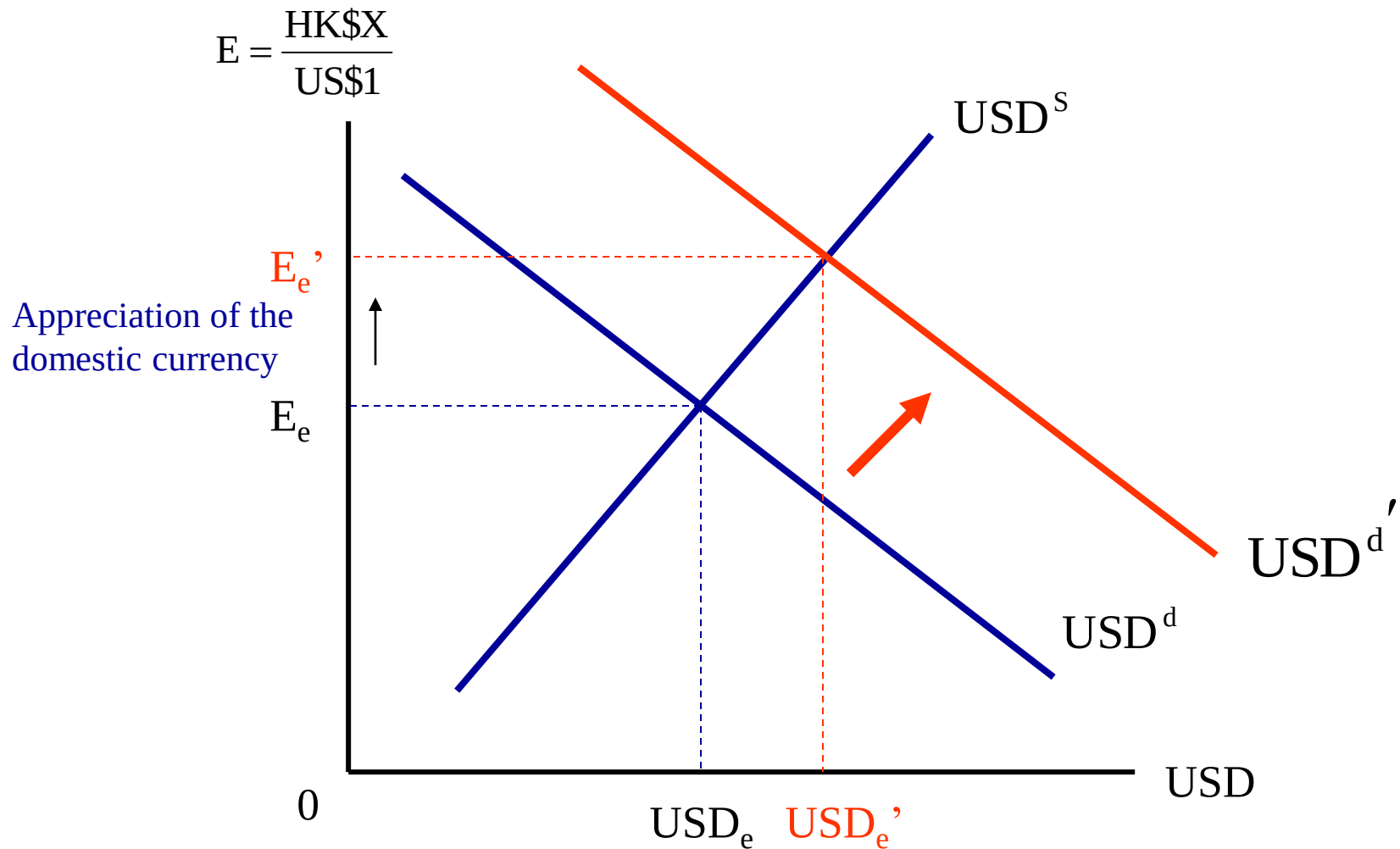
$$\text{USD}^S \uparrow = f(E \uparrow; X \uparrow, \text{Capital Inflow} \uparrow, \text{FX Reserves} \downarrow)$$

Demand for the domestic currency

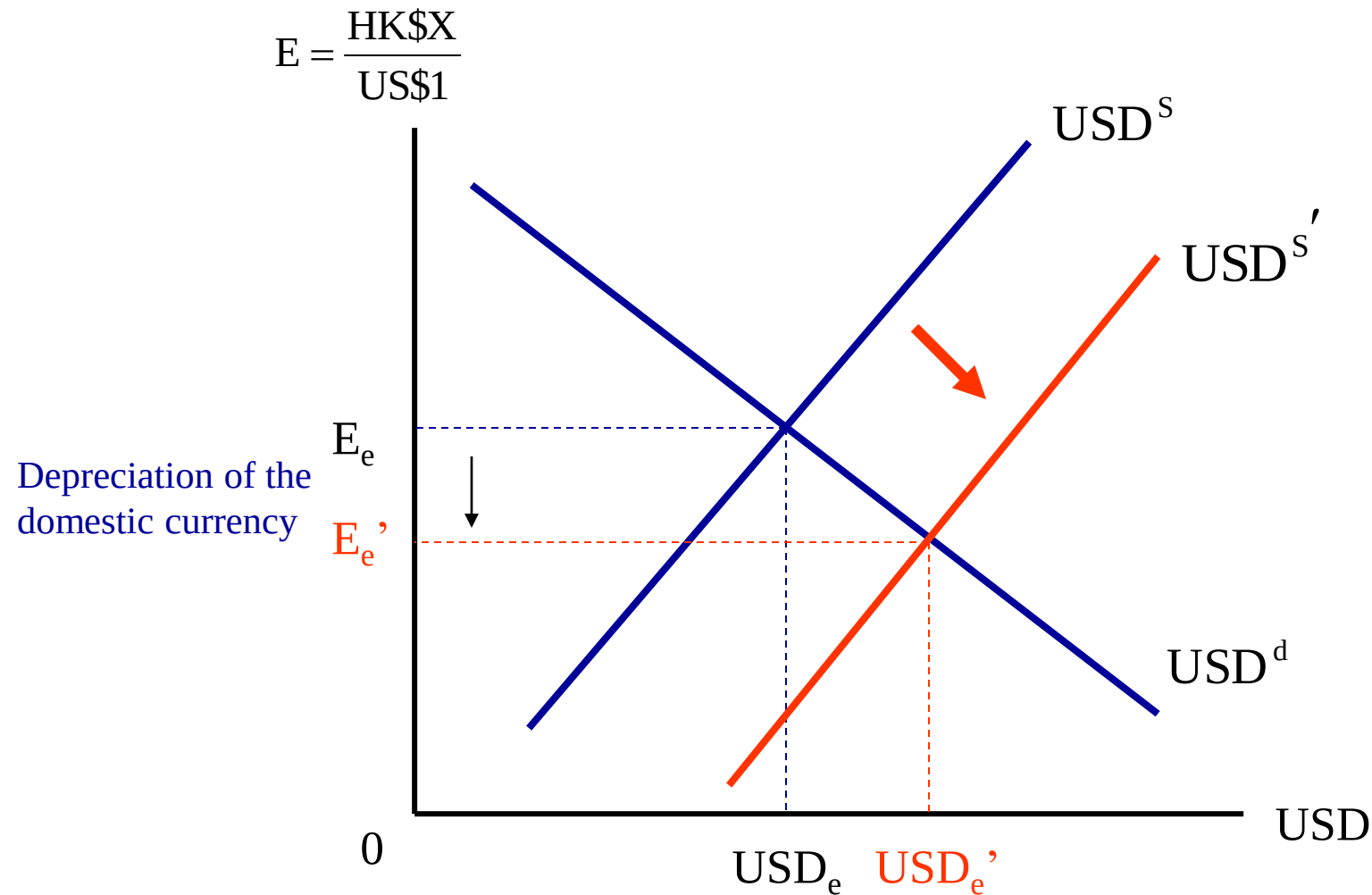
- It arises because holders of the domestic currency wish to make payments in a foreign currency.
- It originates in the debit items in the BP.
- slopes downwards from left to right.

$$\text{USD}^d \uparrow = f(E \downarrow; M \uparrow, \text{Capital Outflow} \uparrow, \text{FX Reserves} \uparrow)$$

Comparative static analysis (1): An increase in imports



Comparative static analysis (2): An increase in FDI inflow



Big Mac PPP (Source:The Economist, 24/04/2003)

	Local currency price (2)	USD price (3)	USD PPP (4)	Actual exchange rate (5)	Over (+) or under (-) evaluation (%)
<i>United States</i>	\$ 2.71	2.71			
<i>UK</i>	£ 1.99	3.14	1.36*	1.58	+ 16
<i>Eurozone</i>	€ 2.71	2.97	1.00*	1.10	+ 10
<i>Argentina</i>	Peso 4.10	1.43	1.51	2.88	- 47
<i>Poland</i>	Zł 6.3	1.62	2.32	3.89	- 40
<i>Thailand</i>	Baht 59.0	1.38	21.8	42.7	- 49
<i>China</i>	Yuan 9.9	1.20	3.65	8.28	- 56
<i>Japan</i>	Yen 262	2.19	96.7	120	- 19

Note : except for the £ et the euro (€) whose exchange rate represents their value in dollars (indicated by a star *), column 5 gives the dollar value of the local currency. Column 3 results from dividing (2) by (5). Column 4 (dollar PPP) results from dividing (2) (local currency price of the Big Mac) by 2,54 (US price of the Big Mac) (except for the UK and the euro zone, where the reverse ratio is taken). Source : <http://www.economist.com>

Global Financial Stability Overview

<https://www.imf.org/en/Publications/GFSR/Issues/2020/10/13/global-financial-stability-report-october-2020#ExecSum>

The Global Financial Stability Report (GFSR) assesses key vulnerabilities in the global financial system. In normal times, the report seeks to play a role in preventing crises by highlighting policies that may mitigate systemic risks, thereby contributing to global financial stability and the sustained economic growth of the IMF's member countries.

Highlights

The COVID-19 pandemic has triggered a global economic crisis of unprecedented magnitude. The World Economic Outlook forecasts a sharp global economic contraction for 2020. Despite the expected rebound in growth in 2021, the level of global output is anticipated to remain below precrisis levels for several years. The swift, aggressive, and broad economic policy response has contained the immediate damage, providing a bridge to recovery. Central banks have eased monetary policy across the globe, with a nearly \$7.5 trillion balance sheet expansion to date in G10 countries, and with about 20 emerging market central banks deploying asset purchases for the first time. The post-2008 regulatory framework has been put to the test for the first time, and has been proven largely successful, as the global banking system entered the crisis with relatively high capital and liquidity buffers. In addition, a fiscal policy response of \$12 trillion globally has provided substantial support to households and firms.

Bridge to Recovery: October 2020 Global Financial Stability Report at a Glance

- Near-term global financial stability risks have been contained for now. Unprecedented and timely policy response has helped maintain the flow of credit to the economy and avoid adverse macro-financial feedback loops, creating a bridge to recovery.
- However, vulnerabilities are rising, intensifying financial stability concerns in some countries. Vulnerabilities have increased in the nonfinancial corporate sector, as firms have taken on more debt to cope with cash shortages, and in the sovereign sector, as fiscal deficits have widened to support the economy.

- As the crisis unfolds, corporate liquidity pressures may morph into insolvencies, especially if the recovery is delayed. Small and medium-sized enterprises are more vulnerable than large firms with access to capital markets. The future path of defaults will ultimately be shaped by the extent of continued policy support and the pace of the recovery, which is expected to be uneven across sectors and countries.
- While the global banking system is well capitalized, there is a weak tail of banks, and some banking systems may experience capital shortfalls in the October 2020 World Economic Outlook adverse scenario even with the currently deployed policy measures.

- Some emerging and frontier market economies face financing challenges, which may tip some of them into debt distress or lead to financial instability and may require official support.
- As economies reopen, accommodative policies will be essential to ensure that the recovery takes hold and becomes sustainable—see the following Policy Road Map. The post-pandemic financial reform agenda should focus on strengthening the regulatory framework for the nonbank financial sector and stepping up prudential supervision to contain excessive risk taking in a lower-for-longer interest-rate environment.

Monetary and Financial Policy Road Map after the Great Lockdown

Gradual Reopening under Uncertainty

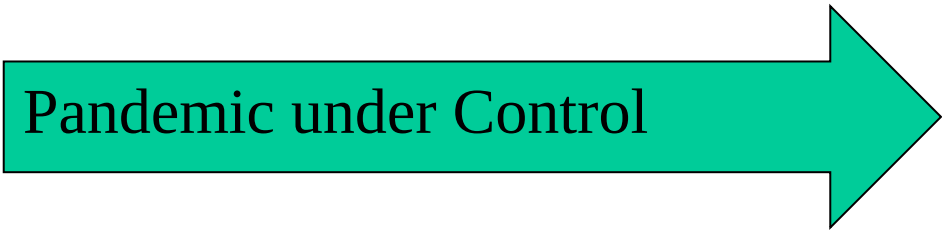
Monetary policy—Maintain accommodation to support the recovery

Liquidity support—Maintain support but adjust pricing to incentivize a gradual exit

Credit provision—Encourage banks to use capital and liquidity buffers to continue lending

Nonfinancial private sector—Extend moratoria on debt service only if necessary to prevent widespread insolvencies, support viable firms through restructuring and efficient out-of-court workouts to reduce the debt burden, as well as by providing solvency support (as appropriate)

Multilateral support—Provide support to emerging and frontier market economies facing financing difficulties



Pandemic under Control

Monetary policy—Maintain accommodation until monetary policy objectives are achieved

Liquidity support—Gradually withdraw

Credit provision—Require banks to gradually rebuild capital and liquidity buffers, develop credible plans to reduce problem assets, and create markets for problem assets

Nonfinancial private sector—Recapitalize, restructure, or resolve nonviable firms

Green recovery—Encourage more proactive management of climate-related risks and green investments

Digitalization—Encourage greater digital investment to enhance financial sector efficiency and inclusion

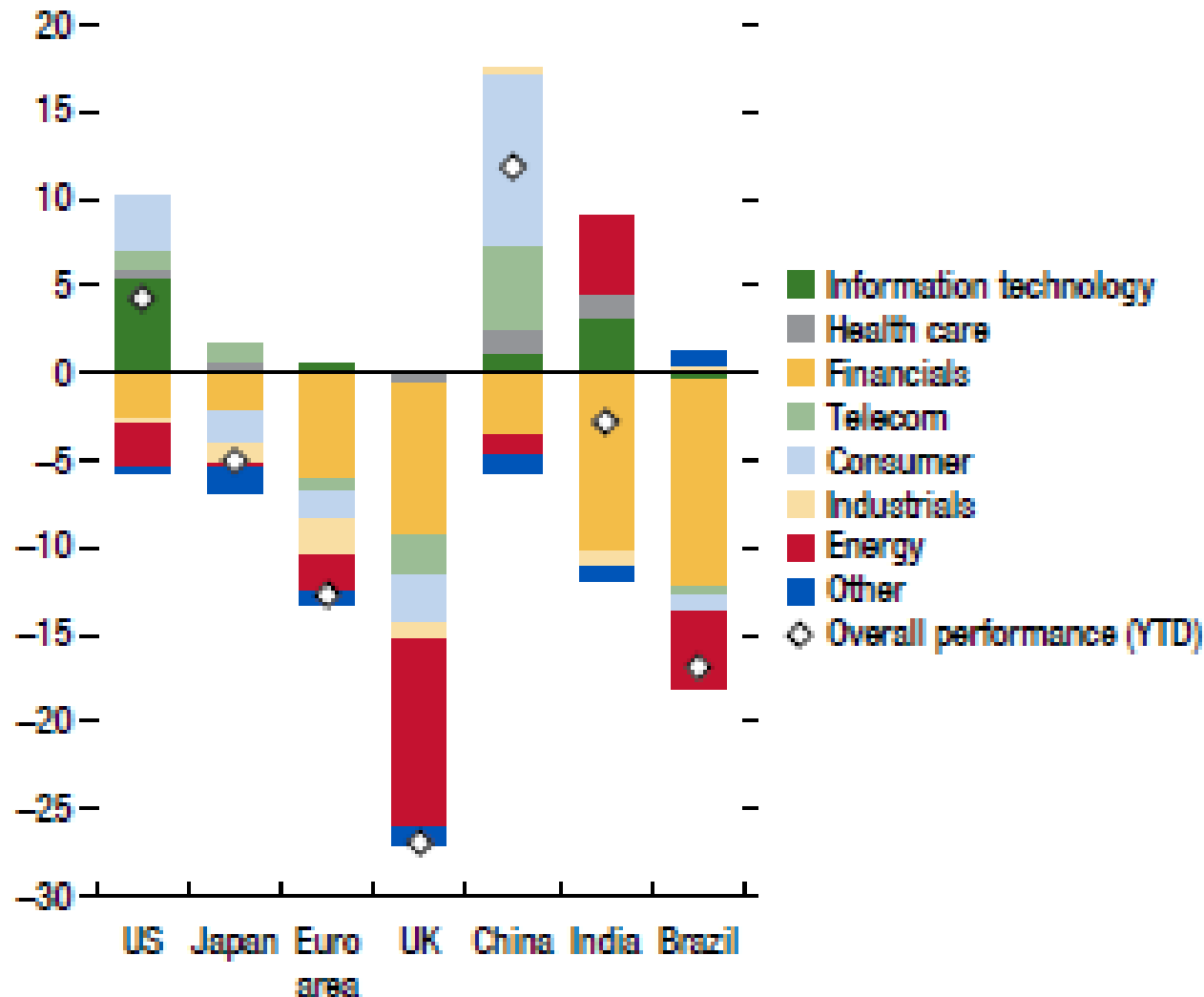


Post-pandemic Financial Reform Agenda

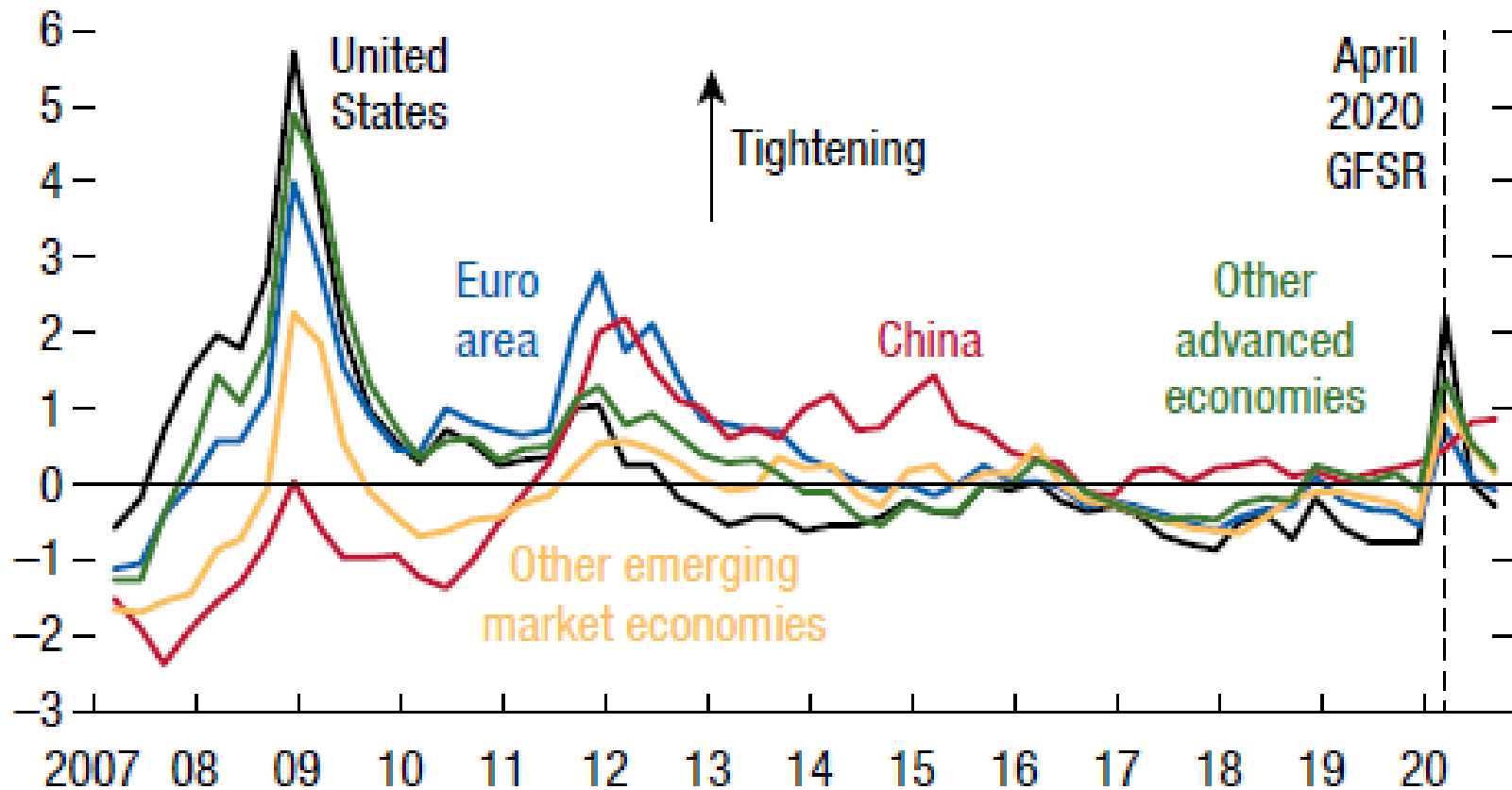
Nonbank financial sector—Strengthen the regulatory framework to address vulnerabilities exposed during the coronavirus disease (COVID-19) crisis.

Lower for longer—Implement prudential measures to contain risk-taking in the lower-for-longer interest-rate environment.

Stock Market Performance in 2020: Sectoral Contributions (Percent, year to date)



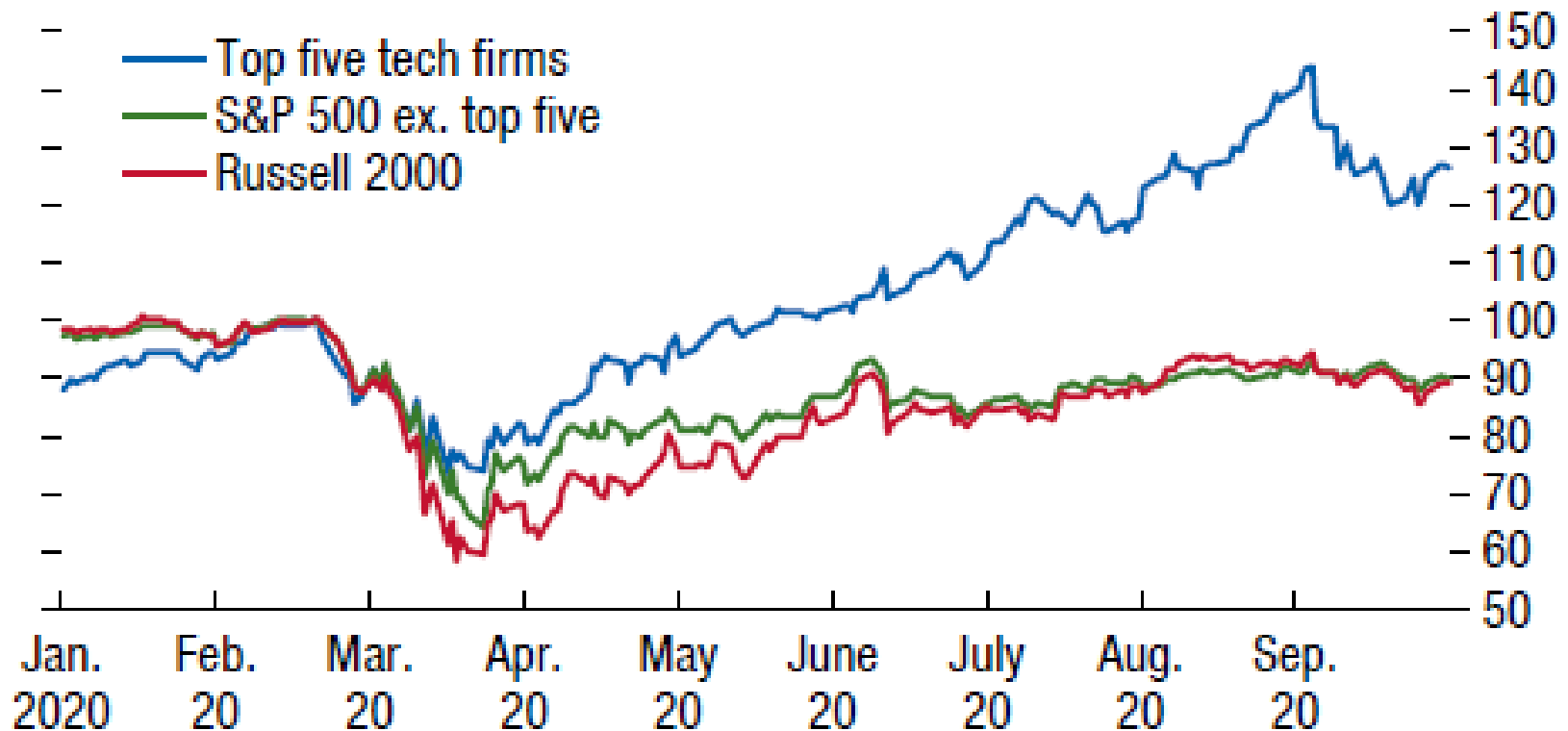
Global Financial Conditions Indices (Standard deviations from mean)



In emerging market economies, financial conditions have eased as well.

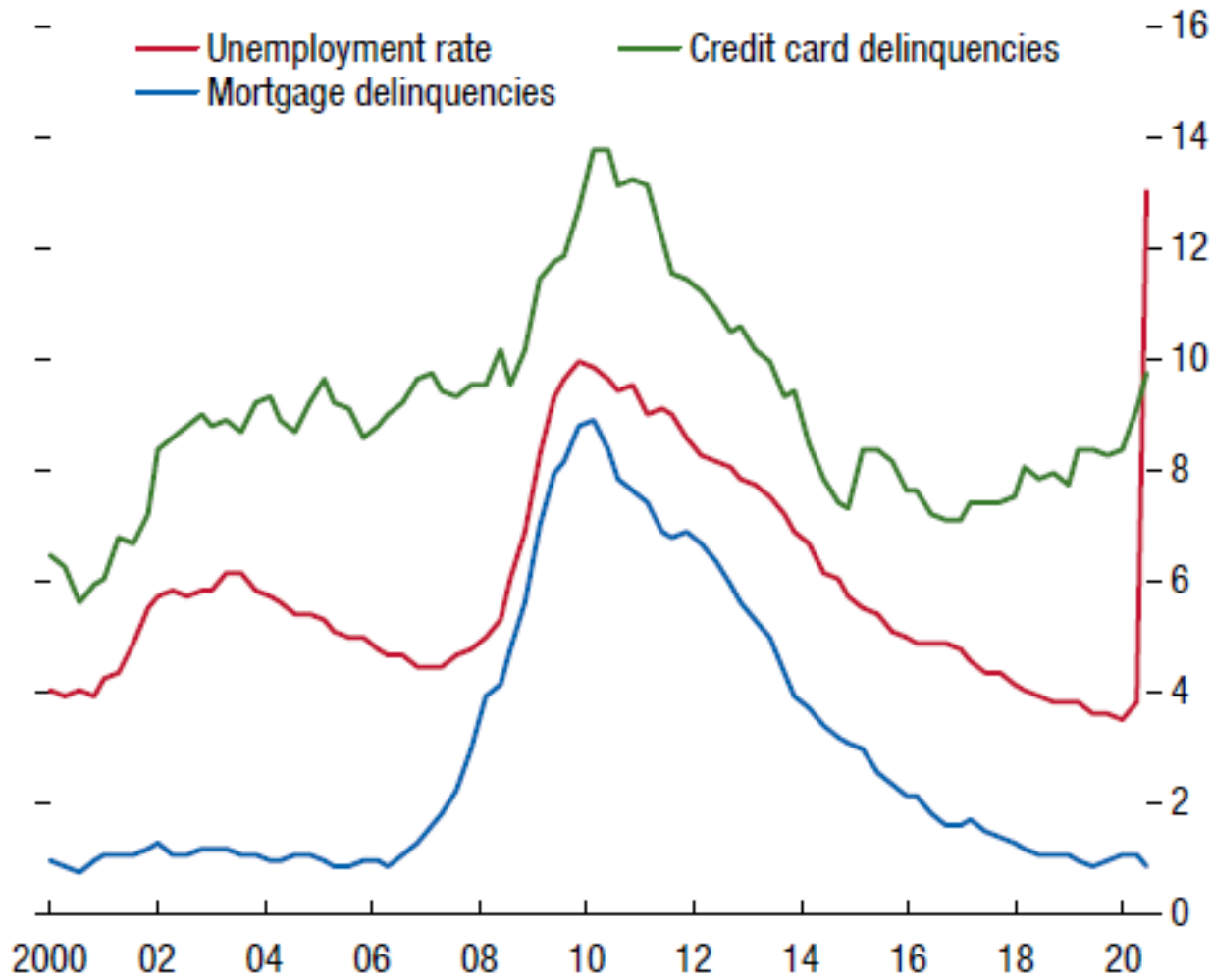
US Stock Market Performance

(Indices; February 19, 2020 = 100)



Valuations in major equity markets have become increasingly stretched by historical standards.

US Unemployment Rate and Delinquency Rates on Credit Card and Mortgage Loans (%)



Rising unemployment may portend higher delinquencies on loans to households.

Thank You