



International Monetary Fund

February 6, 2025

BIS High-Level Chapultepec Conference

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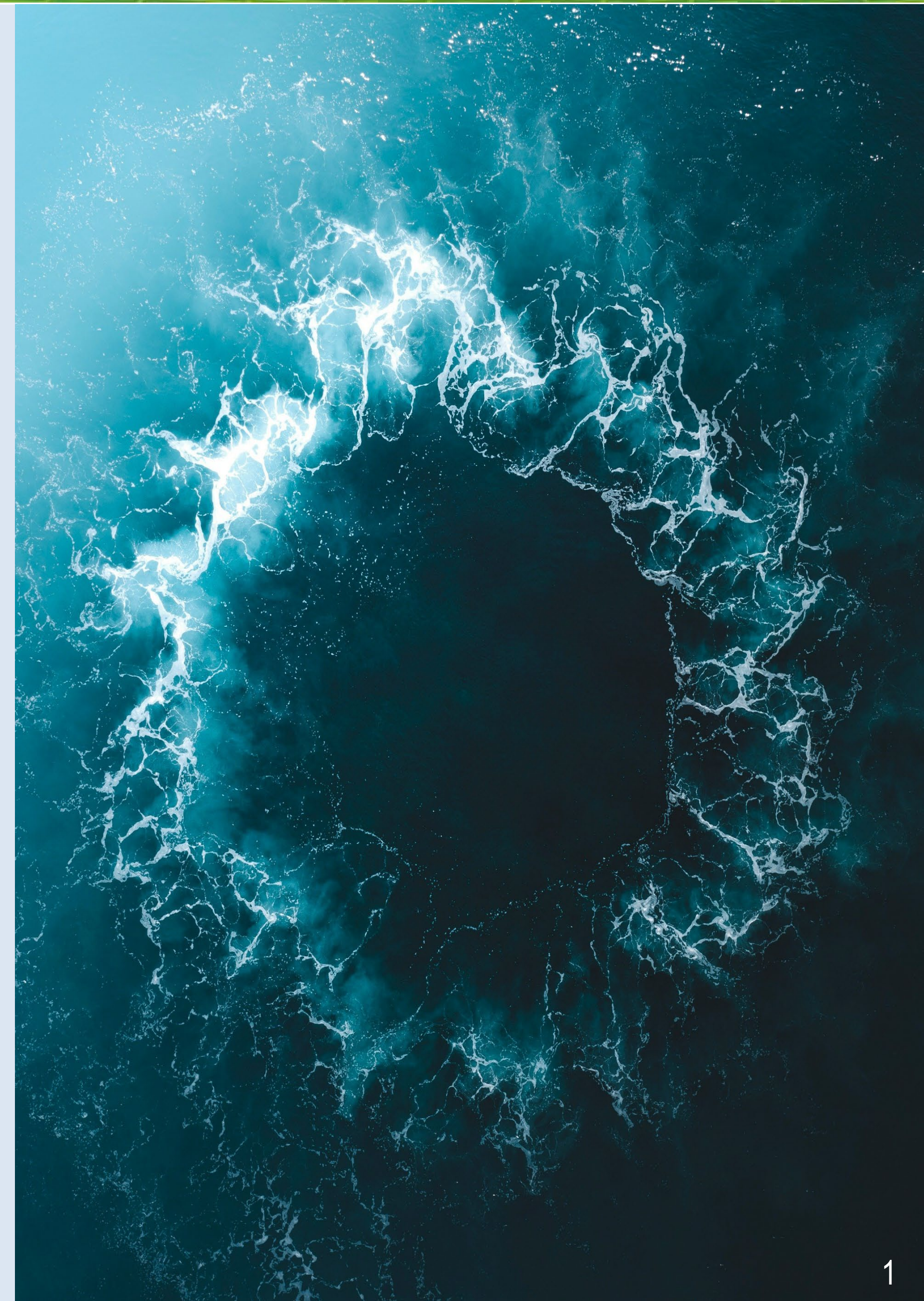
Braving Uncharted Waters

❑ The global policy environment is shifting

- Monetary policy divergences in major jurisdictions widen
- Fiscal and inflation concerns put pressure on long-term rates
- Dollar has strengthened substantially
- US equity markets have outperformed peers

❑ Risks are emerging from

- Potential re-pricing of US equities and tighter global financial conditions
- Diminishing policy space, particularly in EMDEs
- Higher refinancing costs for corporates





Heightened Uncertainty



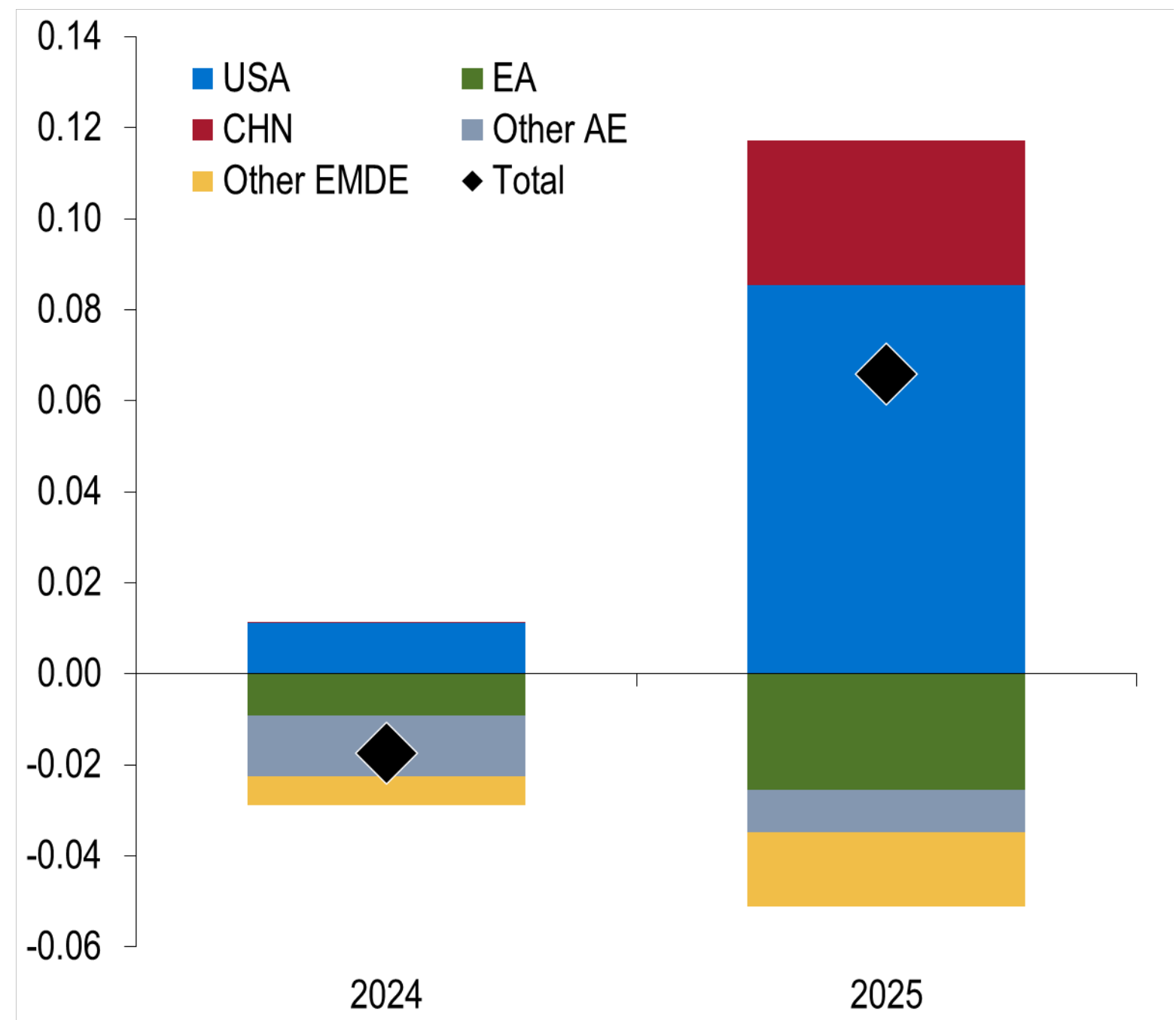
Growth is diverging

Global growth is revised upward this year, led by a few countries...

...as potential growth remains lackluster...

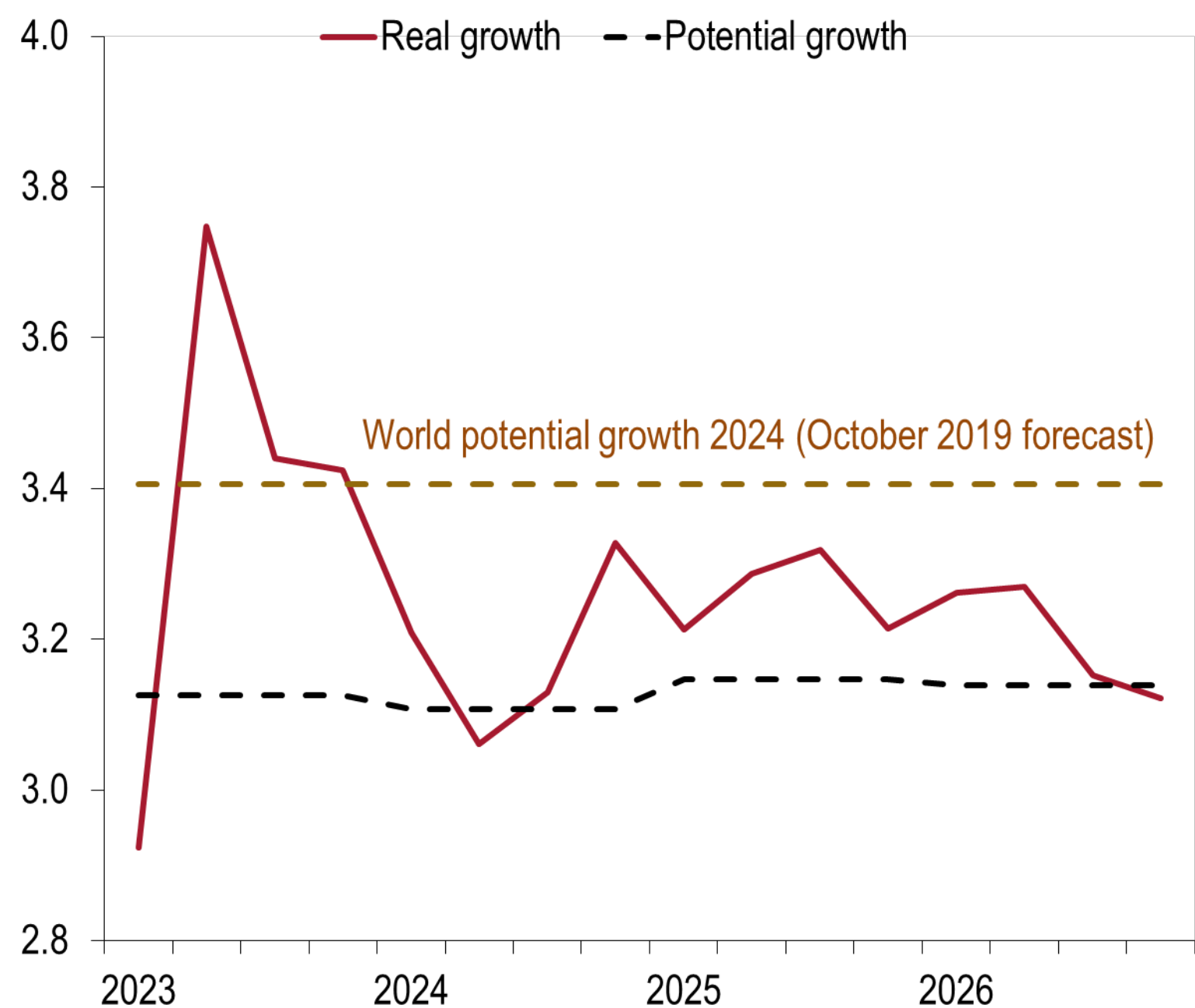
...even as global core inflation is in retreat.

World Growth Revisions Relative to October 2024 WEO
(Percentage points)



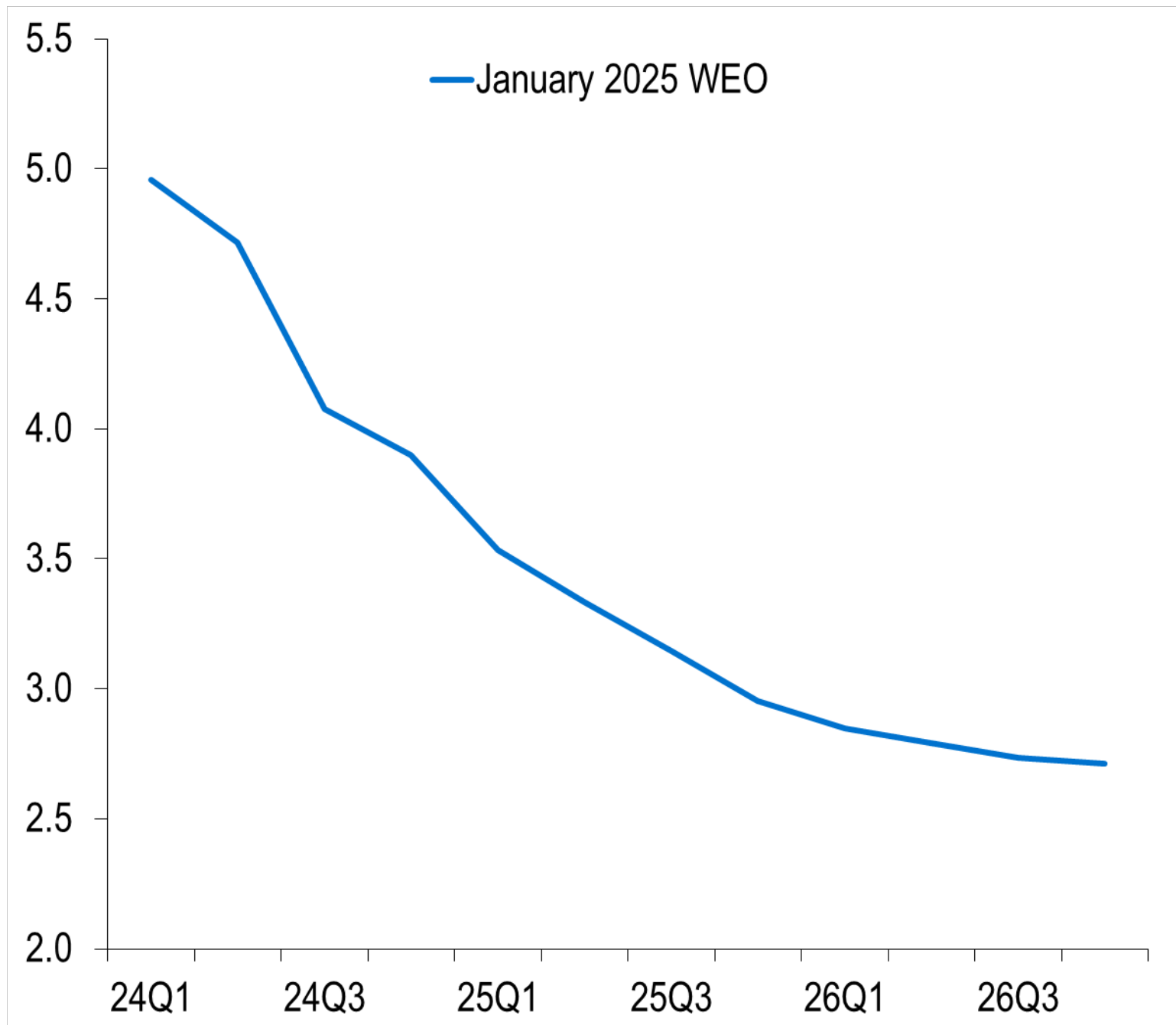
Sources: Central bank websites; Haver Analytics; IMF World Economic Outlook; and IMF staff calculations.

World Growth Evolution
(Percent change, year-over-year)



Sources: Central bank websites; Haver Analytics; IMF World Economic Outlook; and IMF staff calculations.

World Core Inflation
(Percent, year-over-year)



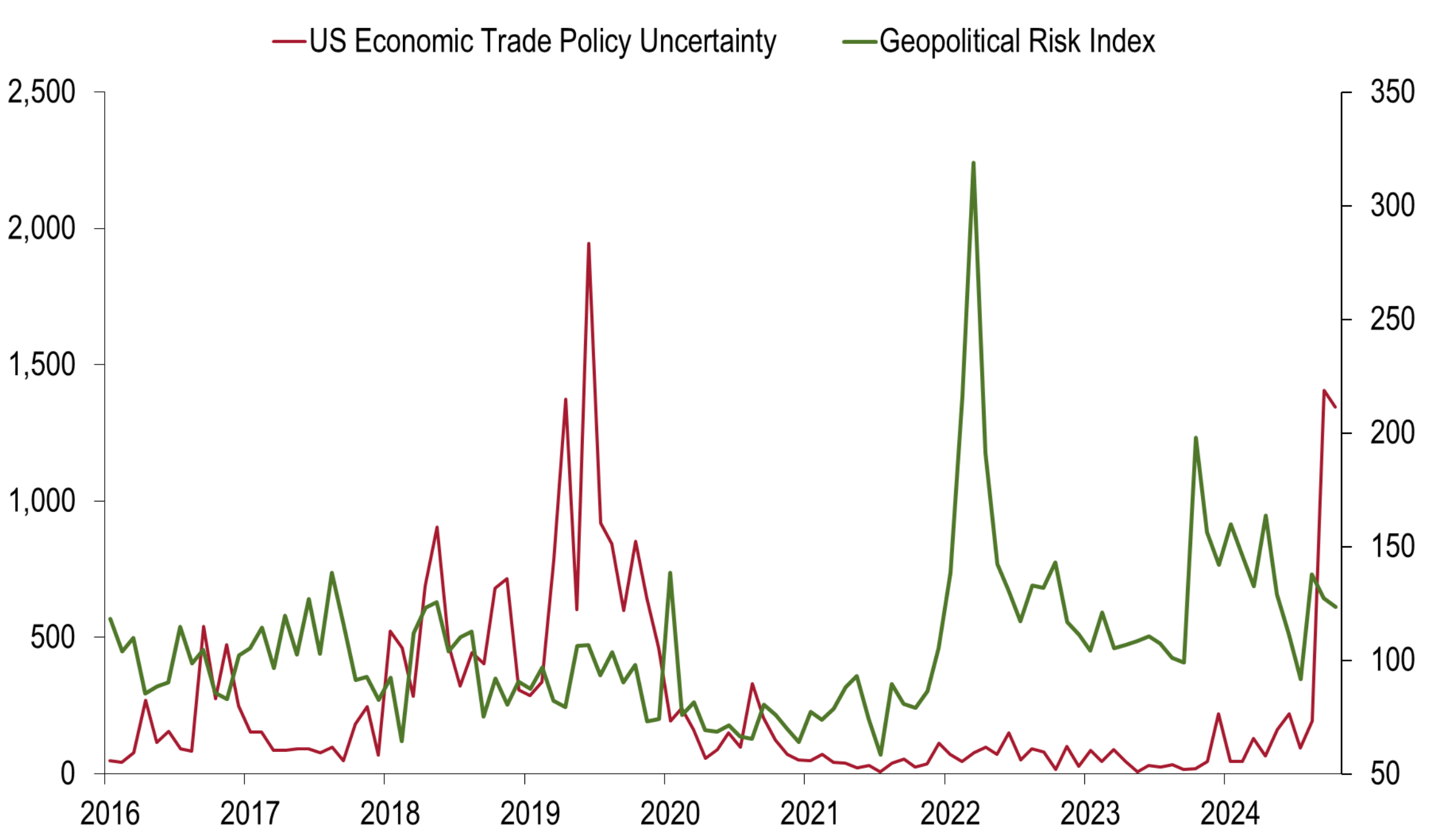
Sources: Central bank websites; Haver Analytics; IMF World Economic Outlook; and IMF staff calculations.

Financial Conditions Remain Accommodative Despite Rising Policy Uncertainties

Trade uncertainty is rising amid heightened geopolitical risk...

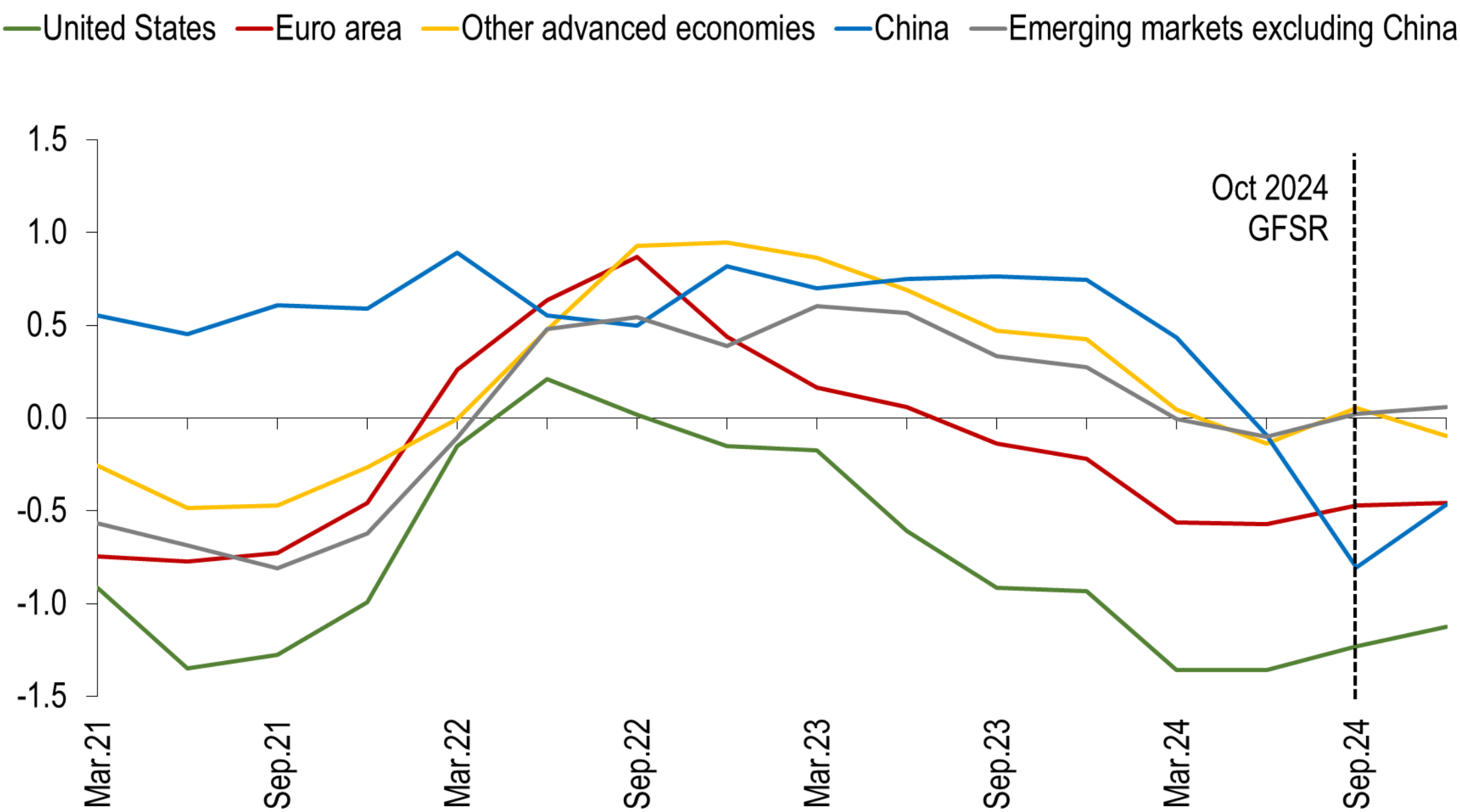
...so far without significantly tightening financing conditions.

Trade Uncertainty and Geopolitical Risk
(Indices)



Sources: Baker, Bloom, and Davis (2019); Caldara, Dario, and Matteo Iacoviello (2022); and IMF staff calculations.

Financial Conditions Index
(Number of standard deviations from the long-term average)



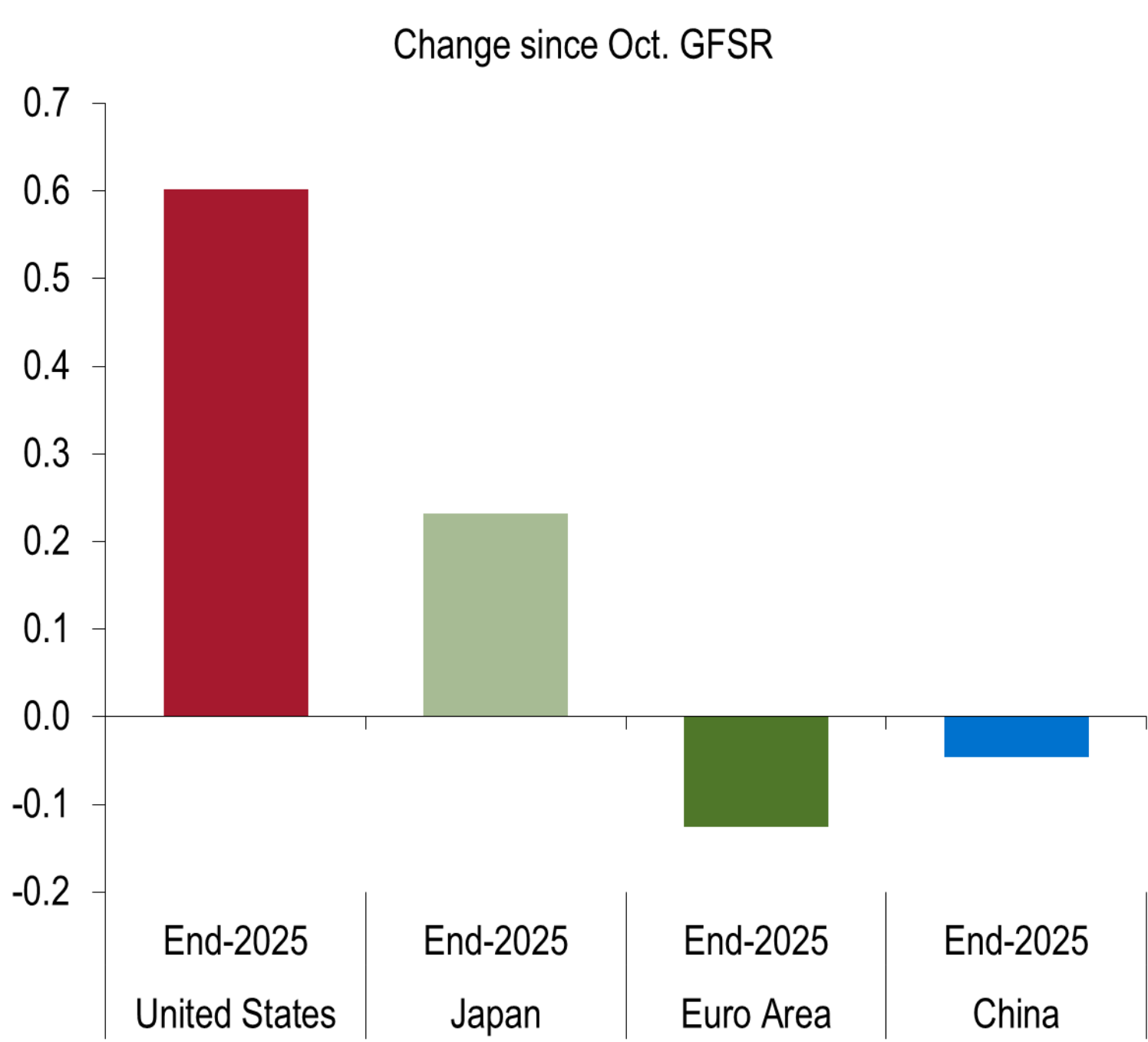
Sources: Bloomberg Finance L.P.; Haver Analytics; national data sources; and IMF staff calculations.

Monetary Policy Divergence

Monetary policy rates are diverging.

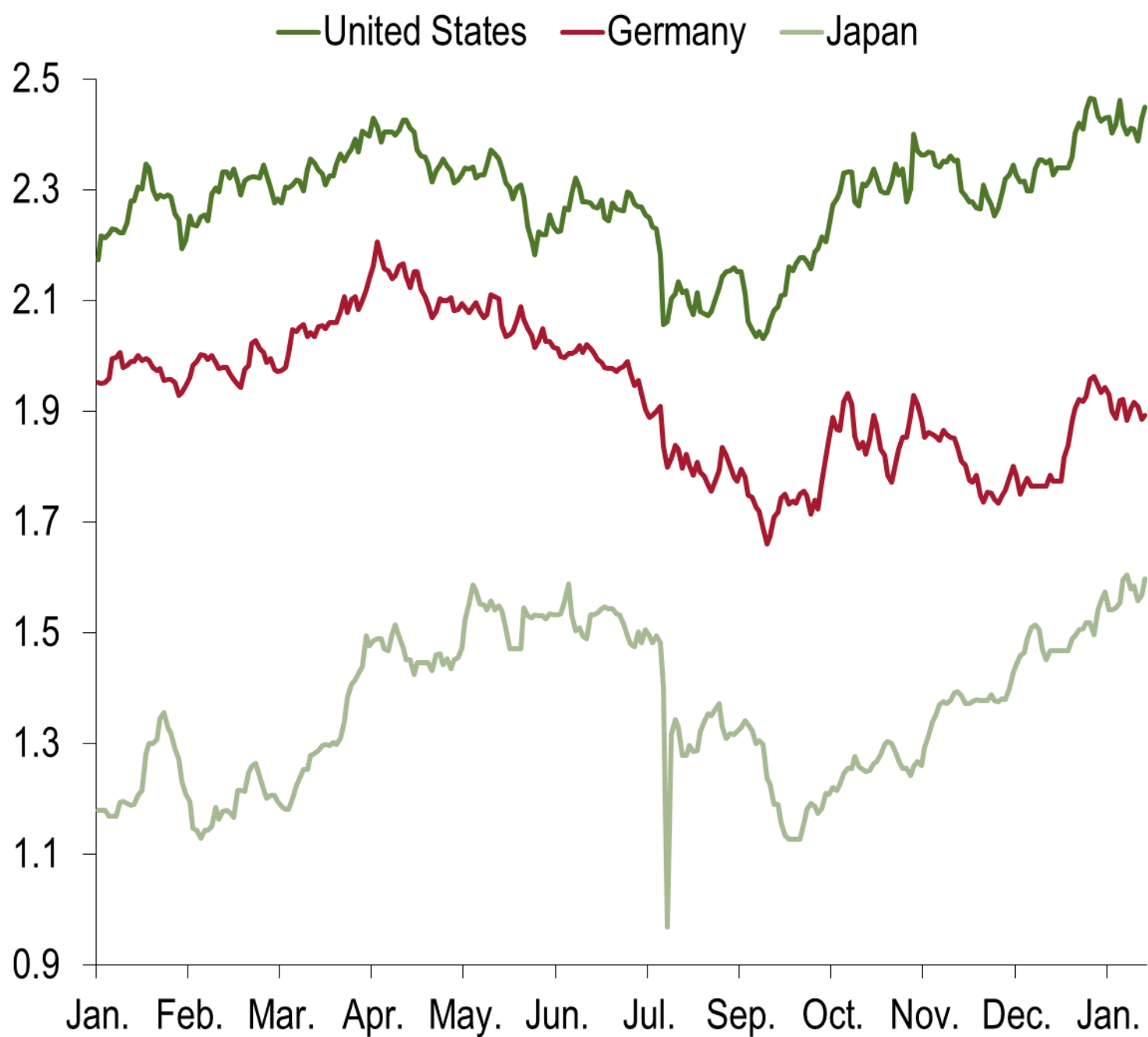
Reflecting diverging paths in the disinflation process and growth.

Policy Rate Expectations at End-2025
(Percent)



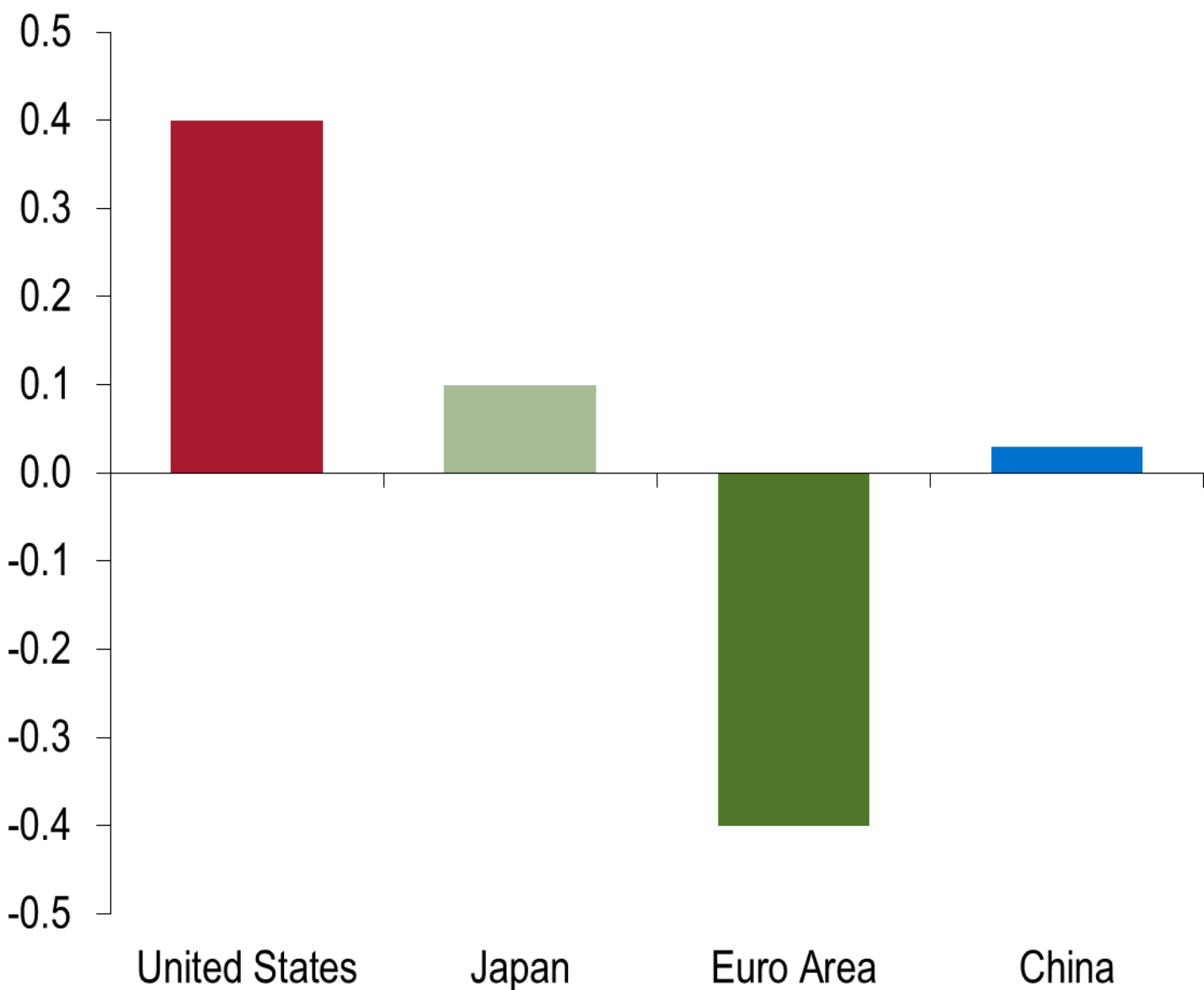
Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Update from end of December 2024

10yr Inflation Breakeven Rates
(Percentage points)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Update from end of December 2024

Changes in 2025 Survey Growth Forecasts Over Past 6-Months
(Percentage points)

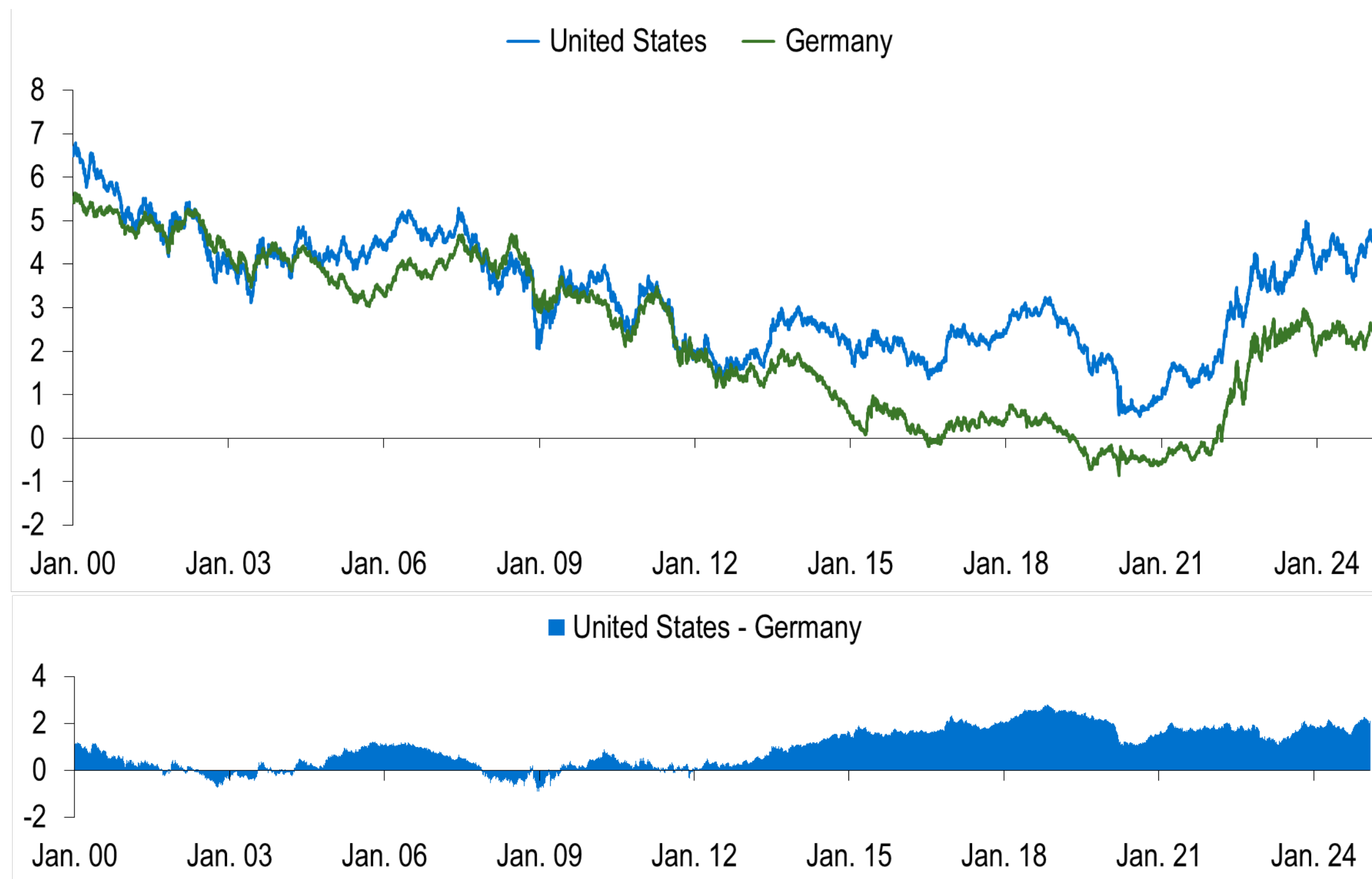


Sources: Bloomberg Finance L.P.; and IMF staff calculations.

Long-Term Government Rates Across Major Economies are Shifting

Divergence between US and German longer-term rates has increased over time...

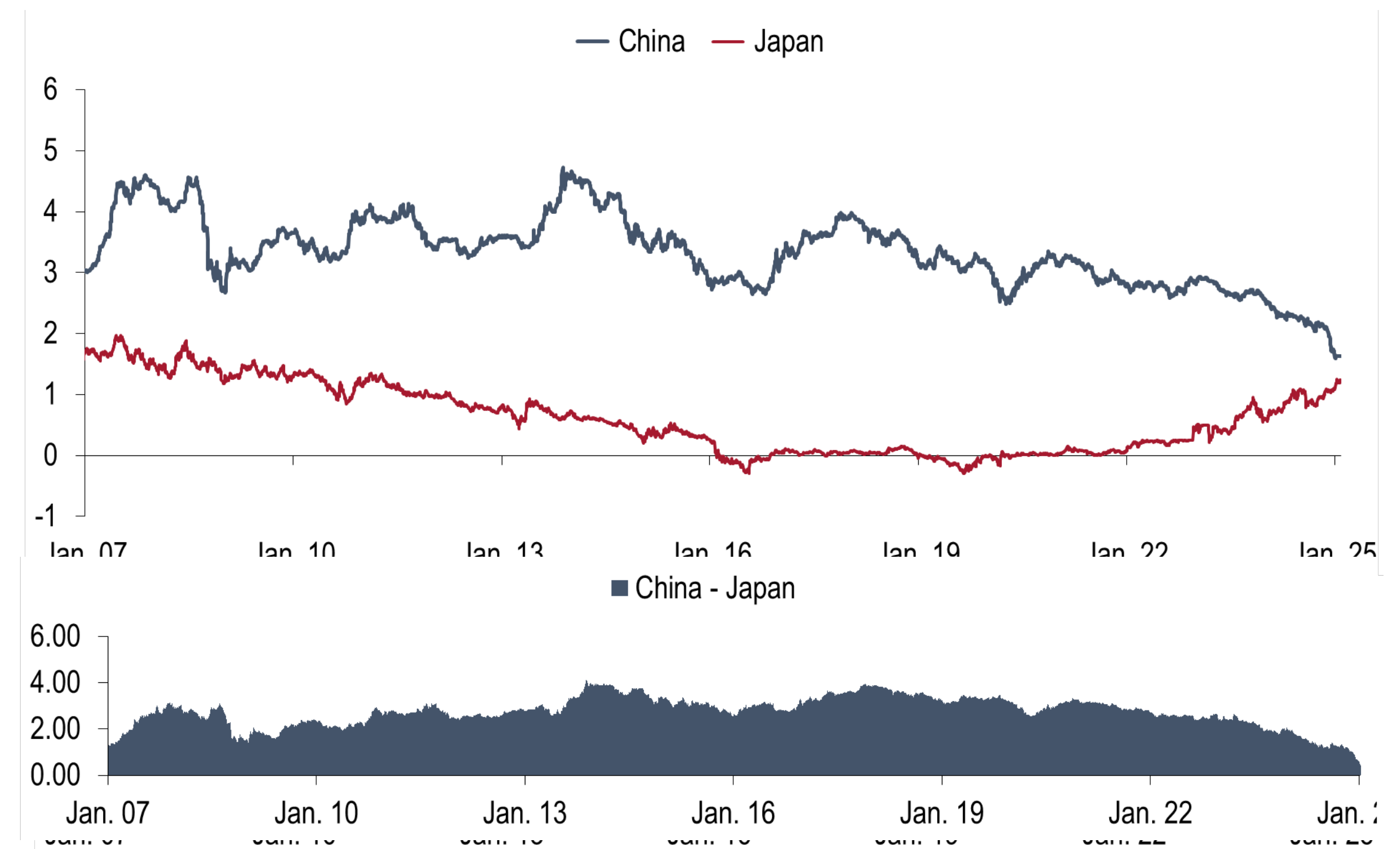
US and Germany 10-Year Sovereign Bond Yields
(Percentage points)



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

...while rates in China and Japan have been converging lately.

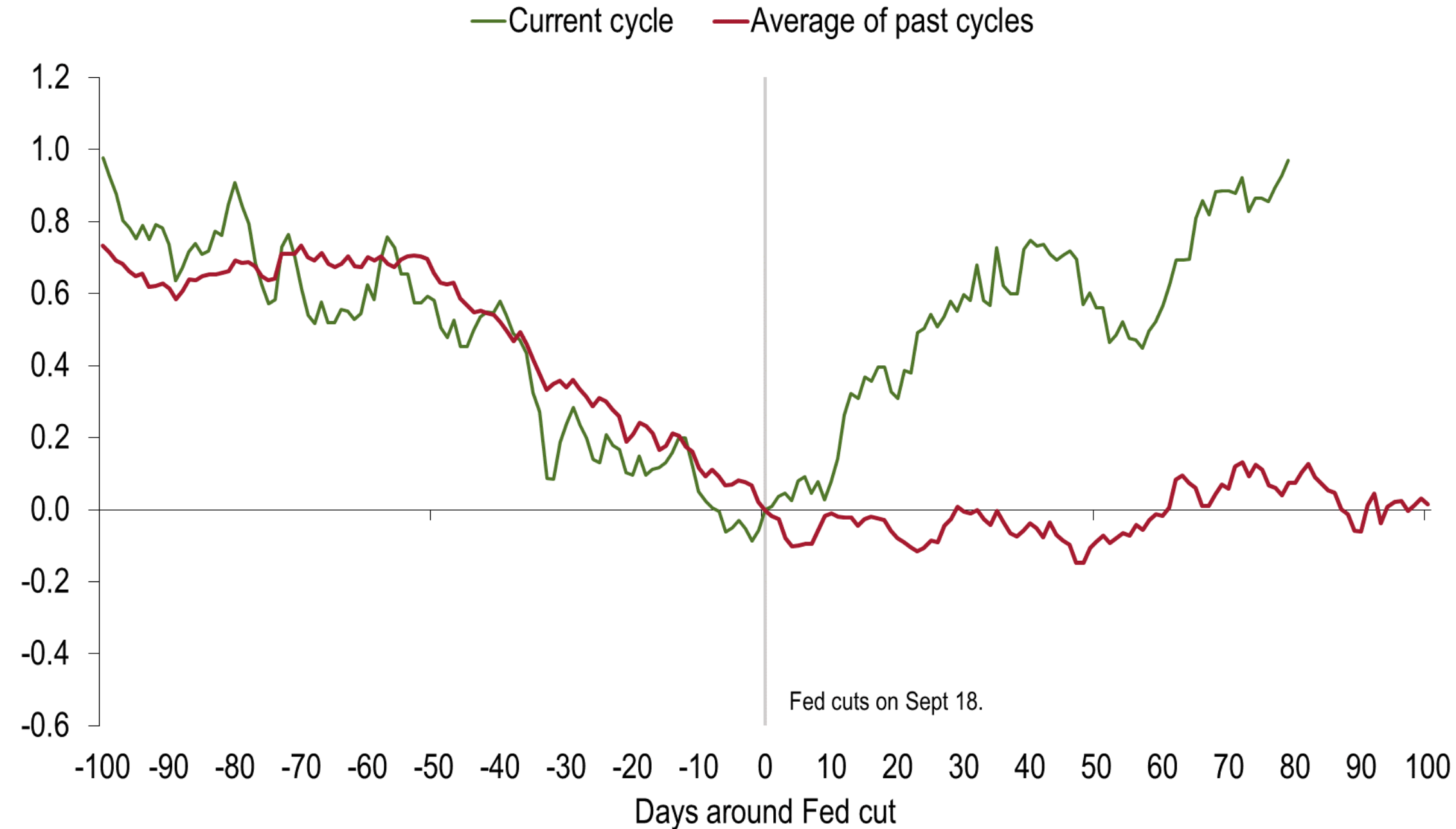
China and Japan 10-Year Sovereign Bond Yields
(Percentage points)



US Long-Term Yields are Rising Despite Cuts to the Policy Rate

US 10-years rates diverge from past-cycles.

**US 10-Year Government Bond Yields
Before and After First Fed cut**
(Percentage points)

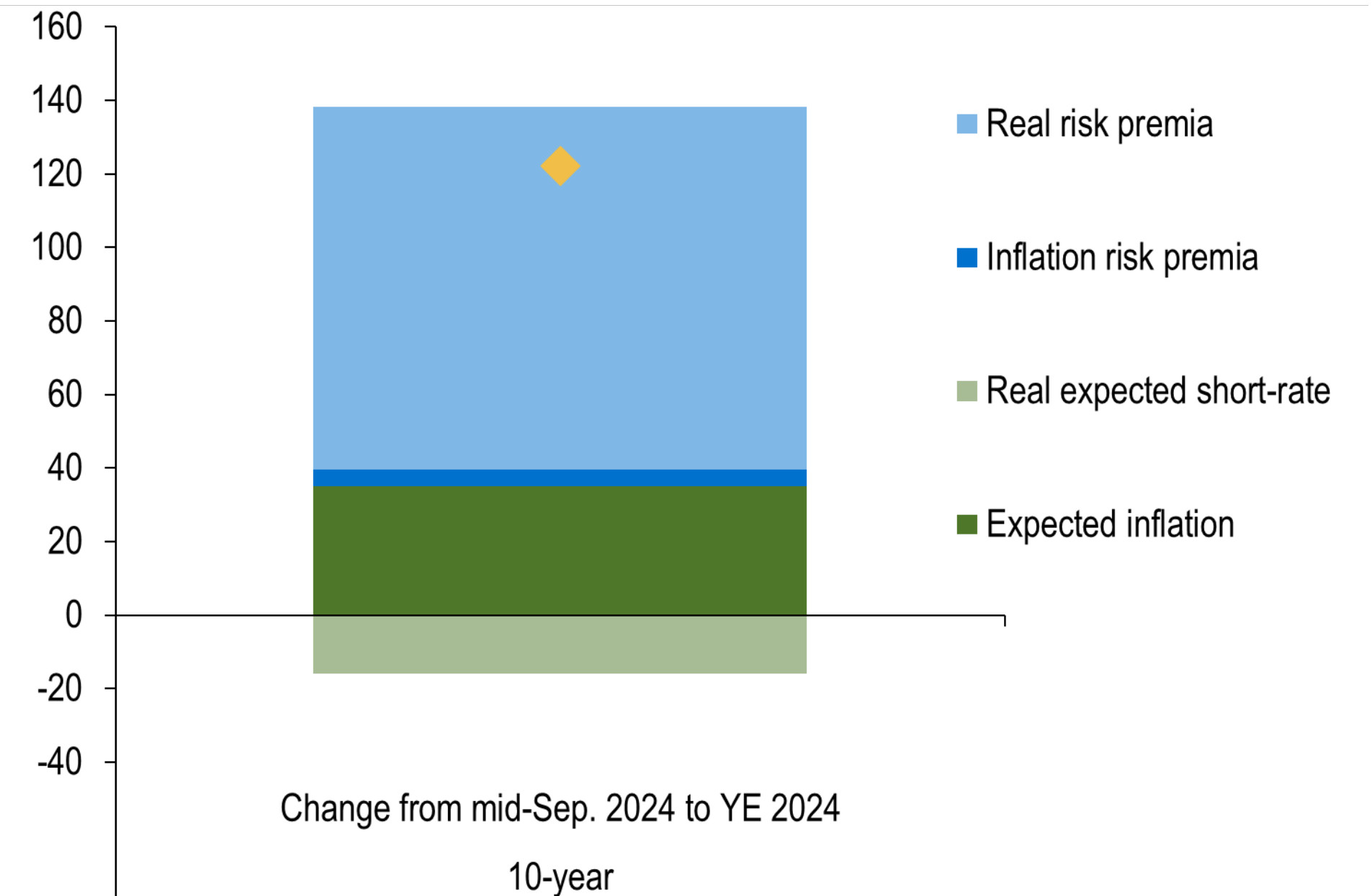


Sources: Bloomberg Finance L.P.; and IMF staff calculations.

Note: Averages from past cycles include cutting cycles beginning in June 1989, September 1998, January 2001, September 2007, and July 2019.

This behavior has been driven by both higher real risk premia and higher inflation expectations.

**Decomposition of the Change in US 10-Year
Government Bond Yields Since the Last GFSR**
(Basis points)



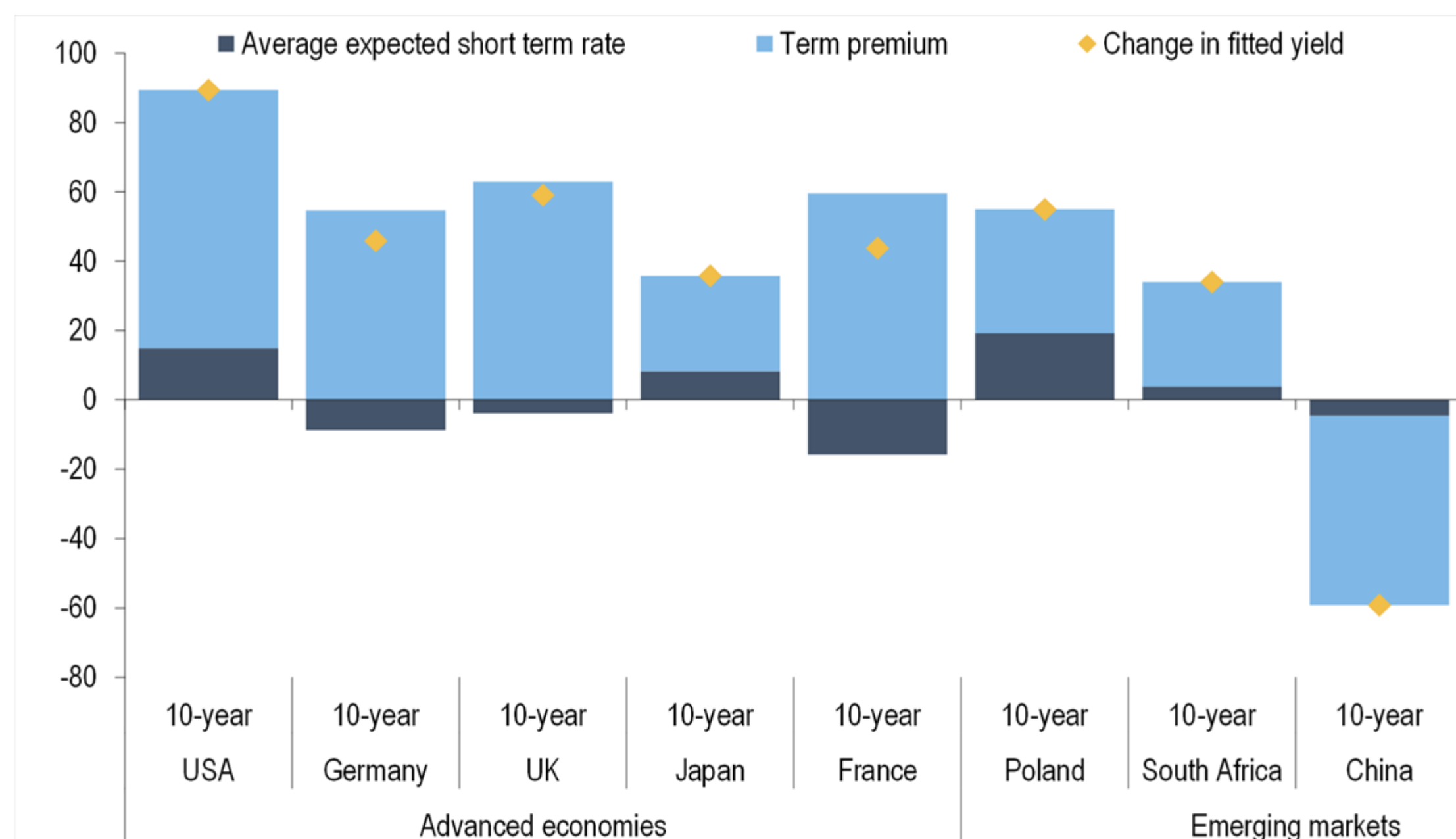
Sources: Bloomberg Finance L.P.; and IMF staff calculations.

Term Premia Remain Elevated Globally, on Fiscal Concerns and Spillovers

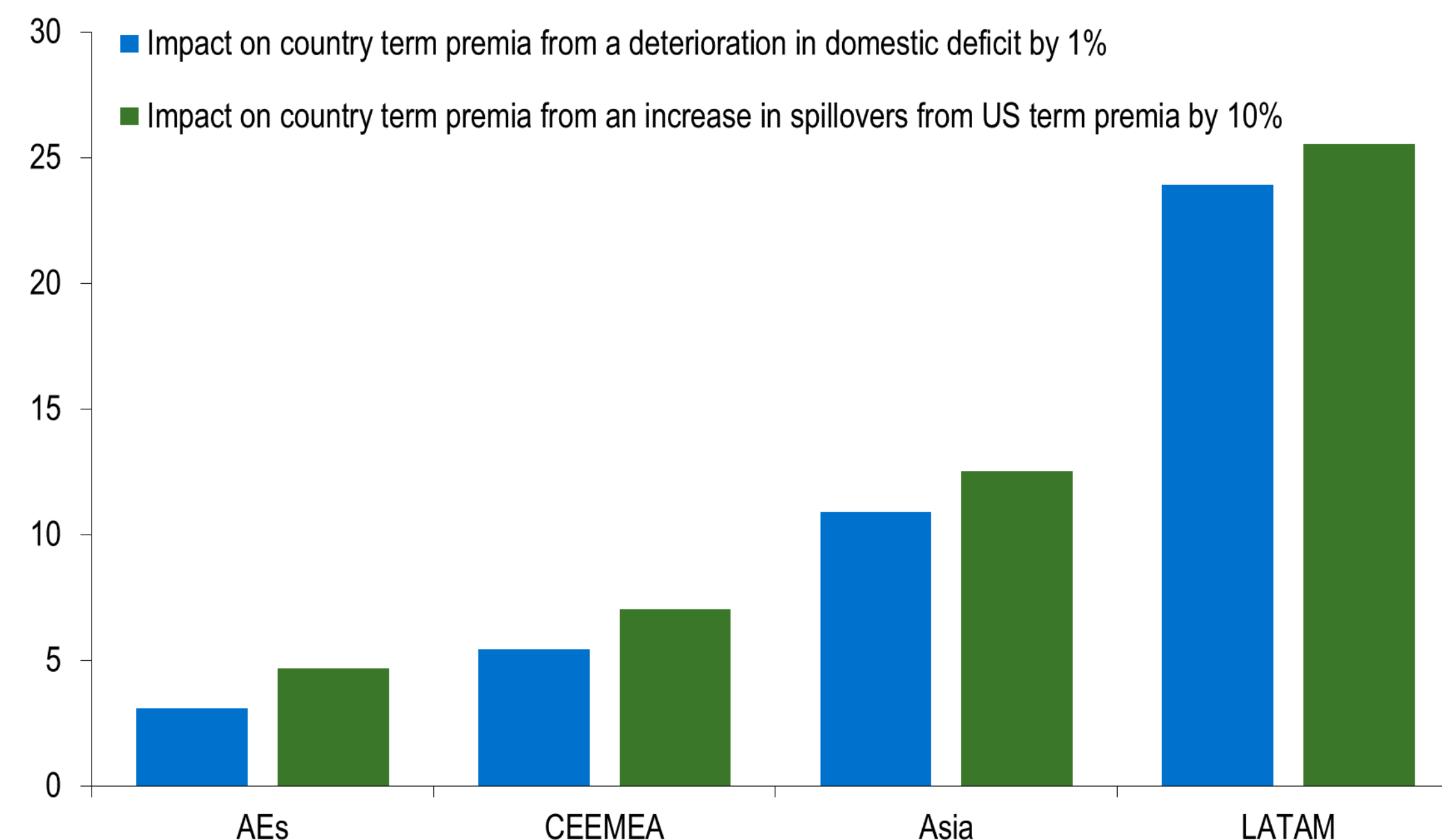
Term premia have increased across most countries...

...due to deteriorating domestic deficits and growing spillovers from the US term premia.

Decomposition of the Change in 10-Year Government Bond Yields Since the Oct. 2024
(Basis points)



Average Impact on Country Term Premia under Different Scenarios
(Basis points)



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

Note: Expected policy rates shown here are based on interest rate futures or swaps. Information conveyed by these markets may deviate periodically from other measures of policy rate expectations, such as those obtained from surveys of professional forecasters.

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

Note: Spillovers are measured by the proportion of variation in AE and EM term premia that can be explained by shocks emanating from the US term premia, following the methodology of Diebold and Yilmaz (2009). AEs include 20 countries and EMs 15 countries. Spillovers correspond to a 50-week rolling window. Regression runs from 1 Jan 1995 to 1 Dec 2024. During 2024, spillovers from the US increased by about 10% on average in 2024.

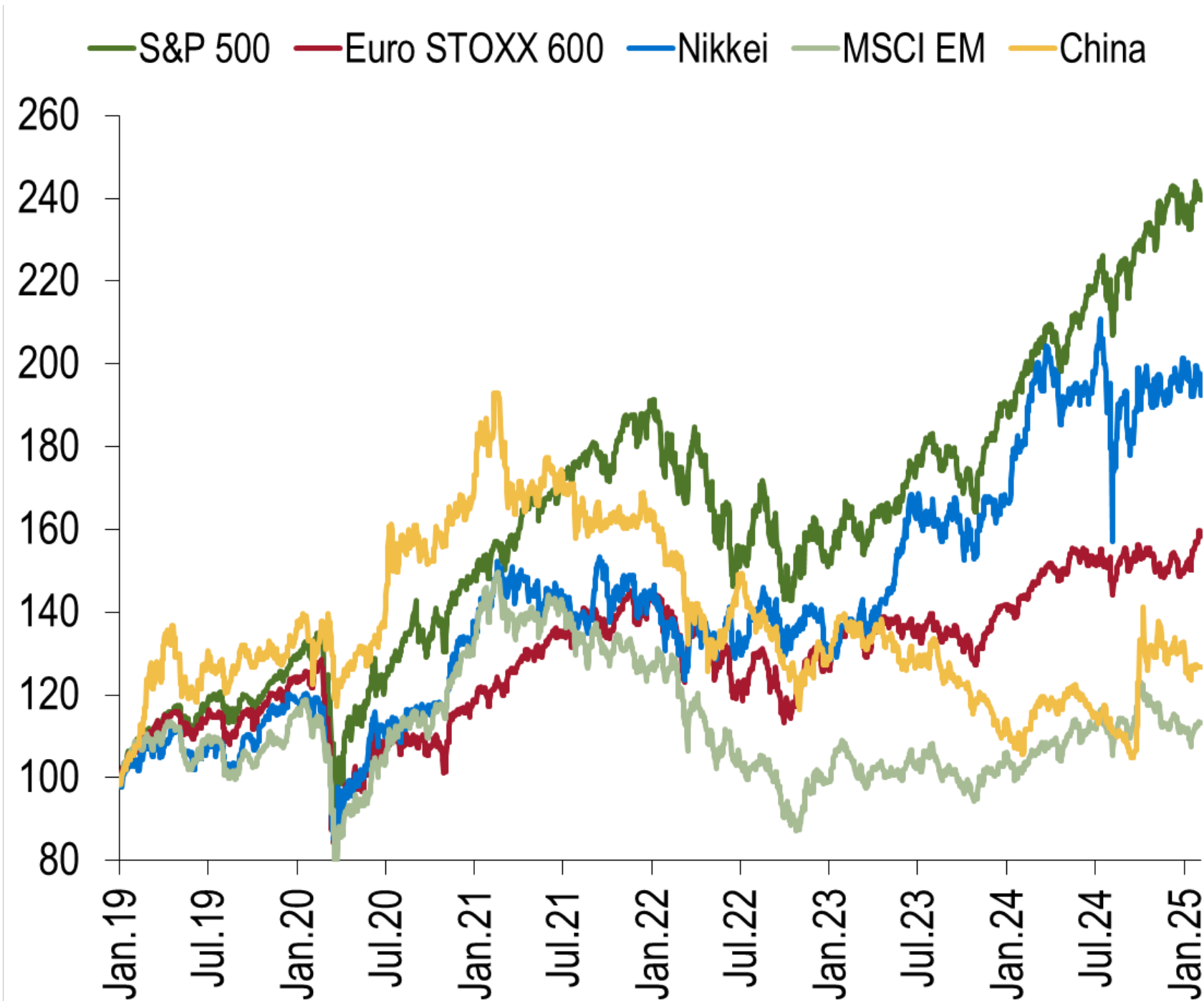
Risks for Financial Stability



Equity Market Rally is “Priced to Perfection”, Increasing the Risk of Repricing

US equity market has outperformed other countries significantly.

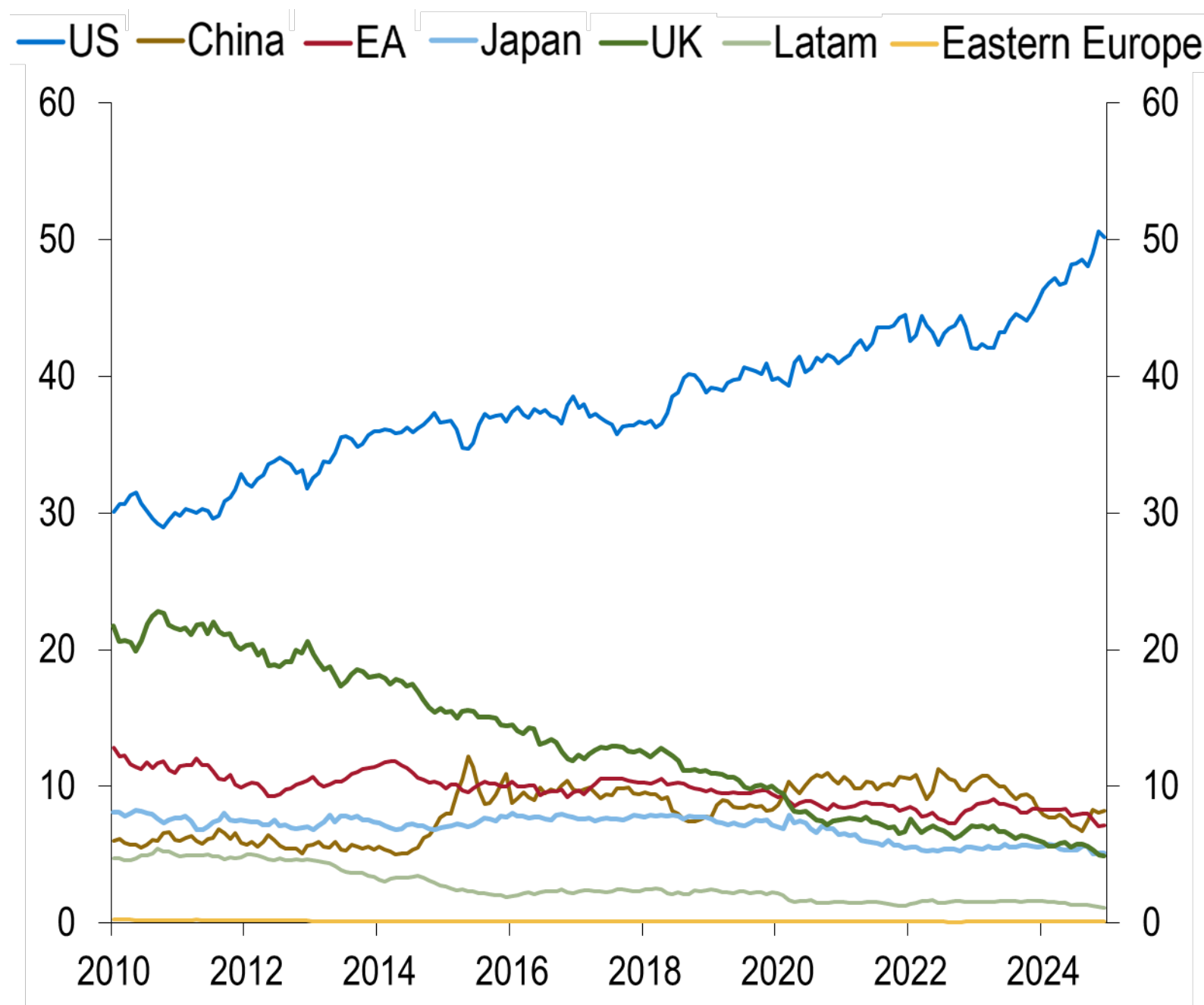
Performance of Selected Indices
(Cumulative growth indexed on December 31, 2018)



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

Increasing US share of world equity markets raises the potential global impact from US repricing.

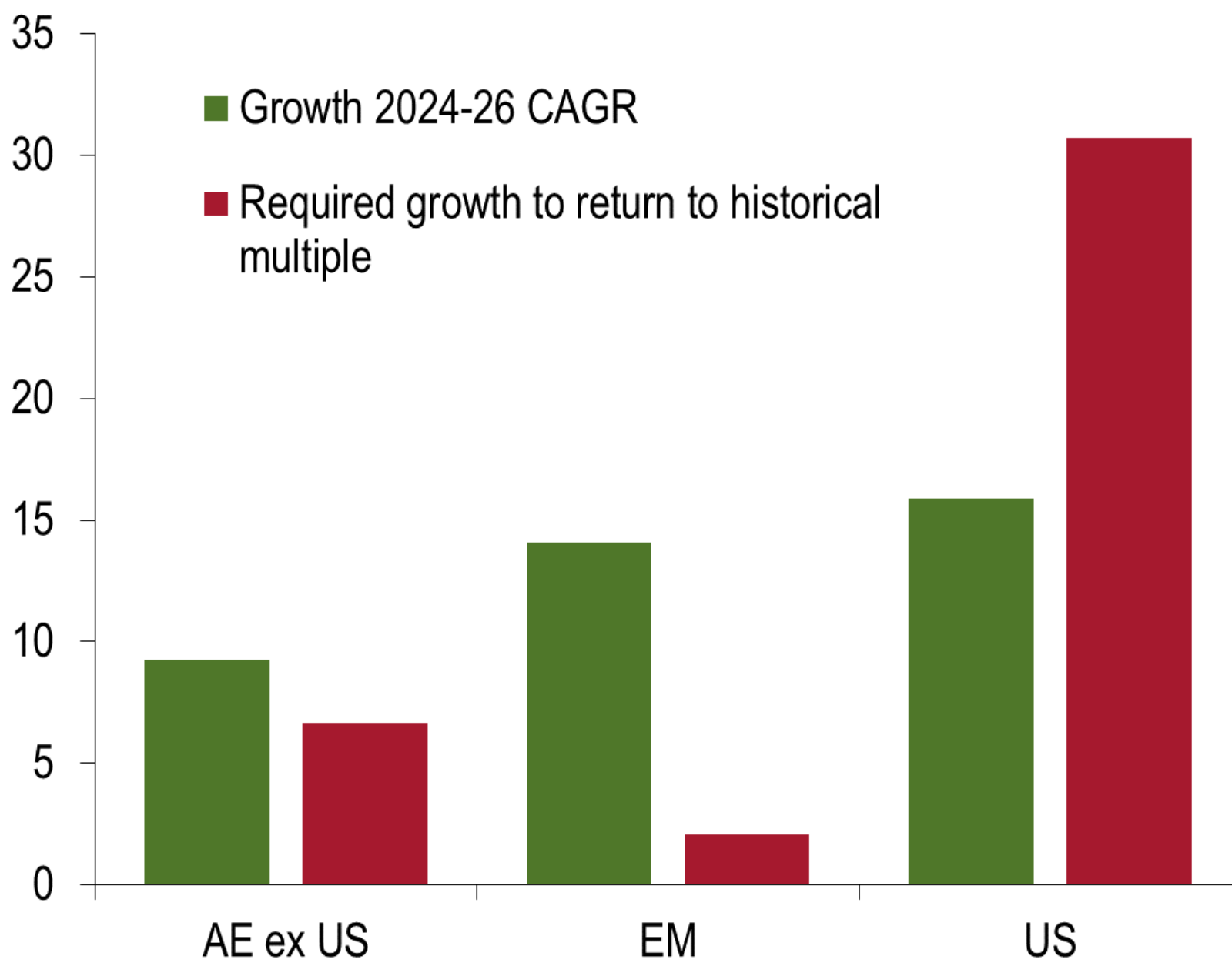
Share of World Equity Market Cap
(Percent)



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

Sustainability of valuations depends on unusually strong earnings growth, especially in the US.

Required Earnings Growth to Return Existing Valuation to Historical Average Multiple
(Percent)

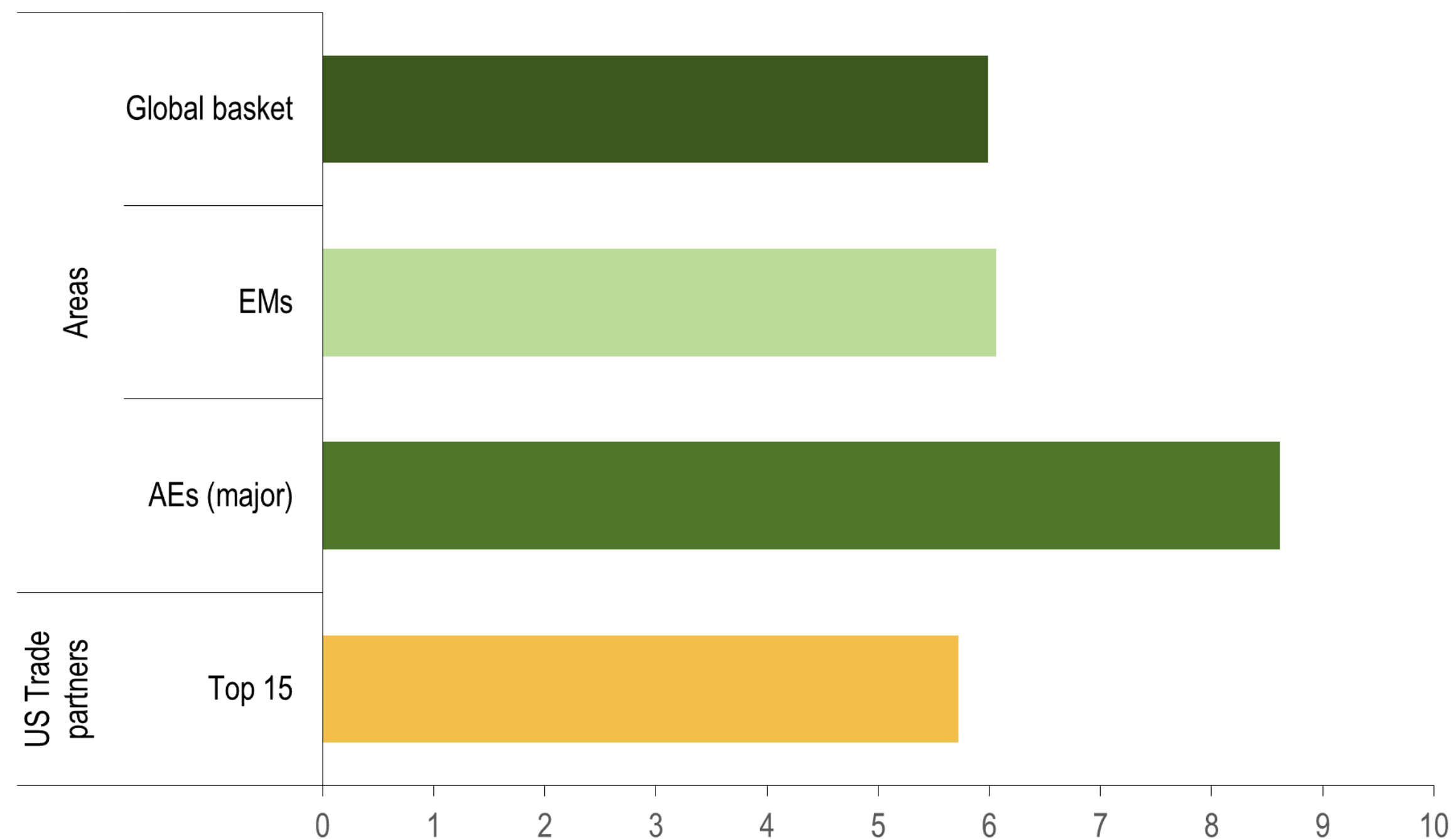


Sources: Bloomberg Finance L.P.; and IMF staff calculations.

US Dollar Strength can Tighten Financial Conditions Globally

US exceptionalism ratcheted up the USD...

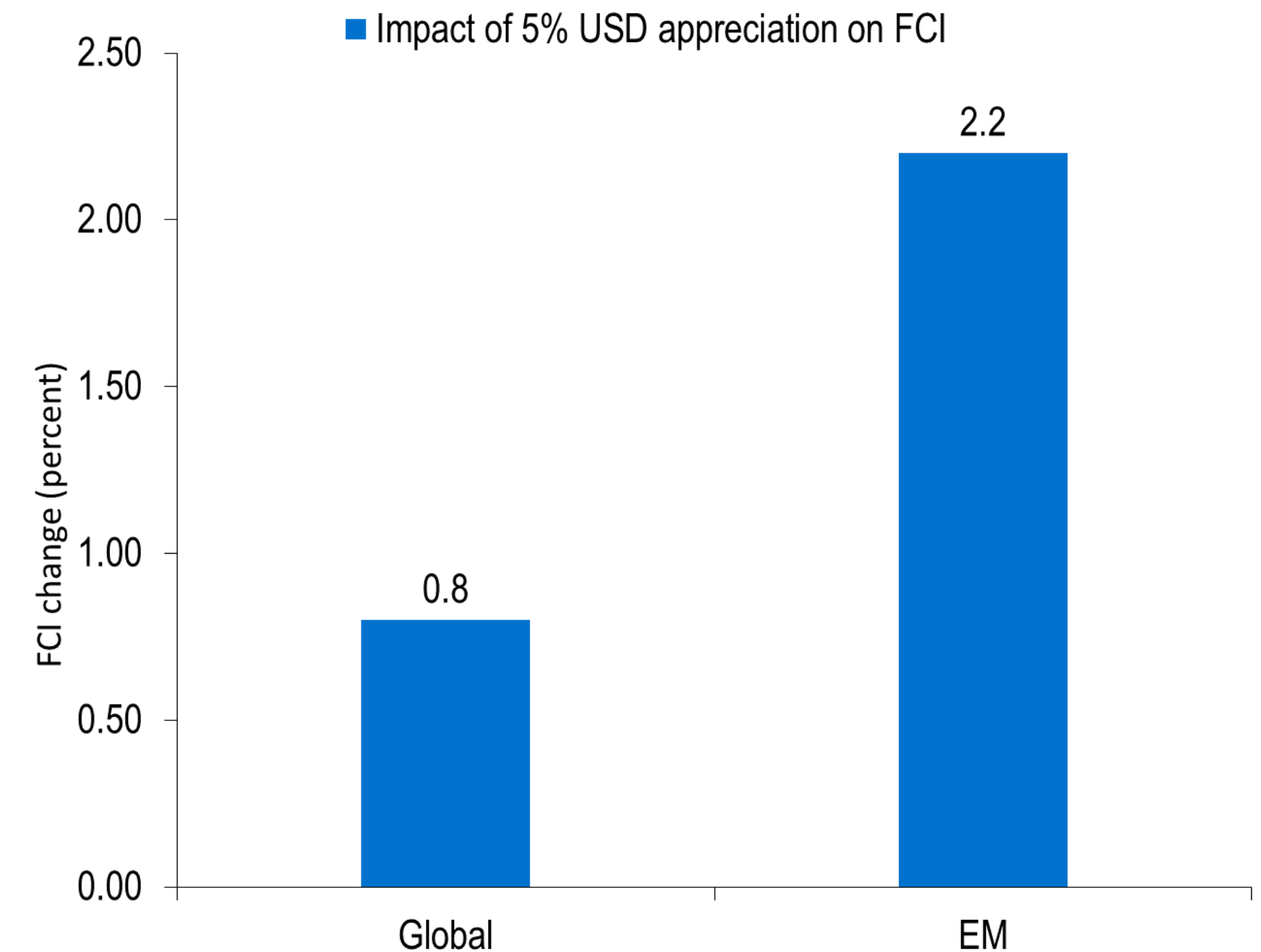
Dollar Appreciation since Sept. 1, 2024
(Percent)



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

...further appreciation of the USD means tighter financial conditions globally, notably in EMs.

Change in FCI indices (percent) Associated with a 5 Percent Appreciation in USD
(Percent)



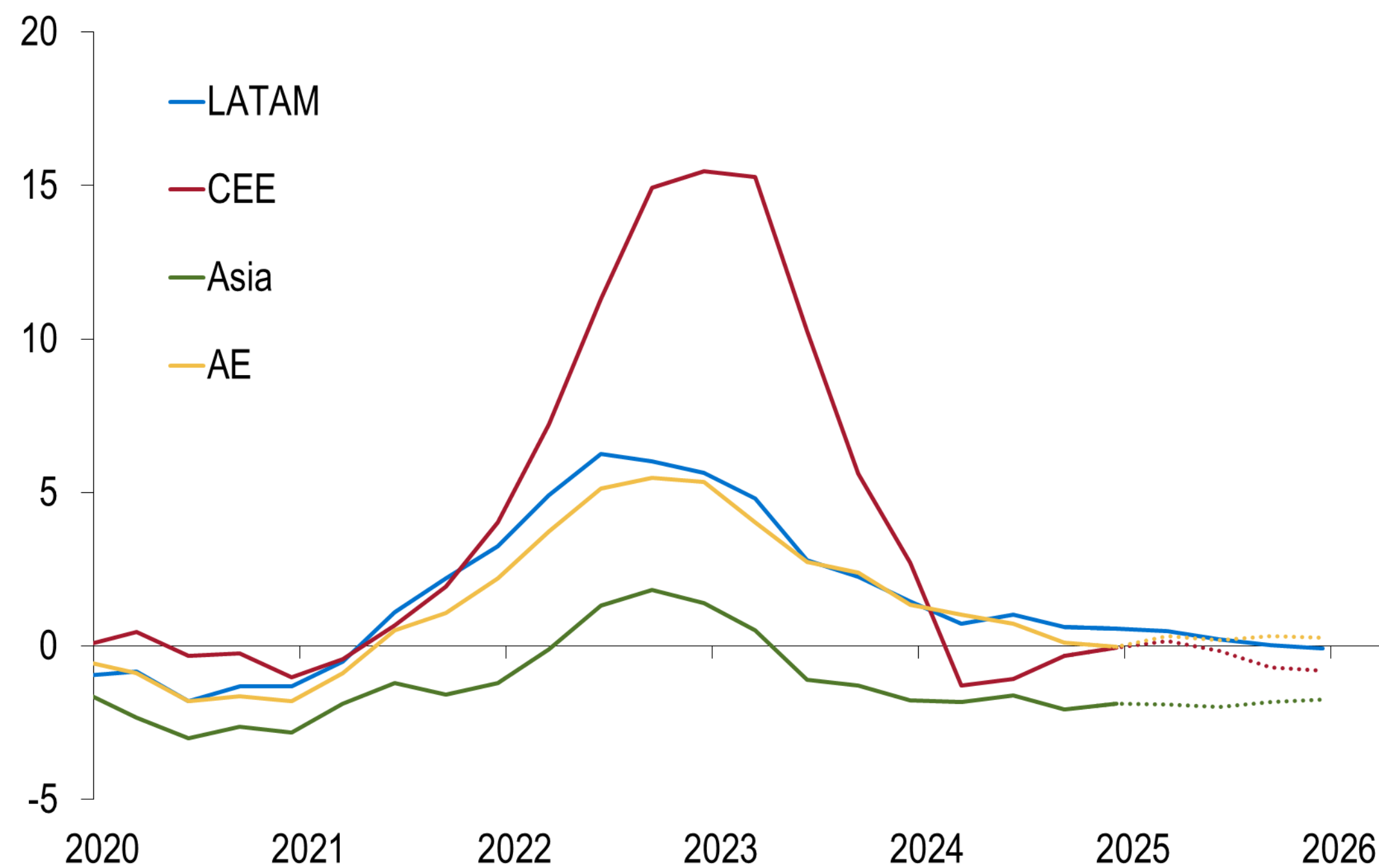
Sources: Goldman Sachs financial condition indices, Bloomberg (USD index) and JP Morgan (EM currency index); and IMF staff calculations.

Note: Regression sample 1 Jan 2022 – 3 Jan 2025.

EM Monetary Policy Faces Constraints

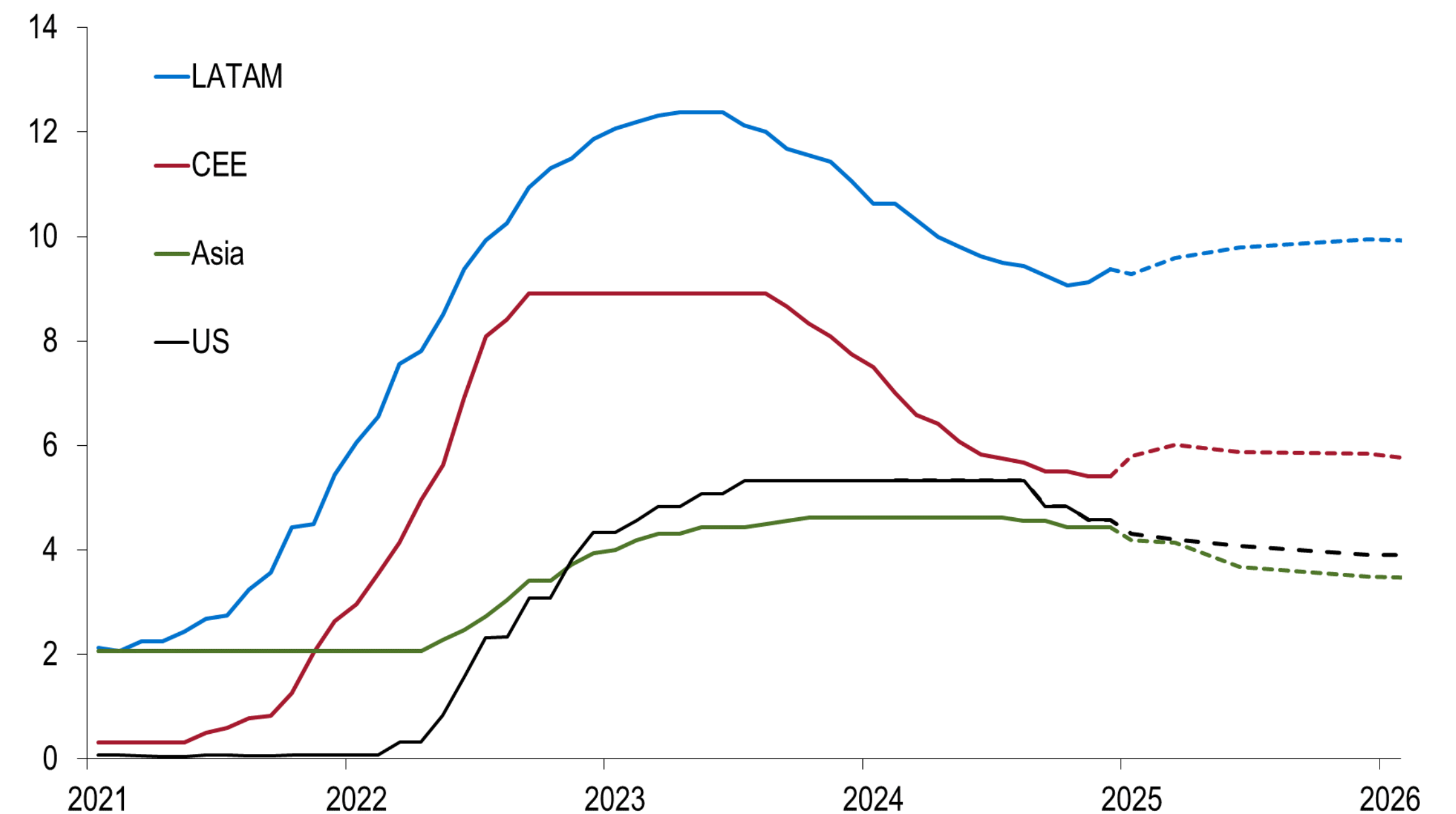
EM inflation is expected to remain near target levels in 2025 and 2026...

EM Inflation: Deviation from Upper Bound of Inflation Target (Percent)



...but concerns about longer-term inflation and shallower US cuts hinder further easing in EMs.

EM Policy Rate: Historical and Forecasts (Percent)



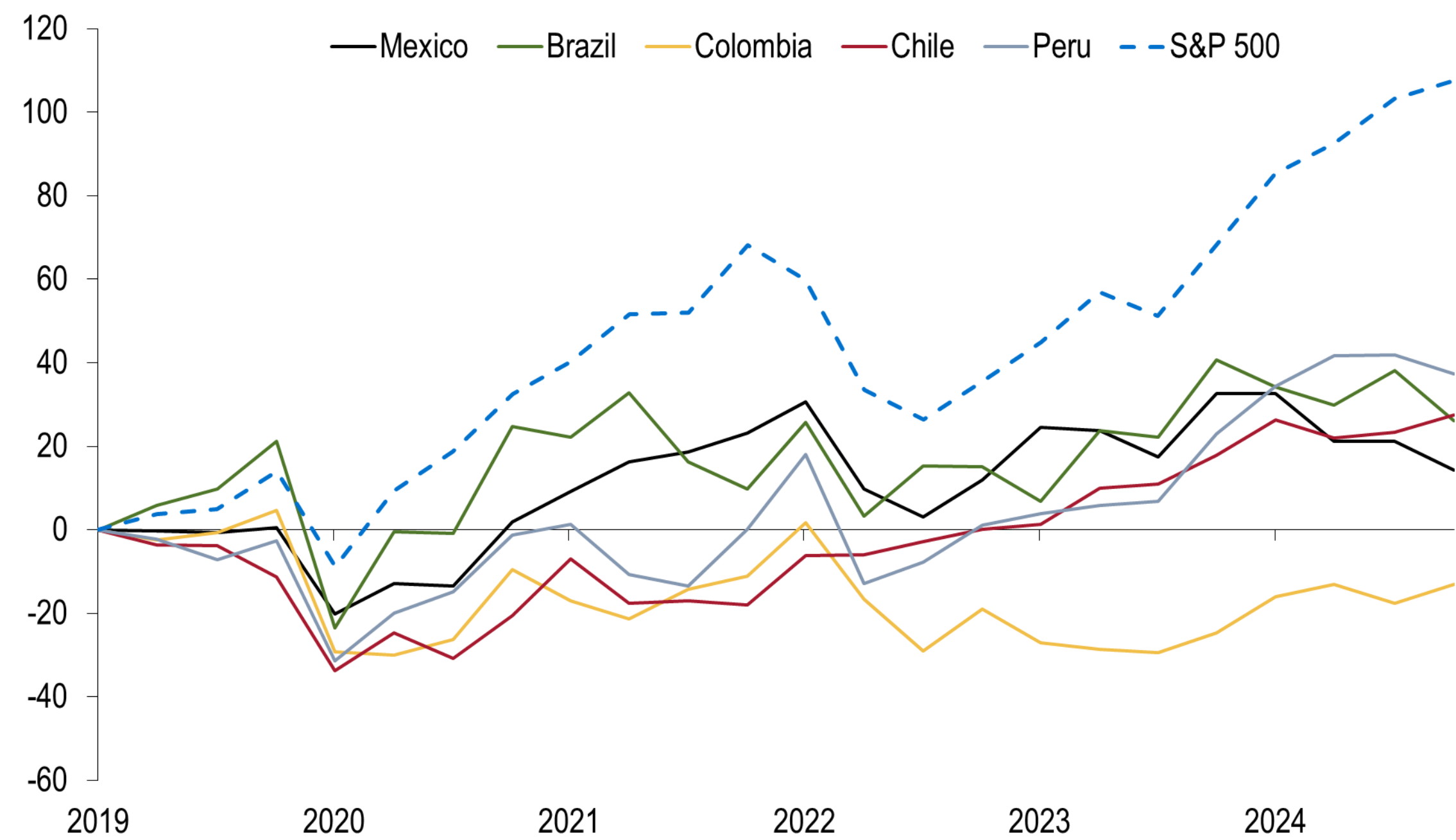
Sources: Bloomberg Finance L.P.; and IMF staff calculations.

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Relative Under-Performance of EMs...

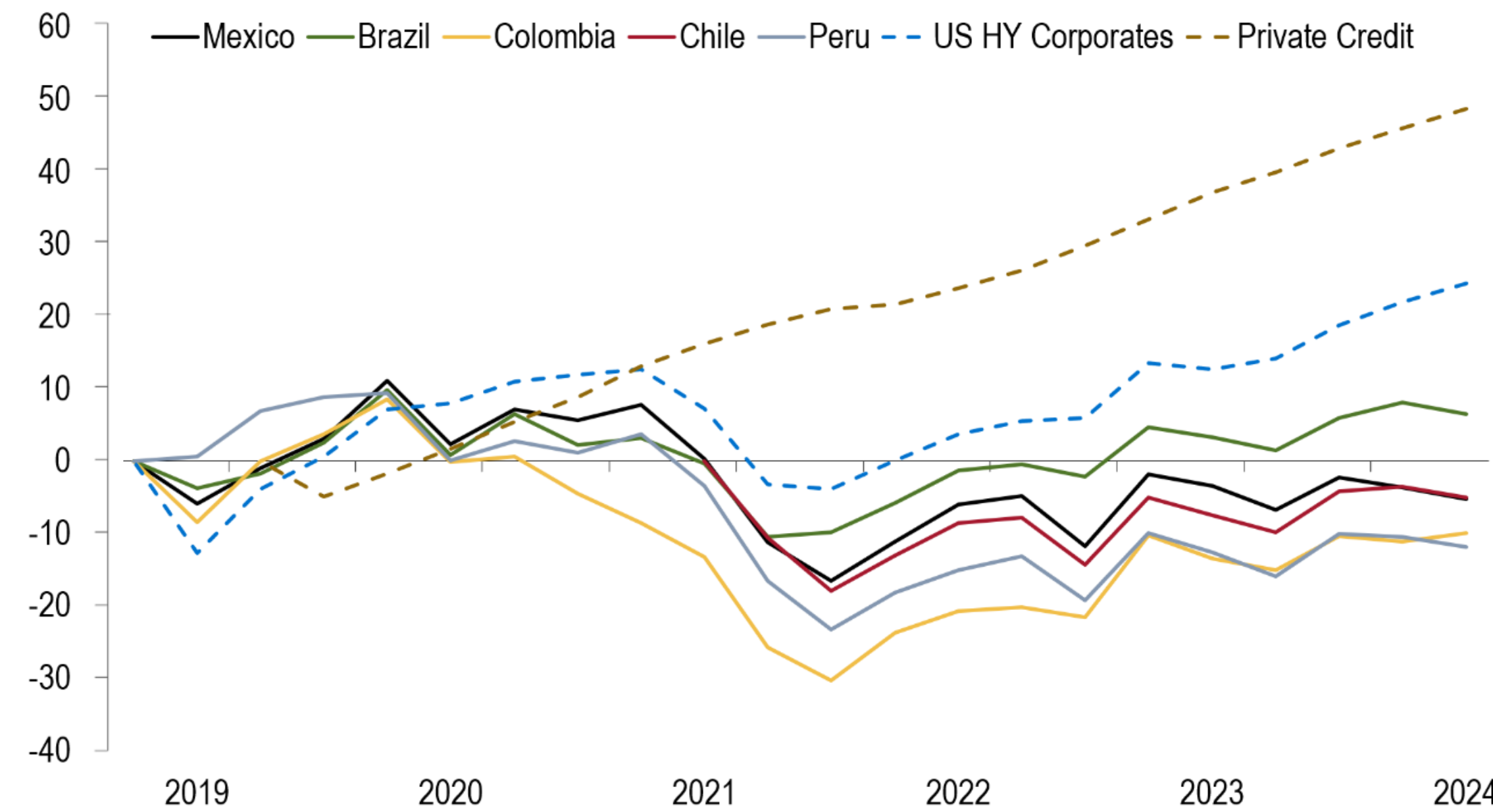
EMs assets have underperformed compared to alternatives.

**Cumulative Latin American Equities Compared to S&P 500
(Percent)**



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

**Latin American Sovereign Bond Returns Compared to
Alternatives
(Percent)**



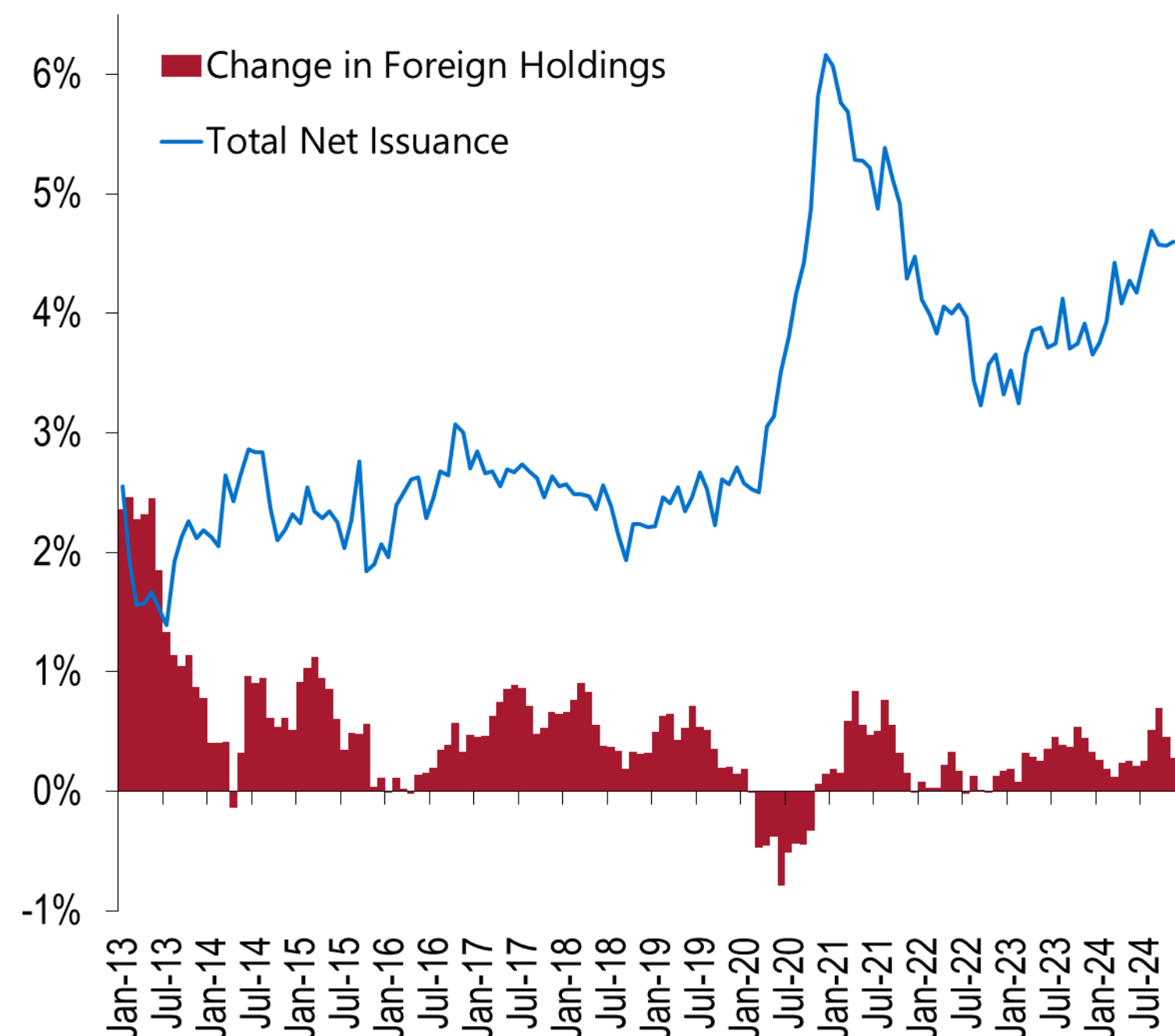
Sources: Bloomberg Finance L.P.; and IMF staff calculations.

...Associated With Foreign Investor Withdrawal

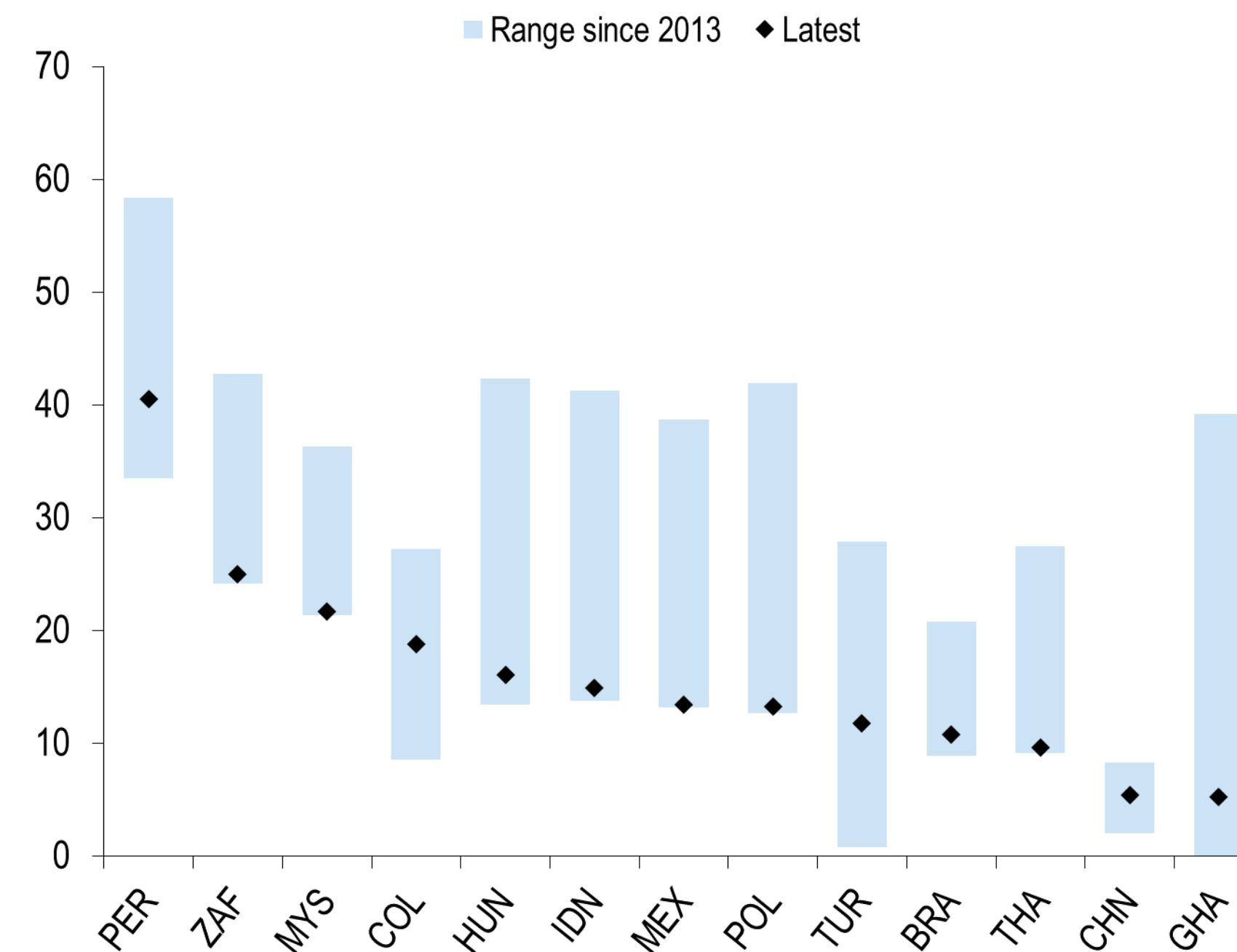
Foreign flows into EMs have not been keeping up with the increase in issuance.

Relatively weak flows are associated with declining participation of foreign investors in EM local currency bonds.

Local Currency EM Foreign Inflows and Domestic Issuance
(Percent of GDP, 12-month rolling sum)



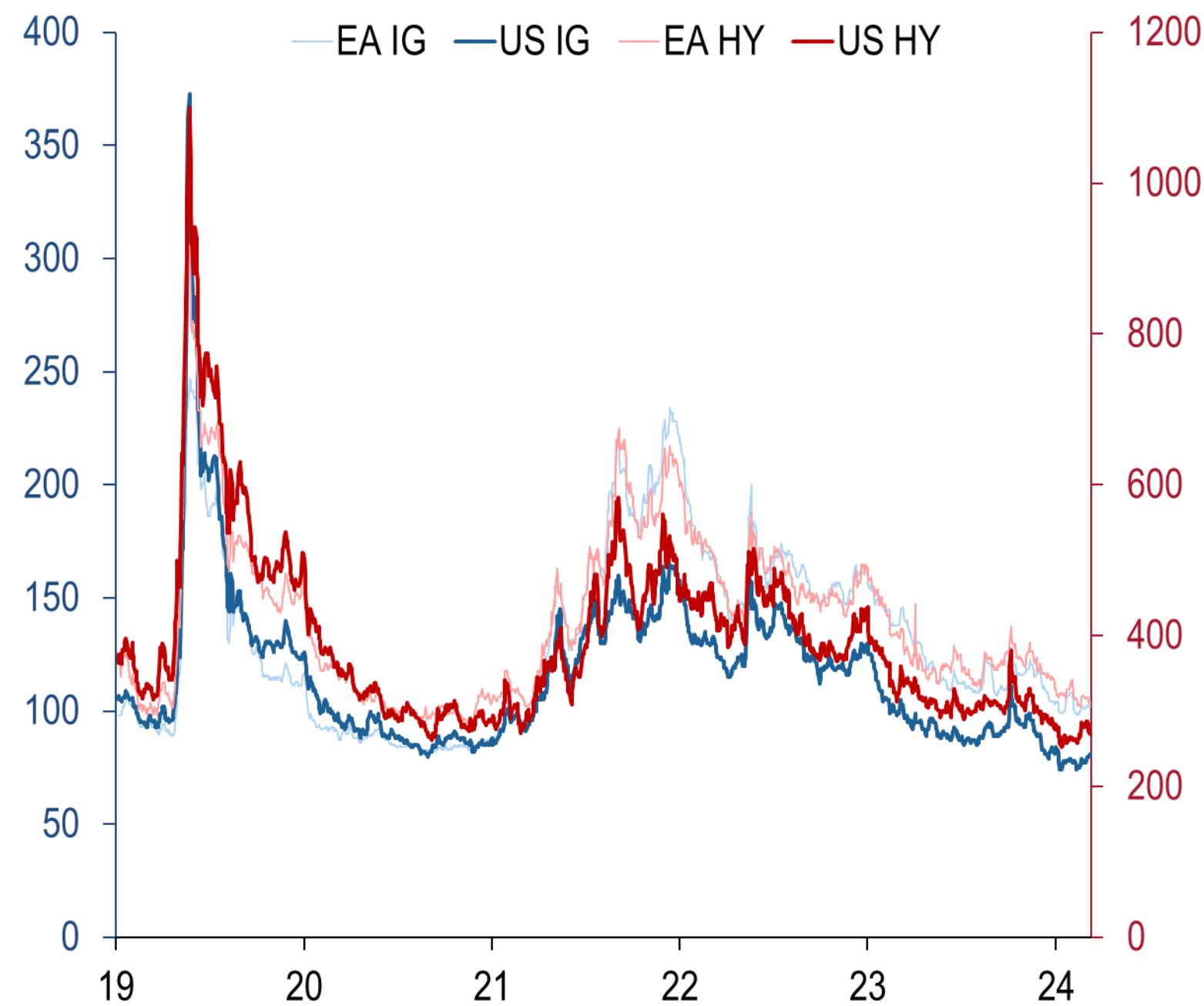
Holdings by Foreign Investors as a Share of Outstanding Local Government Bonds
(Percent)



Despite Low Spreads, Corporates Face High Refinancing Costs

Corporates spreads are historically compressed, but...

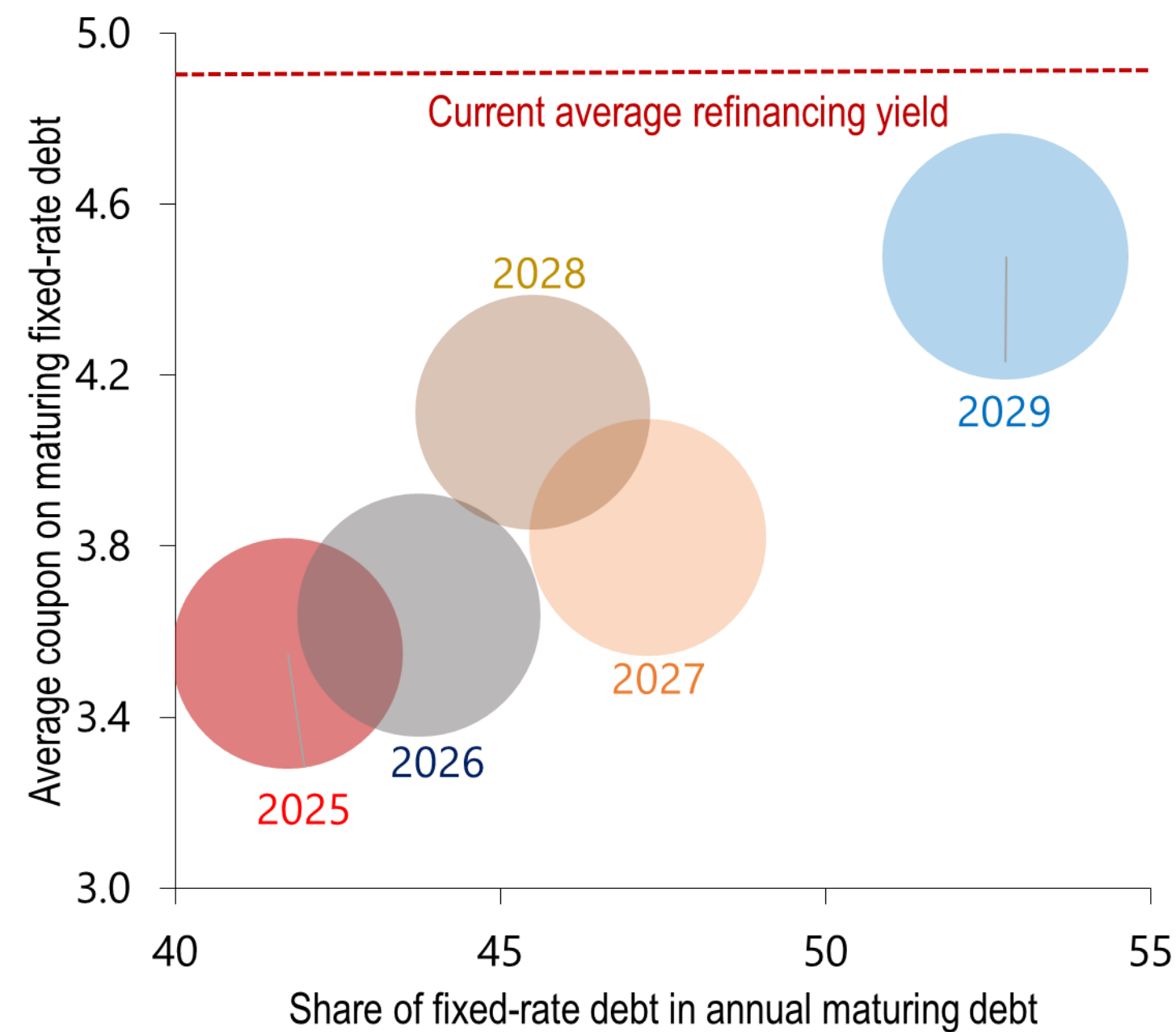
High Yield and Investment Grade average option adjusted spreads
(Basis points)



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

...fixed-rate debt coming due in 2025 has coupons substantially lower than current refinancing yields.

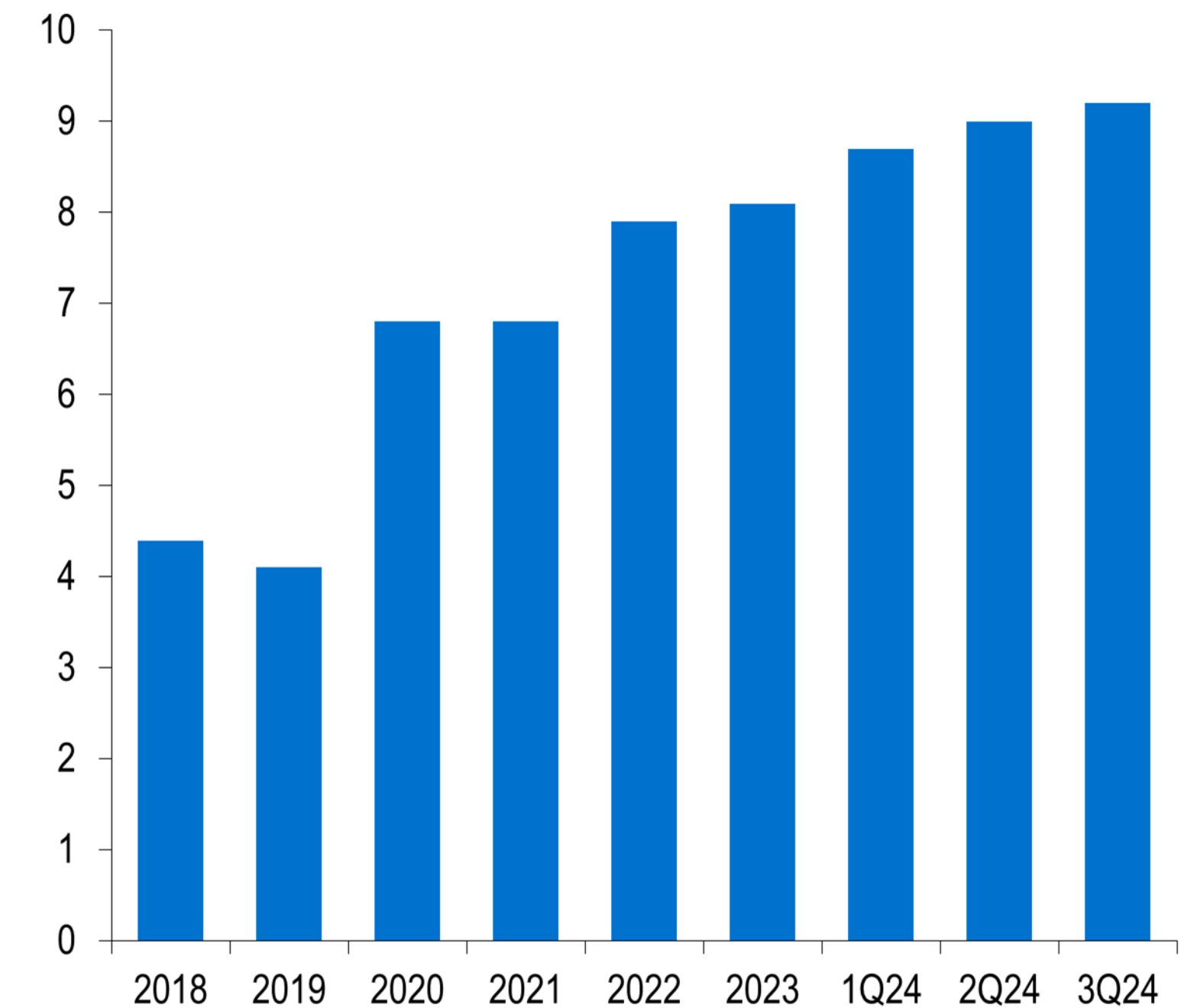
Average Coupon of Maturing Debt Versus Share of Fixed-Rate Debt
(Percent)



Sources: Bloomberg Finance L.P.; Dealogic; and IMF staff calculations
Note: The size of the bubbles represents the total outstanding debt maturing.

Firms exposed to floating rates, like private credit, are already increasingly facing cash flow pressures.

Payment-In-Kind as Share of Interest and Dividend Income of US BDCs
(Percent)



Sources: BDCs disclosures; Fitch Ratings; and IMF staff calculations.
Note: When interest is paid in kind, no cash flow occurs. Instead, the interest coupon is added—usually at an extra cost—to the loan's principal. BDC = business development company