General Discussion of 'Rates Normalization Amid Elevated Global Financial Vulnerabilities'

Participants appreciated the set of stylised facts given in the presentation, but felt there needed to be more of a framework around how these fit into the growth-at-risk framework for considering future risks, fragility and appropriate policy setting. To tease this out participants discussed specific vulnerabilities and the potential concerns they associated with them.

With sovereign debt risks, participants noted that debt to GDP only provides part of the story. Broader fiscal capacity and the currency composition of the debt are also important, and are likely to be less of an issue for a number of countries than they were in earlier years. At face value the indicators about financial risk from China were also seen as concerning by a participant – with the correction in the Chinese housing market and cooling in corporate debt issuances bearing similarities to the 2007–08 US experience prior to the global financial crisis.

Dr Natalucci noted that deleveraging in China since 2017 had been relatively successful, so risks of contagion are also more constrained. A correction in house prices is likely to have a significant negative effect on property developers, however, this is in part because such developers are already heavily credit constrained – with domestic credit more limited for these activities and foreign credit now unavailable. This may lead to the failure of some non-bank financial institutions and smaller weaker banks, but is unlikely to drive a larger crisis. However, this is a key area of risk.

The risk of a correction in US house prices was also discussed – with the presentation indicating that US banks and non-bank financial institutions were not at risk, even as borrowing had climbed and households were expected to see a sharp reduction in owners' equity as a result. Dr Natalucci noted that the crisis in 2007–08 was due to repo markets freezing rather than the correction itself, which is unlikely in the current environment. Furthermore, in the current tightening environment the set of risks are different in nature.

Several participants noted the importance of conceptualising specific risks as triggers to understand what would generate a negative outcome from a financial vulnerability. Climate change, and rapid yield adjustment, were noted as two of the key risks – given that the consequences of both were apparent in 2022.