Global Financial Stability Report

Old Risks, New Challenges

The Global Financial Stability Report examines current risks facing the global financial system and policy actions that may mitigate these. The April 2013 report analyzes the key challenges facing financial and non financial firms as they continue to repair their balance sheets and unwind public and private debt overhangs.

Future potential and risk in economies: IMF

The International Monetary Fund came up with Global financial stability report with focus on the key and structural challenges in euro area, potential risk in financial stability by accelerating capital flows in emerging economies. It examines the monetary policies of various economies and further risk that policy makers should look at and whether SCDS protection buying, indicator of credit risk, needed to ban in European economy.

Banking Scenario

Advanced economies fell by some ¾ percent of GDP in cyclically adjusted terms last year and are projected to decline at a somewhat faster pace in 2013 according to Fiscal monitor report 2013.

The Global Financial Stability Report (GFSR) by International Monetary Fund (IMF) found that the banks around the world are in different stages of repair, report suggests that matching assets and liabilities of banks on a country basis means that they would have to close larger deposit funding gaps. One way of closing the gaps is by raising deposits or other funding locally; another way is by reducing lending, and recent trend says that foreign subsidiary of large EU banks, operating in Eastern Europe have succeeded in rising local deposits.

Outside Europe, banks are also under pressure to change their business models to improve profitability.

Going further commercial banks in India are in need of more capital to support continued credit growth and meet Basel III requirements. Over the next several years banks in particular, public sector banks will need to raise additional capital to comply with Basel III while expanding their balance sheets to support economic growth in India. To address broader-based banking system risks, several economies have also imposed capital measures (Australia), tightened provisioning rules (India), and varied reserve requirements (China, India, Sri Lanka).

Central banks in advanced economies have taken bold policy steps to stabilize markets but according to IMF these policies may lead financial stability at risk if they are longer in the place, as the prolonged period of low interest rates is making banks able to roll over nonperforming loans rather than repairing their balance sheet and raising credit risk over the medium term.

Emerging Markets: Financial Stability Risk

Emerging market risks have also declined, as growth has stabilized and external funding conditions for emerging market economies are very favorable. Growth and economic outlook remained challenged by euro zone crisis; emerging markets have performed quite well due to capital inflows, but too rapid capital inflows can result in increase in domestic credit and asset price, says GFSR report.

India as the emerging market economy needs to manage capital inflows from developed economy through Foreign Direct Investment (FDI), to bring down its current account deficit (CAD). The IMF has projected current account deficit to be 4.9 % in 2013 and 4.6% by 2014, but the pressure will appear if the capital flows change direction and advanced economies begin to withdraw.

"Several countries face stability risks from continued strong credit growth, asset price appreciation, weaker bank balance sheets, and deteriorating asset quality. Supportive monetary policy and strong private demand have bolstered domestic credit in emerging markets, pushing credit-to-GDP ratios to record highs in a number of countries in emerging Asia and Latin America", said the report by IMF.

IMF in support of SCDS

Credit default swaps, protects the buyer against government or company going bankrupt, the instrument becomes more useful if the default is higher. It acts as a kind of insurance for investor holding large debt.

Since March 2012, when ban was imposed on the naked Sovereign credit default swaps (SCDS) protection buying in Europe the market liquidity has declined the ban was imposed as due to speculative nature of SCDS and the concern that its contracts could be destabilizing. IMF study has also found that the SCDS market