Global Financial Stability Report 2024

Why in news?

Recently International Monetary Fund has released Global Financial Stability Report 2024

Global Financial Stability Report 2024
• **Released by-** International Monetary Fund • **Publication**- *Semi-annual* (Twice per year in April and October) • **Theme**- The Last Mile: Financial Vulnerabilities and Risks. • **About-** It provides an assessment of the global financial system and markets, and addresses emerging market financing in a global context. • **Focus-** The report focuses on current market conditions, highlighting systemic issues that could pose a risk to financial stability and sustained market access by emerging market borrowers. • **Frequent assessment**- It replaced two previous reports by the IMF, the annual International Capital Markets Report and the quarterly Emerging Market Financing Report. • **World Economic Outlook**- The Report draws out the financial ramifications of economic imbalances highlighted by the IMF's World Economic Outlook. • **Chapters**- - High Inflation - Unregulated credit market - Cyber-attack on financial institutions

What are the key highlights of the report?

Issues	Recommendations
• **Investor optimism-** The report warns the investor optimism about the end of *high inflation and potential interest rate* cuts by central banks may be premature as inflation has stalled in some economies. • **Geopolitical risks-** Ongoing conflicts in *West Asia and Ukraine* could disrupt supply and keep prices high, preventing central banks from reducing rates soon. • **Market correction risks**-If central banks do not act as investors expect, there could be a significant market correction, resulting in *substantial losses* for those who have invested in anticipation of rate cuts.	• Central banks should avoid easing monetary policy prematurely and push back against overly optimistic market expectations for rate cuts. • In jurisdictions displaying ample evidence that inflation is moving sustainably toward target, policy should gradually move to a more neutral stance • Emerging and frontier economies should strengthen efforts to contain debt vulnerabilities. • Regulatory authorities should use supervisory tools to ensure that banks and nonbank financial institutions are resilient to the credit cycle downturn.

• **Private credit market-** The IMF is concerned about 2.1 trillion dollars unregulated private credit market where non-bank financial institutions lend to corporate borrowers, potentially affecting the broader financial system. • **Higher returns**- The investors are drawn to the private credit market due to the potential for higher returns compared to traditional investments. • **Concerns of financial soundness**- The IMF is concerned that many borrowers in the private credit market may not be financially robust, with some unable to cover even their interest costs. • **Benefits borrowers**- Borrowers who may not have access to *long-term funds* through conventional channels find opportunities in the private credit market.	• Consider a more proactive supervisory and regulatory approach. • Close data gaps and enhance reporting requirements to comprehensively assess risks. • Strengthen cross-sectoral and cross-border regulatory cooperation
• **Cyber risks**- With growing digitalization, evolving technologies, and increasing geopolitical tensions, cyber incidents— especially those with malicious intent—are a rising concern for macro financial stability. • **Economic loss-** Although most losses from cyberattacks are modest, the risk of extreme losses has been increasing	• Strengthen response and recovery procedures to boost resilience against cyber incidents. • Enhance data reporting and information sharing. • Develop national cybersecurity strategies and effective regulation and supervisory frameworks

What does it mean for India?

- **Foreign capital flows**- Emerging markets, including India, have experienced strong fund flows due to optimism surrounding central banks easing interest rates, but this could change rapidly if western central banks signal their intention to maintain high interest rates for an extended period.

  In 2023, India ranked as the second-largest recipient of foreign capital after the U.S., according to Elara Capital

- **Risk of capital outflow-** If investors perceive that interest rates will remain elevated in western economies, they may withdraw money from emerging markets like India this would exert pressure on Indian currency leading to further depreciation of Indian rupee.
- **Rupee depreciation-** The Indian rupee has already been depreciating, trading at a new low of 83.57 against the U.S. dollar recently.Despite likely intervention by RBI, external factors continue to impact the rupee's value.
- **Effects on the financial system**- A severe outflow of capital could have significant consequences for India's financial stability, the RBI may need to take measures to

defend the rupee, such as curbing liquidity or raising interest rates.

- **India's private credit market**-India has seen the emergence of a small but growing private credit market with the rise of Alternative Investment Funds (AIFs), which lend to high-risk borrowers outside the traditional banking system.

  Investments through AIFs in India have more than tripled from 2018 to 2022-23

- **Regulatory scrutiny**- Both the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) have increased their scrutiny over these funds to ensure financial stability.

References

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