

A high level of uncertainty has characterized the global macroeconomic landscape since the COVID-19 pandemic, possibly amid inflation shocks, escalating geopolitical tensions, rapidly emerging new technologies, and increasing climate-related risks.

High macroeconomic uncertainty can potentially affect macrofinancial stability through three key channels. First, it can exacerbate downside market tail risks amid an adverse shock (the “market channel”). Second, it can delay private sector consumption and investment decisions, slowing economic activity, which can increase credit risks for financial institutions and trigger an adverse macrofinancial feedback loop (the “real channel”). And third, it can decrease the availability of domestic credit by worsening the information gap between lenders and new borrowers about their creditworthiness, and by increasing the risk in existing loan portfolios (the “credit channel”).

Drawing on a sample of 43 advanced and emerging market economies, the chapter’s analysis shows that high macroeconomic uncertainty can significantly exacerbate downside tail risks to GDP growth, particularly in countries with large existing vulnerabilities, such as excessive leverage in the private and public sectors. Moreover, high macroeconomic uncertainty worsens the intertemporal trade-off posed by an easing of financial conditions—which boosts GDP growth in the short term but also encourages a buildup of vulnerabilities that exacerbate downside tail risks to GDP growth in the medium term—particularly when financial market volatility is low, that is there is a “macro-market disconnect.” Regarding potential underlying mechanisms, market tail risks and bank lending are important channels through which economic uncertainty can amplify downside tail risks to GDP growth. The chapter’s analysis also shows that macroeconomic uncertainty can spill over across borders due to global financial and economic interconnectedness.

To reduce domestic macroeconomic uncertainty and its adverse implications for macrofinancial stability, policy makers should build credible policy frameworks and improved communication strategies. They should also build resilience against macrofinancial vulnerabilities, particularly when macroeconomic uncertainty is high, notably through implementing adequate macroprudential policies amid easy financial conditions and containing the buildup of high public debt relative to GDP. Adequate international reserve buffers and exchange rate flexibility could help mitigate the downside risks from an increase in foreign macroeconomic uncertainty. Moreover, resources should be devoted to quantifying, managing, and mitigating the risks from rising geopolitical uncertainty on macrofinancial stability.

To see the full report, please refer to the English version here: <http://IMF.org/GFSR-October2024>