Global Financial Stability Amid Geopolitical Conflict and Amplification Risks

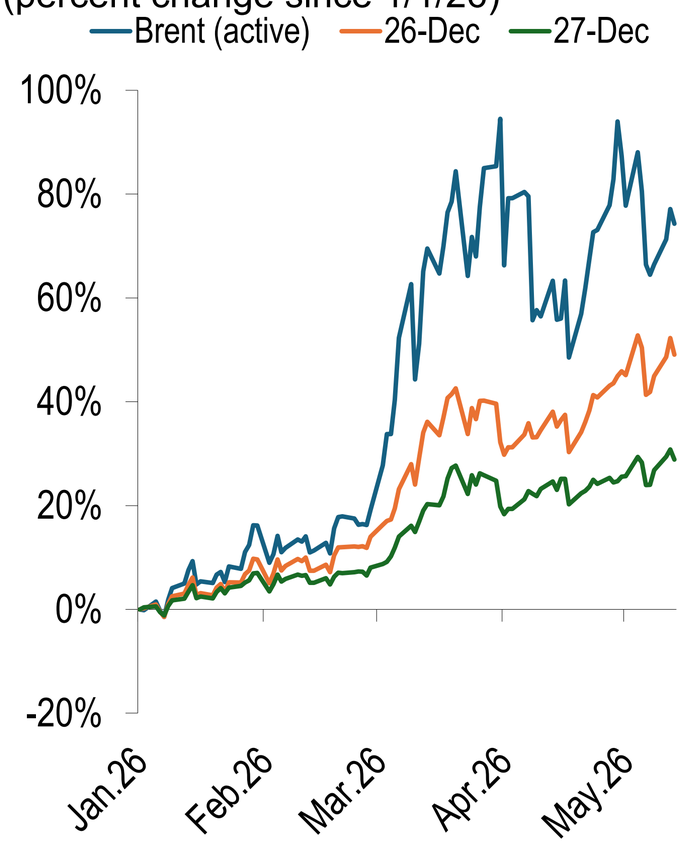
May 20, 2026

Conflict in Middle East is an Energy Shock From a Markets Perspective

Energy prices have risen sharply, exposing energy importers and exporters asymmetrically

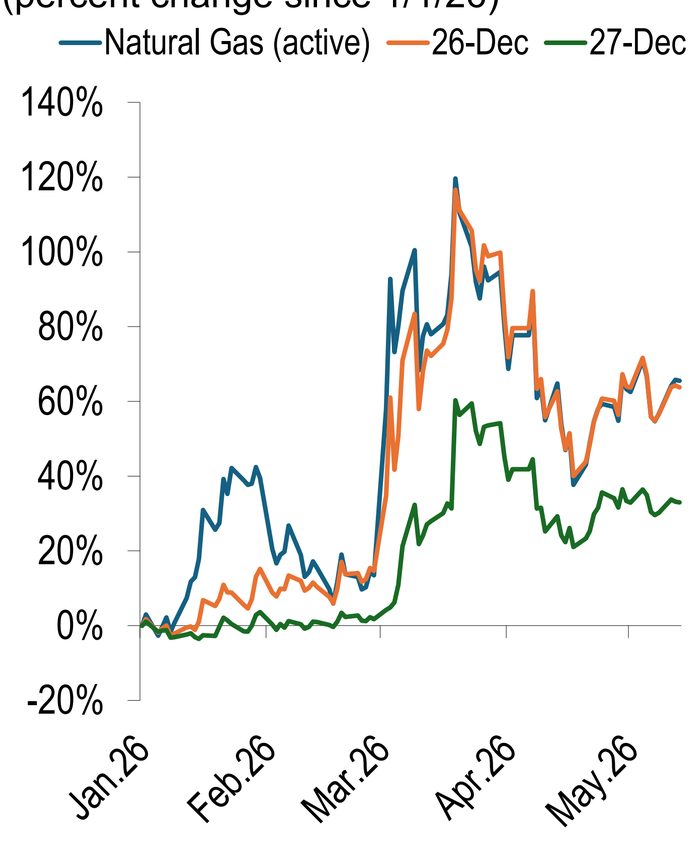
Gradually markets are pricing a longer conflict

Brent Crude
(percent change since 1/1/26)



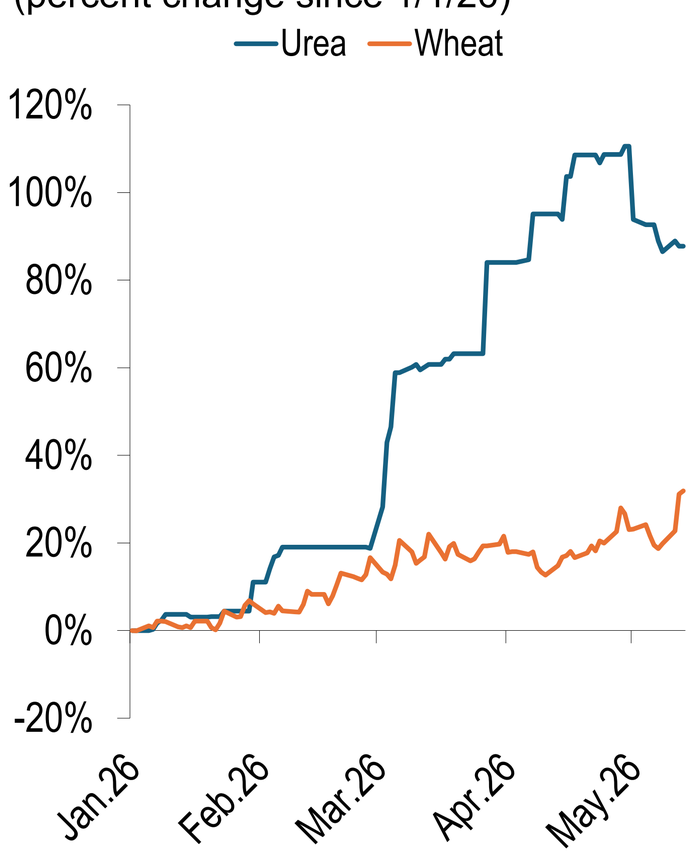
Natural gas prices spiked even more than oil, but retraced somewhat

Natural Gas (Europe)
(percent change since 1/1/26)



Other commodity prices are affected

Wheat and urea
(percent change since 1/1/26)

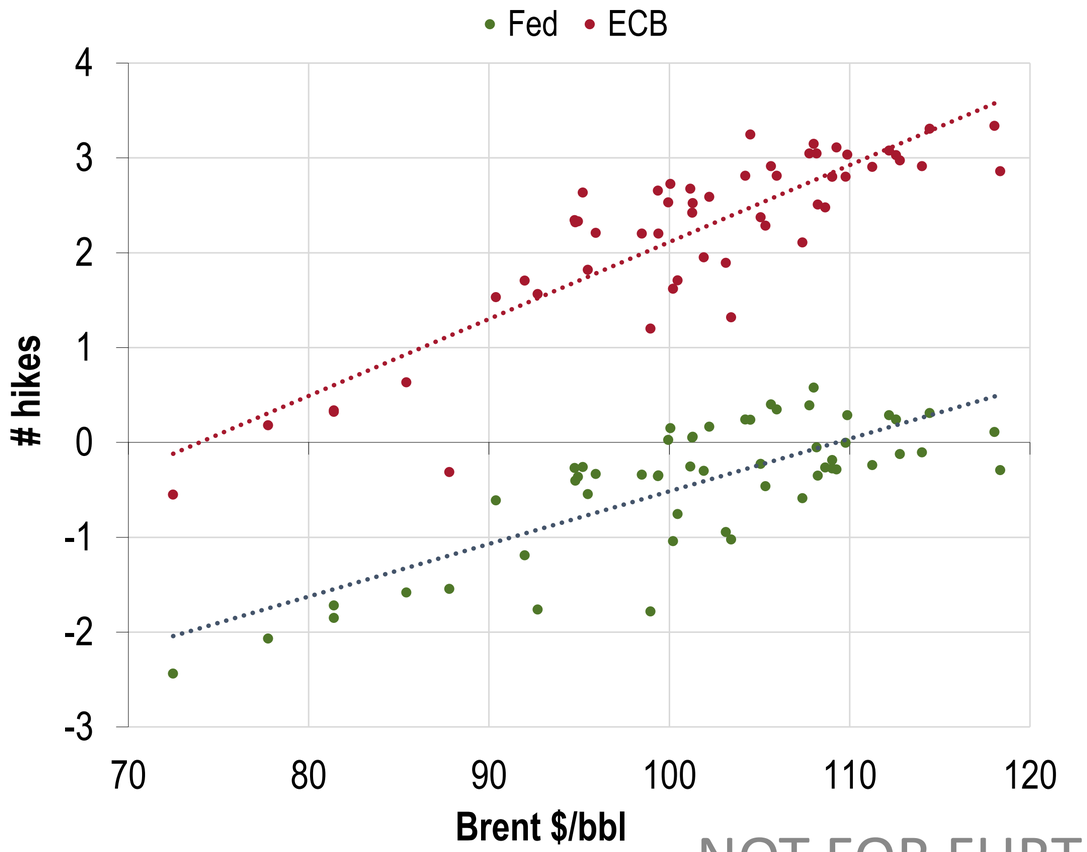


Energy Shock Drives Repricing in Rates Markets

Monetary policy expectations have adjusted sharply, driving a selloff in rates

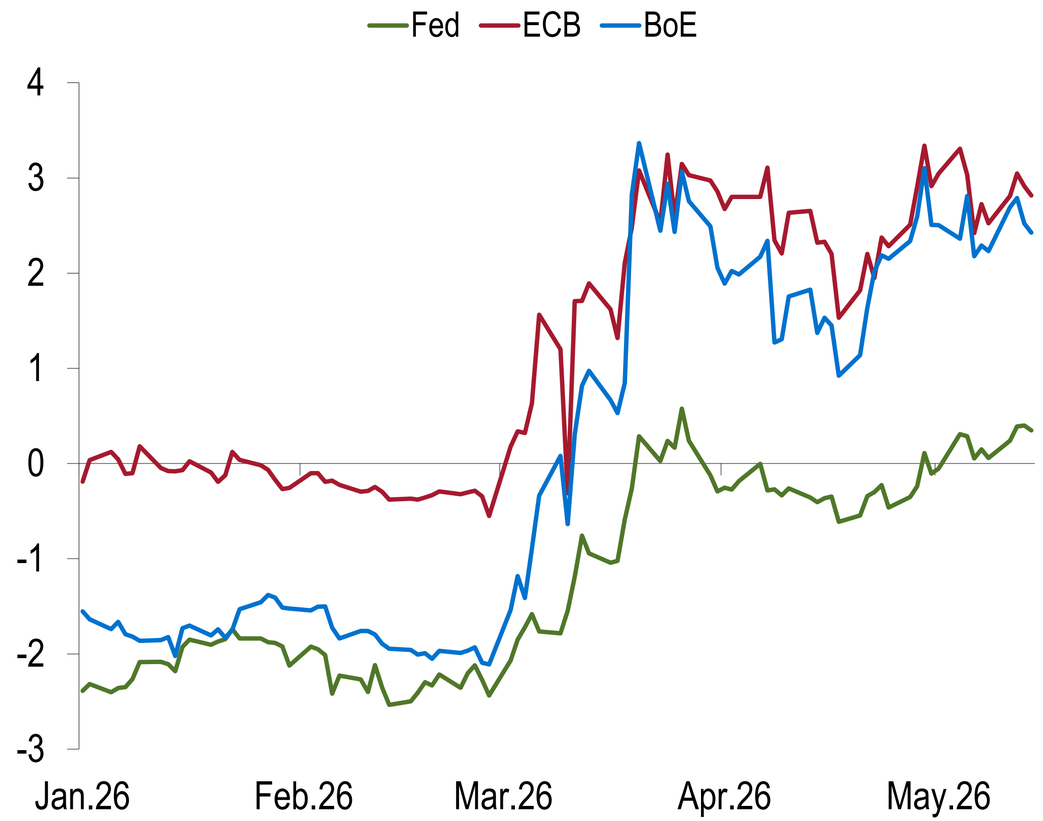
Market implied policy rates adjusted sharply as energy prices drive inflation expectations

Number of rate hikes priced by 2026YE
(number of 25 bps hikes priced)



European policy rates saw a sharper repricing than in the US

Number of rate hikes priced by 2026YE
(number of 25 bps hikes priced)

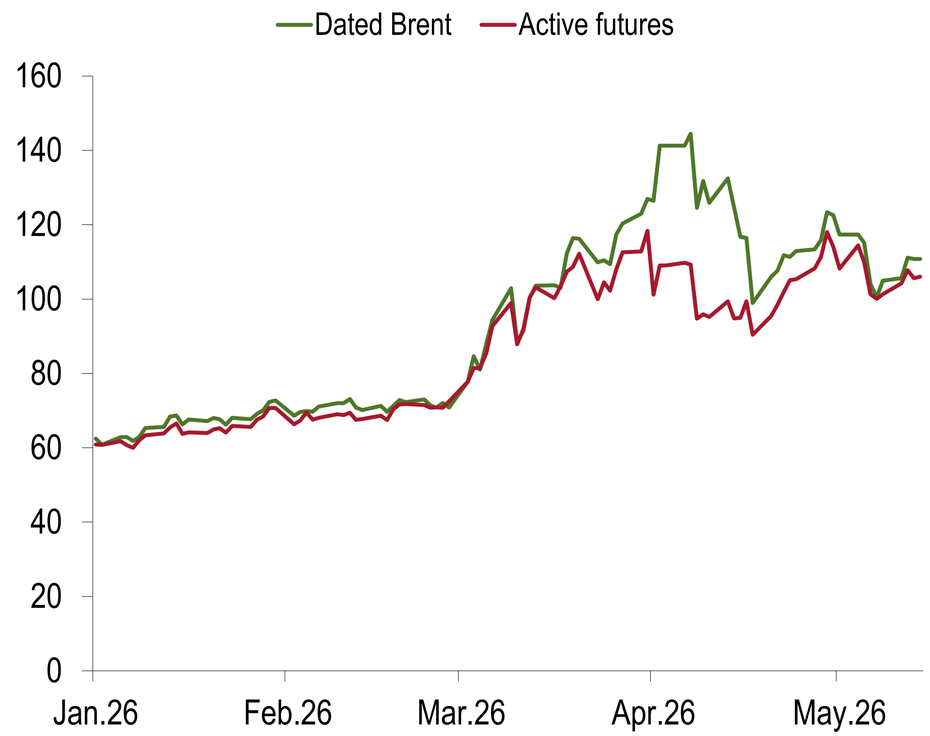


Tension Between Markets and Reality?

The real world tells a different story from markets: "Dated" prices of commodities are higher, refined product shortages intensifying (e.g., jet fuel), and shipping and logistics are affected

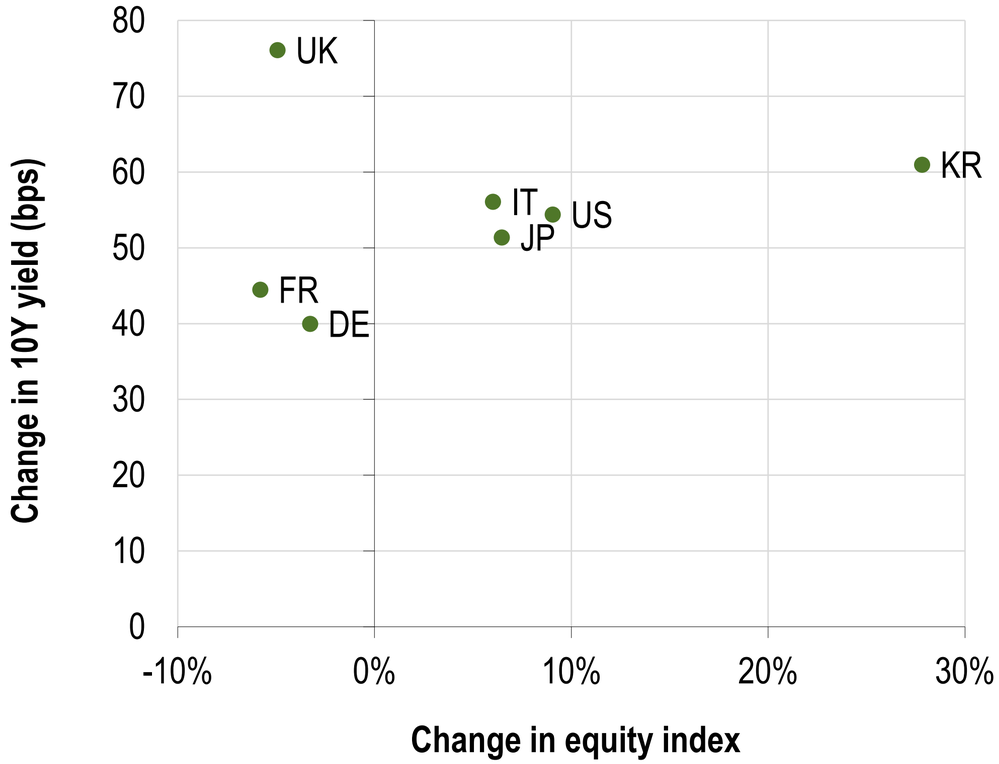
Deviations of "dated" Brent for prompt delivery from futures signal the reality of the possibility of acute shortages

Brent Crude
($/bbl)



Despite the selloff in bonds, some equity markets have performed very strongly since the start of the war

Yield change and stock market performance since 2/27
(basis points, percent)

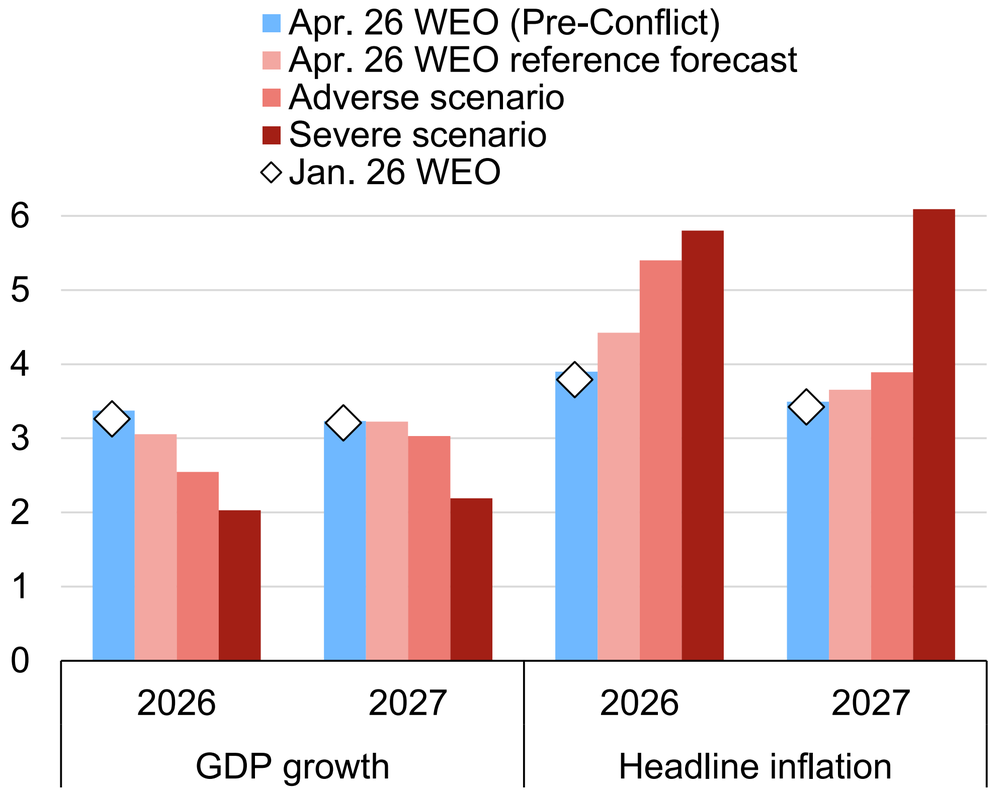


Uncertainty is High, and Forecasting is Difficult

Outcome space has become broader and more discrete, raising the specter for scenario analysis

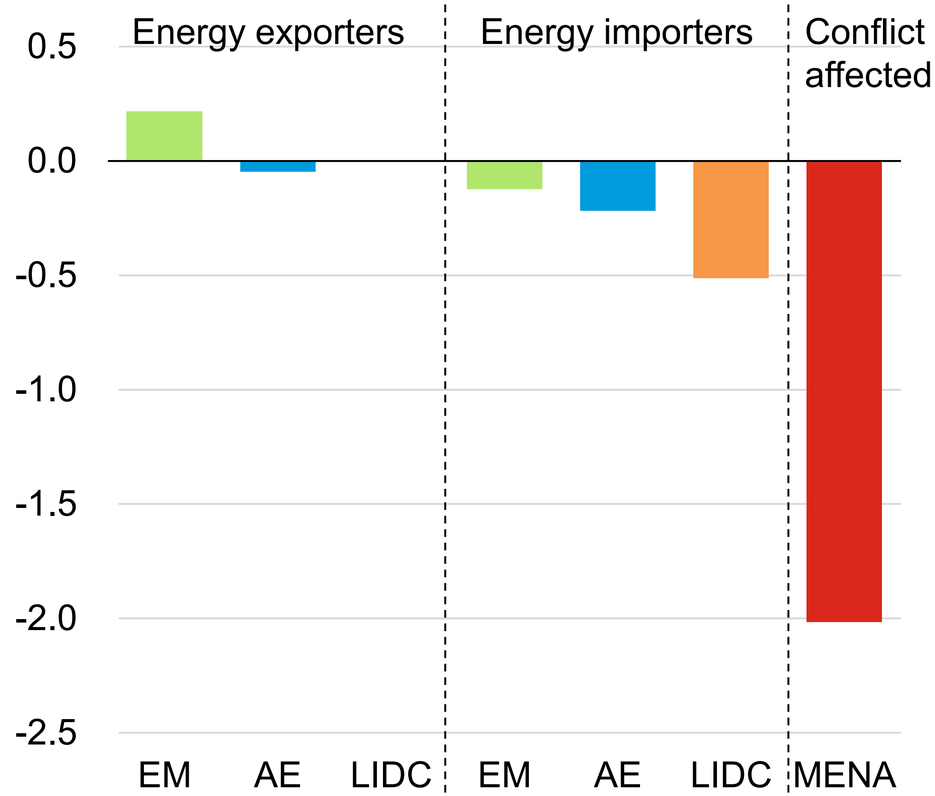
Upward revisions to inflation forecasts and downward revisions to growth

GDP Growth and Inflation
(percent y/y)



Impact is not only uncertain, but also asymmetric

Cumulative GDP growth revisions for 2026
(percentage point, relative to Jan. forecast)



Financial Stability Risks Are Elevated

Financial Stability Risks Are Elevated

- Markets have become more sanguine since the beginning of April, especially for risk assets
- But the real world appears to tell a different story from markets
- Further supply shocks, more persistent inflationary pressures could challenge current market pricing
- And salient financial stability risks could be triggered

In this presentation, we will assess three areas of risk, based on the IMF's GFSR:

1. Government bond market fragilities
2. High and concentrated asset valuations
3. Private credit

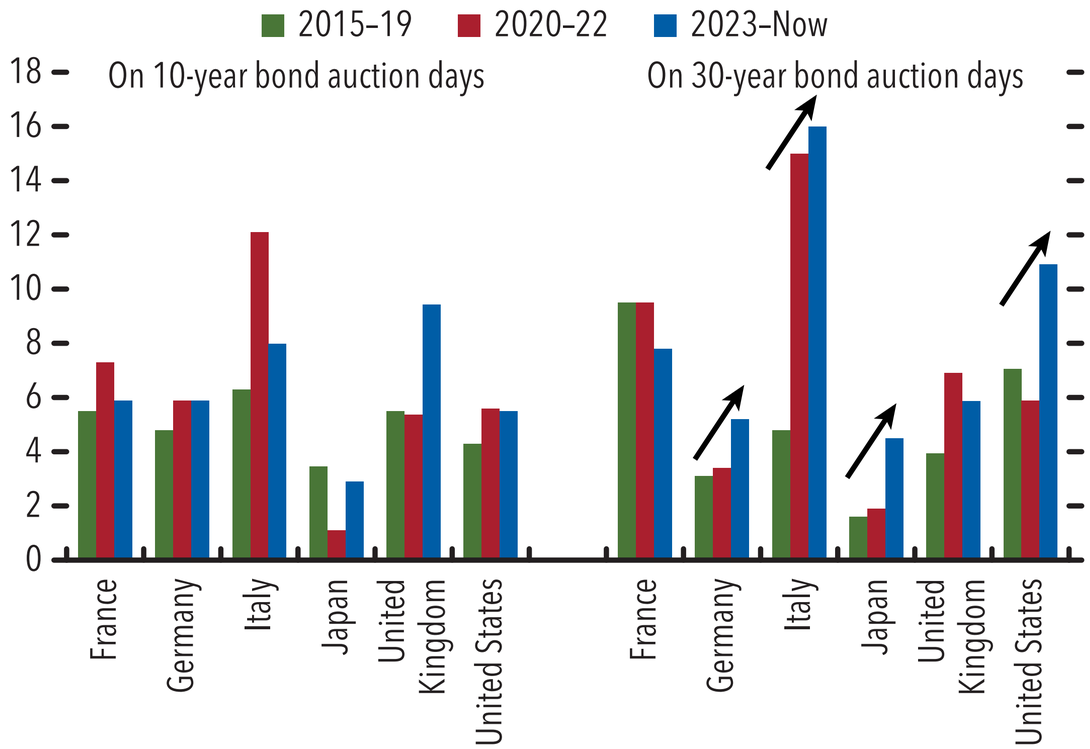
1. **Government bond market fragilities**
2. **High and concentrated asset valuations**
3. **Private credit**

Supply Pressures: Higher Yield Sensitivity on Auction Days

Core Sovereign Bond Markets: Higher Bond Supply and a More Price-Sensitive Buyer Base

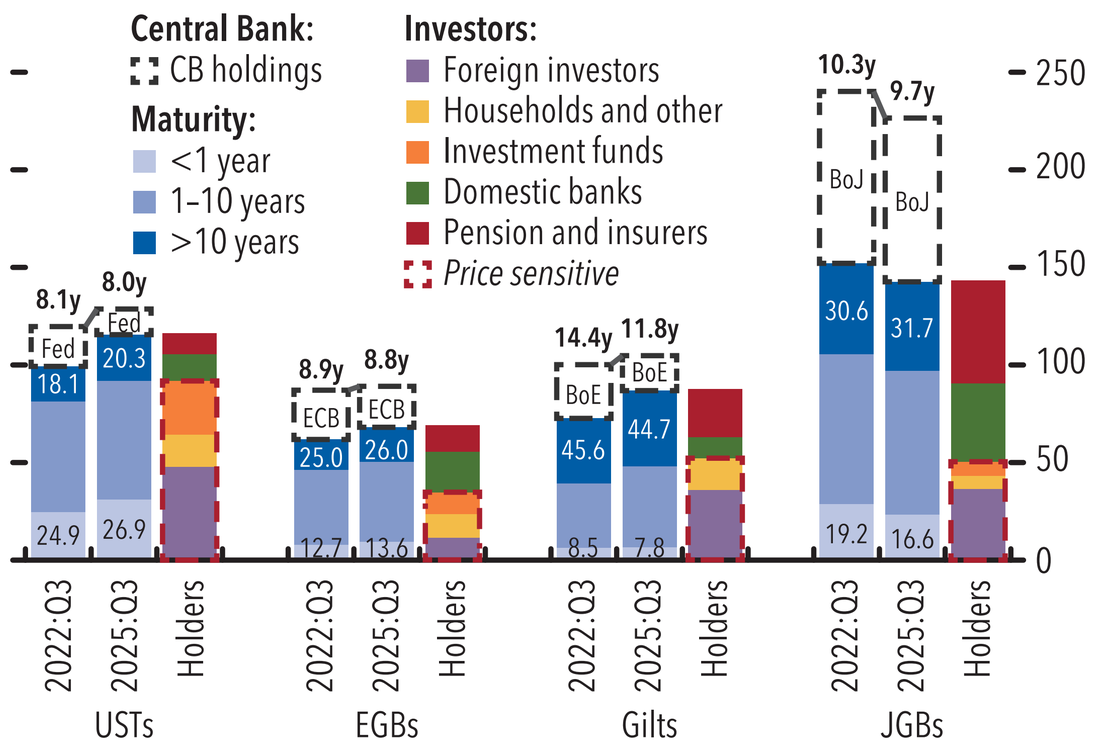
Sovereign bond yields increasingly gyrate on auction days.

1. Daily Changes in 10-Year Bond Yield on Bond Auction Days
(Basis points)



Bonds have shorter maturities and buyers are more price sensitive, increasing rollover risks in inflationary scenarios.

2. G4 Sovereign Debt Profile, Maturity Structure, and Investor Base
(Percentage of GDP)



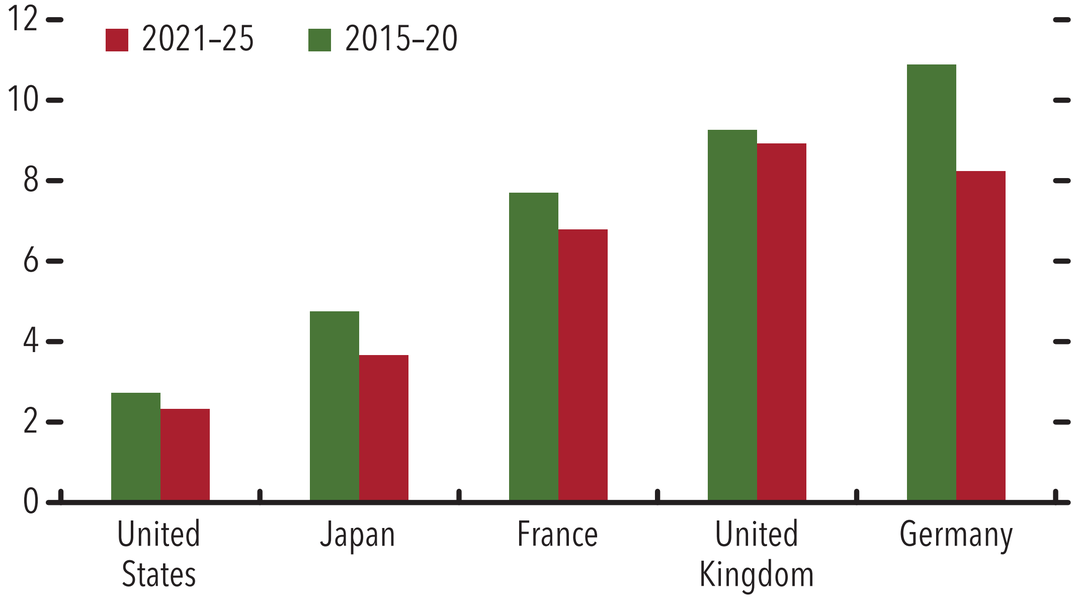
Sources: Bank of England; Bank of Japan; Bloomberg Finance L.P.; EUROPACE AG/Haver Analytics; European Central Bank; London Stock Exchange Group; national debt management offices; US Federal Reserve; and IMF staff calculations.

DMOs Issue at Shorter Maturities – Affecting Funding Markets

The move of sovereign debt issuance toward shorter weighted average maturities has made the link between bond and funding markets more acute

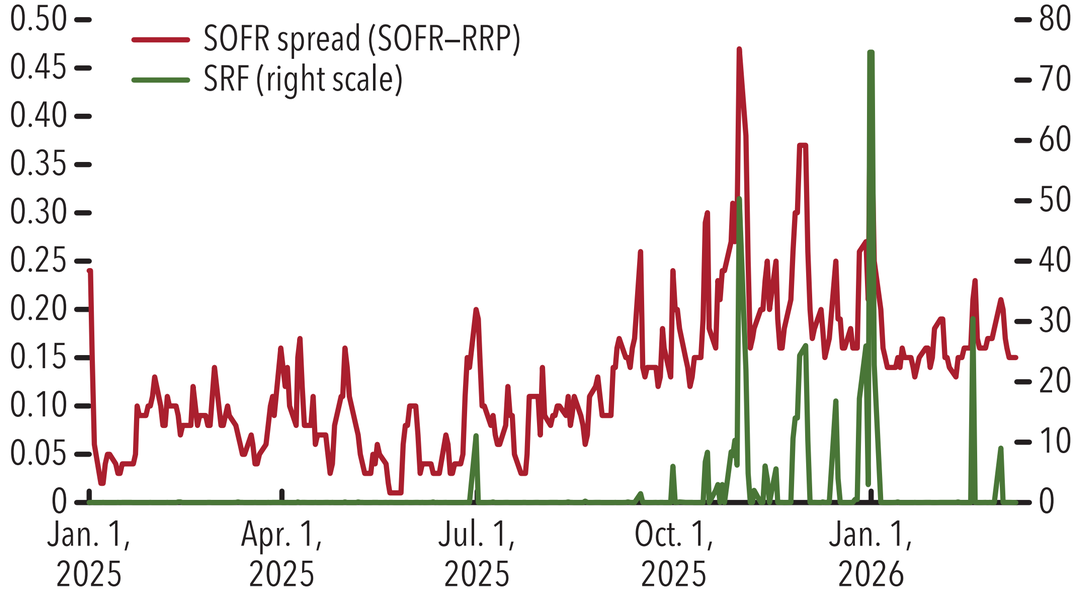
The weighted average maturity of newly issued debt has fallen.

1. Weighted Average Maturity of Newly Issued Debt across Jurisdictions
(Number of years)



As a result, repo rates have been under pressure, leading to usage of the Standing Repo Facility.

2. Repo Market Spreads, Policy Rates, and the Standing Repo Facility
(Percent, left scale; billions of dollars, right scale)



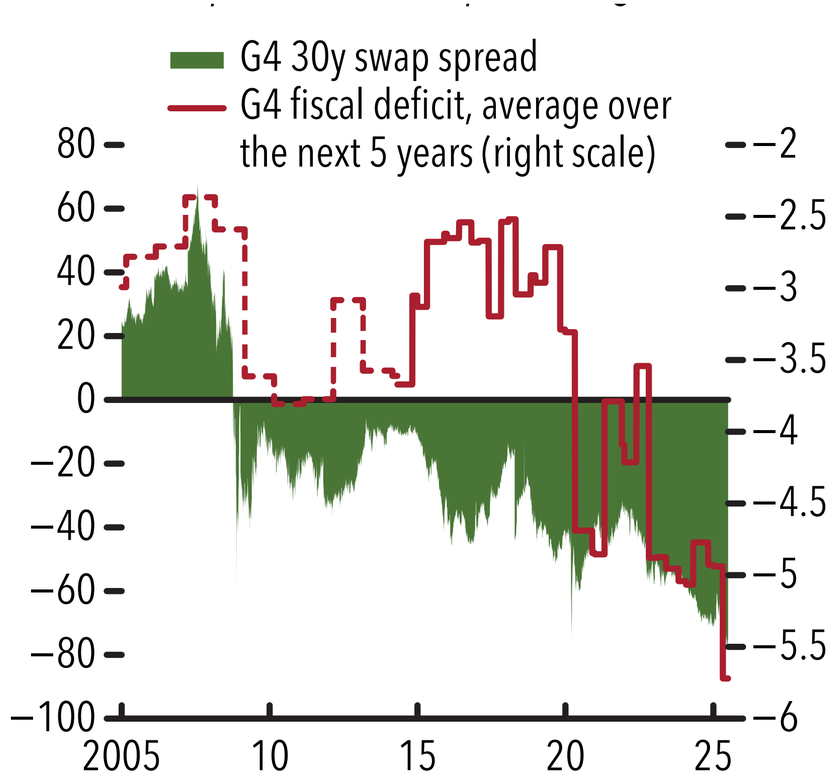
Sources: Bloomberg Finance L.P.; EUROPACE AG/Haver Analytics; JPMorgan; London Stock Exchange Group; US Federal Reserve Board; and IMF staff calculations.

Bond Supply in Major Advanced Economies Has Steepened Yield Curves

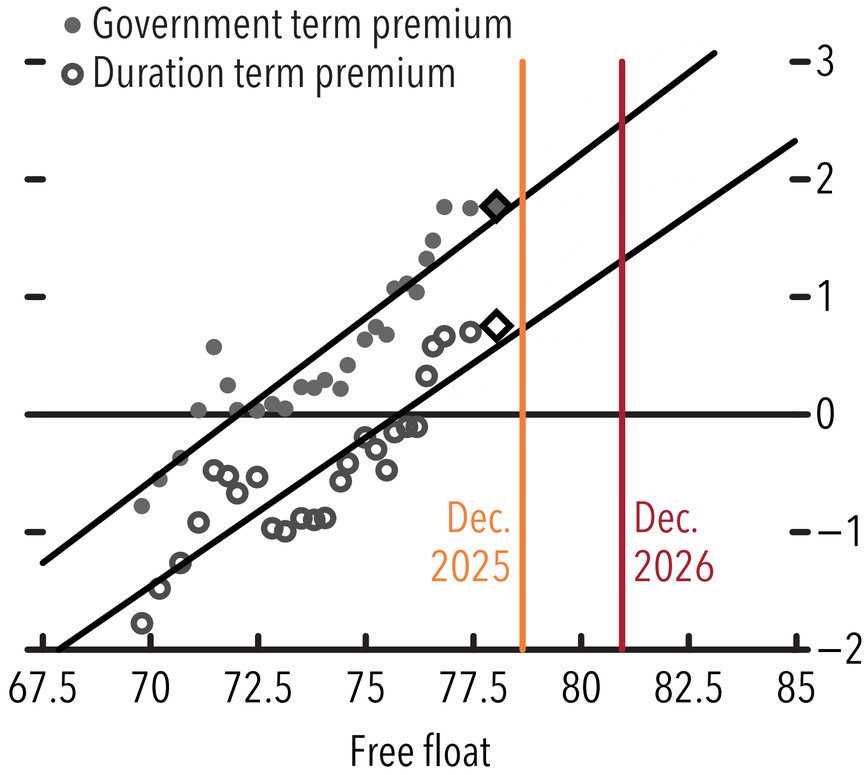
Investor concerns about larger fiscal deficits are increasingly reflected in widening swap spreads ...

... with price-sensitive investors expected to demand higher term premiums as compensation for absorbing rising bond supply, exerting upward pressure on yields.

G4 GDP-Weighted 30-Year Swap Spreads versus Fiscal Deficits
(Basis points, left scale; percent, right scale)



G4 30-Year Government and Duration Term Premium Conditional on Projected Free Float
(Percent)

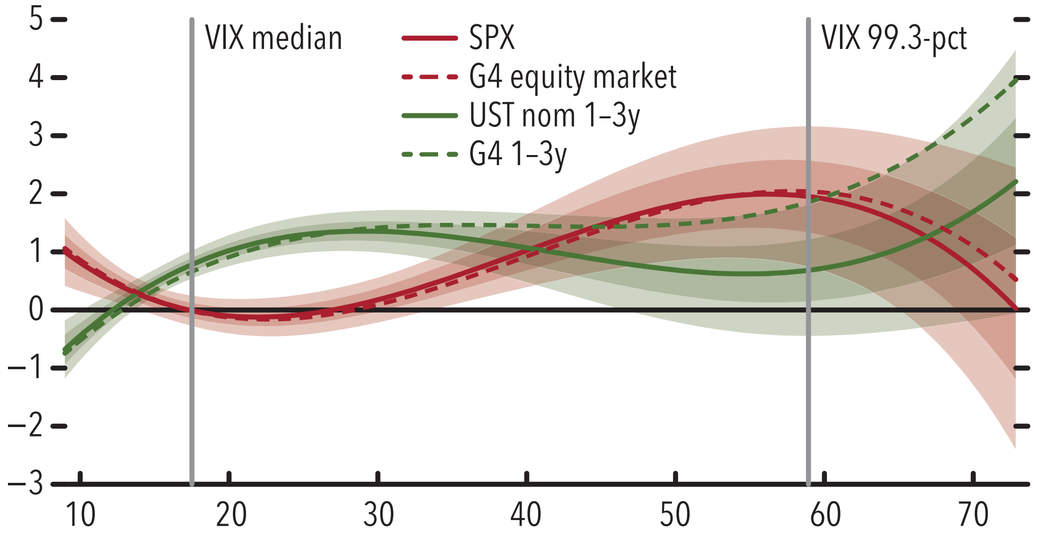


Bonds Are Also Less Attractive as a Hedge for Risk Assets

Equities and Bonds Are Now More Likely to Sell Off at the Same Time

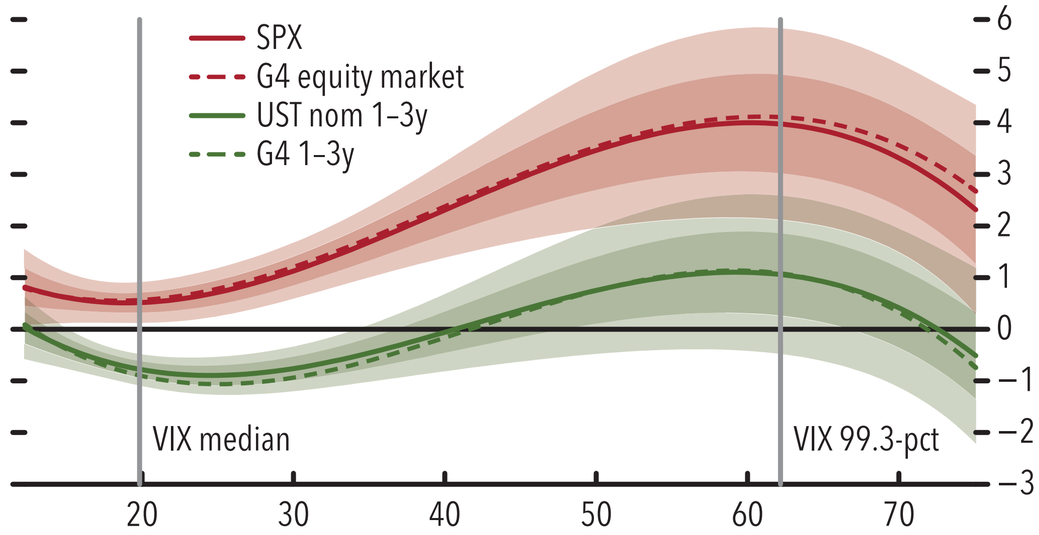
Between 2000 and 2019, equities and bonds demonstrated a strong hedging relationship ...

1. Twelve-Month-Ahead Expected Returns, 2000–19
(Sharpe ratio)



... but the expected returns of both now rise with the VIX, indicating concurrent falling prices.

2. Twelve-Month-Ahead Expected Returns, 2020–25
(Sharpe ratio)



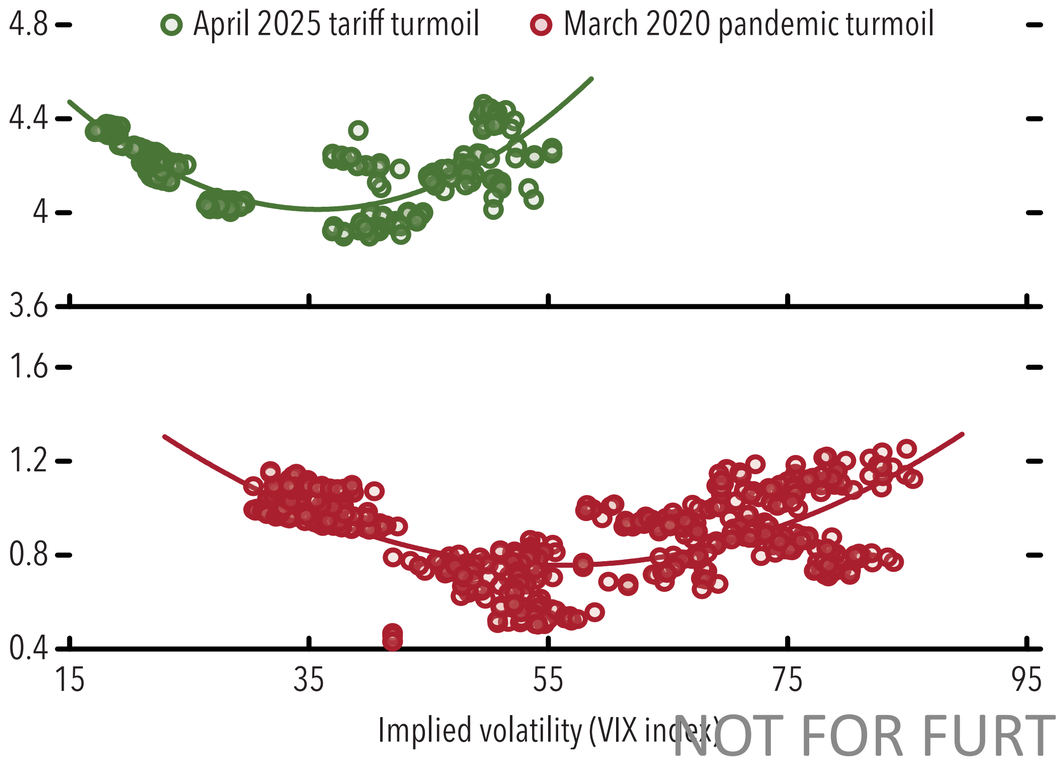
Sources: Bloomberg Finance L.P.; EUROPACE AG/Haver Analytics; London Stock Exchange Group; and IMF staff calculations.

Bond Mutual Funds Can Contribute to a Selloff of Treasuries under Stress

Treasuries' role of "safe asset" may be challenged at high stress levels, as liquidity stresses can trigger forced liquidation

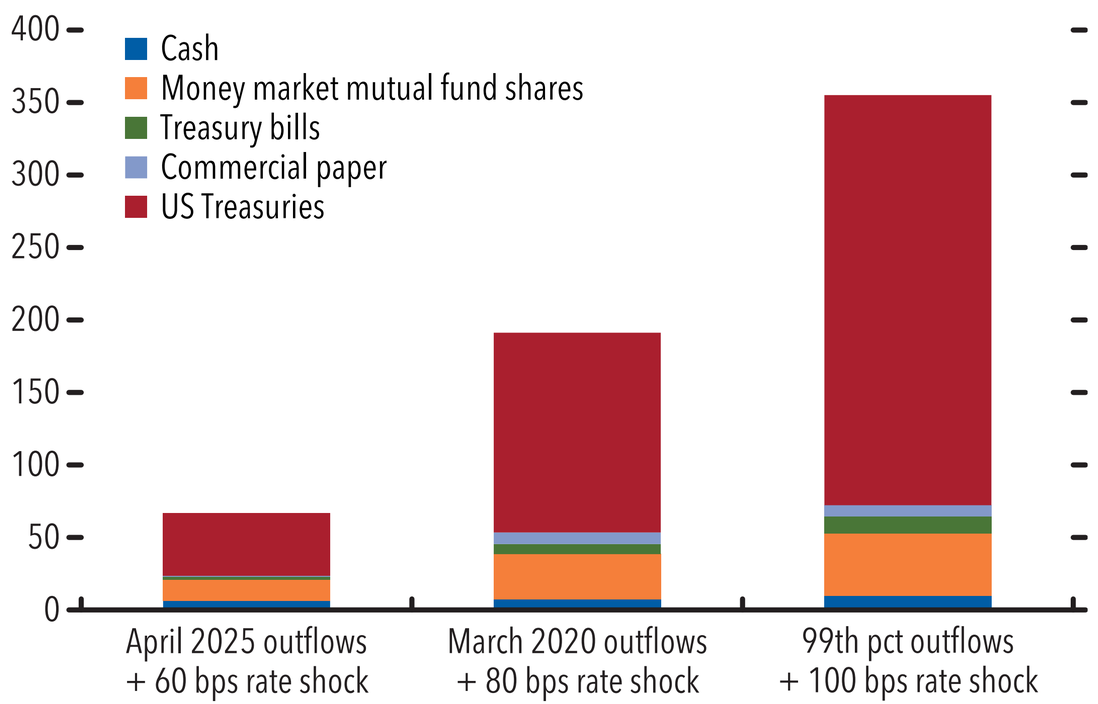
During both the Mar. 2020 and the Apr. 2025 market turmoil, US Treasuries started to sell off beyond a certain VIX level ...

Intraday 10-Year US Treasury Yield
(Yield in percent)



Bond Mutual Fund outflows and margin calls can lead to a selloff of US Treasuries under stress

Forced Sales of Bond Funds under the Waterfall Approach
(Billions of dollars)

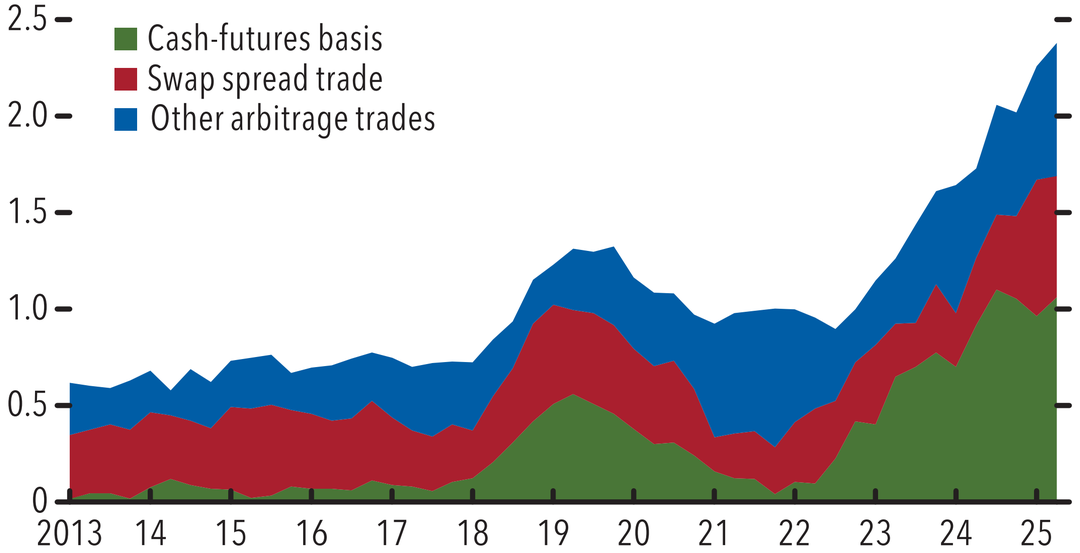


Rising Hedge Fund Leverage Poses Vulnerabilities

Hedge funds also engage fixed-income arbitrage trades and financial market stress has become more correlated with hedge fund losses

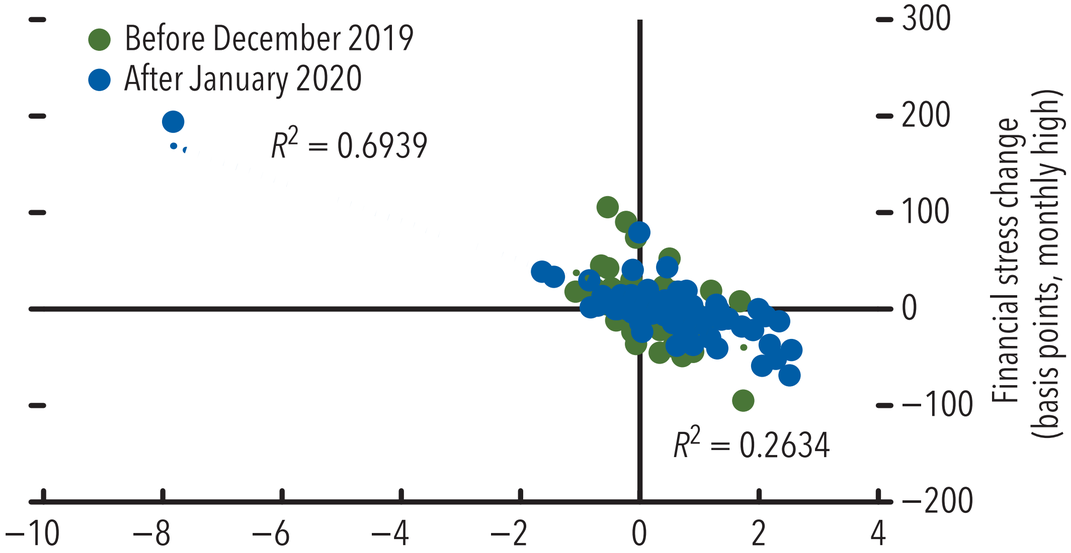
The size of leveraged fixed-income arbitrage trades, including cash-basis and swap-spread trades, has risen rapidly.

1. Relative Value Trades in the US Treasury Market
(Trillions of dollars)



The returns of fixed-income arbitrage hedge funds have a significant relationship with periods of market stress.

2. Hedge Fund Fixed-Income Arbitrage Index Returns and Financial Stress
(Basis points, y-axis; percent, x-axis)



Sources: Bank for International Settlements; Bloomberg Finance L.P.; Commodity Futures Trading Commission; Office of Financial Research; US Securities and Exchange Commission; and IMF staff calculations.

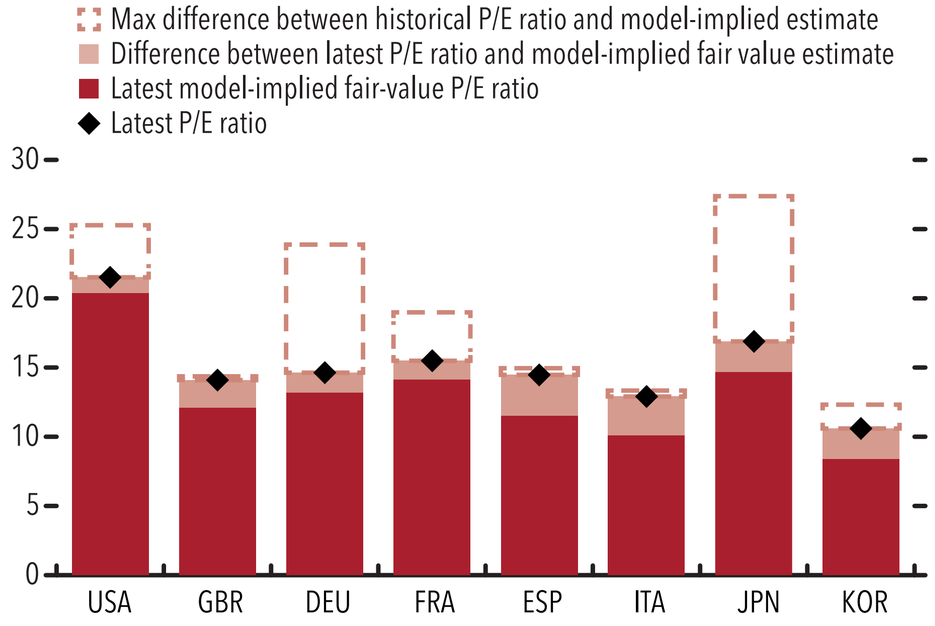
1. Government bond market fragilities
2. **High and concentrated asset valuations**
3. Private credit

Risk Asset Valuations Are Concentrated And On The High Side

High Valuation and Concentration in Equity Markets

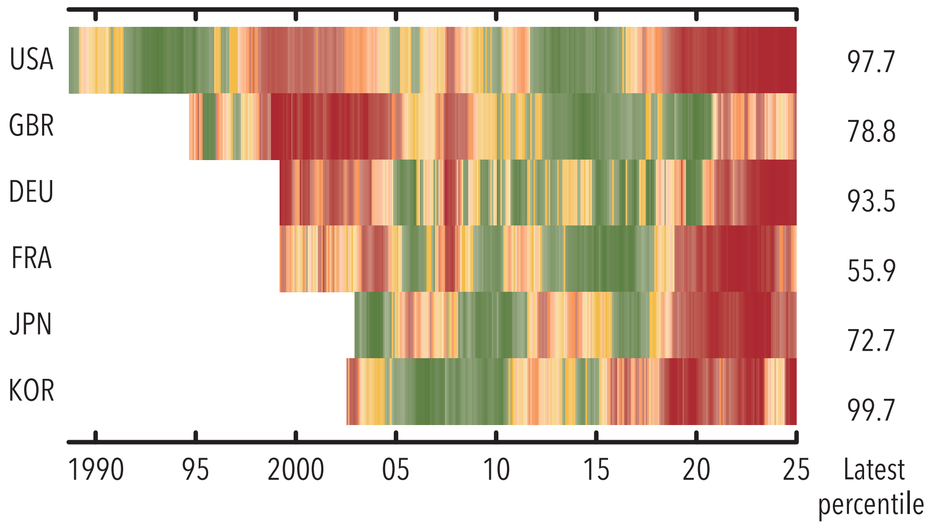
Valuations were high, staying somewhat above model-implied fair-value estimates before the conflict in the Middle East but below historical peaks.

3. Twelve-Month-Forward Price-to-Earnings Ratio versus Model-Implied Fair-Value Estimates
(Multiples)



Concentration risk is historically elevated in tech-heavy markets, especially in the United States.

4. Concentration Risk Heat Map
(Z-score of the Herfindahl–Hirschman Index)

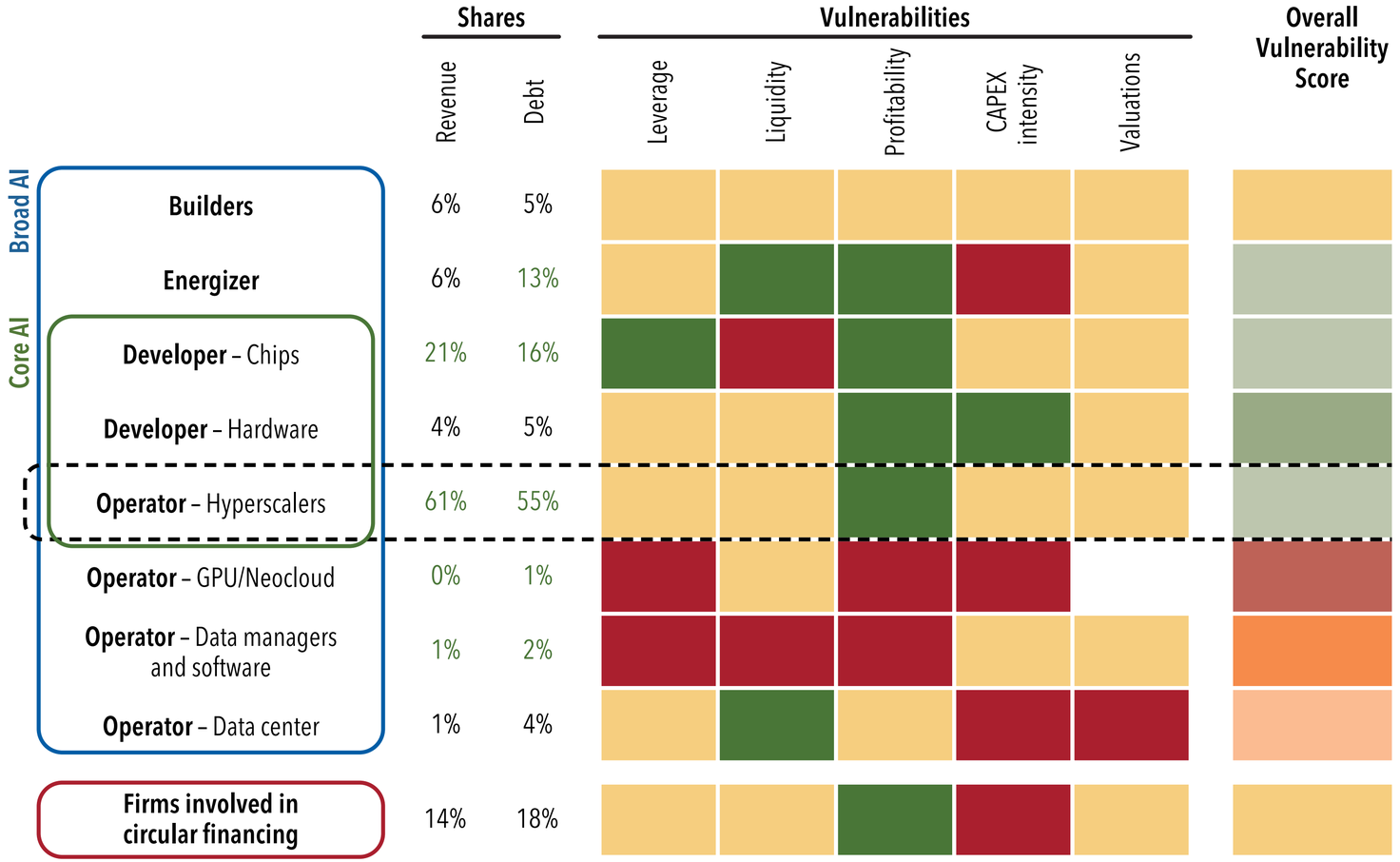


Sources: Bloomberg Finance L.P; LSEG DataStream; and IMF staff calculations.

AI "Circularity" Could Lead To Broader Selloffs In The AI Complex

Firms involved in circular financing do not have weak balance sheets, but their investment activities impact weaker firms

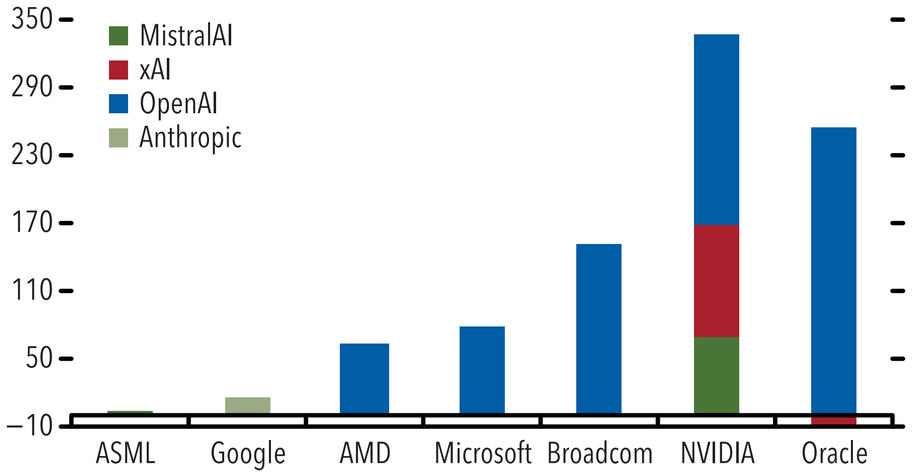
Core AI firms do not currently exhibit balance sheet vulnerabilities, unlike less systemically important firms.



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

Market capitalization of hyperscalers and other AI-related firms rises after deal announcements as part of circular financing arrangements.

1. Change in Market Capitalization after AI Deal Announcements
(Billions of dollars, based on deals in 2025)



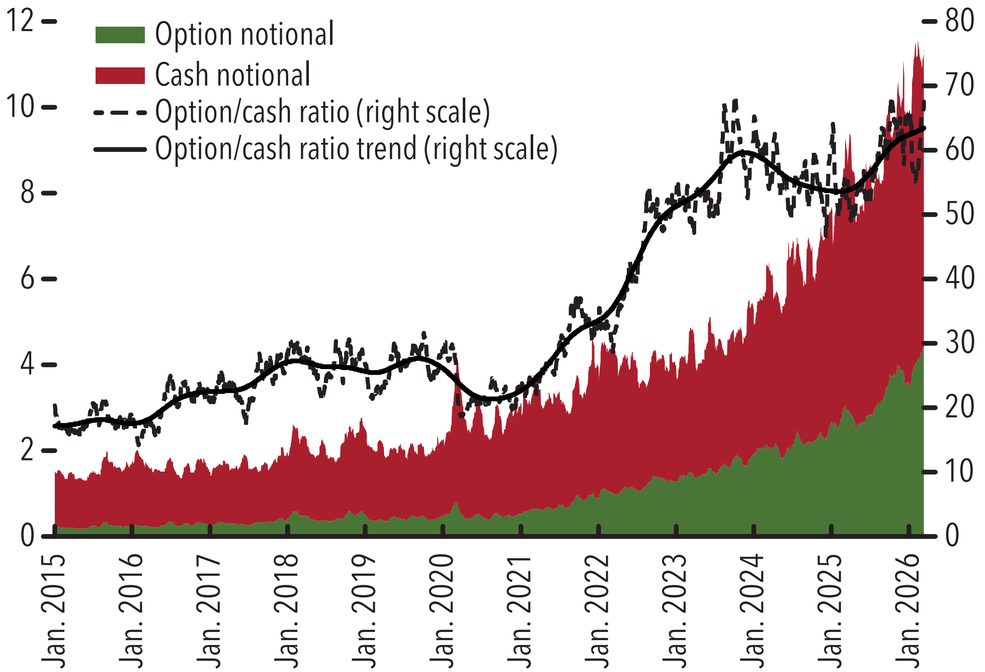
Sources: Bloomberg Finance L.P.; company announcements; and IMF staff calculations.

Volatility Amplification From Options Trading

Equity Options at Near Cash-Market Scale with Heightened Likelihood of Volatility Amplification

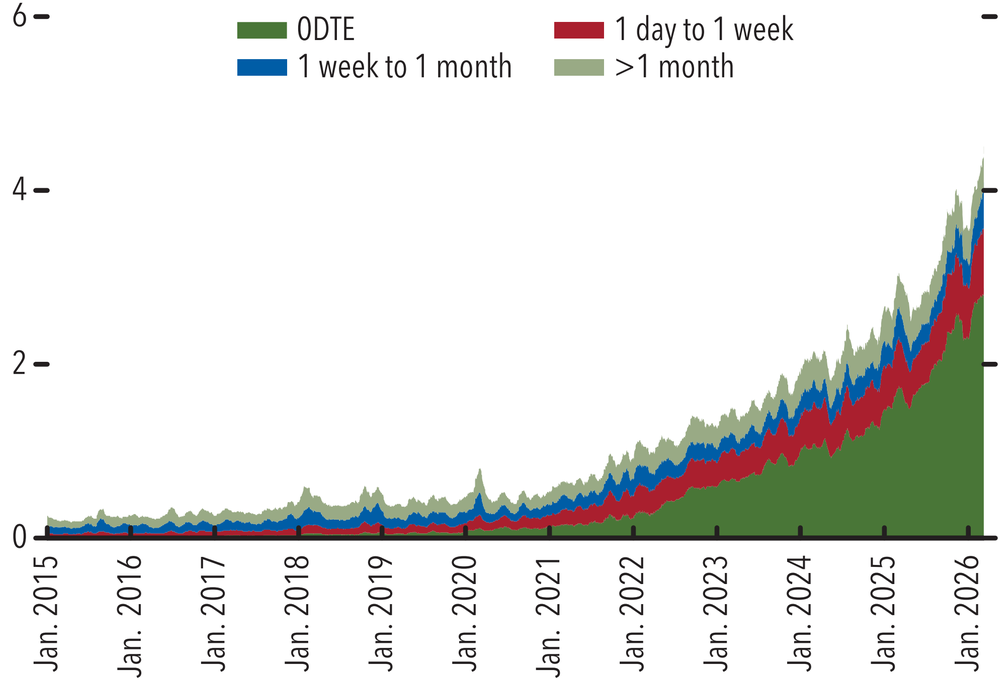
US options trading volumes have risen to near cash-market scale.

1. Trading in Equity Options versus Underlying Cash Equity Market
(Trillions of dollars, left scale; percent, right scale)



Alongside the rise in dynamic volume strategies, short-dated options have increasingly dominated options-trading volumes ...

3. Options Trading Volumes, by Maturity Bucket
(Trillions of dollars)



Sources: Bloomberg Finance L.P.; OptionMetrics; Chicago Board of Exchange; SIFMA;

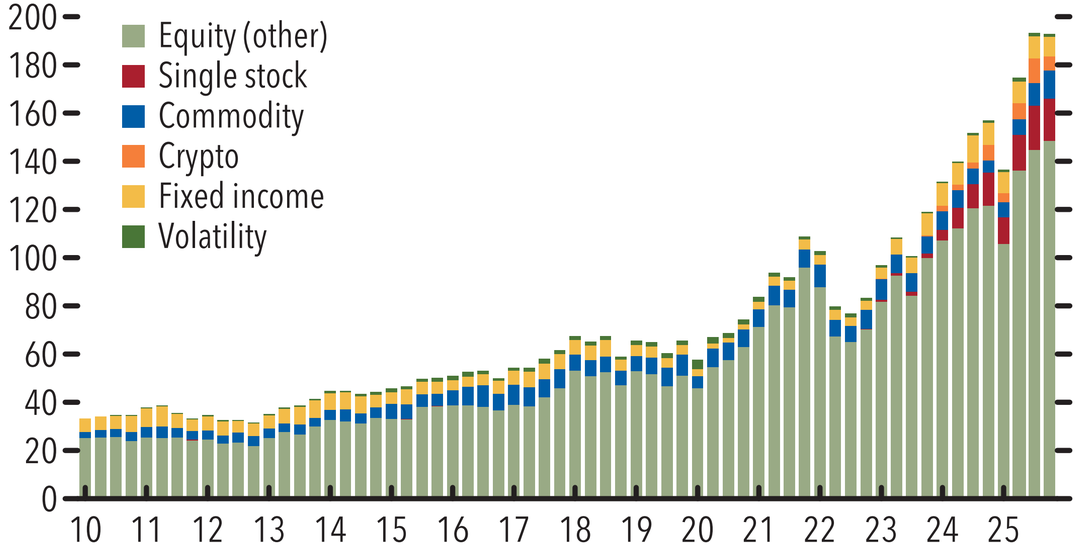
Amplification: Leveraged ETFs

Expansion of Leveraged Exchange-Traded Funds Can Amplify Sell-Offs

Leveraged ETFs have grown rapidly, including newer crypto and single-stock products.

1. Leveraged ETF Total Assets under Managementt

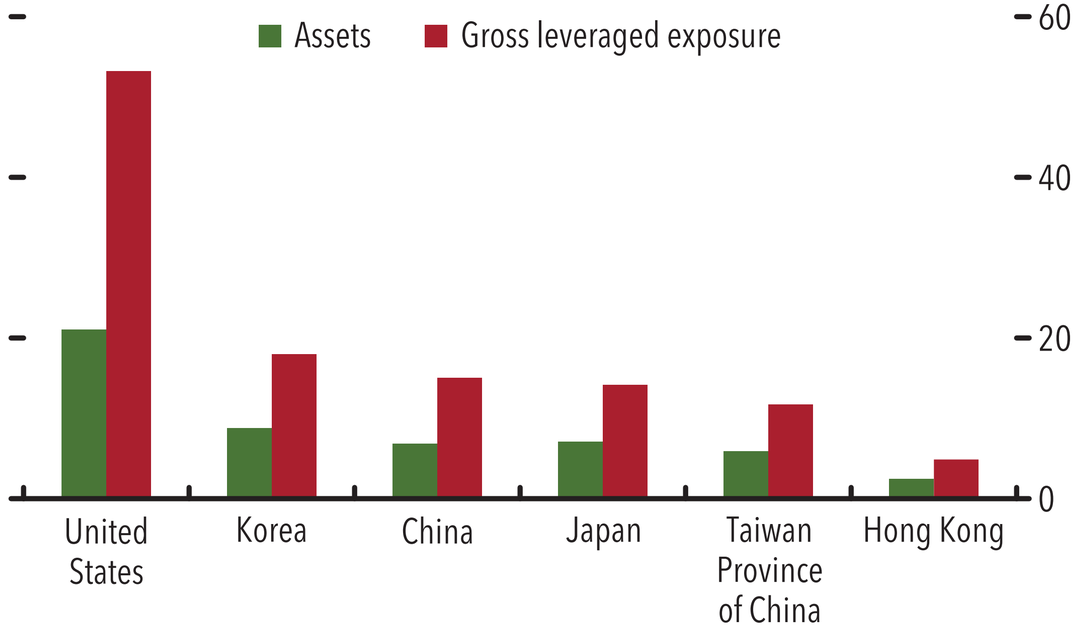
(Billions of dollars)



Leveraged ETFs are popular not only in the United States but also in other jurisdictions, particularly in Asia.

2. Leveraged Equity ETFs' Assets and Gross Leveraged Exposure

(Basis points of country's equity market capitalization)



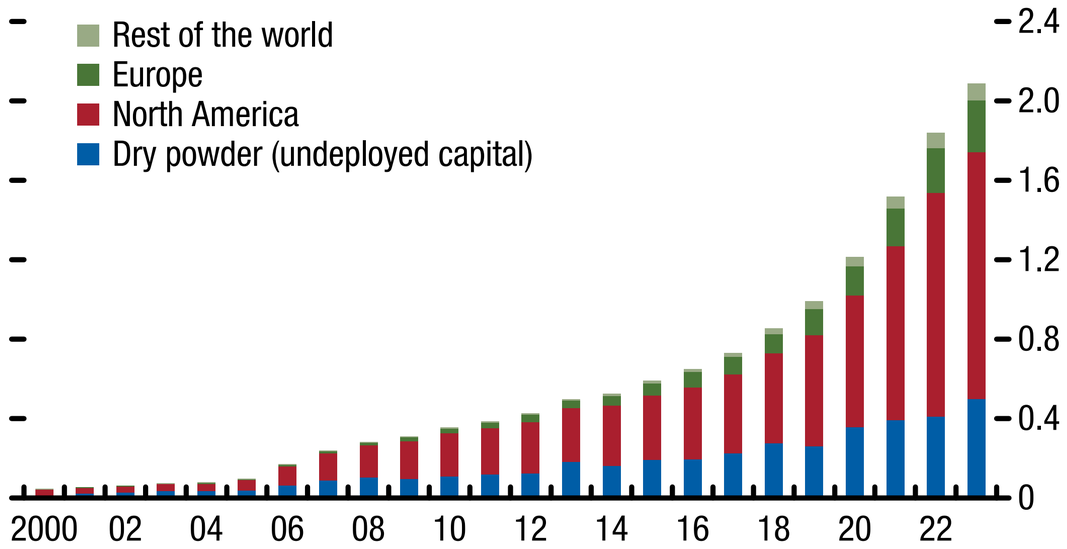
1. Government bond market fragilities
2. High and concentrated asset valuations
3. **Private credit**

Private Credit has Grown Rapidly

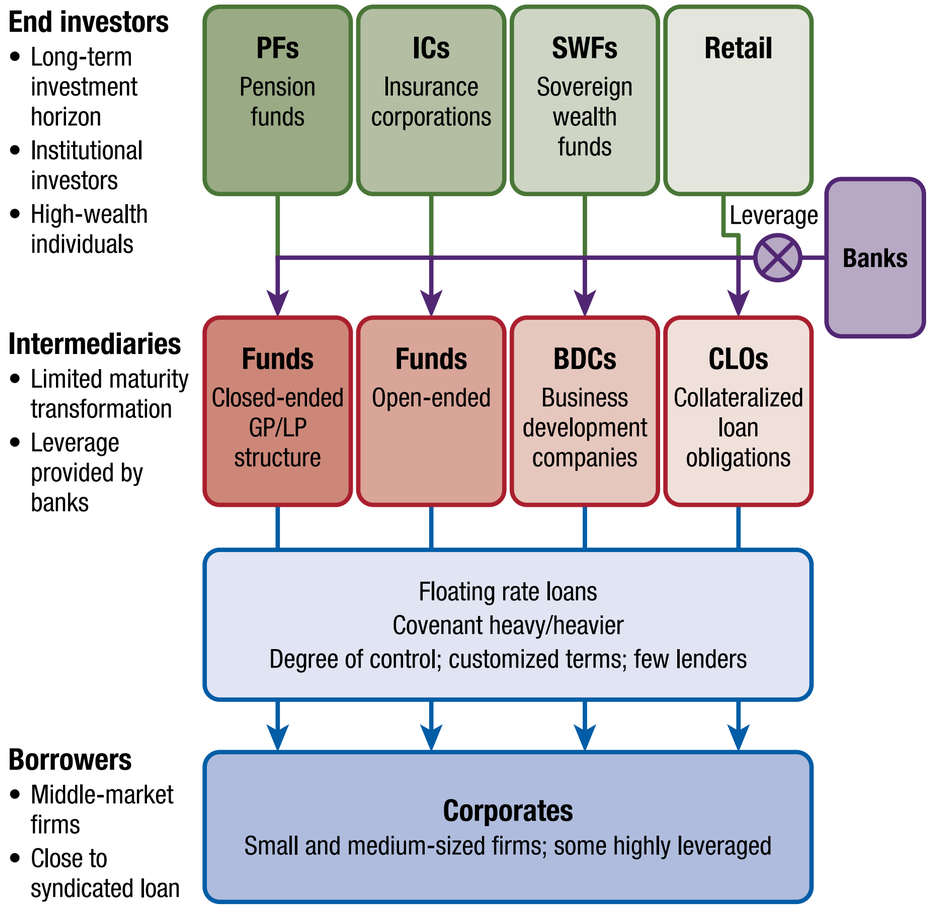
Expansion of Leveraged Exchange-Traded Funds Can Amplify Sell-Offs

The asset class grown exponentially over the last 20 years, and has doubled in the last 4 years, which raises questions about underwriting standards

Global Capital in Private Credit Market
(USD Trillions)



Banks provide leverage to intermediaries; it appears limited, but the full extent of exposures is opaque

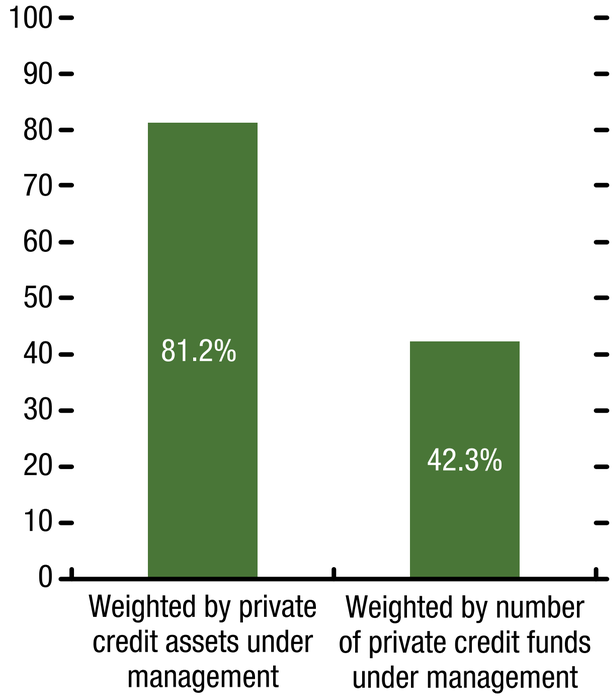


Private Equity And Private Credit Are Deeply Intertwined

Private equity sponsors can support struggling portfolio firms; at the same time, earnings growth is almost required for success

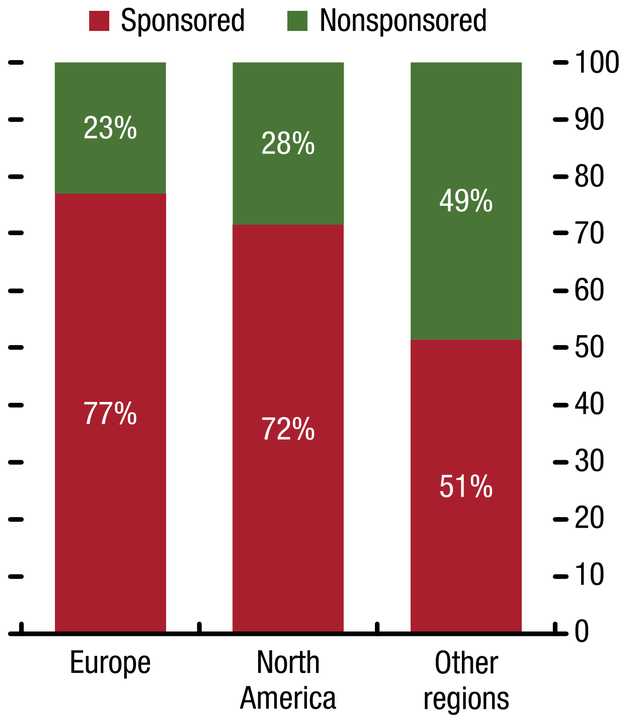
Many firms that manage private credit funds also manages private equity funds.

1. Share of Private Credit Funds Managed by Firms that Also Manage Private Equity Funds
(Percent)



About 70 percent of private credit deals are sponsored by private equity firms.

3. Share of Sponsored and Nonsponsored Private Credit Deals, 2021–23
(Percent)

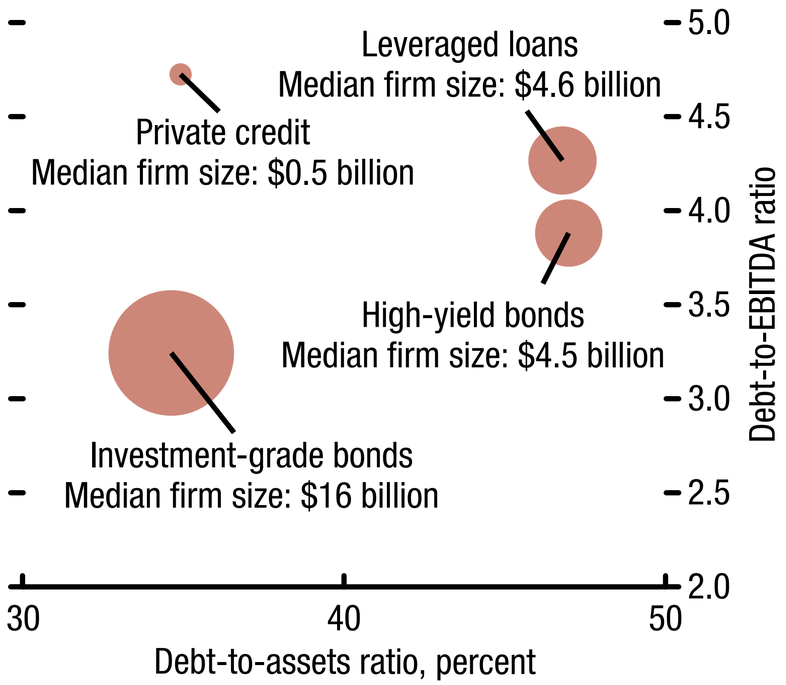


Borrowers: Private Credit is Riskier than its Traded Counterparts

Higher Borrower Leverage and Floating-Rate Debt Increase Vulnerability as Policy Rates Remain Elevated Following the Energy Price Shock

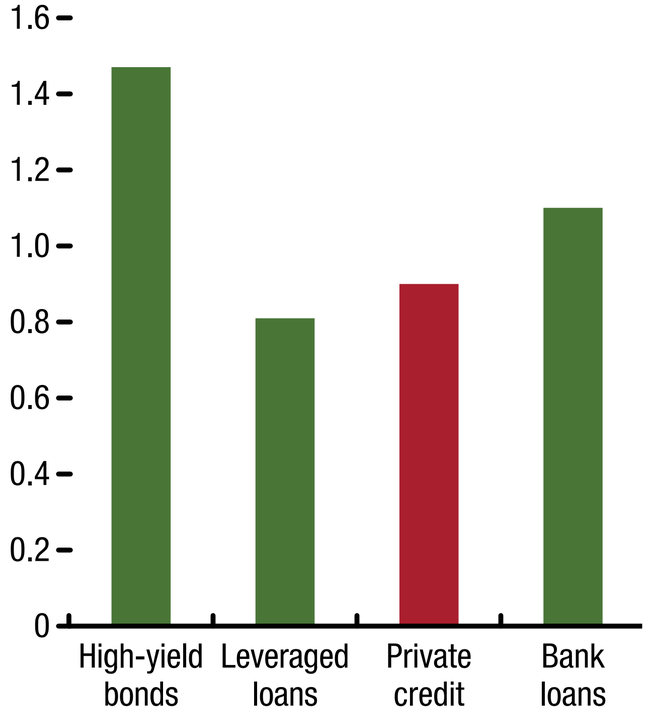
Private credit firms are medium sized, and relatively highly leveraged compared to earnings

Median leverage and firm size of borrowers
(leverage ratios on axes, bubble size = firm size)



Credit losses in private credit have historically not been outsized because of risk mitigants

Average Annual Credit Loss
(last 10 years)



Notes: private credit firm fundamentals are based on a sample of private credit transactions from Preqin that have matching data in Capital IQ Pro.

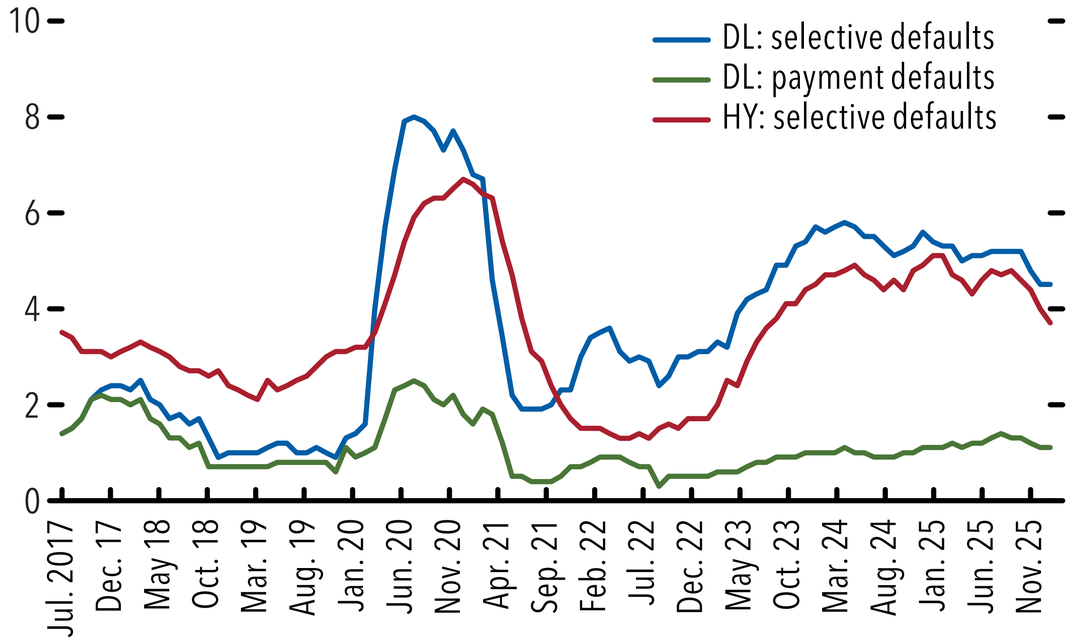
Source: Cliffwater. "Bank loans" refers to US banks' commercial and industrial business loans. Average annual credit losses are computed for a 10-year window between 2013 and 2022.

Private Credit Is under Pressure amid Converging Headwinds

Incidents in the private credit universe appear often fraud related and concentrated in asset backed finance.
Direct lending defaults are elevated but not historically high

Selective defaults of direct-lending borrowers are normalizing, while payment defaults are gradually rising.

1. S&P Direct-Lending and High-Yield Default Rates
(Percent)

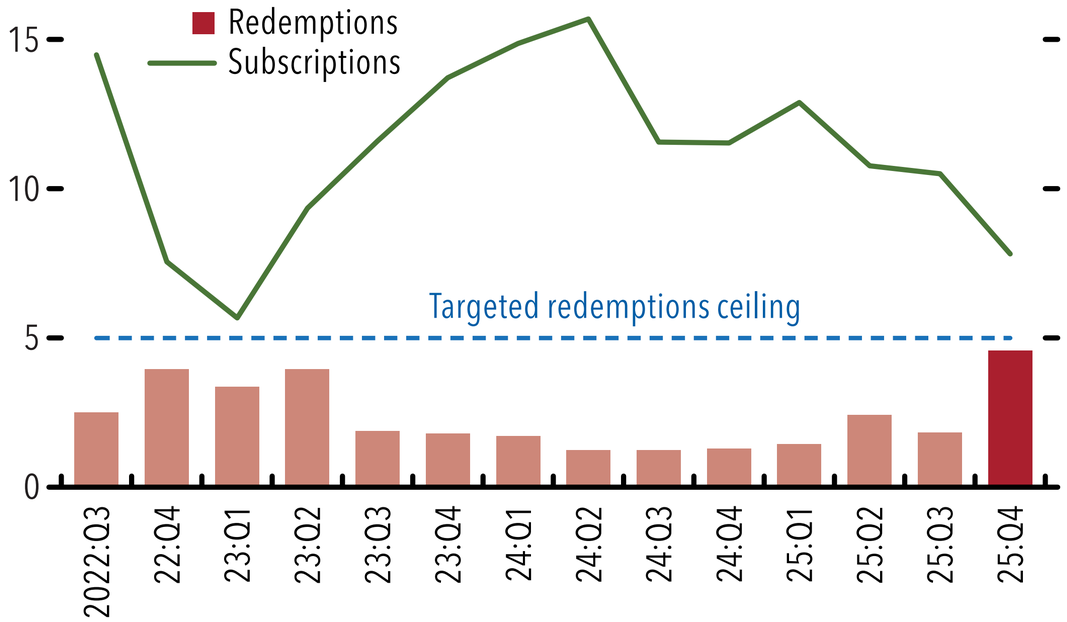


Retail Intermediaries Face Outflows and Impose Redemption Gates

Open-ended Business Development Companies face investor outflows, but account for a limited share of the investor base, as most intermediaries are closed-end funds

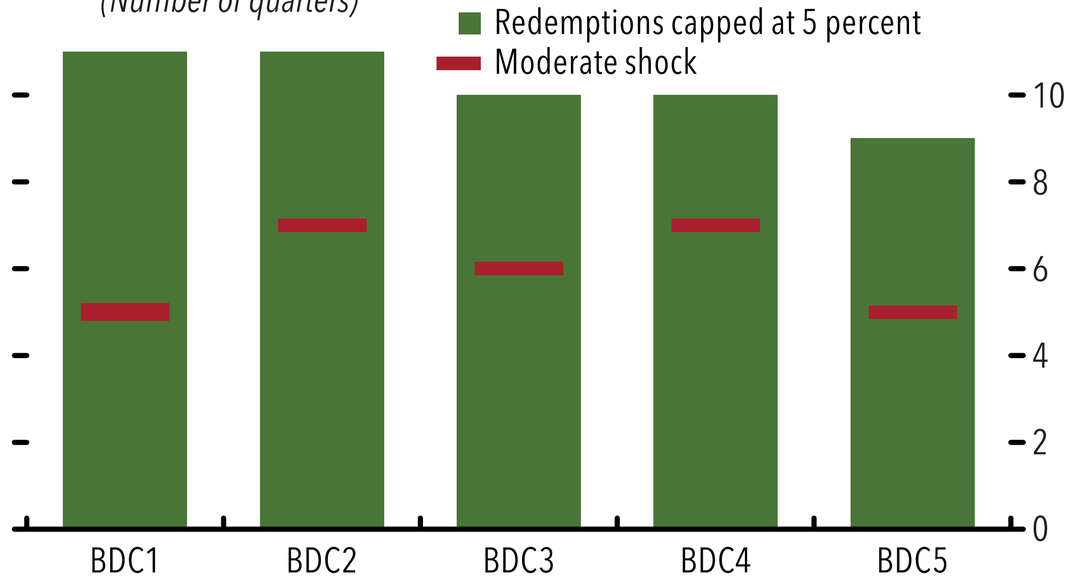
Perpetual nontraded BDCs are facing liquidity pressures as redemptions spike and inflows slow.

3. Quarterly Redemptions for Perpetual Nontraded Business Development Companies
(Percentage of outstanding shares)



Maturing unsecured debt and borrowers' revolvers may crowd out liquidity available for redemptions during a shock.

4. Number of Quarters to Liquidity Gap for Perpetual Nontraded Business Development Companies under High Redemptions and a Moderate Shock
(Number of quarters)



Sources: Capital IQ; S&P Global; and IMF calculations.

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- ❖ Markets have become more sanguine since the beginning of April, especially for risk assets
- ❖ But the real world appears to tell a different story from markets
- ❖ Further supply shocks, more persistent inflationary pressures could challenge current market pricing
- ❖ And salient financial stability risks could be triggered

In this presentation, assessed three areas of risk, based on the IMF's GFSR:

1. **Government bond market fragilities**

   Volatility and rapid yield rises more likely on the backdrop of energy shocks, inflationary pressures, elevated issuance, and structural shifts in the investor base

2. **High and concentrated asset valuations**

   Risk assets have performed strongly in some jurisdictions, despite the conflict. Concentration and vulnerabilities in the "AI complex" could see corrections amplified on the backdrop of structural changes in market dynamics, including the impact of options trading and leveraged ETFs

3. **Private credit**

   Early fault lines in private credit, but limited liquidity mismatch contains systemic impact

Background:

Government bond markets:

Chapter 1 of the October 2025 Global Financial Stability Report

Chapter 1 of the April 2026 Global Financial Stability Report

Private credit:

Chapter 2 of the April 2024 Global Financial Stability Report

Asset valuations:

Chapter 1 of the April 2026 Global Financial Stability Report