FedFin Daily Briefing

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IMF Flags Systemic Sovereign-Debt Exposures, New Doom Loop

The IMF's new assessment of global markets includes a very troubling finding: the doom loop is reverberating in several systemically significant nations. Although the report seemingly targets emerging markets, its chart combining nations with high sovereign debt and domestic banks with large national sovereign-debt holdings includes India, Brazil, Argentina, Mexico, as well as several smaller nations. Countries in which domestic banks have large sovereign-debt exposures relative to capital include Hungary, Poland, Turkey, Brazil, Thailand, India, and seven others. Due to the threat this poses to financial stability, the IMF urges identified nations to act quickly through new fiscal discipline (which we think unlikely under current circumstances). In addition, nations are urged to restrict bank capital distributions, improve asset-quality review, develop resolution plans specific to large sovereign-debt holdings, revamp stress tests, and – after financial conditions normalize – consider ways to cut the loop by, for example, imposing capital surcharges on sovereign-debt holdings above certain thresholds, reviewing bank resolution planning to ensure orderly failure, and diversifying the sovereign-debt investor market. Much of this reminds us of discussions following the 2013 EU sovereign-debt crisis and the efforts spearheaded then by the Basel Committee to increase the risk weighing on sovereign bonds (see FSM Report **CAPITAL220**) or impose the kind of surcharges the Fund has again suggested. Bank-regulatory action in the near term by any of the nations named is unlikely, but others such as the U.S. may take more immediate steps to review the exposure their own banks have not only to affected sovereign debt, but also large banking organizations in these nations.

IMF Panel Highlights Disagreements on CBDC Designs

At a session today on cryptoassets and CBDC during the IMF annual meetings, Managing Director Georgieva noted that the future of money was virtual, but emphasized that the need for interoperability, agile regulation, and protections against money laundering and terrorism pose the biggest barriers for governments. Three government officials actively engaged in this arena also spoke, making it clear that broader disagreements create challenges for many cross-border aspects of digital innovation. Roberto Campos Neto, the President of the Brazilian Central Bank, endorsed retail CBDC as a tool to increase inclusion along with payment speed and security, a point echoed in a recent BIS CBDC analysis (see *Client Report* **CBDC11**). However, he believes that wholesale CBDC is not likely to advance in the absence of cross-border cooperation essential for interoperability. However, Ravi Menon, the Managing Director of the Monetary Authority of Singapore, took the opposite position, supporting wholesale over retail CBDC because Singapore's current payment system already meets the criteria of a retail CBDC, but could greatly benefit from improved cross border payments. Nirmala Sitharaman, India's Minister of Finance, described the country's API framework that would house CBDC through which the government already distributes benefits. She also discussed as India's unique position to test CBDCs due to its large startup culture and its digitized rural population.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing info@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about *GSE Activity Reports*, click here.

- **CBDC11:** As promised, we turn here to an in-depth analysis of a paper from global regulators on whether CBDC contributes to financial inclusion – one of the most vital arguments from those advocating CBDC in the U.S. and in many other nations.

- **GSE-041522:** Cementing her very different vision of Fannie and Freddie, Acting Director Thompson has now finalized a new strategic plan for the FHFA emphasizing the importance of both equitable and sustainable housing finance

- **CBDC11:** Progressive Democrats in the House have introduced an alternative digital-dollar proposal ("e-cash") to the "FedAccount" construct urged by Senate progressives that mandates an electronic currency created by the Treasury Department to devise an electronic substitute for physical fiat currency.

- **GSE-040722:** FHFA has finalized new capital rules for the GSEs designed to accelerate the credit-risk transfer the agency now deems essential for a fast-acting conservatorship exit.

- **SANCTION18:** As anticipated, today's HFSC hearing with Secretary Yellen largely focused on ways to sanction the Russian Federation and its allies and associates.

- **DEFI:** As promised, this report provides an in-depth analysis of IOSCO's new paper on decentralized finance, one sure to advance the FSB's efforts to bring DeFi systems under greater regulatory scrutiny due to the findings we here detail.

- **GSE-032222:** As detailed in our new in-depth analysis, the CFPB's exam-manual rewrite dramatically redefines the compliance-, legal-, and reputational-risk terrain for any consumer-financial company and the vendors or counterparties on which it relies.

- **CONSUMER39:** Reflecting one of its new director's top priorities as well as that of the Biden Administration, the Bureau of Consumer Financial Protection has significantly revised its examination manual when it comes to behavior that might be viewed as discriminatory in a wide range of consumer-financial products, services, underwriting, advertising, marketing, governance, and other arenas.

- **SANCTION17:** The Senate Banking Committee's hearing today on illicit finance focused as expected on cryptocurrency and suggests that targeted legislation addressing specific jurisdiction or compliance issues might advance on a bipartisan basis.

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