

II. Macro environmental risk factors

2.1 International economic and financial conditions

In 2024, monetary policies of major central banks gradually shifted toward easing. The global economy experienced moderate growth, while inflationary pressures eased alongside improvements in labor market conditions. These developments, coupled with market expectations of future interest rate cuts, led to accommodative financial conditions.

Looking ahead to 2025, US tariff policies are expected to exert adverse effects on global economic growth and inflation. In particular, the heightened uncertainty stemming from the tariff measures has already triggered significant volatility in global financial markets and led to a notable tightening of financial conditions. If financial asset prices continue to correct, and volatility in the sovereign bond markets persists, the risks to financial stability could increase and therefore warrant close and ongoing attention.

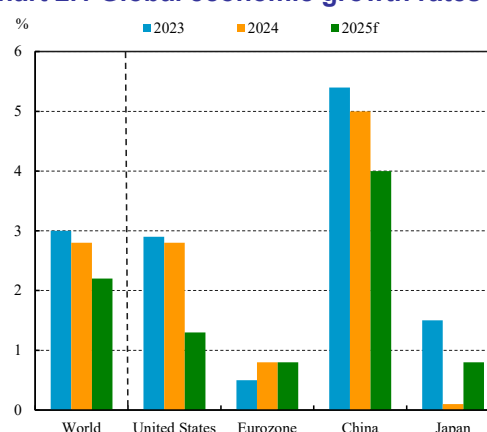
2.1.1 International economic and financial conditions in 2024

Global economic growth remained steady, and inflationary pressures eased

Although global economic growth in 2024 slowed compared to 2023, it remained stable as major central banks gradually shifted toward a more accommodative monetary stance. According to S&P Global,¹¹ the global economic growth rate for 2024 was estimated at 2.8% (Chart 2.1), with economic performance diverging across major economies.

In the US, economic momentum was strong, supported by resilient consumer spending. In

Chart 2.1 Global economic growth rates



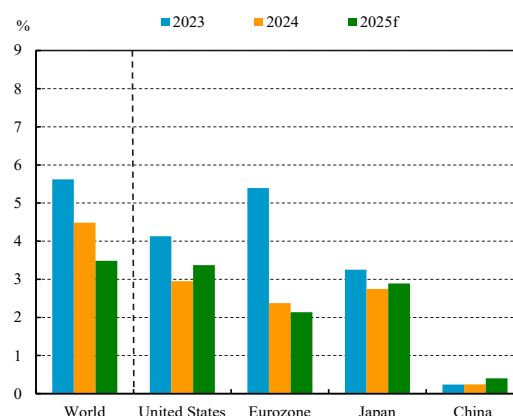
Note: Figures for 2025 are S&P Global Market Intelligence estimates.

Source: S&P Global Market Intelligence (2025/5/15).

¹¹ See Note 1.

the euro area, although manufacturing and goods exports remained weak, continued expansion in private consumption led to slightly higher growth than in 2023. In contrast, China's growth momentum was subdued owing to a sluggish property market and weak consumer demand, accompanied by rising deflationary risks. Japan's economic growth has slowed to near stagnation, primarily reflecting temporary production halts in the auto industry caused by certification violations, as well as the effects of a high base from the previous year.¹²

Chart 2.2 Global headline inflation indices



Note: Figures for 2025 are S&P Global Market Intelligence estimates.

Source: S&P Global Market Intelligence (2025/5/15).

As international oil and grain prices declined, and nominal wage growth slowed amid a gradually stabilizing labor market, global inflation in 2024 eased from the decades-high levels seen in recent years. According to S&P Global,¹³ the global CPI inflation rate fell to 4.5% in 2024, down from 5.6% in 2023 (Chart 2.2), indicating a broad moderation in inflationary pressures. While core goods price inflation declined notably, services price inflation remained somewhat sticky and continued to run above pre-COVID-19 averages, resulting in slower progress toward disinflation in some economies.

Global financial conditions eased

In 2024, as post-pandemic pressures stemming from supply chain disruptions and surging commodity prices gradually subsided, global labor markets became more balanced and inflation steadily converged toward central bank targets. Most central banks adopted a more accommodative monetary stance, with the US, the euro area, and the UK all cutting their policy rates. Supported by widespread expectations of declining interest rates and improved investor sentiment, volatility in global financial markets declined. As a result, financial conditions eased considerably compared to the end of 2023, although they tightened slightly after October.

In an effort to revive sluggish economic growth, China intensified its monetary easing efforts, which led to a narrowing of credit spreads on corporate bonds. Consequently, financial conditions shifted rapidly from restrictive to expansionary, with a notably steeper decline in

¹² Japan's economic growth accelerated significantly in 2023, driven by a surge in inbound tourism.

¹³ See Note 1.

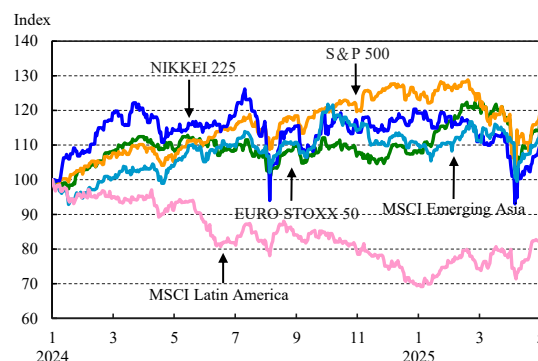
financial condition indicators compared to other major economies.

Financial markets rebounded steadily

Amid easing inflation in 2024, global stock markets, with the exception of Latin America, staged a gradual recovery. However, in August, owing to weaker-than-expected earnings guidance in the technology sector and growing concerns over the US economic outlook, US stock markets turned downward, dragging down stock markets in other economies as well. Since October, US stocks have recovered, buoyed by optimism following Trump’s election victory. Nonetheless, heightened uncertainty over trade policy has limited upward momentum in other markets (Chart 2.3).

In the bond market, US government bond yields were highly volatile throughout the first half of 2024. Although the Federal Reserve System (Fed) began a rate-cutting cycle in the second half of the year, uncertainty surrounding the terminal rate persisted, driven by recession fears, elevated inflation, and increased government bond issuance under new US fiscal policies. These factors led to a rise in the term premium on long-term government bonds, pushing 10-year yields higher (Chart 2.4).

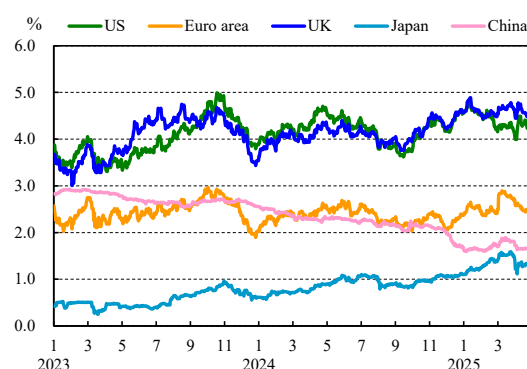
Chart 2.3 Major international equity indices



Notes: 1. January 1, 2024 = 100.
2. The EURO STOXX 50 refers to a stock index consisting of the largest 50 stocks in the 12 major economies of the euro area.

Source: Bloomberg.

Chart 2.4 10-year government bond yields in major economies



Source: Bloomberg.

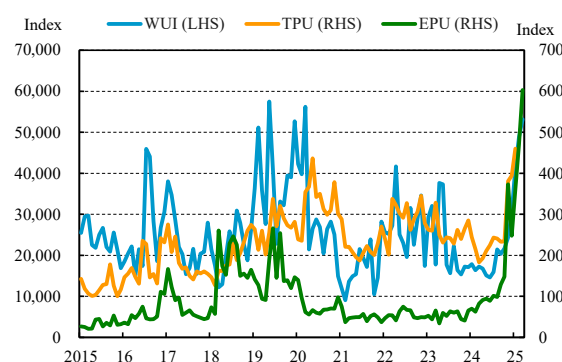
2.1.2 Impact of Trump’s tariff policies on the global economy and financial markets

Uncertainty in trade policy exerts negative effects on global economic growth and inflation

In October 2024, as markets began to anticipate Donald Trump’s potential re-election, investors engaged in the so-called “Trump trade” in response to the perceived implications of his proposed tariff policies. Initially, markets reacted positively to expectations of tax cuts, propelling financial markets to higher levels. Nevertheless, Trump’s policies were perceived as aggressive and unpredictable, exerting varied impacts on economic growth momentum, inflation, and financial markets across major economies. The uncertainty surrounding trade policy, with a particular focus on tariff measures, intensified considerably. Correspondingly, global policy uncertainty indices registered a significant increase (Chart 2.5), reflecting rising market concerns over changes in the future trade landscape. These concerns may have far-reaching effects on global supply chain restructuring, cross-border capital flows, and portfolio allocation strategies.

Following President Trump’s inauguration in January 2025, a series of tariff measures were announced, including reciprocal tariffs targeting major global trading partners.¹⁴ These actions heightened uncertainty in the global trade environment and posed downside risks to the world economy and financial markets. The widespread use of tariffs has also further increased the unpredictability of monetary policy decisions among central banks worldwide. The Fed chair Jerome Powell emphasized that, while tariffs may cause a temporary rise in inflation, the Fed must balance its dual mandate of price stability and maximum employment. The European Central Bank (ECB), despite cutting rates again in April 2025, also underscored the highly uncertain environment and refrained from providing forward guidance on interest rates, highlighting its flexible and cautious policy stance.

Chart 2.5 Policy uncertainty indices



Note: The uncertainty measures are indices that quantify media attention to global news related to world uncertainty (WUI), economic policy uncertainty (EPU), and trade policy uncertainty (TPU).

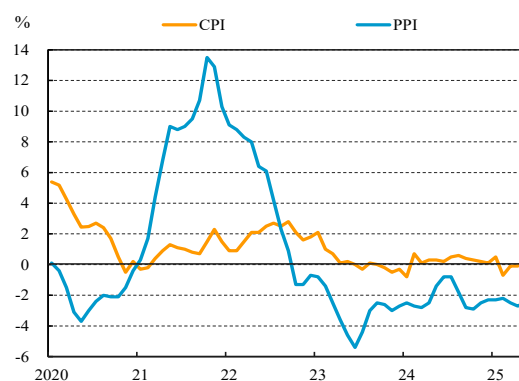
Source: IMF (2025), *World Economic Outlook*, April

¹⁴ See Note 2.

Although the US has recently announced a 90-day pause on the reciprocal tariff measures, policy uncertainty and adverse economic spillovers are likely to persist. S&P Global¹⁵ projects that global economic growth will moderate to 2.2% in 2025 (Chart 2.1), marking the weakest pace since the 2008 global financial crisis, excluding the COVID-19 pandemic. Concurrently, the US CPI annual growth rate is anticipated to rise to 3.4% (Chart 2.2). The US tariff measures are expected to have a particularly strong impact on Canada, Mexico, China, and the US itself. As tariffs constrain capital formation, their effects will likely expand over time. The International Monetary Fund (IMF)¹⁶ projects that global GDP will be reduced by 0.6 pps by 2027. Even so, the inflationary pressures stemming from tariff hikes will be partially offset by the disinflationary effects from reduced economic activity. As a result, global inflation is forecast to edge up only marginally, by approximately 0.1 pps between 2025 and 2026.

After Trump announced the implementation of reciprocal tariffs, China responded with retaliatory measures. Both countries subsequently raised tariff rates in succession, triggering “an upward spiral of tariffs” that further escalated US-China trade tensions and even resulted in economic decoupling between the two nations. These developments would exert substantial pressure on China’s export-oriented economy. Apart from external challenges, China is also grappling with internal economic headwinds, including a persistently sluggish real estate sector, elevated local government debt burdens, and subdued domestic demand caused by weak consumer confidence. The IMF¹⁷ projects that China’s economic growth rate will fall to 4.0% in 2025. Meanwhile, S&P Global¹⁸ expects a notable increase in the probability that China’s annual CPI growth will ease to 1.0%. The producer price index (PPI) has also remained weak (Chart 2.6), signaling a mounting risk of the economy entering a deflationary spiral. Given China’s role as a key global manufacturing exporter, the simultaneous escalation of the US-China trade tensions and rising internal deflationary risks in China may lead to cascading effects on global prices and trade conditions.

Chart 2.6 CPI and PPI movement in China



Note: The data in the chart are monthly figures, each comparing the given month with the same month of the previous year.
Source: S&P Global Market Intelligence (2025/5/15).

¹⁵ See Note 1.

¹⁶ IMF (2025), “Chapter 1: Global Prospects and Policies,” *World Economic Outlook*, April.

¹⁷ See Note 16.

¹⁸ See Note 1.

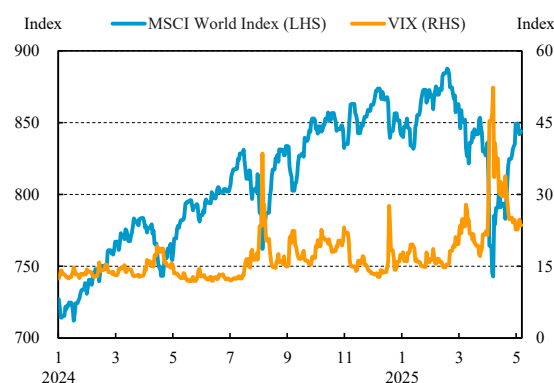
Global financial markets experienced substantial disruptions following US tariff measures, accompanied by a noticeable tightening in financial conditions

In the first quarter of 2025, US tariff policies sparked investor anxiety over the possibility of stagflation, culminating in the weakest performance of US equities since 2022.

Following the Trump administration's April 2 announcement of reciprocal tariffs, global stock markets plunged over several days, risk-off sentiment dominated, and the VIX index spiked sharply. However, on April 9, when the Trump administration announced a 90-day suspension of reciprocal tariffs for all economies except China, both global stock markets and the VIX index stabilized, revealing how investor sentiment and market dynamics are highly reactive to developments in trade policy (Chart 2.7). In bond markets, US bond yields have fluctuated markedly amid heightened uncertainty surrounding tariff policies since the beginning of 2025. In Japan, a policy rate hike in early 2025, coupled with renewed inflationary pressures, drove government bond yields sharply higher, reaching levels unseen since 2008. However, yields later retreated owing to intensified market risk aversion triggered by the US reciprocal tariff measures. In China, amid escalating trade tensions with the US, expectations of a more accommodative monetary policy stance by the People's Bank of China have increased, placing downward pressure on long-term government yields (Chart 2.4).

Prior to the announcement of US tariff policies, stock valuations in most advanced economies were at elevated levels, and corporate bond spreads had tightened. Thereafter, repeated shifts in tariff policies caused a pronounced rise in market volatility, contributing to an evident tightening in financial conditions. In contrast, emerging economies outside China experienced a more moderate degree of financial tightening, as relatively stable exchange rates helped offset the adverse effects of falling stock prices.

Chart 2.7 MSCI World Index and VIX Index



Source: Bloomberg.