



# Assessing how businesses across the globe are addressing inflation-driven risk management

A subject everyone—from financial institutions to depositors—is talking about now: risk management. The reason is obvious: the string of banking failures and the takeover of Credit Suisse by UBS that took place in mid-March.

The ultra-loose monetary policy of 2020-2021 drove inflation to a 40-year high of 9% in the US, ultimately forcing the Federal Reserve to rush into its fastest hiking interest rate cycle in modern history. The global markets experienced 15 years of complacency during near-zero interest rates that led to widespread excesses. People were caught off guard when rates suddenly spiked and, unfortunately, some institutions didn't manage those rate risks. It was a pure example of asset liability mismanagement.<sup>1</sup>

So, what is the inflation story right now? While the IMF (International Monetary Fund) predicts that global inflation peaked in late 2022, rates in 2023 are expected to remain higher than usual in many parts of the world. Following the 8.8% global inflation rate in 2022, the IMF currently forecasts a 6.5% rate for 2023 and 4.1% rate for 2024 based on their most recent January 2023 update, with a potential sharper disinflation in the more advanced economies. Will the U.S. see rate cuts this year? The Fed is dismissing that for now.

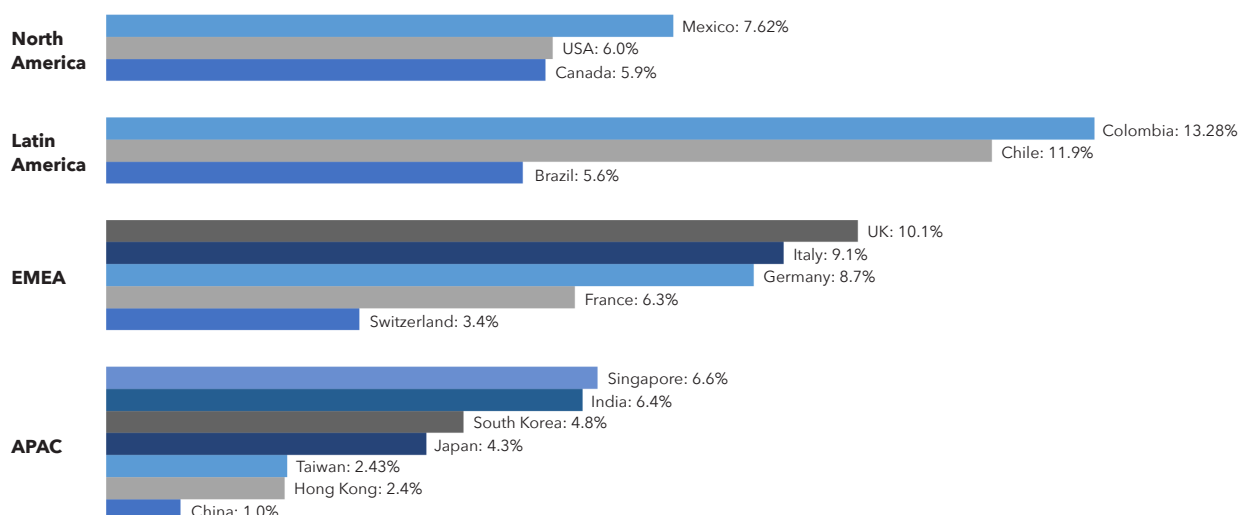
For risk managers that want to protect their companies from the impacts of inflation, it's essential to create an agile blueprint to minimize and manage inflation risk. But how are they doing this? Coincidentally, a little less than two weeks before the onset of the turmoil in the banking sector, Numerix distributed an internal Inflation Risk Management survey to its extensive global team of financial engineers and regional sales leaders based in the U.S./Canada, Latin America, EMEA and APAC to gain their input on the inflation-related products Numerix clients are using to manage against today's inflation risks, among other data. Their input into the survey is based on their work with banks, asset managers, insurers, hedge funds and corporates.

This white paper presents the survey's findings. It is interesting to know how some global firms addressed inflation risk management prior to the banking crisis.

**A recent Global Risk Management Study conducted by Accenture found that 77% of risk leaders (over 700 risk professionals from the Banking and Capital Markets industries, among other industries, were surveyed for the study) believe that complex new risks are emerging at a more rapid pace than ever before. One of those risks is inflation, which is moving to the top of a long list of issues facing businesses right now.**

## A Look at Global Inflation Rates

To begin, let's take a look at the inflation rates (as of January/February 2023), according to [Trading Economics](#), in the main countries where Numerix conducts business globally.



<sup>1</sup> On March 27, 2023, Numerix conducted a roundtable discussion, *Explaining the Banking Crisis: What Happened, Its Wide Implications and Lessons Learned*, in which a number of key questions and issues related to the bank failures are discussed by a panel of financial industry experts representing the banking, insurance, asset management and hedge fund industries. To download the video, click [here](#).

### The Inflation-Related Products Being Used By Region (as of March 1 to March 8, 2023)

Arguably, the most interesting observation we draw from the survey is that the inflation-driven risk management products being employed by each of the four regions vary widely, with the exception of the world-wide demand for derivatives.

	Inflation Derivatives (such as different types of inflation swaps, inflation-indexed options)	CPI Swaps	Inflation Bonds	TIPS	Convertible Bonds	Structured Derivatives Linked to CPI	Major Markets Inflation Linked Swaps	Italian Bonds (Italian inflation linkers)	Natural Resources and Commodities
North America	✓		✓	✓	✓				
Latin America	✓								
EMEA	✓							✓	✓
APAC	✓	✓				✓	✓		

### Regions that Employ Hedging Strategies Against Inflation Risk Eroding Value of Client Portfolios

What could be considered surprising is that only two of the four regions appear to hedge against inflation.

	Products Used to Hedge
North America	Inflation Swaps, Inflation Bonds, TIPS
APAC	CPI Swaps, Structured Derivatives Linked to CPI, Major Markets Inflation Linked Swaps

### By Region, the Top Challenges Regarding Managing Inflation-Related Risks

Inflation is an outcome of many factors, which can make it difficult to manage. It's not enough to understand the complex set of issues that create inflationary environments and the resulting impacts, what matters is how businesses respond in turn. These are some of the specific inflation management challenges risk managers face today.

North America	Latin America	EMEA	APAC
Uncertainties in supply chains, energy prices, less frequent CPI data.	Latin America's overall lack of financial depth, which has significant consequences for economies when threatened.	Energy prices.	Lack of instruments, liquidity, setting up a desk for inflation derivatives.

### Countries that Take the Most Aggressive Approaches to Managing Inflation Risk

Businesses in these regions are taking the strongest steps to counter inflation.

North America	Latin America	EMEA	APAC
USA, Canada	Chile	France	Japan, South Korea, Singapore

## Can't Ignore Downside Risks

As referred to earlier, IMF projections anticipate a decline in global inflation in 2023 and 2024. However, inflationary dynamics appear likely to continue, which will maintain challenging environments for businesses, central banks, and the public sector, given a still supply side crisis (particularly an energy supply crunch), prolonged war in Ukraine, escalating geopolitical tensions, natural disasters and extreme weather events, among other macro threats. This means downside risks to the global outlook remain at large.

According to [The Global Risks Report 2023](#), developed by the World Economic Forum, "Rising Inflation" is ranked among the top risks for 2023 with the greatest potential impact on a global scale. It is clear that managing inflation risks, for now at least, needs to stay on the top of the priority list for the capital markets.

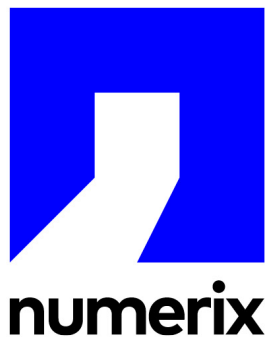
To learn about Numerix's risk solutions, contact [marketing@numerix.com](mailto:marketing@numerix.com).

# Ready to elevate your business?

[Get started →](#)

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More than 550 clients and 90 partners across 52 countries rely on Numerix analytics. Headquartered in the financial capital of the world, with offices around the globe, Numerix brings together unparalleled expertise combined with local market understanding.



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