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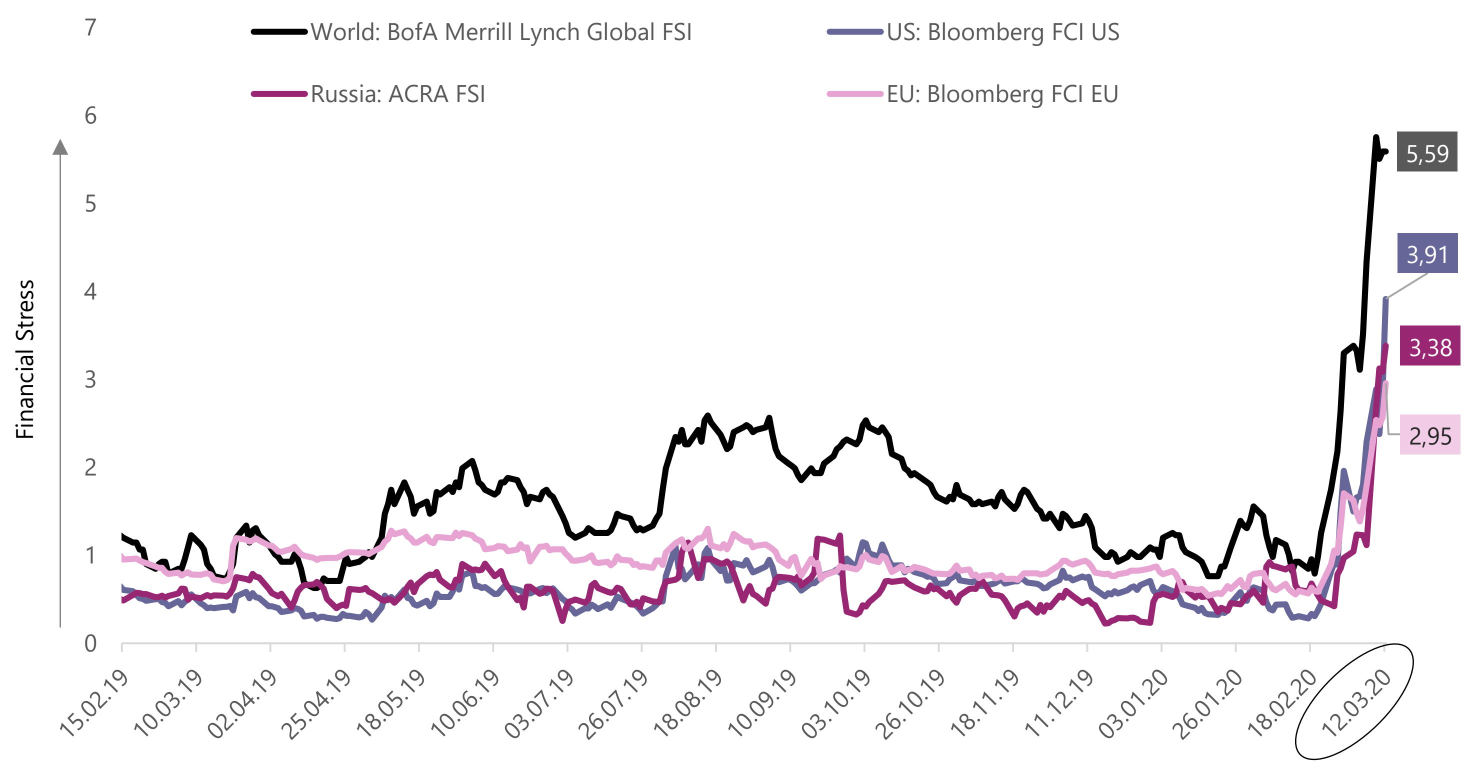
Global risks in the financial system have increased, but it is still too early to talk about a crisis

An analysis of how the coronavirus and the collapse of OPEC+ talks are affecting financial stress indices for Russia and other countries

The COVID-19 coronavirus pandemic has reduced business activity around the world and lowered expectations for economic growth prospects, including in advanced economies. The uncertainty surrounding the spread of COVID-19 has put pressure on financial markets and encouraged flight to quality. Investors are demonstrating increased demand for liquid and low-risk assets and selling financial instruments that have higher risks. The decline in economic activity due to the coronavirus has had a negative impact on the commodity market, where demand has decreased. There has also been a negative impact from the supply side with regard to oil prices, which is due to the termination of the OPEC+ deal due to take effect on April 1, 2020.

The financial stress indices for many countries and regions have increased dramatically amid turbulence in the financial and commodity markets (*Fig. 1*). These indices are calculated using various methods (*Table 1*), making it impossible to directly compare their values. Nevertheless, common trends in these indices, including ACRA's FSI for Russia, suggest that the increase in financial stress in Russia is consistent with global trends.

Figure 1. The impact of recent events on financial stress indices and the state of various countries and regions*



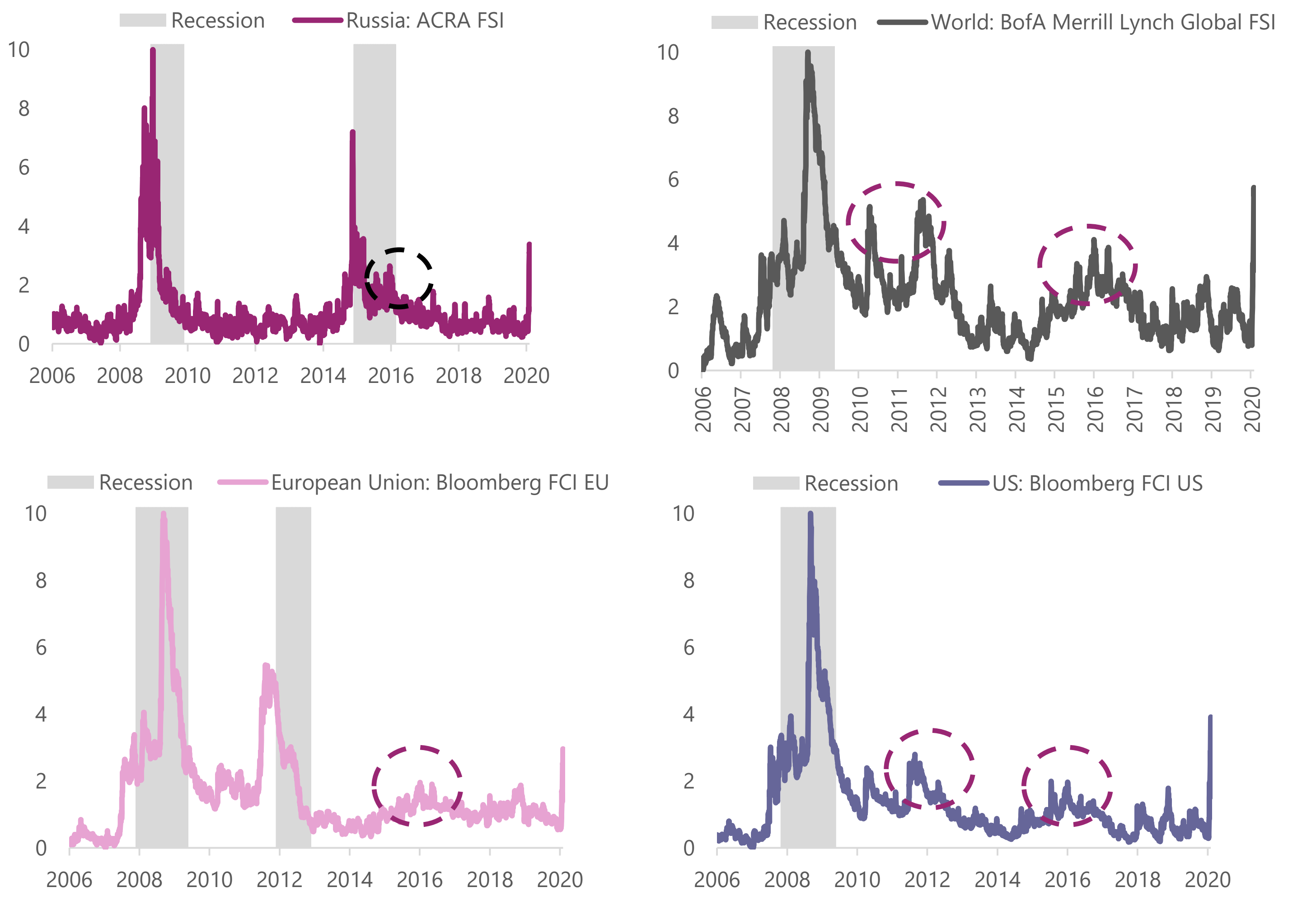
Sources: Bloomberg, Thomson Reuters, ACRA

** For the purposes of comparison, Fig. 1 and Fig. 2 standardized values are used (from 0 to 10 points, from February 9, 2006 to February 28, 2019) for the financial stress indices. Given the difference in calculation methods, only for the ACRA FSI does the crossing of the critical mark at 2.5 points indicate the increased probability of a financial crisis starting.*

Financial stress indices rarely reach high values and do not necessarily predict recessions (*Fig. 2*). For example, the BofA Merrill Lynch Global FSI reached relatively high values in 2011 due to the debt crisis in Europe as well as in early 2016 due to falling oil prices, but these high values were not followed by a global recession. In 2016, ACRA's FSI also increased amid lower oil prices and reached a critical mark of 2.5 points, signaling the increased probability of a financial crisis starting. However, ACRA's FSI peaking in 2016 did not predict a recession and indeed preceded the end the economic downturn in Russia.

Under the optimistic scenario, which envisages stabilization of the situation in stock markets, a reduction in financial stress indicators can be expected along with the absence of a pronounced decline in real GDP. In the event that there are no new production agreements between leading oil producing countries and the negative economic impact of the coronavirus remains unchanged or worsens, ACRA cannot rule out the possibility of further crisis phenomena in financial markets and economic decline in the countries and regions covered by the financial stress indices. The possibility of the pessimistic scenario materializing is currently assessed as high.

Figure 2. High financial stress indicator values are not always precursors to recession*



Sources: Bloomberg, Thomson Reuters, World Bank, Eurostat, NBER, ACRA

Table 1. Financial stress indices calculated and published on a daily basis

Index	Country/region	Description
ACRA FSI	Russia	Twelve financial and economic factors are used to calculate the index, which have been selected to ensure that the index is efficient, consistent and universal (the set of factors does not change with time). Special attention in the factor selection and construction is paid to the comparability of their values in various financial system operating modes (structural surplus vs. liquidity deficit, soft vs. tight monetary policy) and under a priori equal economic conditions (various average price levels, high/low real economic growth rates). A principal component analysis is used to determine the weights of the factors. The principles for calculating the index can be found on ACRA's website: https://www.acra-ratings.com/criteria/129
Bloomberg FCI US	US	These indices are calculated on the basis of ten financial indicators that are grouped by money, equity, and bond markets. Market sub-indices are Z-scores that show the number of standard deviations of an equal-weighted sum of initial factors from its average value for the period. The sub-indices have an equal contribution to the final index. The set of indicators (primarily market instrument spreads) ensure that the index is regularly updated.
Bloomberg FCI EU	European Union	
BofA Merrill Lynch Global FSI	Global	This index illustrates the state of the global financial system rather than the state of markets of individual countries. It includes 41 equally-weighted factors, each of which describe the relative cost, liquidity, risk perception, and special properties of the distribution of income produced by financial instruments traded on the world's largest stock exchanges. Factors can be viewed in the context of three subgroups: - Credit risk and liquidity risk; - Cost of insuring major losses; - Risk appetite.

Source: ACRA, public sources

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