Monitoring financial instability and vulnerability in a globalized world

An update on UNCTAD financial conditions indicators for emerging and frontier markets

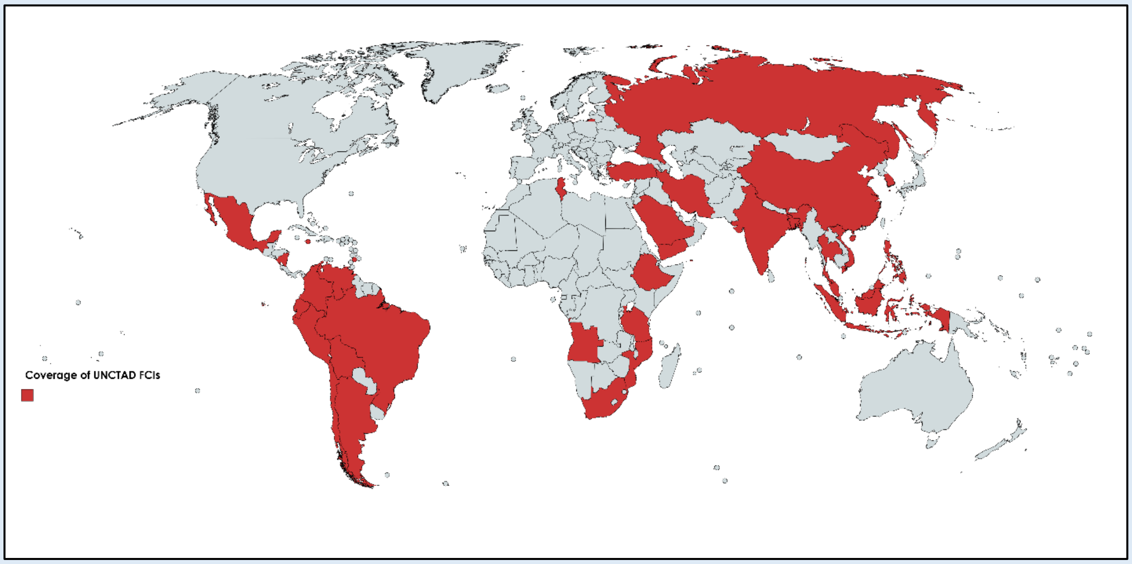
The spillover effects of financial instability, originating in advanced economies, on emerging and frontier markets have not received the attention they merit. It has become clear that conventional macroeconomic indicators based on national accounting are no longer sufficient to reflect and monitor high volatility in deregulated international financial markets, and to provide policy-makers with comprehensive, timely and accurate data to tackle new challenges in this context. One reason is the persistence of statistical hurdles to overcome the scarcity of good-quality financial data in many developing countries at a time when their integration into international financial markets proceeds at a faster speed than ever before. Financial markets in developing economies, too, have become more complex. This complexity goes well beyond standard concerns with sovereign debt sustainability, generally associated with financial crises. Thus, the capacity to monitor financial stability in these countries requires a comprehensive understanding of the various forces at play, their interconnections and their impact on wider economic performance.

UNCTAD's measure and methodology of **Financial Conditions Indicators (FCIs)** for a heterogeneous set of developing countries is an attempt to provide an innovative policy tool that equips policy-makers in developing countries as well as market participants with up-to-date, reliable and leading indicators of financial stress. These new synthetic indicators have the advantage that they are computable at high-frequency (monthly) as well as in real time. Built with the specific difficulties and concerns of developing countries in mind, they can address difficult data (quality and omission) issues and provide insightful information to understand the interplay of the main drivers of financial stress at the country level.

The FCIs tackle the complexity of increasing financial uncertainty and instability by harnessing the richness of information flows in the era of big data. They synthetize into one single indicator a wide range of financial variables from various sources and of mixed frequencies. These include, for instance, real interest rates, stock and bond market indices, commodity and market prices, volatility indices, exchange rates, as well as set of macro-financial indicators, such as residential real price index, debt service ratio and capital flows.

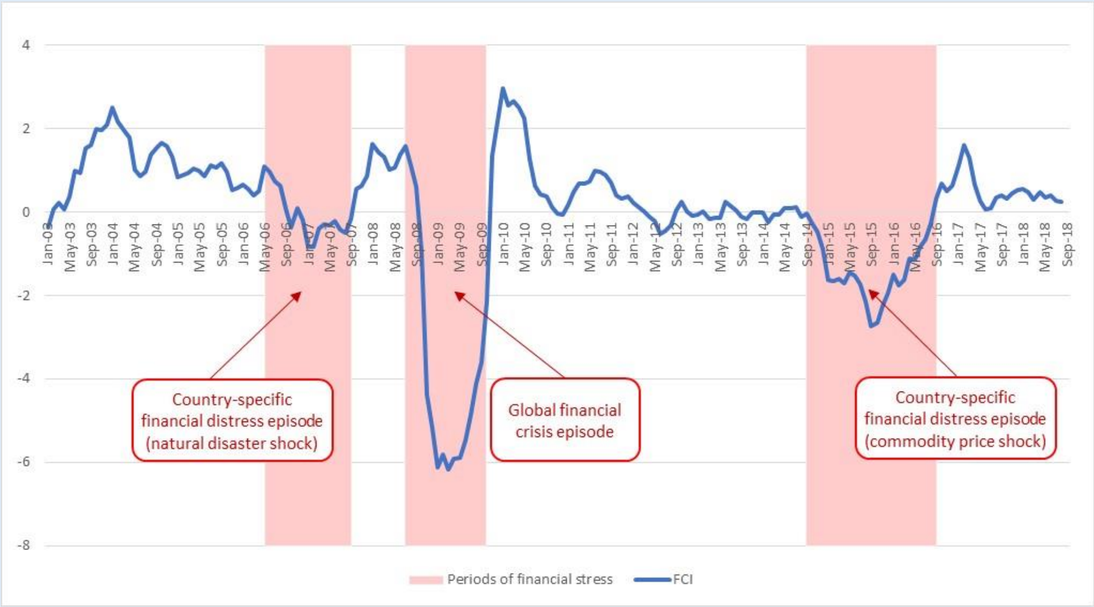
At present, the UNCTAD FCIs are available for **32 developing and transition countries** from various regions of the world (Figure 1). The detailed concept and methodology of the FCIs are explained in **UNCTAD's Compendium on Debt Vulnerabilities in Developing Countries (2018)[i],** including early estimations and results for 11 countries[ii]. The historical analysis shows that the FCIs capture periods of financial stress and near-miss events for these countries accurately (Figure 2), thus offering a unique tool of early warning of financial turmoil. The method also provides information that supports a better understanding of likely and country-specific causes of financial stress episodes.

Figure 1: Coverage of UNCTAD FCIs (2018)



UNCTAD's Debt and Development Finance Branch currently carries out further work in this area, including the extension of country coverage and further analytical and statistical improvements.

Figure 2: Stylized FCI for a developing country (2003-2018)



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[i] Bicchetti, D. and D. Neto (2018). Monitoring financial stability in emerging and frontier markets, in: UNCTAD. *Compendium on Debt Vulnerabilities in Developing Countries: a New Debt Trap? Volume II: Policy Tools and Options*, United Nations, Geneva and New York: 15-32.

[ii] Angola, Brazil, China, Ecuador, India, Jamaica, Russia, Saint Vincent and the Grenadines, South Africa, Tanzania, and Thailand