Financial Conditions Indicators (FCIs)

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UNCTAD workshop

6-7 July 2022

Objective

- Not so to discuss current financial conditions as such

- But seize this opportunity to **showcase:**

i. The tool
ii. How it can be used by economists and/or policy makers
iii. Examples of conclusions and lessons that can be drawn from it

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Outlines

- Section 1: Setting the stage, rationale behind the FCIs and main challenges with a special emphasis on low- and middle-income countries (Rachid)

- Section 2: Statistical methodology and econometric models, live demonstration of the tool (Guillaume)

- Section 3: Economic and policy findings based one specification among many others (Patrick)

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Background

- Developed by a whole team
- Benefited from reviews
- Two papers: one detailed technical report and a policy brief with concrete economic analysis and policy recommendations
- New FCIs drawing on previous UNCTAD FCIs
- Reply to precise specifications from UNCTAD issued in the "*Response and Recovery: Mobilising financial resources for development in the time of Covid-19*"

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UNCTAD Requested Specifications

- Refer to "*regionally-based*" indicators, with regions being defined geopolitically and/or economically
- And for each region thus defined, the tool should "*synthesize into one single indicator a wide range of financial variables*…".
- The specifications add that "*Taken to a meaningful regional level, the FCI analysis will provide a useful diagnostic tool for countries whose data inadequacies preclude country-specific analysis*".
- Two requests: Reduce the information of several financial indicators into one single factor and to be able to cluster countries into regions in a meaningful and flexible manner.

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Contextual Information

- Idea behind the reduction into one single indicator : to be able to make evidence based decisions on a large sample of financial indicators as a whole rather than in silos. Examining co-movements

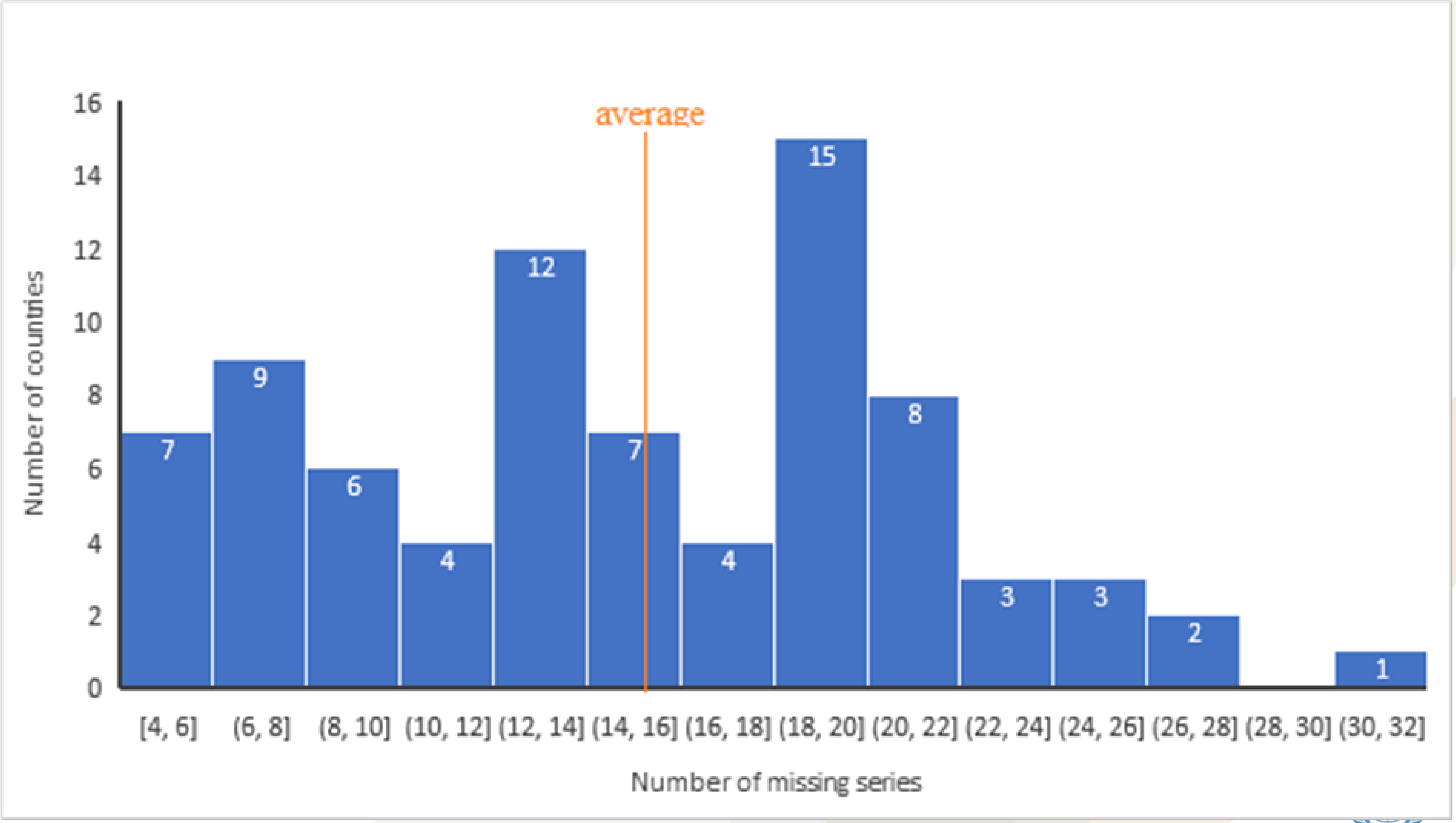
- An additional advantage of these techniques is that they do not impose preconceived economic assumptions and let the data speak for themselves

- Momentum of new economic and statistical tools building on Big Data. Information combined with data mining. Dynamics and nowcasting.

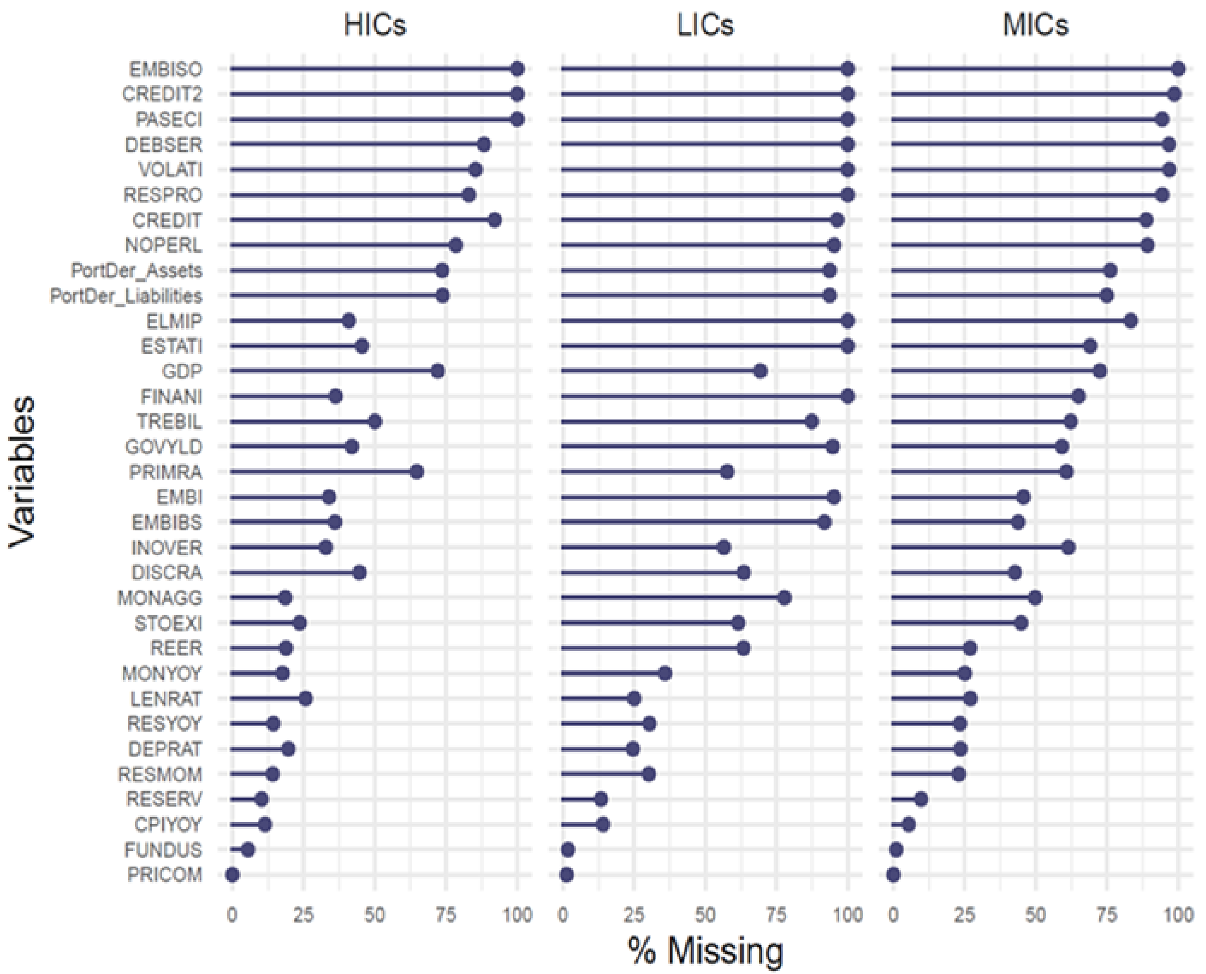
Missing data in LICs and MICs

- Country-level FCIs for developed and some HICs developing countries given expertise and data availability
- "Great data or digital divide": data largely missing, sparse or of low quality in developing countries
- Adverse effect at the international level: global discussions on access to concessional and climate finance, ODA, debt relief as well as SDRs
- Data collection for 81 countries in total
- 33 financial variables targeted as per literature review

Missing data



Missing Data



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Clustering Rationale

- Group countries together based on the similarities of their historical data
- Strong interdependence of financial conditions across countries
- UNCTAD long tradition on the prominent role of global monetary conditions
- Also penetrating mainstream economics: two recent papers Miranda-Agrippino, S., & Rey, H. (2021) and Davis, J. S., Valente, G., & van Wincoop, E. (2021).

Our Approach

- In line with literature: Factor Models
- Initially developed for the study of Business Cycles but slowly moving to the area of finance with adjustments to make room for Minskian "Boom and Bust" fluctuations
- Very flexible approach: 6 ways of calculating regional FCIs that Guillaume will present
- Allowing for regime changes (ex: sudden opening of capital markets)
- And flexibility in the clustering : either an ex ante approach (given classification) or ex post (countries grouped automatically)

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