

 **INSIGHTS FROM  
CFA SOCIETY SINGAPORE**  
By Julie Hammond

# Navigating systemic risks in the global economy: Ukraine, climate and crypto

We need to ensure markets have the infrastructure and regulatory frameworks in place to weather the storms

THE effects of potential crises and dislocations on the global financial system and on systemic risk, in particular, can't all be forecast in advance. The best we can do is prepare for a range of systemic risks and ensure that markets have the right infrastructure and regulatory frameworks in place to weather the storms.

In the case of the war in Ukraine and other geopolitical conflicts, that means understanding the consequences of sanctions, embargoes and potential tariffs, and countering the spillover effects on energy, food and other commodities markets.

For financial institutions, that means enough liquidity to withstand unanticipated shocks. For "stablecoins", cryptoassets and other newer markets, it means having the regulatory oversight, authority and mechanisms in place to protect investors.

Simon Johnson, former International Monetary Fund chief economist and co-chair of the CFA Institute Systemic Risk Council (SRC), thinks about issues like these every day.

He sat down to talk about systemic risk and the many pressing challenges affecting global economies and the global financial system with SRC executive director Kurt Schacht at the Alpha Summit GLOBAL by CFA Institute in May 2022.

**War in Ukraine**  
What implications does the ongoing war in Ukraine have on systemic risk?

"We are watching this very carefully," Johnson said. "(You) have the Russians who are trying to drive up gas prices in Europe. They've actually been very successful in that. They're trying to disturb and unbalance the global oil market — a bit more mixed results on that, but they're definitely still having a go.

"And all of those things, of course, feed into inflation, particularly headline inflation. Food prices have been impacted, energy prices absolutely impacted."

Will the conflict threaten the solvency of financial institutions?

"That is the question of the day and every day right now," Johnson said. "The key is capital. How much equity do we have in the financial system as buffers against losses? That was the problem globally in 2008 and was a big recurring problem in Europe after 2010."

But there's good news. The reforms instituted



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in the aftermath of the global financial crisis (GFC) in the United States and Europe were more effective than many people, Johnson among them, might have anticipated.

"So banks are better prepared for unexpected shocks," he said. "And unexpected shocks — well, we just had 2 big ones in the last 2 years."

"This is a big stress test," Johnson continued. "Covid was a real stress test. Let's agree on that. But Covid actually played out in some ways better and easier. There was a pretty unified and well-organised government response for a while on the economic dimensions at least. Now we're dealing with something much more complicated, I would suggest, and likely more difficult."

He has written extensively on how to respond to Russia's invasion of Ukraine, whether in the form of sanctions, the oil embargo, tariffs or other actions. He worries about Russia shutting down the grain and agriculture trade in the region.

"This is another way they are malevolently putting pressure on the world," he said. "And I

think we need better coordinated — I would propose G7-led — responses to that economic issue, which is a massive overlay with national security considerations."

**Climate change as systemic risk**

What role, if any, should central banks play in addressing climate change risk?

According to Johnson, there's now a consensus in both industrial countries and emerging markets that climate change could impact the financial system either directly or indirectly through its economic impact: "I think that's actually already decided. I think central banks want to go there." The question is how.

"There is some ongoing debate about exactly what central banks should do — what instruments they have, what's the appropriate scope for action. Is it a proactive thing directly to do with financing energy, or is it more about capital buffer and how do we calibrate that?" he said.

"That's a very active, somewhat technical discussion that doesn't always come out clearly in



In the face of the recent Terra collapse, SRC member Sheila Bair stressed the need for immediate regulatory action around stablecoins. PHOTO: AFP

the public context."

Johnson believes both the physical risks of climate change and the energy transition risks in reaching net zero are interconnected and systemic.

"I think in the US military, there's a saying along the lines of 'Plans are worthless, but planning is everything'. I think that same thing goes for systemic risk," Johnson said.

"Because markets are going to go up, markets are going to go down. Financial institutions are going to fail. The questions are, 'Does that affect the core of the financing of your economy? Does it have spillover effects into energy prices, for example? Does that affect, in some destabilising way, the macroeconomy? Those are the issues we have to keep at every day.'"

**Stablecoins, crypto assets, and central bank digital currencies**

The SRC has been outspoken about the need for regulatory action around stablecoins. In February 2022, it issued a letter to the US Treasury and members of the Financial Stability Oversight Council (FSOC) urging action to "address the risks to US financial stability posed by unregulated stablecoins".

The SRC recommended that the FSOC designate stablecoins as systemically important payment, clearing and settlement activities and asked council member agencies to use their existing authorities to oversee and regulate stablecoin markets.

Johnson pointed out that having some markets for assets that go up and go down is not inherently systemic. But in the SRC's view, if the public regards stablecoins as equivalent to cash

money in the conventional US sense, they have potentially systemic implications.

"This is banking without a licence, and banking without a licence typically ends in tears," he said. "That's what we said in the comment letter, and we support actions to get ahead of this issue."

More recently, in the face of the Terra collapse, SRC member and former Federal Deposit Insurance Corporation chair Sheila Bair stressed the need for immediate action, even if the regulatory authority is not entirely clear.

"It is time for regulators to get creative and use their current powers to act," she wrote.

Johnson said: "I think many people in those markets or innovators in those markets have resisted regulation and now, perhaps, are learning some of the consequences of not having appropriate degrees of regulation."

US Treasury Secretary Janet Yellen has advocated for legislation to regulate stablecoin issuers, but getting that legislation through Con-

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gress will be a long and fraught process.

"There's clearly some tension there within official circles," Johnson said. "But we are still on the side of believing that there is enough legislative authority and regulatory authority already in existence. And it needs to be used."

One related area on which the SRC has its eye is central bank digital currencies (CBDCs).

"There certainly is an organised push or consideration of the (CBDC) issues within the central-bank community," he said.

"That, of course, is partly in response to crypto assets and partly attempting to ensure that the US dollar is available through appropriate channels and appropriate mechanisms to people who need it and want to use it."

The application of CBDCs in wholesale as opposed to retail markets is one area that has sparked interest among central bankers. They are now running experiments using CBDCs to speed cross-border payments and move funds between financial institutions and central banks to see if the process is more efficient.

Central banks are gathering the data on the potential for CBDCs, and we will know a lot more in about 12 months, Johnson said. The crypto market's recent travails and stablecoin-related issues will inform their decision-making around CBDCs.

"Central banks will be reflecting further on whether the CBDC would actually enhance stability," he said, "or whether it could be potentially destabilising."

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