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Review Paper

Systemic Risks in the Global Financial System and their Influence on Economic Stability

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ABSTRACT

The modern global financial system is defined by a high level of integration and interaction between countries, which creates a favorable environment for the flow of capital and trade. However, this integration also creates systemic risks that can seriously undermine financial stability. Systemic risks affect key aspects of the global economy and may have further consequences for the economic stability of countries and regions. In this context, the analysis of systemic risks in the global financial system becomes of great importance to identify and understand their impact on economic stability and to develop strategies to overcome and counter these risks. The academic paper focuses on systemic risks in the global financial system and their impact on economic stability. In particular, it examines various aspects of these risks, assessing their potential impact on key segments of the global economy. The importance of analyzing such risks for the development of effective management strategies and the prevention of possible crises is emphasized. In addition, by evaluating the results of systemic risk monitoring, the research contributes to the understanding of their impact on economic stability and formulating strategies to counter and overcome these threats. The general approach to this study is aimed at highlighting key aspects and determining priority areas of action to ensure the stability of the financial system in conditions of global instability.

HIGHLIGHTS

- The increasing significance of systemic risks in the global financial system demands a comprehensive approach to risk management, including monitoring, regulation, and coordination among financial market participants at both national and international levels.
- Despite facing heightened systemic risks due to Russia's aggression, Ukraine's financial stability is under control, with coordinated efforts and measures, such as exchange rate fixation and capital controls, helping to mitigate potential crises and contribute to the country's economic stability and development.

Keywords: Systemic risks, globalization, global financial system, economic stability, macroeconomic imbalances, risk monitoring, financial stresses, financial sector

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In the modern world, where globalization is becoming not only a key economic and financial trend but also an integral part of our daily lives, the efficiency and sustainability of the global financial system are becoming increasingly important. Predictable and unpredictable systemic risks arising in this complex economic environment play a significant role in shaping the economic stability of countries and regions.

The growing interdependence of the financial systems of different countries, the large number of cross-border financial flows, and the integration of markets create a favorable environment for emerging and spreading systemic risks. In a situation where even remote economic events can affect global financial markets, understanding the nature and sources of such risks is a key task for economists, policy makers, and financial market participants.

In addition, effective management of systemic risks is particularly important in the modern environment since unpredictable financial and economic developments can have serious consequences for the economic stability and social development of countries. Current trends in the global financial system, such as the rapid development of technology, the emergence of new financial instruments, and the growth of international trade, make it increasingly vulnerable to both internal and external influences.

The purpose of the academic paper is to systematize the theoretical aspects of systemic risks and the tendencies of their emergence in the global financial system, as well as to study the impact on economic stability.

Literature Review

In her scientific work, Skokova L.H. (2022) emphasized that the instability of social processes in the global context is related to systemic risks of exogenous and endogenous nature arising from various crises, such as economic, financial, political, etc. The author substantiates that states of instability and crisis in society cause the deployment and layering of systemic risks in various spheres of society. Her sociological analysis focuses on the manifestations and localization of systemic risks in the areas of social tension, educational development and employment, democratization on the Internet, recreational activities, the influence of digital media and other aspects determined by the results of sociological studies.

Boiko A.O. and Bozhenko V.V. (2020) revealed that systemic risks have not only primary consequences for the country's financial system but also pose secondary and tertiary risks since they are closely intertwined with social, economic and political risks. One of the primary goals of their investigation is to develop an economic and mathematical model for assessing the impact of systemic risks on the development of social-economic relations in the country. The obtained results indicate that a shock caused by systemic risk leads to an increase in unemployment, a sharp decline in household incomes, a decrease in the business activity of economic entities, and a reduction in foreign trade.

In addition, Bozhenko V.V. and Kirilieva A.V. (2020) determined that the stable functioning of the national financial system contributes to the increase in market capitalization of economic entities, improves the business climate in the country and accelerates GDP growth. The authors are convinced of the close interconnection of the financial and real sectors of the economy and believe that identifying the cause-and-effect relationships between them helps determine the nature of crisis situations. For this purpose, they used methodological tools, including the Granger causality test to estimate autoregressive equations, and chose the financial stress index to characterize the level of systemic risk.

Applied Methods

- the analysis of literature sources was used for defining the concept and factors of systemic risks in the global financial system;
- the analysis of statistical data was used to study the dynamics of Ukraine's debt obligations;
- the generalization method was used to classify systemic risks and determine their impact on the country's economic stability.

Research Results

Discussions and studies on systemic risks in the financial system have focused on banking in recent years since banks play a crucial role in the functioning of this system. Particular emphasis is placed on countries with a bank-centered financial system, where most financial transactions and services are concentrated in banks. For instance, the financial system in Ukraine is focused on the banking sector; consequently, both state-owned and commercial banks dominate the financial landscape (Ustynova, 2022).

Systemic risk is the probability of complex negative events resulting from external or internal stress factors that lead to instability in the financial market and may cause insolvency of a significant number of interdependent financial intermediaries (Riazanova, 2022).

It should be noted that the systemic risk that may arise in the financial system and, in particular, in banking is not limited to the largest banking institutions. This is clearly manifested in the concept of the "contagion effect", where risks that start in certain financial institutions can spread and affect the entire financial system. Moreover, institutions of systemic importance are the primary source of systemic risks. In this context, Standard & Poor's analysts define systemically important financial institutions as financial institutions where an unexpected bankruptcy, given their weight and interconnections with other institutions, would lead to serious disruptions in the financial system of the country or even globally (Ministry of Finance of Ukraine, 2023).

Additionally, the Financial Stability Board characterizes systemically important financial institutions as institutions with a significant volume and high complexity of transactions, systemically interconnected and difficult to replace. Disparities in their functioning can lead to serious financial losses for the system and the economy as a whole. The Council's activities include identifying systemic risks to financial stability and developing recommendations to mitigate the impact of threats to the financial system (About the Financial Stability Board, 2023).

In the Ukrainian context, irrationally distributed risk causes misdirection of cash flows and resources in society, leading to systemic risks and problems in making economic decisions regarding the volume and distribution of production. Thus, the reason for the growth of systemic risk should be sought in the quality of information available to economic agents. Cash flows in highly developed nations are primarily determined by rating data from recognized international rating organizations (Hrudzevych et al., 2021; Kovalko et al., 2022). Currently, Ukraine has been cooperating with the three largest of them: Moody's, Standard & Poor's and Fitch Ratings. The dynamics of Ukraine's credit ratings according to the above-mentioned rating agencies is shown in Table 1.

Based on the analysis of the dynamics of Ukraine's credit ratings on debt obligations from leading international rating agencies, it can be noted that the country is facing changes in its financial stability that affect its creditworthiness and economic development.

Table 1: Dynamics of credit ratings of Ukraine (debt obligations)

Rating agency	Rating of debt obligations in foreign currency	Rating of debt obligations in national currency	Forecast	Date of assignment / confirmation of the rating
"Standard and Poor's" (S&P)	**B**	**B**	Steady	10.09.2021
	CCC+	CCC+	Steady	19.08.2022
	CCC	CCC+	Negative	08.09.2023
"Moody's Investors Service" (Moody's)	Caa2	Caa2	Review with possible reduction	04.03.2022
	Caa3	Caa3	Negative	20.05.2022
	Ca	Ca	Steady	10.02.2023
"Fitch Ratings" (Fitch)	**B**	**B**	Positive	06.08.2021
	B	**B**	Steady	04.02.2022
"Rating and Investment Information, Inc." (R&I)	B+	—	Steady	27.09.2021
	CCC	—	Review with possible reduction	27.07.2022

Source: *Compiled by the author on the basis of (Ministry of Finance of Ukraine, 2023).*

The information on the rating reflects the ambiguity of the economic environment, where stability is combined with possible risks and challenges. A decrease in the credit rating with a "negative" mark indicates potential difficulties and instability in the financial system. The forecasted changes in the ratings, including revisions and possible downgrades, necessitate addressing the reasons for these dynamic changes and taking measures to maintain financial stability (Bazaluk *et al.* 2022). Cooperation with rating agencies and consideration of their recommendations is an important aspect of ensuring positive dynamics and strengthening Ukraine's position in the international financial market.

It should be emphasized that systemic risks in Ukraine have reached a high level at the present time due to large-scale aggression on the part of Russia. This context has significantly increased the level of all types of risks that negatively affect the stability of the financial system. Despite the challenges, the fixation of the exchange rate and the introduction of capital controls contributed to reducing pressure on the foreign exchange market (NBU, 2022). Currently, the NBU is able to maintain an adequate level of international reserves; however, the country's export potential is significantly limited by logistical difficulties. Along with this, prices on energy resources, in particular, natural gas, are growing rapidly, which further complicates the economic situation. Military actions also lead to deterioration in global economic growth forecasts and restrictions on global trade (NBU, 2023).

Currently, the NBU is taking anti-crisis measures to support banks under martial law, including "loan repayment holidays" and loan restructuring for those affected by Russian aggression. Such measures are aimed at ensuring the stability of the financial sector in the face of turbulence and uncertainty about future events. Consequently, even though systemic risks in the financial sector are still very high, it's crucial to remember that they are still under control because of the coordinated efforts of institutions and government agencies. This means that ongoing monitoring and prompt reaction to changes in the global financial environment are still necessary (NBU, 2023).

In order to determine the influence of systemic risks on the economic stability of the state, it is necessary to classify and source different types of financial system risks (Table 2).

The factors leading to systemic risks in the global financial system include various economic and financial aspects that may adversely affect economic stability. For instance, economic and financial imbalances, such as trade and fiscal deficits and surpluses, as well as rising debt burdens, disrupt the economic balance and create systemic risks (Vladyka, 2020).

In turn, periods of intensive lending can artificially increase asset prices and leverage, which creates potential threats to financial stability. Collective behavior, such as banking panics, can lead to an avalanche effect and result in a general lack of liquidity in the system. Moreover, a large concentration of risks, in particular, institutions or industries, as well as insufficient competition, can increase the overall level of systemic risks. Significant interaction and dependence between financial institutions can accelerate the spread of problems and increase the risk of a systemic crisis (Petrova, 2020).

Globalization and liberalization of financial markets increase the impact of external factors on domestic economies, creating new ways of spreading systemic risks. The introduction of new financial instruments and practices may give rise to unanticipated risks since their effects are not always fully understood or controlled (Lavreniuk, 2020; Sumets *et al.* 2022). In addition, the growths of financial activities outside of traditional banking, which are not subject to thorough regulation, as well as rapid growth in asset prices that are not supported by real fundamentals, threaten financial stability.

Systemic risks in the current environment have a significant impact on the country's economic stability, causing various consequences for financial and economic market segments. These risks arise from the complex interconnections and interactions of various entities and markets that constitute the global financial system (Demianyshyn *et al.* 2020). The major aspects of the influence of systemic risks in the global financial system on the country's economic stability include:

1. The bankruptcy or financial problems of large and systemically important financial institutions, such as banks or insurance

Table 2: Classification of systemic risks in the global financial system

Title of the risk	Features
Financial risks	
Banking crisis	A decline in overall confidence in the financial system, loss of liquidity and assets could lead to the bankruptcy of banks
The state debt crisis	The inability of the state to repay its debt in the long run leads to default and losses for creditors
Economic recessions	
Global economic disruptions	Global economic disruptions can be caused by international trade conflicts, financial market instability, or environmental disasters
Unexpected events and crises	
Natural disasters and environmental changes	Natural disasters cause significant damage to infrastructure and reduce economic activity
Global pandemics	Pandemics such as COVID-19 cause economic downturns by restricting business operations and reducing consumer demand
Technological risks	
Cyberattacks	Cyberattacks on banks, financial institutions, and infrastructure cause confidential information leakage and, as a result, large financial losses
Technological disruptions	Malfunctions in information systems cause shutdowns of trading platforms, limiting access to financial services
Political risks	
Trade conflicts	Tariff wars and other trade conflicts lead to a decline in international trade and financial difficulties
Geopolitical tensions	Tensions among countries or regions cause instability in financial markets
Financial innovations	
Inadequate risk management	The rapid development of new financial technologies, if not properly regulated and implemented, can lead to uncertainty and inadequate risk management

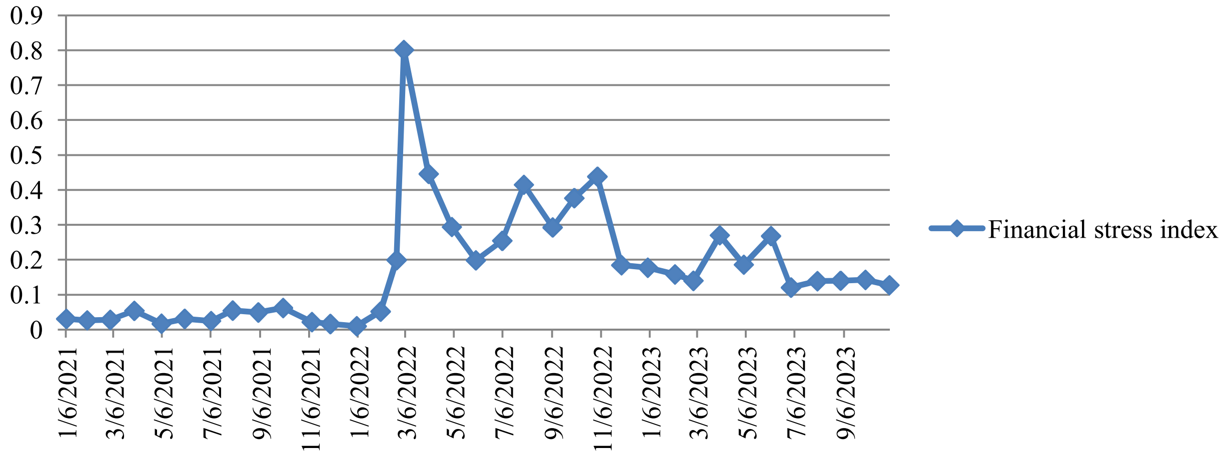
Source: *Compiled by the author on the basis of (Shevtsova et al. 2022).*

companies, have an impact on other segments of the economy through large networks of financial interconnections, and cause chain reactions and, as a result, a "domino effect" (Aleksieienko, 2022);

2. Decreased confidence in the system and increased credit risk reduce banks' ability to provide loans, leading to a reduction in lending to businesses and consumers (Cherniai *et al.* 2023);
3. Fluctuations in financial markets and currency values caused by systemic risks influence exports and imports, causing imbalances in foreign economic relations;
4. Systemic risks have a significant impact on the real sector of the economy, causing a decline in investment, rising unemployment, a general decline in production, etc. (Skokova, 2020);
5. Volatility in price indicators such as stock, bond, or commodity prices affects consumer confidence and expenditures, which in turn affects overall economic activity (Volkova *et al.* 2022; Bazaluk *et al.* 2020).

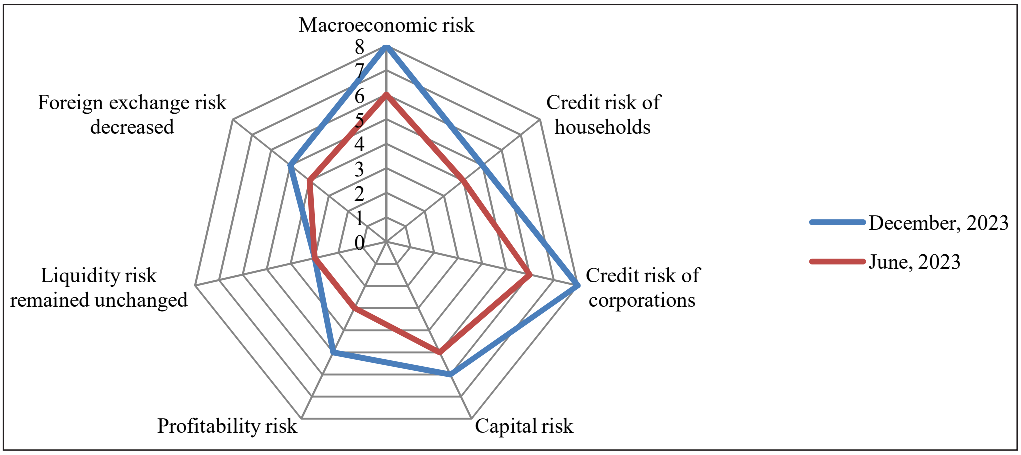
In general, systemic risks in the global financial system have the potential to disrupt economic stability and cause serious consequences for various sectors of the economy. In order to mitigate the impact of systemic risks on economic stability, it is important to develop preventive strategies and a system for predicting possible crisis scenarios.

Thus, ensuring economic stability in the context of globalization requires a comprehensive approach to risk management, including improving mechanisms for monitoring, regulation and coordination between different financial market participants at the national and international levels. Currently, the systemic risk monitoring system in Ukraine falls under the Financial Stability Department of the NBU, and its main tools for identifying and



Source: *Compiled by the author on the basis of (NBU, 2023)*

Fig. 1: Financial stress index in Ukraine for 2021-2023



Source: *Compiled by the author on the basis of (NBU, 2023).*

Fig. 2: Map of risks in the financial sector of Ukraine

analyzing risks are the financial stress index and the map of financial sector risks (Batrak, 2023).

The Financial Stress Index measures the level of tension in the financial system at a given moment in time (Fig. 1). Its use involves monitoring and comprehensive analysis of changes in the financial sector in order to anticipate risks in the near future. The index is also an important element for calibrating macroprudential policy instruments (NBU, 2023).

The map of financial sector risks includes a wide range of factors that can influence financial stability (Fig. 2). The key risks include the debt burden of the oil and gas sector and state guarantees, lending conditions and demand for loans from the oil and gas sector and state guarantees, the real estate market, macroeconomic imbalances, the state of the banking sector, behavior of households, corporate and government securities, the foreign exchange market, and risks associated with lending to the oil and gas sector and state guarantees (Yarovyi, 2022).

Based on the map of financial sector risks, it should be noted that the NBU has currently recorded an improvement in its risk assessment of the financial sector, which is the result of the resilience of the energy system, growing domestic demand, and increased bank profits. As indicated in the Financial Stability Report for June 2023, the overall financial sector risk assessment decreased by 22,5% (from 40 to 31) compared to December 2022, bringing it in line with the mid-range (Levytska *et al.* 2022).

Thus, the coordinated efforts and activities of different financial market participants play a significant role in risk management. The measures taken by the NBU are aimed at stabilizing and preventing possible crises. According to the latest reports, there has been an improvement in risk assessment, which is a positive reflection of the resilience of the energy system, growth in domestic demand and bank profits. Therefore, systematic analysis and effective risk management contribute to Ukraine's economic stability and its potential for further development.

DISCUSSION

We agree with the statement of Skokova L.H. (2022), who in her scientific work highlighted that the instability of social processes in the global context is due to systemic risks of exogenous and endogenous nature arising from various crises, such as economic, financial, political, etc. The author studies the interconnection of states of instability and crises in society and the deployment of systemic risks in various spheres of community life. Her sociological analysis is aimed at examining the manifestations and localization of systemic risks in the areas of social tension, educational development and employment, democratization on the Internet, recreational activities, the impact of digital media and other aspects determined by the results of sociological studies.

We partially agree with Boiko A.O. and Bozhenko V.V. (2020), who determined that systemic risks have consequences that are closely related in the context of social, economic and political risks. Although systemic risks are indeed important and potentially dangerous in the global financial system, we believe it is necessary to further consider specific aspects of the interaction between systemic risks and elements of social-economic relations.

We fully support the opinion of Bozhenko V.V. and Kirilieva A.V. (2020) that the stable functioning of the national financial system contributes to the increase in market capitalization of economic entities, improvement of the business climate in the country and acceleration of GDP growth. Our opinion is based on a mutual understanding with the authors of the importance of interaction between the financial and real sectors of the economy. Moreover, we strongly agree with the effectiveness of the methodological approach to the analysis used by the authors, in particular, the financial stress index for determining the level of systemic risk.

CONCLUSIONS

The general analysis of systemic risks in the global financial system and their impact on economic stability shows their significance and potentially serious consequences for various sectors of the economy. Systemic risk, which determines the probability of occurrence of unfavorable events due to external or internal shocks, creates preconditions for financial market instability and may lead to insolvency of a large number of interdependent financial intermediaries.

Systemic risks in the Ukrainian context are increasing due to irrational risk distribution, which leads to misdirection of cash flows and resources in society. This approach causes problems in economic decision-making and systemic risks in the face of global challenges. Currently, due to Russia's full-scale aggression, Ukraine is facing an increased level of all types of risks that negatively affect the overall stability of the financial system. Nevertheless, some measures, such as exchange rate fixation and capital controls, help reduce pressure on the foreign exchange market.

In general, systemic risks in the global financial system include various economic and financial imbalances that disrupt the economic balance and pose threats to stability. Reducing the impact of such risks requires the development of preventive strategies and a system for preventing possible crisis scenarios. The coordination and joint actions of various financial market participants, as well as effective risk management implemented by the National Bank of Ukraine, play a crucial role in ensuring stability and contributing to the further development of the country's economy.

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