Fault Lines in Finance

Is Geopolitics on Your Credit Risk Radar?

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Abstract

The world is shifting – from a global pandemic to a full-blown military conflict in Europe that questions the international order we've known since World War 2. Both phenomena have greatly impacted businesses worldwide in their own way: Uprooting our assumptions, contributing to inflation, and disrupting supply chains. The shift is also impacting the world of corporate financing and liquidity. High prices on the one hand and tightening monetary policy on the other, are increasing the risk for customer payment default and higher DSO.

When political and economic instability meet the office of the credit and risk manager, they need to be ready to navigate the fault lines in finance. In this article, we will explore how current geopolitical escalations, supply chain disruptions and inflation impact corporate finance and what credit and risk managers can do to control the impact on their business.

From Invasion to Inflation – Making Sense of the Current Multifaceted Risk Landscape

In a highly dynamic world economy with fluctuating risk, credit and risk managers must factor in all kinds of market volatilities, while also processing credit limit applications for individual customers. They have to determine how this volatility could possibly affect their organizations' customer debt portfolio and financial stability and analyze the available data to control the impact of these interconnected risk factors. How effectively they perform their analysis will determine the success of their organization as a whole in uncertain times. To estimate how current market instabilities pose risk for corporate finance, we want to look closer at sanctions, supply chain disruptions and inflation, and how they influence each other.

Sanctions and Trade Volatility

Geopolitics is back – and it is affecting trade and markets globally. After the recent Russian invasion of Ukraine, Western countries initiated a series of economic and financial sanctions. These sanctions include: A ban on secondary trade in Russian government bonds, limits on key Russian banks, prohibiting the export of critical technology to Russia, and freezing the assets of Russians oligarchs. The list of sanctions is growing longer by the day and by now, sanctions against the Central Bank of Russia (CBR) have become a central focus area. It is now nearly impossible for the CBR to obtain access to its foreign reserves, of which a sizable share is held in other countries and currencies – mostly dollars, euros and pounds. This makes Russia's currency (the ruble) vulnerable to collapse, which could trigger a run on their domestic banks.