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Dating systemic financial stress episodes in the EU countries

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Abstract

This paper introduces a new methodology to date systemic financial stress events in a transparent, objective and reproducible way. The financial cycle is captured by a monthly country-specific financial stress index. Based on a Markov Switching model, high financial stress regimes are identified and a simple algorithm is used to select those episodes of financial stress that are associated with a substantial negative impact on the real economy. By applying this framework to 27 EU countries, the paper is a first attempt to provide a chronology of systemic financial stress episodes in addition to the expert-detected events available so far.

Keywords: Financial Stress Index, Markov Switching, Systemic Financial Crises, Crises Dating

JEL codes: C54, G01, G15

Non-Technical Summary

It is widely agreed that the global financial crisis that started in 2007 was an episode of severe financial market stress, which spilled over to the real economy causing the Great Recession. However, it is much more difficult to identify and classify other periods of, possibly systemic, financial market stress. The expert-based approach of identifying systemic financial stress episodes prevails so far but an objective and reproducible method for the detection of low and high financial stress periods is lacking. A comprehensive analysis of the succession of tranquil and stress periods is a prerequisite to determine leading indicators of systemic financial stress and to evaluate the effectiveness of prudential policies implemented over the course of the financial cycle.

This paper provides a new framework for a transparent and objective identification of systemic financial stress episodes, i.e. periods of high financial stress which are associated with a substantial and prolonged decline in real economic activity. By applying the framework to the countries of the European Union (EU), this is the first paper to build a consistent monthly chronology of EU systemic financial stress episodes beyond the expert-detected crises available so far. In fact, a continuous measure of financial stress is converted into a binary systemic stress dummy, commonly used in early warning models.

The model-based framework consists of three steps. First, we build on the existing financial stress literature and construct a simple country-specific financial stress index for 27 EU countries starting as early as 1964 for core EU countries. The essential feature of the financial stress index is that it captures co-movements in key financial market segments. Second, we apply the Markov Switching model, commonly used in the business cycle dating literature, to endogenously determine low and high financial stress periods. Third, in order to characterise the systemic nature of financial stress episodes, we create a simple algorithm to select the episodes of financial stress that are associated with a significantly negative impact on the real economy.

We identify 68 systemic financial stress episodes which are defined as coincident financial market and real economic stress, possibly reinforcing each other. Financial market stress is considered as “systemic” if there are six consecutive months of real economic stress within at least one year of financial market stress. Real economic stress corresponds to a simultaneous decline of both industrial production as well as GDP.

Our model-implied systemic financial stress dates encompass about half of all recessionary events and are shown to be consistent with many expert-detected crises. 82% of the systemic financial stress dates we identify are also included in crises datasets compiled by experts. We capture, respectively, 100%, 92%, 90% and 89% of the banking crises identified by [Laeven and Valencia \(2013\)](#), [Babecky et al. \(2012\)](#), [Detken et al. \(2014\)](#) and [Reinhart and Rogoff \(2011\)](#). In addition, our systemic financial stress dates tend to be robust to event-reclassification once new data become available.

1 Introduction

The classification of the global financial crisis as a period of “systemic” financial stress, during which severe financial market stress spilled over to the real economy causing the Great Recession, appears straightforward. More generally, it seems rather challenging to identify and classify other periods of, possibly systemic, financial stress (Liang, 2013). The expert-based approach of identifying systemic financial stress episodes prevails so far but a reproducible method for the detection of low and high financial stress periods is lacking. Besides, a comprehensive analysis of the succession of tranquil and stress periods is a requirement to determine the best leading indicators of systemic financial stress and to evaluate the effectiveness of policies implemented over the course of the financial cycle.¹

This paper is the first one to fill this gap by identifying systemic financial stress events in a transparent, objective and reproducible way. Systemic financial stress episodes are defined as periods of financial market stress associated with a substantial and prolonged negative impact on the real economy, or, alternatively, as real economic stress periods which are not ordinary recessions but are also associated with high financial market stress.² No assumptions are made about the sequence of events, i.e. whether the financial market or real economic stress occurred first. Instead, the focus is on the detection of periods in which financial market and real economic stress mutually reinforce each other.

To the best of our knowledge this paper is the first which provides a chronology of systemic financial stress episodes based on a simple and reproducible method and thereby complements the existing expert-based crises databases. Note that model-based systemic financial stress periods are not supposed to coincide perfectly with expert-based crises since both represent two different concepts.³ Model-based stress episodes are identified on the basis of market prices of traded instruments and are thus broader than expert-detected episodes, usually focusing on financial institutions, that rely on qualitative information and on past policy actions.

Laeven and Valencia (2013) provide the most widely used database on systemic banking crises where a banking crisis is defined as being systemic under two conditions: (i) the presence of *significant* signs of banking distress, and (ii) the presence of *significant* bank-

¹While there is no consensus on the definition of the financial cycle, Borio (2014) characterises it as “self-reinforcing interactions between perceptions of value and risk, attitudes towards risk and financing constraints, which translate into booms followed by busts”.

²We use the terms financial market stress and financial stress interchangeably to refer to a turmoil occurring simultaneously on several financial market segments.

³Schwartz (1987) finds that the word crisis is often used to describe ordinary situations. Most events since 1933 in the US are identified as pseudo-financial crises, characterised by a decline in asset prices, depreciation of the currency, or financial distress of large entities. A real financial crisis is then narrowly defined as situations when institutions do not exist or when preventive measures have not been credibly undertaken.

ing policy intervention measures.⁴ However, the qualitative assessment of such events as well as the time lag until the next update becomes available call for a new model-based approach.⁵ Both approaches have specific advantages and disadvantages. Model-based methods aim at providing a timely, transparent and reproducible dating of systemic financial stress episodes in order to perform real time assessments for financial stability purposes, but the events might have a broader definition than banking stress due to the available data. Expert-based approaches provide a historical chronology tailored to each country but might be biased by the perceptions of experts. Two other datasets for European Union (EU) countries, [Babecky et al. \(2012\)](#) and [Detken et al. \(2014\)](#), have been compiled by relying on the judgement of national central banks. Note that, so far as the EU is concerned, [Reinhart and Rogoff \(2011\)](#) cover the crises of 16 EU countries which are taken into consideration for robustness.

The model-based approach outlined in this paper consists of three main steps which are subsequently described in more detail: (i) constructing a simple Financial Stress Index (FSI), (ii) identifying periods of high financial market stress, and (iii) narrowing down the financial market stress episodes to those with a “systemic” character.

First, contrary to the business cycle dating literature, where GDP is the de-facto benchmark measure of the business cycle, there is no commonly accepted metric for financial market stress. Thus, the first step is to construct an appropriate coincident measure of financial market stress which is comparable across countries and covers a long time span. As systemic stress should not be limited to the summation of individual risks ([Allen and Carletti, 2013](#)), our computation choice emphasises the role of correlations across risk segments. Many alternative methods have been proposed to compute FSIs (for a survey, see [Kliesen et al., 2012](#)). However, only a few of these indices are available for EU countries, and due to their specific nature, computation choices and time span, their comparability is limited.⁶

Second, taking the country-specific FSIs as an input, a Markov Switching (MS) model –often applied in the detection of business cycle turning points– is used to distinguish between periods of low and high financial market stress.⁷ [Burns and Mitchell \(1946\)](#) investigated the distribution of turning points of a large number of disaggregated time series. However, recent efforts mostly focused on the analysis of a single aggregate indicator of business cycle fluctuations. On the one hand, the [Bry and Boschan \(1971\)](#) algorithm identifies local minima and maxima in possibly non-stationary time series. On the other hand, a more structural approach follows the seminal work by [Hamilton \(1989\)](#)

⁴[Laeven and Valencia \(2013\)](#) build on previous work by [Caprio et al. \(2005\)](#) but focus on banking crises with a systemic impact by adding the second criterion above.

⁵[Chaudron and de Haan \(2014\)](#) find that there are large and statistically significant discrepancies in the identified crises between three expert-based datasets.

⁶For the euro area as a whole, see [Blix Grimaldi \(2010\)](#) or [Hollo et al. \(2012\)](#). Only very few FSIs are computed for individual EU countries.

⁷For a recent survey on automatising the dating of business cycle turning points, see [Hamilton \(2010\)](#).

to distinguish between different states of the economy and infer the probability of being in a specific state. [Chauvet and Piger \(2008\)](#) show that the latter method improves over the NBER methodology in the speed at which business cycle troughs are identified. The underlying assumption is that the data, usually GDP, are generated by a mixture of two distributions, one for the phases of expansions and the other for the phases of recessions. Thus, the transition between these two phases can be modelled as a hidden Markov chain.

Nevertheless, several challenges arise when dating turning points in the “financial cycle” and establishing a chronology of systemic financial stress episodes. First, financial market stress and systemic financial stress are still pervasive concepts for which a single coherent measure both in the time dimension as well as in the cross-sectional dimension is missing. Second, financial market stress periods are usually characterised by a larger co-movement of variables related to financial sector activity, which is more coherent with the “average-then-date” approach than the “date-then-average” method of [Burns and Mitchell \(1946\)](#). Third, if one is interested in the turning points themselves or the ability to forecast the build-up of financial market stress, then the identification of the evolution of financial market stress between peaks and troughs makes sense. However, if one wants to identify episodes of low versus high financial market stress, the moment at which the data suggest that it is more likely to be in a high stress period is the relevant information. Therefore, using a MS model is better suited for the purpose of dating the episodes of financial market stress.⁸ Fourth, financial market stress variables tend to be mean-reverting, which is consistent with the assumption of the MS data generating process, i.e. a mixture of two time-invariant distributions. This feature supports the detection of a threshold above which financial market stress may adversely impact the real economy.

Third, once the periods of high financial market stress have been identified, the events associated with a substantial and prolonged decline in real economic activity need to be isolated. Since financial market stress could be limited to financial markets without spillovers to the real economy, the stress episodes that are considered “systemic” have to be narrowed down.⁹ To this end, a simple algorithm is implemented, which detects financial market stress episodes associated with a substantial and prolonged decline in both industrial production and GDP.

The model-based approach identifies 68 episodes of systemic financial stress in 27 EU countries. About 50% of all recessionary events are classified as systemic, while the other half are not characterised by simultaneous financial market stress. 84% of the model-detected systemic financial stress periods are also included in the crises datasets compiled

⁸For instance, [Coe \(2002\)](#) apply this tool to reassess the timing of the US systemic financial crisis of the 1930s by looking at simultaneous switches in the deposit-currency ratio and the corporate versus government bonds spread.

⁹Using spectral analysis applied to EU countries, [Schüler et al. \(2015\)](#) show that the real and financial cycles coincide about two third of the time.

by experts. Out of the banking crises identified by [Laeven and Valencia \(2013\)](#), [Babecky et al. \(2012\)](#), [Detken et al. \(2014\)](#) and [Reinhart and Rogoff \(2011\)](#), on average 100%, 92%, 90% and 89%, respectively, are captured by the model-based approach. The identified systemic financial stress episodes have recurrent patterns. In most cases, financial market stress occurs first, followed by real economic stress. As documented by [Reinhart and Rogoff \(2009\)](#), real economic stress lasts on average six months longer and GDP decline is three percentage points larger when it is associated with financial market stress. The large country coverage allows us to construct an EU Crisis Simultaneity Index (CSI) which shows that systemic financial stress usually occurs in the form of “clusters” with many countries entering a systemic stress event simultaneously. In this respect, our results reveal that the global financial crisis and the subsequent Great Recession can only be compared to the “first oil shock” of 1973 where many countries simultaneously entered the systemic stress event. Finally, the model-based systemic financial stress periods tend to be robust to event-reclassification once new data become available.

The remainder of the paper is structured as follows. Section 2 describes the construction of the monthly FSIs for 27 EU countries over a time span of up to 50 years. Section 3 outlines our method for identifying episodes of systemic financial stress. Section 4 compares our chronology of systemic events to existing expert-based episodes both in the cross-sectional and in the time dimension. Section 5 provides robustness checks. Section 6 concludes.

2 Designing a simple financial stress index

For 27 out of the 28 EU countries, we construct a monthly coincident measure of financial stress covering up to 50 years from February 1964 to December 2014.¹⁰ By doing so we pay particular attention to ensure (i) cross-country comparability, and (ii) a sufficiently large time span to cover as many financial stress events as possible. The number of countries we aim to cover and the large time span impose some restrictions on the underlying data compared to existing country-specific measures. Our financial stress measure focuses on three core segments of financial markets and, as a result, we provide a broad coincident measure of financial stress, instead of a measure of stress occurring in one specific segment (e.g. in the banking sector).

The construction of our FSI follows the approach of the Composite Indicator of Systemic Stress (CISS) proposed by [Hollo et al. \(2012\)](#) that relies on the correlation of stress across different market segments. Figure A.1 illustrates the different elements involved in the computation of our FSI.

¹⁰At the time of writing there are no Estonian sovereign debt securities that comply with the definition of long-term interest rates for convergence purposes. No suitable proxy indicator has been identified and hence we focus on 27 instead of 28 EU countries.

2.1 Measuring financial market stress

Underlying data. For our benchmark FSI, we use data capturing three financial market segments: (i) equity markets: stock price index (STX), (ii) bond markets: 10-year government yields ($R10$), and (iii) foreign exchange markets: real effective exchange rate ($rEER$) computed as the geometric average of bilateral exchange rates weighted by bilateral trade volumes. Alternative series such as the interbank rate or the three-month Treasury bill rate are typically available only for the most recent years and thus left for robustness checks. In particular, we lack data capturing developments in the real estate market despite its major contribution to the 2008 crisis. This could be a source of concern as tools aimed at mitigating a possible overheating of the real estate market are key macroprudential instruments one would like to calibrate throughout the cycle. However, we focus on the co-movements of prices across markets that possibly indirectly capture sharp variations in real estate prices.

The data are summarised in the online appendix. Most data are taken from the [Statistical Data Warehouse \(SDW\)](#) of the European Central Bank at the daily frequency¹¹ and are extended using [Global Financial Data \(GFD\)](#) for longer time spans where available.¹² The real effective exchange rate is taken directly from the [Bank for International Settlements \(BIS\)](#) at a monthly frequency.¹³

Sample homogeneity. We want to make sure that the data are broadly comparable throughout the entire sample from 1964 onwards, as it encompasses periods such as the Great Moderation.

First, in many countries inflation rates declined substantially over time. To account for this, we use real stock prices ($rSTX$) and real government bond yields ($rR10$).¹⁴

$$\begin{cases} rSTX_t &= \frac{STX_t}{CPI_t} \\ rR10_t &= R10_t - \frac{CPI_t - CPI_{t-261}}{CPI_{t-261}} \cdot 100 \end{cases} \quad (1)$$

Second, as outlined in the business cycle dating literature, there could be potential

¹¹In order to fill possible data gaps at the daily frequency, we interpolate using the last available observation.

¹²When required, we perform a simple OLS projection in order to scale the stock market composites from GFD to match the leading stock indices from SDW. We run the following regression for each country c : $STX_{c,t}^{SDW} = \alpha + \beta \cdot STX_{c,t}^{GFD}$ to reproject the explained variable $STX_{c,t}^{SDW}$.

¹³The BIS provides either a broad real effective exchange rate or a narrow one. The former includes bilateral exposures to more countries, but is available only from 1994 onwards, while the latter is restricted to fewer countries but starts in 1964. Depending on the availability of the other data, the longer series are preferred.

¹⁴In order to obtain real daily returns, the monthly Consumer Price Index (CPI) is linearly interpolated using the last known value. As the bond yields are annualised, we subtract the annual inflation rate. As we later use an ordinal standardisation and get an index at the monthly frequency, the choice of the base or scale is irrelevant.

complications due to structural breaks in output volatility. This issue was also raised in the financial stress literature, especially for the NFCI index starting in 1973 computed by the Federal Reserve Bank of Chicago. [Brave and Butters \(2012\)](#) show that accounting for the decline in the volatility of output and inflation makes the stress index more stable in the post-1984 period. Due to the parsimonious nature of our dataset, corrections like in [Hatzius et al. \(2010\)](#) using principal components techniques are not feasible. Instead, before computing volatilities, we divide the data by a 10 years trailing standard deviation.¹⁵ A tilde denotes this rolling standardisation.

Equity market stress. Stress in the equity market is captured by two variables. First, the monthly realised volatility ($VSTX$) is computed as the monthly average of absolute daily log-returns of the real stock price index. Second, we compute the cumulative maximum loss ($CMAx$) that corresponds to the maximum loss compared to the highest level of the stock market over two years. Except for the first two years, it is computed over a rolling window of 522 days.

$$\left\{ \begin{array}{lcl} \ln STX_t & = & \log(rSTX_{t-i}) - \log(rSTX_{t-1-i}) \\ \widetilde{\ln STX}_t & = & \frac{\ln STX_t}{\sigma_{\ln STX_{t,t-2609}}} \\ VSTX_t & = & \frac{\sum_{i=0}^{19} |\widetilde{\ln STX}_t|}{20} \\ CMAx_t & = & 1 - \frac{rSTX_t}{\max_{i=0}^{521} (rSTX_{t-i})} \end{array} \right. \quad (2)$$

Bond market stress. Stress in the bonds market is also captured by two variables. First, the monthly realised volatility ($VR10$) is computed as the monthly average of absolute daily changes in the real 10-year government bond yields. We prefer using changes and not growth rates as for some periods very low real yields would create excessively large variations. Second, we compute the cumulative difference ($CDIFF$) corresponding to the maximum increase in basis points of the real government bond spread with respect to Germany over a two-year rolling window. We prefer using the spread instead of the 10-year yield in order to disentangle changes in the risk profiles

¹⁵As expected, this does not impact the crisis detection ability of countries for which we have data only from the 1990s onwards. Hence, an alternative method would be to restrict our dataset to the post-1990 era. Similar results are obtained in the crisis dating part of the paper.

from changes in a proxy for the risk free rate.

$$\left\{ \begin{array}{lcl} chR10_t & = & rR10_t - rR10_{t-1} \\ \widetilde{chR10_t} & = & \frac{chR10_t}{\sigma_{chR10_t,t-2609}} \\ VR10_t & = & \frac{\sum_{i=0}^{19} |\widetilde{chR10_{t-i}}|}{20} \\ CDIFF_t & = & rR10_t - rR10_{DE,t} - \min_{i=0}^{521} (rR10_{t-i} - rR10_{DE,t-i}) \end{array} \right. \quad (3)$$

For Germany, we instead compute the increase of a 10-year “bond index” compared to the minimum ($CMIN$) over a two-year rolling window.¹⁶

$$CMIN_{t,DE} = \frac{(100 + rR10_{t,DE})}{\min_{i=0}^{521} (100 + rR10_{t-i,DE})} - 1 \quad (4)$$

Foreign exchange market stress. Stress in the foreign exchange market also relies on two variables, available only at a monthly frequency. First, the realised volatility ($VEER$) is computed as the absolute value of the monthly growth rate of the real effective exchange rate. Second, longer lasting changes in the real effective exchange rate should be associated with more severe stress due to the necessary adjustment of the real economy. Thus we compute the cumulative change ($CUMUL$) over six months: if $CUMUL > 0$, then the real effective exchange rate is volatile around a changing rate.

$$\left\{ \begin{array}{lcl} lnEER_t & = & \log(rEER_t) - \log(rEER_{t-1}) \\ \widetilde{lnEER_t} & = & \frac{lnEER_t}{\sigma_{lnEER_t,t-119}} \\ VEER_t & = & |\widetilde{lnEER_t}| \\ CUMUL_t & = & |rEER_t - rEER_{t-6}| \end{array} \right. \quad (5)$$

2.2 Aggregation to capture cross-market linkages

Standardisation. The second step consists of converting the individual stress indicators, two for each financial market segment, into a common unit. While there are various ways of standardisation with specific advantages and disadvantages (Kliesen et al., 2012), we follow the strategy of Hollo et al. (2012) and use the empirical cumulative density function (CDF) computed over an initial window of 10 years that expands progressively to

¹⁶We define a bonds index as the value after one year of holding a bond whose price is normalised to 100 at the beginning of the period. Thus we compute the cumulative stress on a positive variable while real yields could be negative with misleading economic interpretations in the $CMIN$ framework. The choice of a base of 100 does not impact the results as we subsequently use the relative ranking of the observations.

take new data points into account.¹⁷

$$\hat{z}_t = F_n(z_t < z) = \begin{cases} \frac{r}{n} & \text{for } z_{[r]} < z_t < z_{[r+1]}, r = 1, 2, \dots, n-1 \\ 1 & \text{for } z_t > z_{[n]} \end{cases} \quad (6)$$

where $z_t \in \{VSTX, CMAX, VR10, CDIFF, CMIN, VEER, CUMUL\}$

The empirical CDF $F_n(z_t < z)$ transforms each variable into percentiles. The output $\hat{z}_t$ is a unit free index where the most extreme (smallest) values, corresponding to the highest (lowest) levels of stress, are characterised by the 99th (1st) percentile.

Aggregation. As the individual stress indicators capture the same facets of risk (i.e. volatility and large losses) for each financial market segment, we aggregate them by computing their average.¹⁸ The sub-indices are given by:

$$\begin{cases} I_{STX} = \frac{\widehat{VSTX} + \widehat{CMAX}}{2} \\ I_{R10} = \frac{\widehat{VR10} + \widehat{CDIFF}}{2} \\ I_{EER} = \frac{\widehat{VEER} + \widehat{CUMUL}}{2} \end{cases} \quad (7)$$

Similarly to [Hollo et al. \(2012\)](#), we aggregate the sub-indices for the three financial market segments based on a portfolio theory approach which weights each sub-index by its cross-correlation with the others. By aggregating correlated sub-indices, the resulting index reflects increased risk due to the stronger co-movement with overall financial stress. In contrast, less correlated sub-indices result in a lower composite index as it captures non-systematic components and diversifiable risk across market segments. As our FSI should be meaningful for financial stability purposes and the detection of systemic financial stress episodes, it is crucial to capture the systematic co-movement across financial market segments.¹⁹ The FSI is thus computed as follows:²⁰

$$FSI_t = \mathbf{I}_t \cdot C_t \cdot \mathbf{I}_t' \quad (8)$$

¹⁷The implicit assumption is that as more points become available, the CDF distribution is increasingly accurate, which amounts to assuming a certain stationarity of the distribution over time. Else if the features of the financial cycle are themselves time-varying, old observations may not always be a good benchmark to classify and rank current observations, especially since we have 50 years of data for some countries. We discuss this issue in the robustness section.

¹⁸For Germany the bonds sub-index is: $I_{R10} = \frac{\widehat{VR10} + \widehat{CMIN}}{2}$

¹⁹Across countries, the average correlation of the FSI with and without cross-correlation weights is 0.87, and ranges from a minimum of 0.79 for Cyprus and a maximum of 0.93 for Slovenia.

²⁰Note that our measure is bounded between 0 and 9, where the maximum is obtained when the cross-correlations are all equal to unity.

where $\mathbf{I}_t$ is the 1×3 vector of standardised sub-indices and C_t is the 3×3 time-varying cross-correlation matrix of the sub-indices:

$$C_t = \begin{bmatrix} 1 & \rho_{STX,R10,t} & \rho_{STX,EER,t} \\ \rho_{STX,R10,t} & 1 & \rho_{R10,EER,t} \\ \rho_{STX,EER,t} & \rho_{R10,EER,t} & 1 \end{bmatrix}.$$

The time varying cross-correlations $\rho_{i,j,t}$ are estimated using an Exponentially Weighted Moving Average (EWMA) specification with smoothing parameter $\lambda = 0.85$.²¹ Similar results are obtained with a multivariate GARCH but it unnecessarily adds estimation uncertainty to an otherwise simple FSI. $\sigma_{i,j,t}$ stands for the covariance, $\sigma_{i,t}^2$ for the volatilities and $\bar{s}_{i,t} = I_{i,t} - 0.5$ the demeaned sub-indices from the “theoretical” median.

$$\begin{aligned} \sigma_{i,j,t} &= \lambda \sigma_{i,j,t-1} + (1 - \lambda) \bar{s}_{i,t} \bar{s}_{j,t} \\ \sigma_{i,t}^2 &= \lambda \sigma_{i,t-1}^2 + (1 - \lambda) \bar{s}_{i,t}^2 \\ \rho_{i,j,t} &= \frac{\sigma_{i,j,t}}{\sigma_{i,t} \sigma_{j,t}} \end{aligned} \tag{9}$$

where $i, j = \{STX, R10, EER\}$, $i \neq j$. The initial values for the covariance and volatilities are set to the average over the first 10 years where the sub-indices are available.

3 A judgement-free dating of systemic financial stress

In the next step we combine information on financial market conditions, captured by the country-specific FSIs, and real economic conditions, captured by annual industrial production index (IPI) growth, to date episodes of systemic financial stress. Systemic financial stress episodes are defined as periods of financial stress associated with a substantial and prolonged negative impact on the real economy.

We use a sequential approach to identify systemic financial stress events while an alternative strategy would be to identify real and financial stress in a bivariate framework. This more complex approach is left as a robustness check.

3.1 Identifying financial stress: A Markov switching model

Most kernel densities of the country FSIs are characterised by a fat tail or a bi-modal distribution. This suggests that the data can be approximated by a mixture of two distributions with different mean and variance parameters. This is exactly what the MS

²¹The smoothing parameter λ is found by minimising, across countries, the squared errors compared to a multivariate diagonal BEKK GARCH(1,1) process for countries with sufficient data for a meaningful estimation (i.e. with at least 300 data points, starting in 1990 at the latest). When looking at individual countries, the fit of the GARCH(1,1) is better in terms of log-likelihood or Schwarz criterion over models with more lags. We find a λ equal to 0.85 (see the online appendix).

model does by distinguishing whether a given data point was drawn from a distribution corresponding to a low or high FSI regime.

Our benchmark is the Fixed Transition Probability (FTP-MS) model proposed by [Hamilton \(1989\)](#) where we take the specificities of detecting financial stress episodes into account. First, as our FSI is characterised by mean-reversion and has been stationarised, we do not consider including lagged dependent variables in the benchmark model.²² As a result, we can interpret the mean of the FSI in the high financial stress regime as a country-specific threshold above which the corresponding FSI value is likely to be associated with a financial stress period.

Second, we allow for a regime-specific mean and variance (μ^s and σ^s with $s = \{L, H\}$ corresponding, respectively, to a low and high financial stress regime). It is likely that a high financial stress regime exhibits both a larger absolute level of stress as well as more uncertainty. Models with only regime-specific means may generate very volatile signals of financial stress during the same financial stress episode if the financial stress is reduced for a short period of time, e.g. following temporarily good news or government interventions. Allowing for regime-specific variances results in a more robust identification of financial stress episodes.

$$FSI_t = \begin{cases} \mu^H + \sigma^H \epsilon_t & \text{in the high stress regime} \\ \mu^L + \sigma^L \epsilon_t & \text{in the low stress regime} \end{cases} \quad (10)$$

where $\epsilon_t \rightarrow N(0, 1)$ and the transition probability across regimes $S_t \in \{L, H\}$ is driven by a hidden two-state Markov chain whose transition probability matrix is given by:

$$P(S_t = s | S_{t-1}) = \begin{bmatrix} p = \frac{\exp(\theta_p)}{1 + \exp(\theta_p)} & 1 - p \\ 1 - q & q = \frac{\exp(\theta_q)}{1 + \exp(\theta_q)} \end{bmatrix} \quad (11)$$

We identify the financial stress regime as the one with the largest mean FSI ($\mu^H > \mu^L$). The output of the model is a time series of the smoothed probability of being in one regime $P(S_t = s)$ that we discretise in order to get a vector $\mathbb{C}$ of binary variables proxying the time series of financial stress episodes. At each point in time, it takes a value of one for cases where the probability of being in the high financial stress regime H is greater than 0.5 and a value of zero otherwise.²³

$$\mathbb{C} = \left\{ \mathbb{1}_{P(S_t=H)>0.5} \right\}_{t=1,\dots,T} \in \{0; 1\} \quad (12)$$

The results of the benchmark MS model are shown in Table [B.1](#). One concern could be

²²The robustness checks yield similar results. When introducing an auto-regressive term, the coefficient might be so high for some countries (especially for those where the data covers only a small time span) that the estimation fails. In such cases, for AR(1) terms above 0.9, we use a second lag.

²³The choice of this threshold has no impact on subsequent results.

that the MS model identifies two regimes in the FSI irrespective of the actual existence of different regimes. However, the following aspects seem to suggest the presence of at least two regimes in the FSI. First, the large time span of up to 50 years captures several financial crises with high levels of financial market stress as well as benign periods. Second, for all countries, the regime-specific means are significantly different across the two regimes.²⁴ Third, standard tests for breaks in univariate time series confirm the presence of breaks in the FSI of each country.

3.2 Selecting systemic financial stress events: An algorithm

Figure A.2 displays annual industrial production growth for different quantiles of the FSI distribution averaged across time and countries. It clearly shows that, on average, levels of financial stress above the 90th percentile of the distribution are associated with a substantial drop in industrial production. Figure A.3 illustrates the annual industrial production growth and the deviation from its long-term trend during the months following high financial stress. It shows that the average annual industrial production growth becomes negative during the month in which the FSI exceeds the 90th percentile threshold. Industrial production recovers 12 months after the beginning of high financial stress, while it takes on average 2.5 years to get back to its long-term trend. This simple exercise offers two valuable insights. First, episodes of high financial stress tend to be associated with real economic turmoil. Second, looking at a window of one year after the start of the financial stress seems to be reasonable to investigate whether financial stress is indeed associated with a pronounced decline in real economic activity.

As a consequence, financial stress is considered to be “systemic” if there are six consecutive months of real economic stress, either during one year following the start of the financial stress period, or during the whole financial stress period if it lasts more than one year. We define periods of real economic stress as a substantial and prolonged decline in real economic activity occurring both in the production sector as well as in the overall economy.

Industrial production growth is used as a benchmark for the start and end date of real economic stress instead of GDP as the former is available at a monthly frequency like the FSI. However, a simultaneous drop in GDP is required to capture more severe real economic stress not only restricted to the industrial sector. Taking GDP explicitly into account allows restricting systemic financial stress episodes to those in which recessionary events occurred.

The algorithm to identify systemic financial stress episodes is as follows:

²⁴However, regular tests in the MS framework are known to be hard to compute as they do not follow standard asymptotic distributions. Thus we restrict ourselves to testing regime differences in the mean computed in the case where variances are constant across regimes.

1. Define periods of real economic stress as events with (i) at least six consecutive months of negative annual industrial production growth,²⁵ and which (ii) overlap at least partly with a decline in real GDP during at least two –possibly non-consecutive– quarters.²⁶
2. Identify the start date of the next financial stress period.
3. Identify the end date of the financial stress period. If no end date is identified, it means that, at the end of the sample, the country is still in a period of financial stress, hence the sample end date is taken as the end date of the financial stress episode.
4. If the financial stress occurred during a period of prolonged real economic stress since the previous systemic financial stress episodes, connect the period of financial stress with the previous period of systemic financial stress. Back to point 2.
5. Check if the period qualifies as “systemic” financial stress: a period of six consecutive months of real economic stress either during one year following the start of the financial stress period,²⁷ or during the whole financial stress period if it lasts more than one year.²⁸
 - (a) The financial stress period is “systemic” and is followed by real economic stress. Back to point 2.
 - (b) The financial stress period is “systemic” but is preceded by real economic stress.
 - If another financial stress period ended less than two quarters before the currently identified start date, both periods are considered as being part of the same financial stress episode and are thus merged. Identify the start date of this merged financial stress episode. Back to point 4.
 - The financial stress period has already been extended by merging two adjacent financial stress episodes. Such a situation can happen only once to avoid merging two stress episodes occurring within a short period of

²⁵Alternatively, we could use a MS model to obtain periods of real economic stress. All episodes of real economic stress identified based on negative growth rates are also captured by a MS model. We rely on the simple rule-based criterion since consecutive months of decline in industrial production is a more severe criterion selecting fewer events.

²⁶When only one of the two variables (industrial production or GDP) is available, we keep only one of the two criteria for defining real economic stress.

²⁷As suggested by the above graphical analysis, this corresponds to a mean recovery of the real economy with positive growth rates after 12 months.

²⁸For financial stress episodes that occurred at the beginning of the sample period, the stress episode might have started earlier if we had been able to compute the FSI over a longer time span. Thus periods at the beginning of the sample may also qualify as “systemic” if there is only a *partial* overlap with six consecutive months of real economic stress around the start date of financial stress.

time but being associated with a different shock and different periods of real economic stress. Back to point 2.

- If no other financial stress episode is identified in the previous six months, this event is labelled as being “late”. Back to point 2.

(c) The financial stress episode is not considered as being “systemic”.

- If another financial stress period ended less than two quarters before the currently identified start date, both periods are considered as being part of the same financial stress episode and are thus merged. Identify the start date of this merged financial stress episode. Back to point 4.
- The financial stress period has already been extended by merging two adjacent financial stress episodes. Such a situation can happen only once as explained above. Back to point 2.
- If no other financial stress episode is identified in the previous six months, back to point 2.

3.3 Systemic financial stress events: Results

Chronology of systemic financial stress. The upper part of Figure A.4 shows all systemic financial stress episodes identified by the MS model and the filtering algorithm described above. Systemic financial stress periods are in black while tranquil periods are in white and insufficient data is in light grey. Separately, we also identify periods where the financial stress started more than one quarter after the start of the real economic stress (shown in dark grey). For these few events, either the stress started in the real economy and subsequently spilled over to the financial market, or our FSI fails to capture some dimension of the financial stress leading to a late detection of the event. In addition, Figure A.5 shows the intensity of financial and real economic stress during each period of systemic financial stress. If systemic financial stress events are always characterised by a FSI above the 70th percentile, systemic financial stress events around 2008 are associated with a stronger loss in industrial production that can reach 30%.

As the methodology is identical for all countries, one can take a closer look at the chronology of the global financial crisis and how it spread across Europe. The lower part of Figure A.4 ranks the countries by the starting date of the systemic financial stress episode occurring from January 2007 onwards. The group of countries hit first in mid-2007 is composed of Slovenia, Ireland, Czech Republic, Croatia, as well as Bulgaria, Romania and Great Britain at the end of 2007. A second group of countries hit in the first quarter of 2008 consists of Denmark, Italy, Luxembourg, the Netherlands, Spain, Portugal, Austria, France, Greece and Hungary. A later wave of countries hit in the second half of 2008 consists of Germany, Sweden, Latvia, Lithuania and Finland. Apart

from Germany, countries of this group were confronted with financial stress only after the real economic stress had materialised.

In addition, the results allow inferring for which countries the sovereign debt crisis starting in 2011 can be considered as a systemic financial stress episode. In the cases of Croatia, France, Luxembourg, the Netherlands and Cyprus, the sovereign debt crisis is identified as being clearly separated from the global financial crisis. In other countries like Belgium, Slovenia, Ireland, Italy, Portugal, Spain and Greece the systemic financial stress period expanded beyond the global financial crisis. Finally, in the cases of Poland, Malta and Slovakia, the financial market stress occurring from 2008 to 2012 did not have sufficiently severe or prolonged real economic stress for being considered as “systemic”.

Depth and length of systemic financial stress. Table B.2 compares important characteristics of ordinary recessions (left) and recessions occurring simultaneously with financial market stress (right). Accordingly, 42% (44%) of the recessionary events characterised by two (two consecutive) quarters of declining GDP are not associated with simultaneous financial market stress.²⁹ As expected, recessions occurring simultaneously with financial stress episodes feature an average FSI in the 70th percentile of the distribution during the quarter before the start of the recession, while the FSI is below the median for recessions without simultaneous financial market stress.

In line with the literature on financial crises (Reinhart and Rogoff, 2009; Reinhart and Rogoff, 2014), recessionary events are longer when they are associated with simultaneous financial market stress.³⁰ Ordinary recessions last on average eleven months while recessions associated with financial stress have an average duration of 17 months. In addition, according to Jorda et al. (2013), the magnitude of output losses is much larger during recessions coinciding with financial market stress than during ordinary recessions. We find that the difference in GDP decline is three percentage points larger. Even prior to 2008, recessionary events associated with financial market stress were on average two months longer, with the GDP decline being one percentage point larger.

Cross-country simultaneity of systemic financial stress. Our large country coverage and the unified framework allow to construct a measure of the simultaneity of systemic financial stress in Europe. The Crisis Simultaneity Index (CSI) shown in Figure A.6 corresponds to the share of countries experiencing a systemic financial stress episode at a given point in time. The difference between the black line and the black area corresponds to those periods of systemic financial stress where the real economic stress started at least three months before the financial market stress. We observe that three main

²⁹Note that several recessions can occur during one financial stress episode.

³⁰However, the recent paper by Romer and Romer (2015) suggests that output decline following financial crises varies across OECD countries and depends on the length of the financial stress itself.

episodes of systemic financial stress affected more than 50% of the EU countries at the same time: (i) the episode between the first and second oil shocks in 1973 and 1979, (ii) the years from 1993 to 1994 with banking, currency and real economic stress, and (iii) the global financial crisis.

Country by country results. Table B.5 lists all identified systemic financial stress episodes. It also reports the intensity of real and financial stress, the degree of simultaneity with other countries as well as the associated classification identified by experts.³¹

4 Comparison with other chronologies

We now turn to the comparison of our chronology of systemic financial stress periods with identified crises periods based on expert judgement. The expert-based events consist of the banking crises of Detken et al. (2014), the banking, currency and debt crises identified by Babecky et al. (2012), the systemic banking crises of Laeven and Valencia (2013) and the crises dates of the 16 EU countries covered by Reinhart and Rogoff (2011) which are classified as banking and currency crises as well as stock market crashes. The first two datasets are at a quarterly frequency, while the last two are at an annual frequency.

4.1 Comparison methodology

As frequencies are different, we compare model- and expert-based events, rather than monthly signals as it is common in the early warning literature. We require at least a one month overlap to consider that systemic financial stress episodes coincide with expert-identified crises.³² As a result, the “missed crises” or “false alarm” rate that we compute are not strictly speaking equivalent to their meaning in the early warning literature,³³ but rather correspond to, respectively, the share of expert-based crises not captured by the model, and the share of systemic financial stress events not identified by experts.

We do not expect systemic financial stress events to coincide perfectly with expert-identified crises. On the one hand, we may fail to capture crises identified by experts for several reasons. First, the expert-based stress episodes are more narrowly defined than

³¹The online appendix provides, for each country, a detailed overview of (i) the FSI with the threshold above which financial market stress is identified, (ii) the contribution of each financial market sub-index and their correlations to the overall FSI as well as (iii) various model- and expert-based systemic financial stress periods. It is worth noting that cross-correlations tend to contribute positively to the FSI in periods of systemic financial stress and negatively in tranquil periods and are thus an important component of the FSI.

³²Jing et al. (2015) define correctly identified banking crises when money market stress was signalled up to two years before the expert-identified crisis and until one year after the start of the crisis. Still, they only obtain a rate of correctly identified crises of 28% compared to the crises of Laeven and Valencia (2013).

³³In practice, we cannot compute the share of events with no crisis, while in the early warning literature one can compute the number of months without a signal.

our systemic financial stress periods, thus limiting their comparability. Second, stress episodes identified using our approach rely on market data while expert-based episodes usually use policy actions as a key criterion. Thus we compute an ex-post measure of market stress, while public interventions occurring in the meantime might mitigate the observed stress.

On the other hand, our approach may capture systemic financial stress episodes which were not identified by the experts for several reasons. First, surveyed experts often identify crises events based on qualitative criteria, which might introduce a subjectivity bias leading to fewer identified crises. Second, there exists a time lag before the next update of the expert-based crises events becomes available, so that our approach is more likely to identify additional events at the end of the sample. Third, since our criterion to identify systemic financial stress is a prolonged decline in the industrial production and GDP during a financial market stress period, we may also capture periods of real economic stress which spilled over to the financial sector and led eventually to an acceleration of the overall level of financial market stress. This interplay between real economic and financial market stress may result in the identification of more stress episodes. However, about half of the recessions did not occur during periods of high financial market stress, and, except for a few cases,³⁴ financial market stress occurred first, and real economic stress materialised in the subsequent twelve months.

4.2 Model- vs. expert-based episodes in the cross-section

Table B.3 compares systemic financial stress episodes with the expert-identified crises dates. The first two columns report the share of model-based stress episodes which were also identified as crises events by experts. On average, 62% of the systemic financial stress episodes identified by our approach are also in the list of banking crises identified by experts. Overall, 84% of the model-based systemic financial stress periods are captured by experts irrespective of the type of crisis considered. This ratio is up to 95% if we exclude the eleven countries not covered by Reinhart and Rogoff (2011). The other two columns report the share of expert-based crises which are also captured by the model-based approach. 85% of all expert-based banking crises were also identified by our approach as systemic financial stress periods. When considering all crises, only 51% of them were also identified as systemic financial stress episodes according to our definition.

These results suggest that most of the model-based systemic financial stress episodes are banking crises. Table B.4 confirms that the model-based stress periods coincide particularly well with banking crises. All of the systemic banking crises identified by Laeven and Valencia (2013) are captured by our model-based approach as well as on

³⁴Out of 17 “late” events where financial stress started at least one quarter after the real economic stress, four events were not identified by experts (namely France, Austria and Germany in the early 1980s, France in 2002) and one event falls outside the time span covered by experts (Finland in 2012-3).

average 92%, 90% and 89% of the banking crises identified by [Babecky et al. \(2012\)](#), [Detken et al. \(2014\)](#) and [Reinhart and Rogoff \(2011\)](#), respectively. The crises types which are identified by the model-based approach in only less than half of the cases are the currency and equity crises of [Babecky et al. \(2012\)](#) and [Reinhart and Rogoff \(2011\)](#), respectively.

4.3 Model- vs. expert-based episodes in the time dimension

Figure [A.7](#) shows the share of expert-based crises not captured by the model-based approach (“missed crises”) and the share of systemic financial stress events not identified as crises by experts (“false alarms”) by pooling *all* available countries and crises dates at each point in time (banking, currency, debt, equity).³⁵ The left axis shows the monthly ratio (black area) while the right axis shows the number of events missed or identified in excess of expert dates (red line). The upper graph reveals that most “missed crises” occur in the late 1960s, the early 1980s and during the 1990s, while almost all expert-based events around 2008 are captured by the model-based approach. From the lower graph it becomes clear that we capture very few events in addition to the expert-based crises. The main discrepancy is during the global financial crisis where the model-based approach captures three additional events which were not identified by experts (for Bulgaria, Croatia and Czech Republic).

These results are rather reassuring, as it means that (i) the model does not capture all possible crises of the different types identified by experts, and (ii) the model-identified episodes do not tend to signal periods not captured by experts, irrespective of the type of crisis considered. However, these overall results hide some heterogeneity across the different crises types.

When looking at the different types of crises separately, the share of “missed crises” is much lower. Only three systemic banking crises of [Detken et al. \(2014\)](#) in the early 1990s (Figure [A.8](#)) and a few currency crises around 1980 and in the early 1990s of [Babecky et al. \(2012\)](#) (Figure [A.9](#)) are not captured by the model-based approach.

Figure [A.10](#) reports the share of “false alarms” when considering only systemic banking crises (upper graph) and systemic banking crises as well as stock market crashes (lower graph). Even if the stock market crashes of [Reinhart and Rogoff \(2011\)](#) cover only 16 countries, it becomes clear that most of the crises captured by the model-based approach, besides systemic banking crises, seem to be stock market-related events. Three clusters of “false alarms” can be observed in Figure [A.10](#). The first period is the one after the two oil shocks of 1973 and 1979. About five stress episodes are identified by

³⁵The possible few months of difference between the start or end date of the model- and expert-based episodes are not included for the computation of the ratios. Otherwise, a model-based stress episode starting in June 2007 but identified by experts only from 2007Q3 onwards would wrongly show up as a “false alarm” during the three initial months.

the model-based approach only, which amounts to a share of “false alarms” above 50%. Oil shocks had a negative impact on the economies of the respective countries and led to financial market turmoil and strong price co-movements among the assets in the financial system, above and beyond what can be attributed to the banking sector.³⁶ The second period corresponds to the currency stress of the early 1990s which might be captured more often as the foreign exchange market is one of the three components of the FSI. The third period is the global financial crisis from 2008 until 2013. Up to six additional events that represent about 20% of all crises dates over this period are identified by the model-based approach. Namely Bulgaria, Croatia, Czech Republic, Finland in 2012, as well as Finland in 2008 and Romania where the last two are identified as stock market crashes by [Reinhart and Rogoff \(2011\)](#).

5 Robustness analysis

5.1 Alternative FSI with banking data

Including banking sector variables into the computation of the FSI allows changing its scope from a broad index capturing aggregate financial market developments to a narrower, bank-focused, index. However, data availability and quality is limited which reduces cross-country comparability and may weaken the robustness of the MS model estimations.

One way of incorporating banking sector information into the FSI is to compute a stock market sub-index based on banks’ stock prices. For large countries like France, Germany, Italy, the Netherlands, Spain, Sweden and the United Kingdom, the stock market sub-index of the FSI uses the stock index of Globally Systemically Important Banks (G-SIBs) instead of the stock index of non-financial corporations used in the benchmark model.³⁷ The underlying hypothesis is that the equity valuation of large banks is a sufficient proxy for the valuation of the overall banking sector. However, the activities of these banks changed substantially over time with mergers and acquisitions. For the seven countries for which banking data is available, the periods identified as systemic banking stress are very similar to the benchmark case. However, the stock market stress which occurred during the 2000s in France and Germany is not captured anymore. Note that the French banking crisis identified by some experts during the mid-1990s does not qualify as systemic as it was not accompanied by a simultaneous real economic stress.

An alternative is to introduce, for the 19 countries for which the relevant data is

³⁶As displayed in country-by-country figures in the online appendix, the cross-correlations are large contributors to the FSI during this period.

³⁷If necessary, stocks are weighted by the relative market capitalisation of the different banks in each country.

available, a money market sub-index³⁸ by computing the spread between the three-month interbank offered rate³⁹ and the three-month treasury bill rate. This fourth FSI sub-index is constructed as described in section 2.1 by combining a measure of volatility and a measure of large variations (*CDIFF*). However, the government interventions during the global financial crisis potentially affected interbank markets through a flattening of the spread and a reduction of the volatility. Overall, systemic stress episodes are similar to the benchmark case. As above, the stock market stress which occurred during the 2000s in France and Germany does not qualify as systemic banking stress, nor the currency stress in Denmark which occurred from 1979 to 1980. In addition, the banking stress in Greece during the early-1990s is better captured. Last, additional periods are identified as systemic stress for Portugal in 1992 and Malta in 2007.⁴⁰

5.2 The stationarity of the stress distribution over time

When computing the realised volatilities, the variables are adjusted for a possible change in the volatilities which might otherwise overstate financial market stress during the 1970s and 1980s. This volatility-adjustment of the FSI allows for a somewhat better identification of the financial stress in Portugal in 2008 and in Sweden in the first part of the 1990s. An alternative is to restrict the sample to start in 1990, so that financial stress is compared across more similar periods. The correlation of the benchmark FSI with the volatility-adjusted FSI and the FSI based on the restricted sample are very high. On average, the correlations are, respectively, 0.94 and 0.91. For those countries in which the FSI started after 1990, as expected, there is almost no difference between the benchmark FSI and the volatility-adjusted one.

The possible presence of different volatility regimes is an issue because the MS model estimation requires a stationary FSI distribution over time. If the structural features of the FSI changed over time, recent stress periods might not be adequately identified. For example, the level of financial stress could be structurally lower today due to lower volatilities compared to the early 1970s. One way to test the stationarity assumption is to consider alternative standardisation windows when converting the different stress indices into a common unit using the empirical cumulative distribution function. To this end, a ten year rolling window can be used to gradually discard older periods when classifying new observations. Alternatively, the entire time series, including past and future information, can be used for the standardisation. The resulting systemic financial stress episodes are similar, which suggests that the stationarity assumption holds.⁴¹

³⁸Jing et al. (2015) extend the existing literature on money market pressure indices and compare it with episodes of banking stress.

³⁹Before the adoption of the euro, this corresponds to the interbank rate on the national market. Once a country joined the euro area, the rate is replaced by the three-month EURIBOR.

⁴⁰Episodes of systemic banking stress using either methods are reported in the online appendix.

⁴¹Those episodes are reported in the online appendix.

5.3 The stability of event classification

The stability of event classification can be tested in-sample by identifying the systemic financial stress episodes over gradually expanding samples. To this end, an initial sample covering the first 25 years of data is used to estimate the MS model, and, in each of the subsequent rounds, the sample is expanded by one year.

Overall, the model-based approach appears to be relatively robust to the reclassification of events when new data become available. However, since the MS model, by definition, uses the unconditional sample mean and variance to infer the two regimes in the FSI, future stress episodes may still impact the precise dating of stress periods, especially when only a limited history of financial stress is available or when financial stress has a mild intensity (like in the Netherlands in 1974-75). In addition, since our approach requires six consecutive months of real economic stress within a 12 months window, a consistent classification of systemic financial stress periods might be complicated if the financial stress identified by the MS model is one month longer or shorter (like in the UK in 1990). Moreover, in a few cases, when new data is taken into account, the start and end dates of systemic financial stress episodes differ substantially from the previous update. This is due to the filtering algorithm which merges successive stress episodes occurring within a window of six months as in the case of Spain in the late 1970s or Germany in 1994.⁴²

Still, as there is at least one large systemic financial stress episode (i.e. the global financial crisis) included in the dataset, the identified systemic stress periods are unlikely to vary substantially over time. It is reassuring that previous systemic financial stress episodes were not reclassified once the global financial crisis was included in the dataset.

5.4 Modelling jointly economic and financial dynamics

The last robustness test investigates a model which explicitly captures the joint dynamics of financial market and economic variables.⁴³ We use a threshold vector autoregressive (TVAR) model⁴⁴ with the FSI and the annual industrial production growth ($gIPI$) in which each variable depends on its own n lags as well as those of the other variable. The TVAR model distinguishes between periods of significantly different joint dynamics above (A) or below (B) a specific percentile of the FSI, possibly lagged by d periods. This allows to infer the country-specific FSI threshold τ that best separates the joint dynamics of financial and real economic stress into two regimes. Hence the regime switching

⁴²Those events are flagged in Table B.5. More detailed results are displayed in the online appendix.

⁴³Hartmann et al. (2013) use a large Markov Switching Vector Autoregression model in order to capture changes in the joint dynamics between financial stress and other macroeconomic aggregates. The authors confirm that when financial instability is high, the behaviour of macroeconomic aggregates is significantly different from tranquil periods.

⁴⁴Hollo et al. (2012) use this approach as a robustness check to endogenously determine the stress threshold above which their financial stress measure, the CISS, significantly distorts the real economy.

now directly depends on observables, namely the level of financial stress, instead of an unobserved Markov chain:

$$\begin{cases} FSI_t = c_1^A + \sum_{p=1}^n (\beta_{1,1,p}^A FSI_{t-p} + \beta_{1,2,p}^A gIPI_{t-p}) + \epsilon_1^A \\ gIPI_t = c_2^A + \sum_{p=1}^n (\beta_{2,1,p}^A gIPI_{t-p} + \beta_{2,2,p}^A FSI_{t-p}) + \epsilon_2^A \end{cases} \quad \text{if } FSI_{t-d} > \tau \quad (13)$$

$$\begin{cases} FSI_t = c_1^B + \sum_{p=1}^n (\beta_{1,1,p}^B FSI_{t-p} + \beta_{1,2,p}^B gIPI_{t-p}) + \epsilon_1^B \\ gIPI_t = c_2^B + \sum_{p=1}^n (\beta_{2,1,p}^B gIPI_{t-p} + \beta_{2,2,p}^B FSI_{t-p}) + \epsilon_2^B \end{cases} \quad \text{if } FSI_{t-d} < \tau$$

The periods obtained from the benchmark model are roughly consistent with those obtained from the TVAR model (when $FSI_{t-d} > \tau$). The average threshold estimated with the TVAR model corresponds to the 81 percentile of the FSI.⁴⁵

The TVAR model is not the benchmark for several reasons. (i) First, it does not take the length of the real economic stress into account while the filtering algorithm can handle cases of very short-lived stress periods or identify periods of prolonged real economic stress to justify the classification as “systemic”. (ii) Second, systemic financial stress periods are “mechanically” identified as episodes above the threshold, while the MS model also includes a regime-dependent variance which is observed in the empirical distributions of the FSI. (iii) Third, the MS model provides the probability to be in the high or low stress regime, allowing for some degree of uncertainty in the estimation of the regime, while any small breach of the TVAR threshold leads to the classification of one period as a stress event. (iv) Fourth, the TVAR model requires the correct estimation of many more parameters whose uncertainty is likely to be excessively large for countries with a limited time-span. (v) Finally, the estimation of the TVAR model fails for countries with a limited time span, namely Latvia, Lithuania, Romania and Slovenia.

6 Conclusion

The novelty of this paper is to provide a framework for identifying systemic financial stress episodes in a transparent, reproducible and objective way. Systemic financial stress episodes are periods in which high financial market stress coincides with a substantial and prolonged decline in real economic activity. We bridge the gap between the literature on measuring systemic financial stress and that on business cycle dating using Markov Switching (MS) models. The approach follows a stepwise strategy: (i) construct

⁴⁵The results are reported in the online appendix.

a Financial Stress Index (FSI), (ii) identify periods of high financial market stress, and (iii) narrow down the financial stress episodes to those with a “systemic character”. By applying this framework to the EU countries, the paper is a first attempt to provide a chronology of EU systemic financial stress episodes in addition to the expert-based stress events available so far.

The 68 systemic financial stress episodes identified by the model-based approach are shown to be consistent with many expert-based stress periods. In particular, 82% of the model-based systemic financial stress periods are also identified as crises by experts. Focussing on banking crises, the approach captures on average 100%, 92%, 90% and 89% of the crises identified by [Laeven and Valencia \(2013\)](#), [Babecky et al. \(2012\)](#), [Detken et al. \(2014\)](#) and [Reinhart and Rogoff \(2011\)](#), respectively. Besides, the identified systemic financial stress episodes tend to be robust to event reclassification once new data become available. Overall, systemic financial stress events have recurrent patterns: (i) financial stress usually occurs first and is followed by real economic stress, (ii) when associated with financial market stress, recessionary periods last on average six months longer, and the output decreases on average by three additional percentage points, (iii) a crisis simultaneity index shows that systemic financial stress usually occurs in “clusters” affecting several EU countries at the same time. In this respect, the global financial crisis is only comparable to the first oil shock.

This work has important implications for further macroprudential analyses. First, the proposed objective approach limits the bias potentially arising when relying on expert judgement to identify financial crises. Second, the model-based approach allows for the identification of systemic financial stress events in real time while expert-based episodes are only updated occasionally. Third, in order to measure the build-up of risks, early warning models use past crises episodes to assess the predictive power of candidate leading indicators. Fourth, to analyse the effectiveness of macroprudential measures, policy actions should be evaluated throughout the cycle. A robust identification of periods of systemic financial stress provides valuable information for all these purposes.

Still, more efforts are needed for a disaggregated analysis of cyclical dynamics in specific market segments, such as the real estate market. Besides, the broad definition of systemic stress events used in this paper may have to be adjusted for the analysis of disaggregated macroprudential policies. Nevertheless, the country specific approach adopted here can be considered as a first step which should allow for a better analysis of domestic versus EU-wide policies.

A Graphical appendix

Figure A.1: Construction of the Financial Stress Index

^a We use the sovereign spread with respect to Germany to compute the CDIFF. For Germany, however, we use the real 10-year government bonds yield to compute the CMIN.

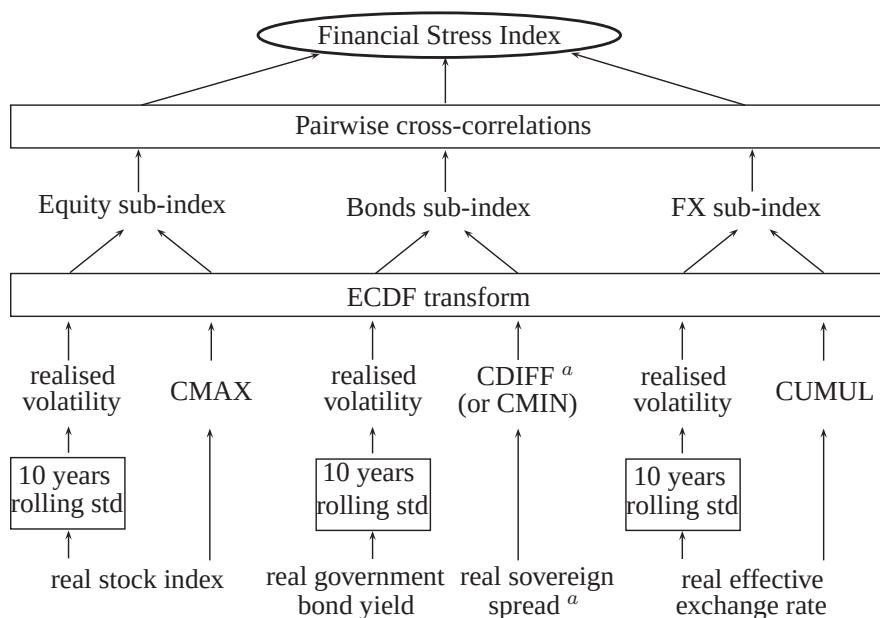


Figure A.2: **Industrial production growth per quantiles of FSI**

Note: This figure shows the average annual industrial production growth on the y-axis and the quantiles of the country-specific financial stress indices on the x-axis. The blue line corresponds to the country average while the grey area corresponds to the 20th and 80th percentile, respectively. The data is pooled both in the time and cross-sectional dimension over the 27 EU countries.

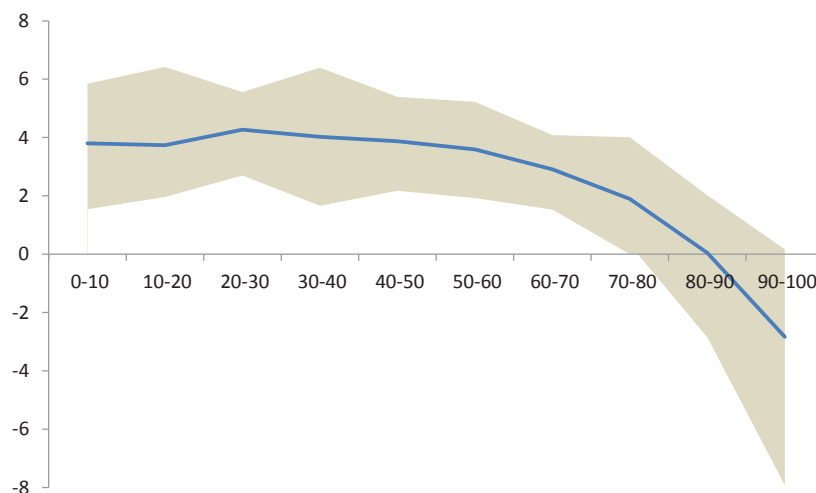


Figure A.3: **Decline in industrial production for different horizons conditional on high financial stress**

Note: The blue line shows the average annual industrial production growth around the months following high financial stress. The dashed red line shows the difference between the average annual industrial production growth and its long-term trend around the months following high financial stress (FSI above its 90th percentile) on the x-axis. The long-term trend is obtained using a one-sided HP filter with a smoothing parameter $\lambda = 129600$. The x-axis refers to the months around the breach of the 90th percentile threshold identified in Figure A.2. Only cases where the FSI breaching the 90th percentile threshold for the first time over the previous 12 months are considered. Both lines are averages in the time and cross-sectional dimension over the 27 EU countries.

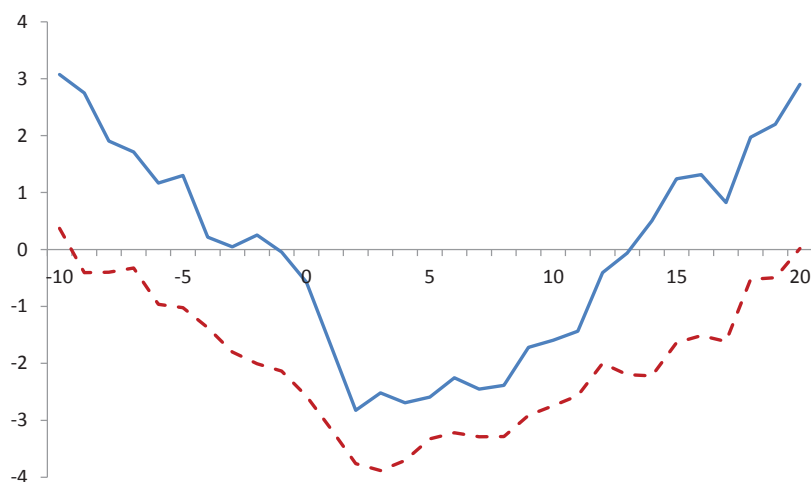


Figure A.4: **Chronology of systemic financial stress across countries**

Note: This figure shows the chronology of systemic financial stress across 27 EU countries. In the upper graph, systemic financial stress periods are in black while tranquil periods are in white. Stress episodes in dark grey correspond to periods where the financial stress started at least three months after the start of the real economic stress identified using a decline in industrial production. Periods for which no sufficient data is available are in light grey. The lower graph focuses on the period starting in 2007 and countries are ranked based on the start date of the global financial crisis.

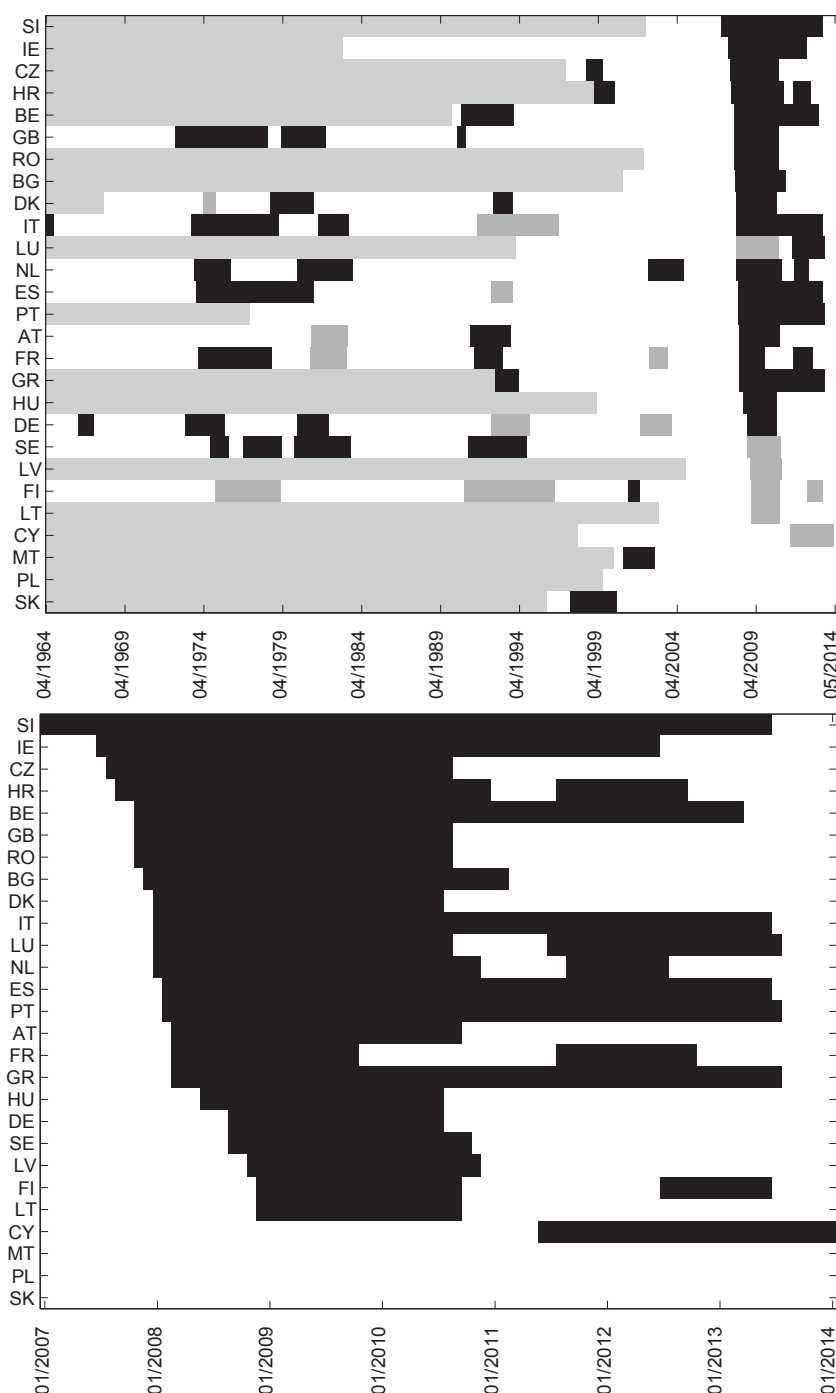


Figure A.5: **Intensity of financial market and real economic stress during periods of systemic financial stress**

Note: This figure shows the intensity of financial market and real economic stress during the periods of systemic financial stress in the 27 EU countries. In the upper graph, the average intensity of financial market stress during each systemic financial stress period is represented by the colours from yellow (low stress, FSI around 50th country-specific percentile) to black (high stress, FSI around 90th country-specific percentile). In the lower graph, the average intensity of real economic stress during each systemic financial stress period is represented by the colours from yellow (low stress, small IP loss from peak to trough) to black (high stress, IP loss from peak to trough around 30%). Periods for which no sufficient data was available are in light grey. Countries are ranked based on the start date of the global financial crisis.

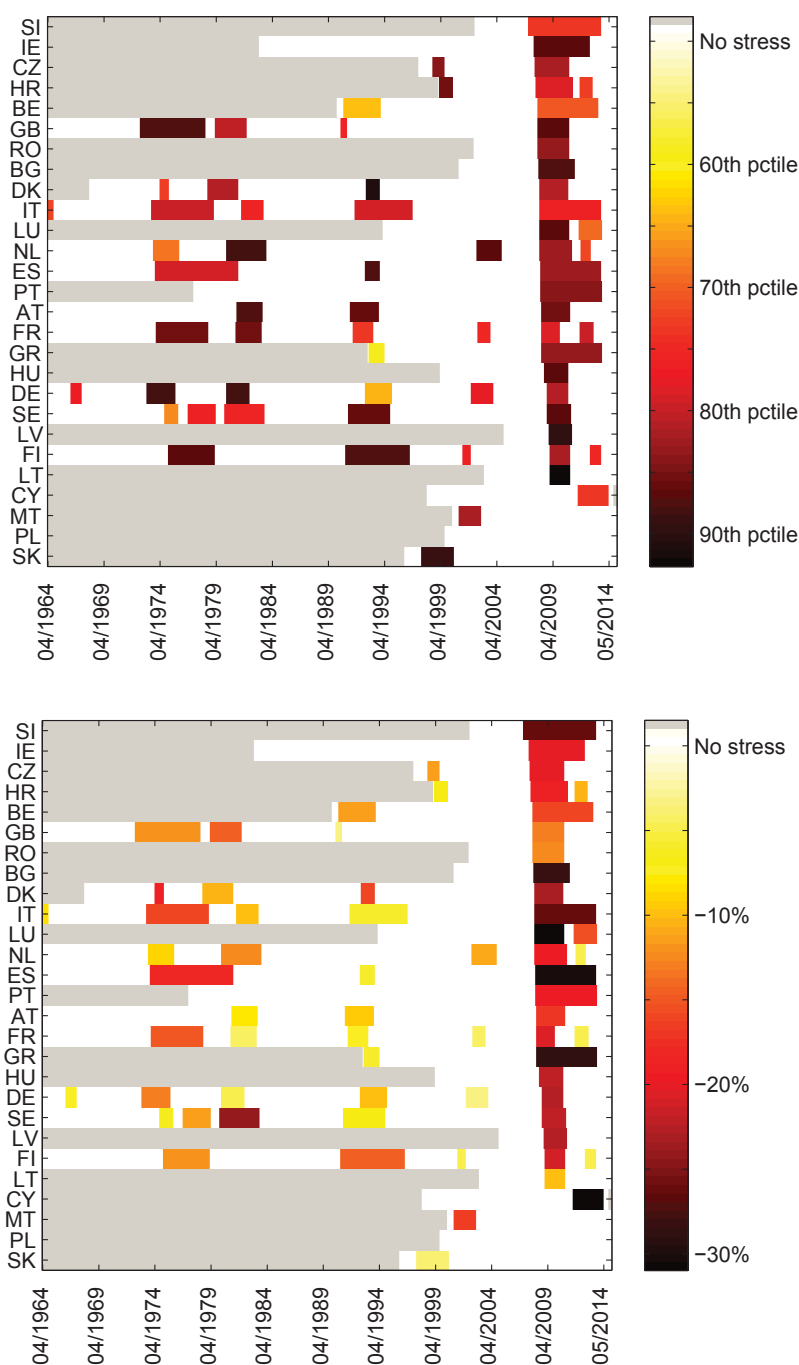


Figure A.6: **Crisis Simultaneity Index (CSI)**

Note: The Crisis Simultaneity Index (CSI) corresponds to the share of countries experiencing systemic financial stress in a given month. The difference between the black line and the black area corresponds to those episodes of systemic financial stress where the real economic stress started before the financial market stress.

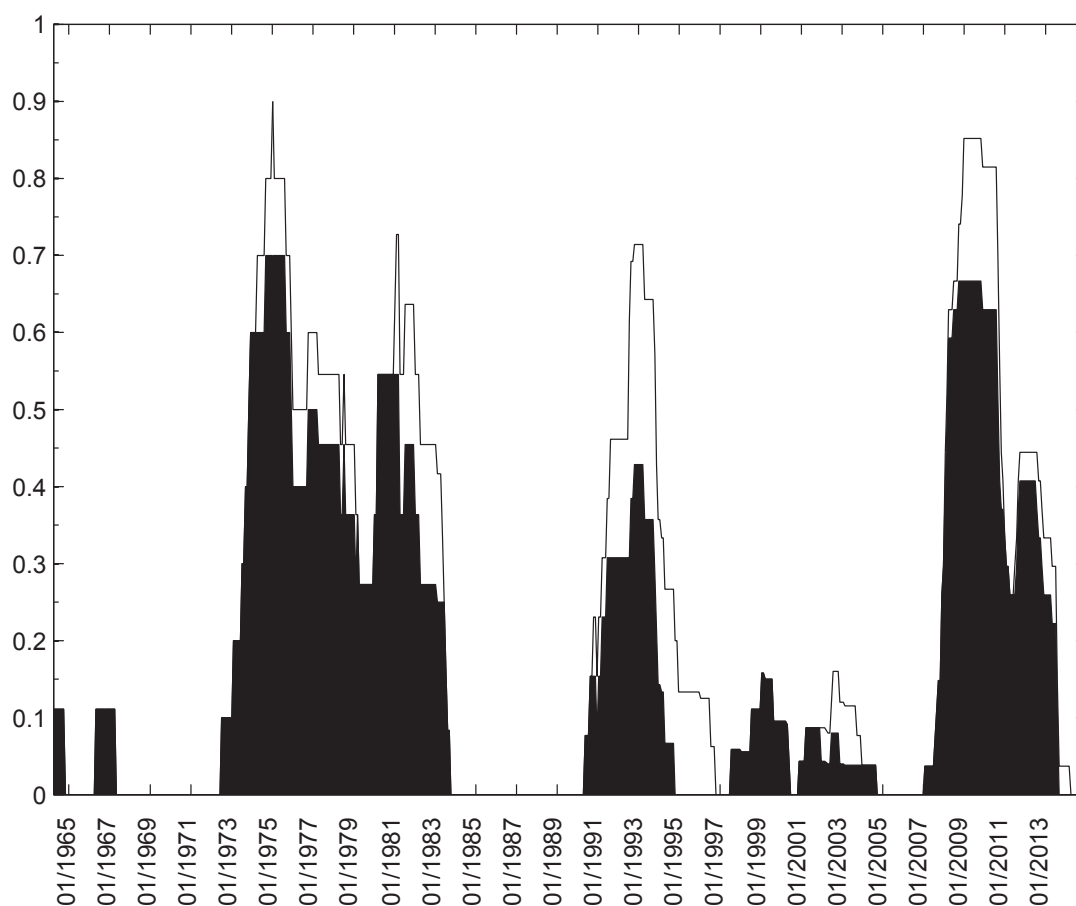


Figure A.7: Comparison with all expert crises dates in the time dimension

Note: This figure compares model-based systemic financial stress episodes with expert-based crises in the time dimension. The expert-detected crises correspond to those identified by [Detken et al. \(2014\)](#), [Babecky et al. \(2012\)](#) (banking, currency and debt crises), [Laeven and Valencia \(2013\)](#) and [Reinhart and Rogoff \(2011\)](#) (banking, currency, equity). The upper graph focuses on the “missed crises”. The left (right) axis shows the share (number) of expert-based crises not captured by the model-based approach as the black area (red line). The lower graph focuses on the “false alarms”. The left (right) axis shows the share (number) of systemic financial stress events not identified as crises by experts as the black area (red line).

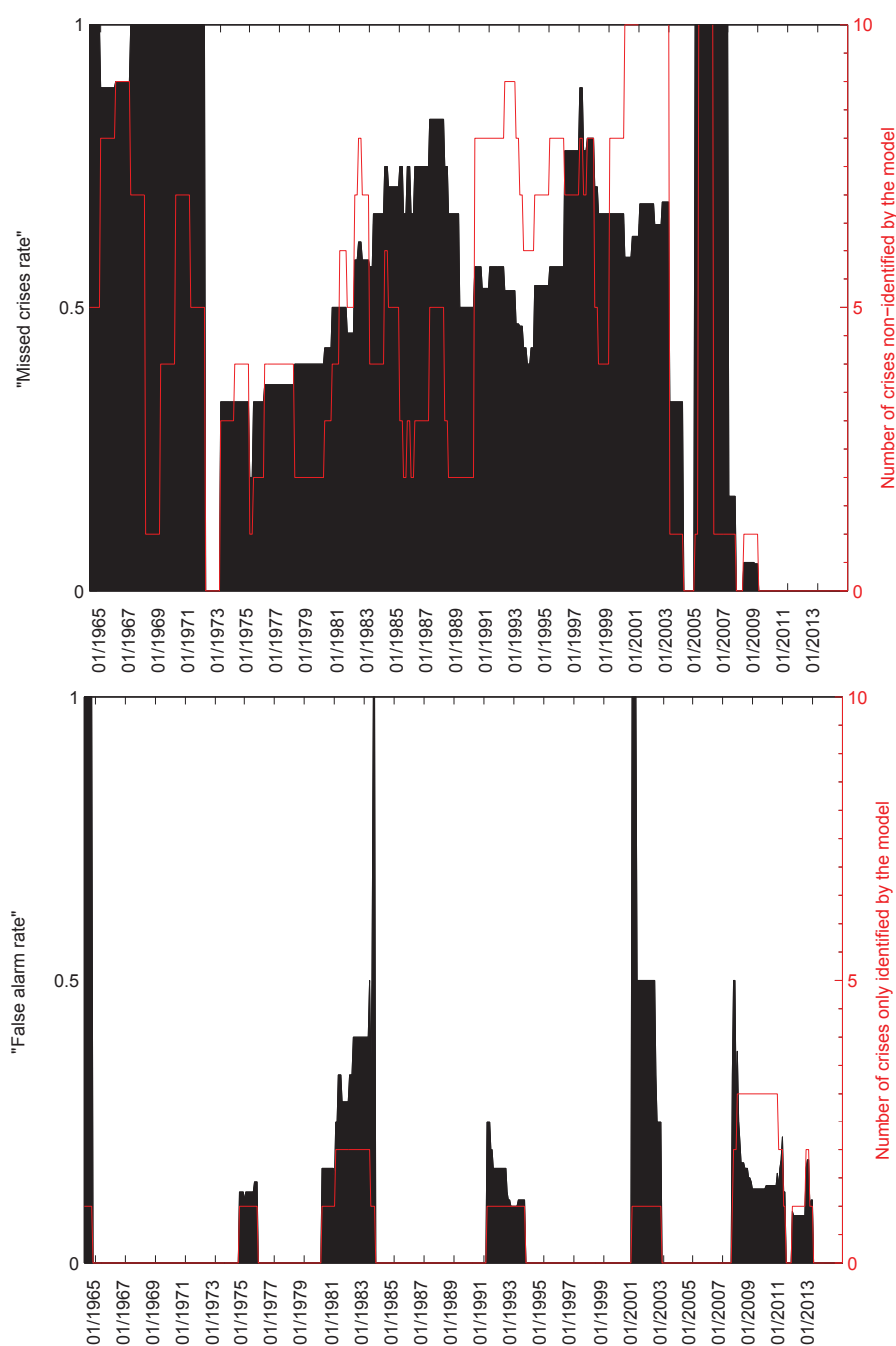


Figure A.8: Comparison with Detken et al. (2014) dates in the time dimension

Note: This figure compares model-based systemic financial stress episodes with crises from one particular expert-database. The focus is on banking crises only. The left (right) axis shows the share (number) of crises identified by Detken et al. (2014) not captured by the model-based approach as the black area (red line).

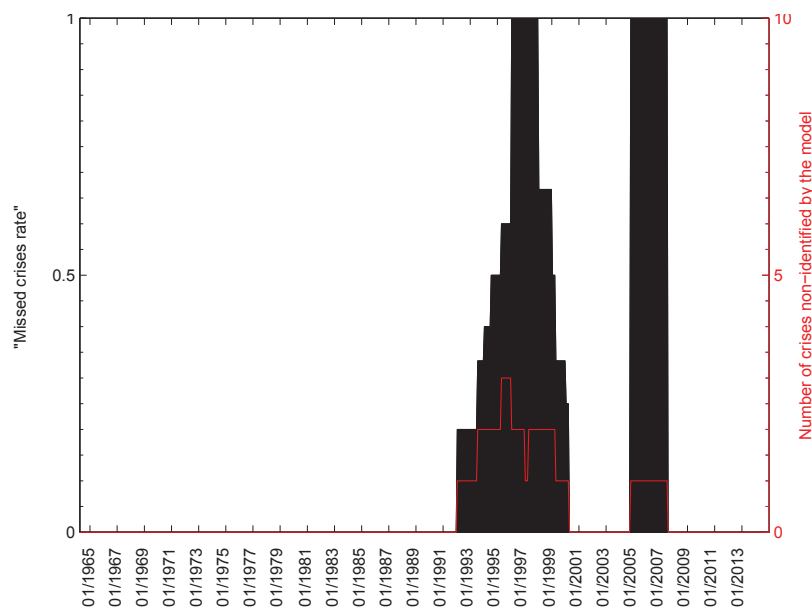


Figure A.9: Comparison with Babecky et al. (2012) dates in the time dimension

Note: This figure compares model-based systemic financial stress episodes with crises from one particular expert-database. The events considered encompass currency, debt and banking crises. The left (right) axis shows the share (number) of crises identified by Babecky et al. (2012) not captured by the model-based approach as the black area (red line).

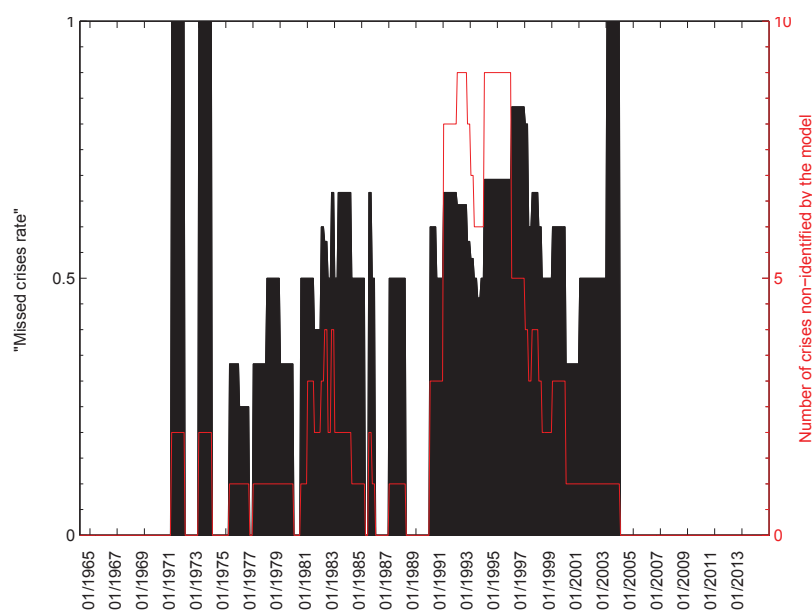
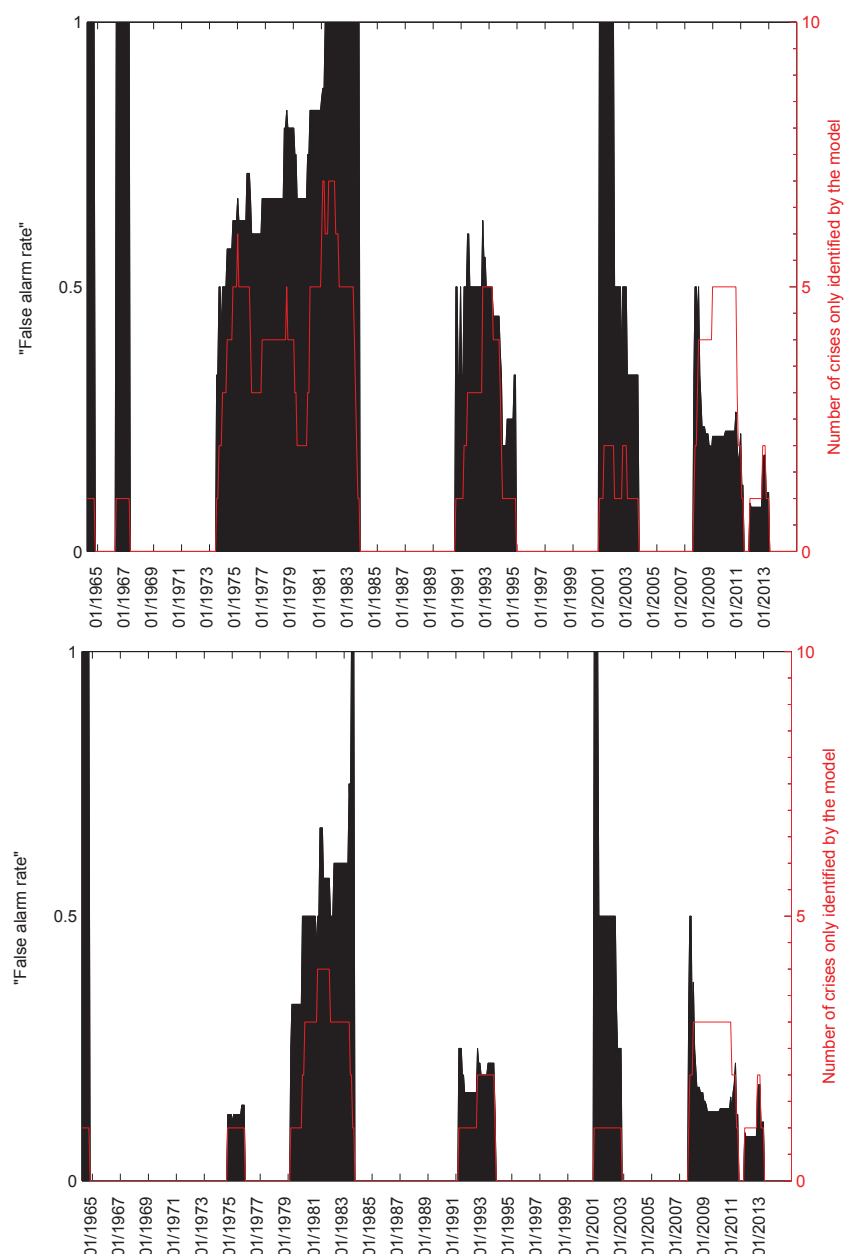


Figure A.10: Comparison with all expert identified systemic banking crises and stock market crashes in the time dimension

Note: This figure compares model-based systemic financial stress episodes with expert-based crises in the time dimension. The expert-detected crises correspond to all banking crises identified by the [Detken et al. \(2014\)](#), [Babecky et al. \(2012\)](#), [Laeven and Valencia \(2013\)](#) and [Reinhart and Rogoff \(2011\)](#) (the last dataset covers only 16 EU countries). Both the upper and the lower graph focus on the “false alarms”. The left (right) axis shows the share (number) of systemic financial stress events not identified as crises by experts as the black area (red line). In the lower graph the expert-based crises also include the stock market crashes identified by [Reinhart and Rogoff \(2011\)](#) for 16 EU countries. A large fraction of model-based stress episodes which are not identified as crises by experts are in fact stock market crashes.



B Table appendix

Table B.1: Results of the Markov Switching model and break tests

	Crisis regime		Tranquil regime		Wald test $\mu_1 = \mu_2$		Breaks sequentially determined		Breaks globally determined	
	mean μ_1	std err $\ln(\sigma_1)$	mean μ_2	std err $\ln(\sigma_2)$	t-stat	F-stat	F-stat 0 vs. 1 break	Number of breaks	Significant F-stat largest	Schwarz criterion
AT	1.933 (0.075)	-0.262 (0.049)	0.684 (0.023)	-1.249 (0.062)	28 (1.96)	787 (3.86)	93 (9.63)	7	9	9
BE	1.867 (0.068)	-0.306 (0.055)	0.689 (0.038)	-1.205 (0.084)	-18 (1.97)	342 (3.87)	136 (9.63)	8	9	10
BG	2.571 (0.171)	-0.011 (0.299)	0.760 (0.039)	-0.936 (0.081)	16 (1.97)	263 (3.90)	67 (9.63)	9	10	8
CY	1.576 (0.089)	-0.579 (0.086)	0.614 (0.031)	-1.501 (0.112)	16 (1.97)	265 (3.89)	23 (9.63)	4	7	6
CZ	2.588 (0.152)	0.275 (0.080)	0.689 (0.027)	-1.212 (0.064)	-15 (1.97)	232 (3.89)	36 (9.63)	8	10	8
DE	2.103 (0.073)	-0.034 (0.046)	0.678 (0.021)	-1.171 (0.051)	23 (1.96)	546 (3.86)	91 (9.63)	4	10	10
DK	1.797 (0.067)	-0.249 (0.047)	0.623 (0.023)	-1.322 (0.070)	24 (1.96)	559 (3.86)	104 (9.63)	5	10	10
ES	2.096 (0.084)	-0.052 (0.049)	0.707 (0.025)	-1.178 (0.072)	-23 (1.96)	537 (3.86)	44 (9.63)	10	10	7
FI	2.954 (0.108)	0.249 (0.052)	0.959 (0.027)	-0.716 (0.038)	-29 (1.96)	831 (3.86)	149 (9.63)	6	8	8
FR	2.345 (0.078)	-0.152 (0.053)	0.847 (0.022)	-0.994 (0.042)	-28 (1.96)	774 (3.86)	126 (9.63)	8	10	10
GB	2.687 (0.110)	0.179 (0.052)	0.834 (0.026)	-0.897 (0.046)	25 (1.96)	636 (3.86)	59 (9.63)	10	10	9
GR	2.357 (0.085)	-0.090 (0.064)	0.653 (0.027)	-1.172 (0.064)	24 (1.97)	568 (3.88)	106 (9.63)	6	9	7
HR	1.581 (0.094)	-0.457 (0.087)	0.588 (0.031)	-1.352 (0.100)	15 (1.97)	222 (3.89)	24 (9.63)	4	4	4
HU	4.644 (0.448)	0.583 (0.151)	0.937 (0.049)	-0.608 (0.068)	-23 (1.97)	527 (3.89)	27 (9.63)	6	10	5
IE	3.045 (0.138)	0.378 (0.058)	0.810 (0.037)	-0.841 (0.063)	26 (1.97)	681 (3.87)	53 (9.63)	8	10	10
IT	2.095 (0.070)	0.055 (0.045)	0.597 (0.017)	-1.230 (0.044)	22 (1.96)	472 (3.86)	79 (9.63)	8	10	10
LT	3.366 (0.180)	-0.240 (0.171)	0.677 (0.033)	-1.049 (0.068)	26 (1.98)	687 (3.91)	30 (9.63)	4	6	4
LU	2.313 (0.123)	-0.078 (0.077)	0.936 (0.050)	-0.786 (0.076)	-13 (1.97)	161 (3.88)	29 (9.63)	8	10	10
LV	2.538 (0.231)	0.211 (0.127)	0.582 (0.024)	-1.548 (0.081)	18 (1.98)	336 (3.92)	44 (9.63)	4	6	5

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Note: This table reports in the first four columns the estimated parameters from the Markov Switching (MS) model, namely the regime-specific mean and the regime-specific standard error (standard errors of the parameters are reported in parenthesis). The fifth and sixth column report the Wald test of the difference between the mean values of both MS regimes (critical values at the 5% level are reported in parenthesis). Note that this test is computed for a MS model without regime-specific variance as otherwise the asymptotic properties do not follow standard distributions. The last four columns report the results of testing the presence of breaks in the FSI, which is a prerequisite for fitting a MS model. Critical values are reported in parenthesis. The tests require at least 5% of observation per break and allow for heterogeneous error distributions across breaks. Reported results correspond to breaks which are significant at the 5% level using robust HAC standard errors.

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	Crisis regime		Tranquil regime		Wald test $\mu_1 = \mu_2$		Breaks sequentially determined		Breaks globally determined	
	mean μ_1	std err $\ln(\sigma_1)$	mean μ_2	std err $\ln(\sigma_2)$	t-stat	F-stat	F-stat 0 vs. 1 break	Number of breaks	Significant F-stat largest	Schwarz criterion
MT	2.067 (0.096)	-0.305 (0.085)	0.883 (0.040)	-0.966 (0.075)	14 (1.97)	201 (3.89)	14 (9.63)	6	10	10
NL	1.731 (0.069)	-0.122 (0.047)	0.607 (0.018)	-1.353 (0.054)	-24 (1.96)	558 (3.86)	140 (9.63)	6	9	8
PL	1.890 (0.110)	-0.181 (0.085)	0.506 (0.027)	-1.463 (0.095)	20 (1.97)	394 (3.89)	87 (9.63)	8	7	8
PT	1.941 (0.068)	-0.346 (0.063)	0.550 (0.017)	-1.294 (0.043)	-26 (1.97)	669 (3.86)	88 (9.63)	10	10	10
RO	2.131 (0.101)	-0.271 (0.092)	0.733 (0.033)	-1.214 (0.081)	-15 (1.98)	221 (3.90)	58 (9.63)	4	6	8
SE	2.133 (0.082)	0.012 (0.114)	0.729 (0.023)	-1.119 (0.053)	-23 (1.96)	509 (3.86)	70 (9.63)	4	10	8
SI	2.064 (0.108)	-0.073 (0.082)	0.629 (0.028)	-1.464 (0.084)	-15 (1.98)	240 (3.91)	122 (9.63)	6	9	6
SK	2.208 (0.162)	-0.138 (0.109)	0.644 (0.027)	-1.129 (0.063)	19 (1.97)	365 (3.88)	44 (9.63)	8	9	7

Table B.2: Real economic vs. systemic financial stress episodes

Definition of recession in terms of GDP decline:	Ordinary recessions				Recessions with financial market stress			
	Number events	Length	GDP loss	FSI pcent	Number events	Length	GDP loss	FSI pcent
Two quarters	60	11	-0.62	44	84	17	-3.80	65
Two consecutive quarters	38	7	-1.46	41	48	13	-3.98	71
Before 2008 and two quarters	47	11	-0.44	46	48	13	-1.61	72
Before 2008 and two consecutive quarters	30	7	-1.42	42	27	9	-2.05	76

Note: This table provides summary statistics for two different types of stress events: (i) real economic stress periods (ordinary recessions), and (ii) systemic financial stress episodes (recessions coinciding with financial market stress). The following summary statistics are reported: the number of events across the 27 EU countries, the average length of the episodes in months, the average magnitude of GDP decline in percent, and the average percentile (*pcent*) of the FSI during one quarter prior to the start of the respective episode. Recessions correspond to periods of at least two quarters of GDP decline, either allowing for one quarter of recovery in-between, or limited to consecutive quarters of GDP decline. Systemic financial stress episodes correspond to recessionary periods coinciding with financial market stress, i.e. they are characterised by (i) high financial market stress identified by a MS model applied to the FSI, and (ii) at least six consecutive months of negative annual industrial production growth.

Table B.3: **Comparison of model-based systemic financial stress episodes with expert-based crises**

	Share of expert identified stress events among model-based events		Share of model identified crises dates among expert-based events	
	All banking crises	All experts crises	All banking crises	All experts crises
AT	0.33	0.33	1.00	1.00
BE	0.50	1.00	1.00	0.60
BG	0.00	0.00	0.00	
CY	1.00	1.00	1.00	1.00
CZ	0.50	0.50	1.00	1.00
DE	0.50	1.00	0.75	0.55
DK	0.50	1.00	1.00	0.57
ES	0.67	1.00	1.00	0.43
FI	0.20	0.80	1.00	0.67
FR	0.33	1.00	0.50	0.55
GB	0.75	1.00	0.75	0.57
GR	1.00	1.00	1.00	0.40
HR	0.33	0.33	1.00	1.00
HU	1.00	1.00	1.00	0.50
IE	1.00	1.00	0.50	0.17
IT	0.40	0.80	1.00	0.44
LT	1.00	1.00	1.00	1.00
LU	1.00	1.00	1.00	1.00
LV	1.00	1.00	1.00	1.00
MT	0.00	0.00		
NL	0.60	0.80	1.00	0.50
PL				
PT	1.00	1.00	0.50	0.14
RO	0.00	1.00		1.00
SE	0.40	0.80	1.00	0.50
SI	1.00	1.00	1.00	1.00
SK	1.00	1.00	1.00	1.00
Total	0.53	0.84	0.85	0.51
Mean	0.62	0.82	0.88	0.69

Note: This table compares the systemic financial stress episodes identified by the model-based approach with the crises episodes identified by experts, namely [Detken et al. \(2014\)](#), [Babecky et al. \(2012\)](#), [Laeven and Valencia \(2013\)](#). The first and third crisis database focus on banking crises only while the second crisis database includes banking, currency and debt crises. We also report statistics for the 16 EU countries of the [Reinhart and Rogoff \(2011\)](#) crisis database which includes banking and currency crises as well as stock market crashes. The *All banking crises* columns pool the banking crises of all four crises databases. The *All experts crises* columns pool all crises types of all four crises databases. We compute two ratios to capture the extent of the similarity between the model-based systemic financial stress episodes and the expert-based crises. First, the share of expert identified stress events among model-based events is defined as the share of systemic financial stress periods also identified by experts. Second, the share of model identified crises dates among expert-identified events is defined as the share of expert-based crises also identified by the model-based approach. We compute the ratios only on the relevant time span for which both expert- and model-based episodes are available. The ratio cannot be computed when the denominator is zero or non-available. *Total* refers to the ratio over all episodes. *Mean* refers to the average across countries.

Table B.4: **Expert-based crises captured by the model-based approach**

	Detken	Babecky et al.			Leaven	Reinhart and Rogoff		
	et al.	Banking	Currency	Debt	Valencia	Banking	Currency	Equity
AT		1.00			1.00			
BE		1.00	1.00		1.00	1.00	0.00	0.67
BG	0.00							
CY	1.00							
CZ	1.00	1.00	0.00		1.00			
DE	1.00	0.67			1.00	0.50	0.00	0.75
DK	1.00	1.00	0.50		1.00	1.00	1.00	0.50
ES	1.00	1.00	0.67		1.00	1.00	0.33	0.20
FI	1.00	1.00	0.50		1.00	1.00	0.50	0.80
FR	0.50	0.50			1.00	0.50	0.33	0.60
GB	1.00	0.50	0.00		1.00	0.40	0.60	0.50
GR	1.00	1.00	0.00	1.00	1.00	1.00	0.00	0.80
HR	1.00				1.00			
HU	1.00	1.00		1.00	1.00	1.00	0.00	0.50
IE	1.00	0.67		1.00	1.00	1.00	0.00	0.50
IT	1.00	1.00	0.67		1.00	1.00	0.67	0.57
LT	1.00	1.00						
LU		1.00			1.00			
LV	1.00	1.00			1.00			
MT								
NL	1.00	1.00			1.00	1.00	0.00	0.60
PL							0.00	0.00
PT	0.50	1.00	0.00		1.00	1.00	0.00	0.00
RO							1.00	1.00
SE	1.00	1.00	1.00	1.00	1.00	1.00	0.80	0.50
SI	1.00	1.00			1.00			
SK		1.00			1.00			
Total	0.89	0.85	0.56	1.00	1.00	0.78	0.36	0.54
Mean	0.90	0.92	0.43	1.00	1.00	0.89	0.33	0.53

Note: This table reports the ratio of expert-identified crises also captured by the model-based approach. The following expert databases are included: [Detken et al. \(2014\)](#), [Babecky et al. \(2012\)](#), [Laeven and Valencia \(2013\)](#), and [Reinhart and Rogoff \(2011\)](#). The first and third crisis database focus on banking crises only while the second crisis database includes banking, currency and debt crises. We also report statistics for the 16 EU countries of the [Reinhart and Rogoff \(2011\)](#) crisis database which includes banking and currency crises as well as stock market crashes. We compute the ratios only on the relevant time span for which both expert- and model-based episodes are available. An empty cell reflects that the country was not covered by the experts (Croatia in the [Babecky et al. \(2012\)](#) database and eleven countries in the [Reinhart and Rogoff \(2011\)](#) database), or that experts did not identify crises periods. *Total* refers to the ratio over all episodes. *Mean* refers to the average across countries.

Table B.5: Model-based systemic financial stress episodes

Country	Code	Start date	End date	Max CSI	Mean CSI	Max % FSI	Mean % FSI	IP loss	Number month loss	Banking	Equity	Debt	Currency
Austria	AT	1981 February	1983 May	0.73	0.52	0.99	0.87	0.08	7				
Austria	AT	1991 March	1993 September	0.71	0.55	1.00	0.86	0.09	12				
Austria	AT	2008 March	2010 September	0.85	0.78	1.00	0.85	0.17	16	✓			
Belgium	BE	1990 August	1993 November	0.71	0.48	1.00	0.64	0.11	14		✓		✓
Belgium	BE	2007 November	2013 March	0.85	0.57	1.00	0.71	0.16	15		✓		
Bulgaria	BG	2007 December	2011 February	0.85	0.70	1.00	0.88	0.28	17	✓			
Croatia ^a	HR	1999 January	2000 April	0.16	0.12	1.00	0.85	0.07	4	✓			
Croatia	HR	2007 September	2010 December	0.85	0.68	0.98	0.79	0.19	22				
Croatia	HR	2011 August	2012 September	0.44	0.44	0.95	0.73	0.10	9				
Cyprus ^{bc}	CY	2011 June	2014 February	0.44	0.31	0.97	0.73	0.31	33	✓			

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Note: This table reports the episodes of systemic financial stress as identified by the model-based approach. These stress episodes are identified using a MS model which is applied to each country-specific FSI and a filtering algorithm which selects those financial stress episodes being associated with a substantial and prolonged decline in real economic activity. *Max CSI* and *Mean CSI* correspond to the maximum and average Crisis Simultaneity Index (CSI) during the period of systemic financial stress, respectively. The CSI reflects the share of the 27 EU countries experiencing systemic financial stress at the same time and thus provides an indication on the simultaneity or commonality of the shock. *Max % FSI* and *Mean % FSI* refer to the maximum and mean percentile of the FSI during each systemic financial stress episode, the percentiles are computed for each country separately. *IP loss* is the loss from peak to trough of industrial production during the real economic stress period which corresponds to the period of systemic financial stress. *Number month loss* provides the number of months of consecutive decline in the industrial production since the start of the systemic financial stress. The last four columns display the type of crisis identified by experts (Detken et al., 2014; Babecky et al., 2012; Laeven and Valencia, 2013; Reinhart and Rogoff, 2011), if any, that overlaps at least partly with our model-based events.

^a This episode was identified at the beginning of the sample, and thus only the end date of the event should be considered. The systemic financial stress might have started earlier.

^b The real economic stress (a prolonged decline in industrial production) started at least one quarter prior to the identified period of financial market stress.

^c The data quality of the 10-year government bond yield of Cyprus is limited, which may reduce the informational content of our FSI and the dating of systemic stress should be taken as indicative only.

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Country	Code	Start date	End date	Max CSI	Mean CSI	Max % FSI	Mean % FSI	IP loss	Number month loss	Banking	Equity	Debt	Currency
Czech Republic	CZ	1998 July	1999 July	0.16	0.13	0.97	0.84	0.11	13	✓			
Czech Republic	CZ	2007 August	2010 August	0.85	0.69	1.00	0.82	0.20	17				
Denmark ^b	DK	1974 April	1975 January	0.90	0.76	0.92	0.73	0.19	15				
Denmark	DK	1978 July	1981 March	0.73	0.45	0.98	0.81	0.11	8		✓		✓
Denmark	DK	1992 August	1993 October	0.71	0.67	1.00	0.91	0.16	9	✓	✓		✓
Denmark	DK	2008 January	2010 July	0.85	0.77	0.99	0.81	0.23	23	✓	✓		✓
Finland	FI	1975 January	1979 February	0.90	0.58	0.98	0.87	0.12	16		✓		✓
Finland ^b	FI	1990 October	1996 June	0.71	0.36	1.00	0.88	0.14	17	✓	✓		✓
Finland	FI	2001 March	2001 November	0.09	0.09	0.88	0.76	0.05	7		✓		
Finland	FI	2008 December	2010 September	0.85	0.82	0.96	0.82	0.21	15		✓		
Finland ^b	FI	2012 July	2013 June	0.44	0.35	0.87	0.75	0.05	29				
France	FR	1973 December	1978 July	0.90	0.62	1.00	0.86	0.15	14		✓		✓
France ^b	FR	1981 January	1983 April	0.73	0.53	1.00	0.86	0.04	8		✓		
France	FR	1991 June	1993 March	0.71	0.55	0.98	0.74	0.08	21		✓		
France ^b	FR	2002 July	2003 August	0.16	0.13	0.89	0.75	0.04	15		✓		
France	FR	2008 March	2009 October	0.85	0.78	0.99	0.78	0.21	20	✓	✓		
France	FR	2011 August	2012 October	0.44	0.43	0.94	0.80	0.05	16	✓			
Germany	DE	1966 May	1967 April	0.11	0.11	0.88	0.77	0.07	14		✓		
Germany	DE	1973 February	1975 August	0.90	0.60	1.00	0.88	0.13	16	✓	✓		
Germany	DE	1980 March	1982 March	0.73	0.59	1.00	0.88	0.05	12		✓		
Germany	DE	1992 July	1994 November	0.71	0.50	0.99	0.64	0.10	19		✓		
Germany ^b	DE	2001 December	2003 November	0.16	0.11	0.95	0.78	0.04	10	✓	✓		
Germany	DE	2008 September	2010 July	0.85	0.82	1.00	0.81	0.23	16	✓	✓		

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^b The real economic stress (a prolonged decline in industrial production) started at least one quarter prior to the identified period of financial market stress.

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Country	Code	Start date	End date	Max CSI	Mean CSI	Max % FSI	Mean % FSI	IP loss	Number month loss	Banking	Equity	Debt	Currency
Greece ^a	GR	1992 October	1994 March	0.71	0.58	0.70	0.59	0.06	9	✓	✓		
Greece	GR	2008 March	2013 July	0.85	0.56	1.00	0.83	0.28	49	✓	✓	✓	
Hungary	HU	2008 June	2010 July	0.85	0.81	1.00	0.87	0.22	17	✓	✓	✓	
Ireland	IE	2007 July	2012 June	0.85	0.57	1.00	0.87	0.20	8	✓	✓	✓	
Italy	IT	1964 February	1964 October	0.11	0.11	0.88	0.72	0.08	6				
Italy	IT	1973 July	1979 January	0.90	0.59	1.00	0.79	0.16	15		✓		✓
Italy	IT	1981 July	1983 June	0.64	0.49	0.97	0.75	0.10	15		✓		✓
Italy ^b	IT	1991 August	1996 September	0.71	0.36	1.00	0.79	0.06	3	✓	✓		✓
Italy	IT	2008 January	2013 June	0.85	0.57	0.99	0.77	0.26	18	✓	✓		
Latvia ^b	LV	2008 November	2010 November	0.85	0.78	1.00	0.89	0.23	14	✓			
Lithuania	LT	2008 December	2010 September	0.85	0.82	1.00	0.93	0.10	15	✓			
Luxembourg ^b	LU	2008 January	2010 August	0.85	0.77	1.00	0.87	0.31	3	✓			
Luxembourg	LU	2011 July	2013 July	0.44	0.38	0.95	0.70	0.16	24	✓			
Malta	MT	2000 November	2002 October	0.16	0.09	0.98	0.82	0.16	13				
Continued on the next page...													

^a This episode was identified at the beginning of the sample, and thus only the end date of the event should be considered. The systemic financial stress might have started earlier.

^b The real economic stress (a prolonged decline in industrial production) started at least one quarter prior to the identified period of financial market stress.

^d This episode does not always meet the criteria to be classified as a systemic financial stress period when the model-based approach is applied on a rolling window by including new data progressively starting with an initial window of 25 years.

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Country	Code	Start date	End date	Max CSI	Mean CSI	Max % FSI	Mean % FSI	IP loss	Number month loss	Banking	Equity	Debt	Currency
Netherlands ^d	NL	1973 September	1975 December	0.90	0.70	0.96	0.69	0.09	12		✓		
Netherlands	NL	1980 March	1983 September	0.73	0.50	1.00	0.88	0.13	8				
Netherlands	NL	2002 June	2004 August	0.16	0.09	1.00	0.87	0.11	6	✓	✓		
Netherlands	NL	2008 January	2010 November	0.85	0.74	1.00	0.82	0.20	14	✓	✓		
Netherlands	NL	2011 September	2012 July	0.44	0.44	0.86	0.72	0.05	6	✓			
Portugal	PT	2008 February	2013 July	0.85	0.56	0.99	0.84	0.19	22	✓			
Romania	RO	2007 November	2010 August	0.85	0.74	1.00	0.83	0.13	12		✓		✓
Slovakia	SK	1997 July	2000 May	0.16	0.09	1.00	0.89	0.04	6	✓			
Slovenia	SI	2007 January	2013 June	0.85	0.49	1.00	0.74	0.26	13	✓			
Spain ^b	ES	1973 November	1981 March	0.90	0.56	1.00	0.79	0.18	7	✓	✓		✓
Spain	ES	1992 July	1993 October	0.71	0.67	0.99	0.87	0.06	16				✓
Spain	ES	2008 February	2013 June	0.85	0.57	1.00	0.83	0.30	22	✓			
Sweden	SE	1974 September	1975 November	0.90	0.79	0.88	0.67	0.07	14				
Sweden	SE	1976 October	1979 March	0.60	0.52	0.97	0.76	0.11	20		✓		✓
Sweden	SE	1980 January	1983 July	0.73	0.51	0.98	0.76	0.24	22				✓
Sweden	SE	1991 January	1994 September	0.71	0.47	1.00	0.86	0.07	13	✓	✓	✓	✓
Sweden ^b	SE	2008 September	2010 October	0.85	0.79	1.00	0.87	0.22	16	✓	✓		✓
United Kingdom	GB	1972 July	1978 April	0.90	0.53	1.00	0.88	0.12	13	✓	✓		✓
United Kingdom	GB	1979 March	1981 December	0.73	0.49	0.96	0.80	0.15	19				
United Kingdom ^b	GB	1990 May	1990 November	0.23	0.14	0.88	0.76	0.03	20	✓			
United Kingdom	GB	2007 November	2010 August	0.85	0.74	0.99	0.87	0.13	20	✓	✓		

^b The real economic stress (a prolonged decline in industrial production) started at least one quarter prior to the identified period of financial market stress.

^d This episode does not always meet the criteria to be classified as a systemic financial stress period when the model-based approach is applied on a rolling window by including new data progressively starting with an initial window of 25 years.

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