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KAPITÁLOVÝ TRH: DOPADY NA FINANČNÍ BEZPEČNOST ZEMĚ (V PŘÍPADĚ UKRAJINY)

CAPITAL MARKET: EFFECTS FOR THE FINANCIAL SECURITY OF A COUNTRY (THE CASE OF UKRAINE)

Inna Shkolnik, Tetyana Kubakh

ABSTRAKT

Globalizace finanční krize radikálně změnila ukrajinský kapitálový trh, což vzbuzuje obavy o její závislost na vývoji na mezinárodních trzích a vytváří další riziko pro finanční bezpečnost Ukrajiny. Studie je zaměřena na vliv na kapitálovém trhu pro finanční bezpečnost Ukrajiny. Mechanismy a důsledky účinků kapitálového trhu pro finanční bezpečnost a ekonomický rozvoj Ukrajiny jsou identifikovány. Tendence na národním trhu cenných papírů a úvěrů jsou zobrazeny pomocí dat z národního regulačního orgánu (Národní banka Ukrajiny).

Klíčová slova:
kapitálový trh, trh s cennými papíry, úvěrový trh, finanční bezpečnost, globalizace

ABSTRACT

Globalization financial crisis have radically changed the Ukrainian capital market, raising concerns about its dependency on trends in the international markets and creating additional risks for financial security of Ukraine. The study is devoted to capital market effects for the financial security of Ukraine. Mechanisms and consequences of capital market effects for the financial security and economic development of Ukraine are identified. Tendencies in the national market o f securities and the loans market are shown by use of data from the national regulatory body (National Bank of Ukraine).

Keywords:
the capital market, the loans market, the market of securities, the credit market, financial safety, globalization

INTRODUCTION

Intensification of globalization processes and the recent financial crisis have led to essential change not only at the global capital market, but at the Ukrainian capital market as well. The crisis radically changed the investment capital flow and raised concerns about dependency of the Ukrainian capital market on trends in international markets and decisions taken by foreign governments. The financial crisis that broke out in the USA due to uncontrolled offers of mortgage loans suppressed global economic development and revealed problematic issues at country level. Regarding Ukraine, the issue of the capital market expansion and its effects for the financial security of the country is becoming increasingly important given acute resource deficit and strong dependency on foreign capital.

1. RELEVANCE

Study of the capital market effects for the financial security of Ukraine, conducted from theoretical and practical perspectives, allows for identification of not only mechanisms of capital market effects for its financial security, but also their consequences for its financial stability and economic development. Lack of effective regulatory measures cannot allow the capital market to perform its main functions, suppressing in this way financial and economic security of Ukraine.

Presence of a foreign capital at the capital market of Ukraine creates additional risks and increases potential dangers for its financial security. They are not so explicit now, but it can be seen from more detailed analysis, that presence and permanent growth of foreign capital within the banking system of Ukraine increases certain categories of risks. Apart from this, the financial crisis revealed the problem related with utilization of foreign capital in transactions with securities, which, being mostly speculative in Ukraine, led to rapid capital outflow and strong reduction in the amount of market capitalization. This determines relevance of studies of the relationship between the capital market specifics and the financial security level in Ukraine.

Objective of the study is to identify potential mechanisms and consequences of effects from capital market transactions for the financial security and economic development of a country, and most important problems faced by the banking sector now. The problem of capital market development has been elaborated in works of distinguished Ukrainian researchers (L. M. Alexeyenko, M. O. Burmaka, O. D. Vasilik, V. M. Heyets, O. V. Herasymenko, A. M. Yermoshenko, O. M. Ivanytska, B. A. Karpinsky, O. V. Kozmenko, S. M. Kozmenko, V. V. Korneyev, I. O. Lyuty, V. O. Povoriznik, O. R. Romanenko, O. Yu. Smolyanska, V. P. Uninets-Khodakivska, V. M. Sheludko etc.) Studies of the financial security as a component of the economic security of the country have been also quite intensively conducted in Ukraine. National researchers making significant contributions in elaborating and developing theoretical grounds of the problem include O. I. Baranovsky, I. F. Binko, B. V. Hubsky, M. M. Yermoshenko, G. V. Zadorozhny, O. D. Ladyuk, V. I. Muntiyan G. A. Pasternak-Taranushenko, A. I. Sukhorukova, V. T. Shlemko. However, aspects related with the capital market effects for the financial security of the country remain overlooked, and, therefore, require systemic study with due consideration for the latest tendencies at global markets and their effects for the development of the Ukrainian financial market.

2. DESCRIPTION OF RESULTS

The capital market has an important role in the national economy and takes a special position in ensuring the financial security at country level. In the modern economic theory the Ukrainian scientists' largest majority holds the view that the capital market includes not only the market of securities but also the loan market. The loan market, similar to the market of securities, provides individuals, enterprises and the government with financial resources.

A developed infrastructure, an effective administrative regulation and the market of securities and the loan market stability are the main conditions for the dynamic development of the capital market. The developed capital market that is subject to effective administrative regulation ensures the optimal by industry distribution of limited financial resources and encourages economic growth in a country. Instability at the national capital market leads to its degradation and creates quite significant threats for the financial security of the country.

Results from the study allow for identification of the three main categories of mechanisms of effects from transactions in the national capital market and their respective consequences for the financial security of the country (see Table 1): (i) through transactions at loans market; (ii) through transactions at the market of securities; (iii) through reliability and stability in the performance of key infrastructure components of the capital market.

The global finances and financial systems impact on the state is radically changing now, as economic globalism creates conditions for establishing specific financial power allowing it to influence both global and national economic areas through controlling both the global long-term funds and the value of their management.

Table 1:

Mechanisms of the capital market effects for the financial security of the country and their economic consequences

Mechanisms	Consequences
a) Through loans market: 1. Micro level: 1.1 Washing out dirty money. 1.2 Rapid growth in the amount of mortgage loans. 1.3 Imbalance between loans for consumption and production sector in favor of the former. 1.4 Reducing amount of loans for investment and innovation. 1.5 Rapidly increasing loans in foreign currency. 2. Macro level: 2.1 Washing out dirty money. 2.2 Rapidly increasing international loans, both in public and private sector.	a) Through the loans market: 1. Micro level: 1.1 Deficit of financial resource s for the corporate and socio-economic development. 1.2 Risk of default at realty market due to speculative growth in prices. 1.3 Declining rate of growth in production sector, as a result of the declining amount of tax returns. Washing out of money from the national economy and stimulation of other economies, due to a large share of imports at consumer market. 1.4 Loss of international competitiveness by national enterprises, as a result of out-dated and physically worn equipment, declining profitableness in the production sector, declining social and economic indicators. 1.5 Increasing reliance on dollar in the national economy, threat to the stability of the national currency, the increasing burden related with servicing of the government debt. 2. Macro level: 2.1 Loss of trust in the banking system. Rise of the quasi-payment sector, leading to non-elastic response of macroeconomic indicators on changes in the amount of monetary mass. 2.2 Increasing government debt, interference of international financial and credit organizations in domestic and foreign policies.
б) Through securities market: 1. Transactions with shares: 1.1 Washing out dirty money. 1.2 Increasing amount of direct foreign investment. 1.3 Increasing amount of portfolio investment. 2. Transactions with bonds: 2.1 Washing out dirty money. 2.2 Increasing amount of debt in business enterprise and government sector.	b) Through securities market: 1. Transactions with shares: 1.1 Risk of the appearance of pseudo privatization process, reducing amount and increasing price of investment resources. 1.2.1 Increasing influence of Trans-National Corporations and financial conglomerates on the development of selected industries, resulting in pressures on national macroeconomic parameters. 1.2.2 Negative balance of payments, as a result of repatriation of profits of Trans-National Corporations and financial conglomerates. 1.2.3 Increasing influence of conjuncture fluctuations at global financial markets on the national financial and capital market. 1.3.1 Increasing risk of "soap bubbles" at the securities market, as a result of rapid expansion of multiple forms of financial instruments. 1.3.2 Launch of financial crisis at capital market, as a result of rapid taking out of "hot" money from the security market. 2. Transactions with bonds: 2.1 Worsening of the country's international image. 2.2 Increasing risk of enterprises' bankruptcies and sovereign default.
c) Through capital market infrastructure: 1.1 Reliability of the payment system. 1.2 Reliability of the settlement system. 1.3 Reliability of the stock exchange, trade and information system. 1.4 Reliability of the accounting system. 1.5 Reliability of the system of electronic trading.	c) Through capital market infrastructure: 1.1 Imbalance of commodity and monetary flows, leading to crisis of payments, which, in turn, leads to deformation of the monetary sector, decreasing competitiveness of the national economy, disruptions in the investment process. 1.2 Increasing risk of shadow transactions, slowing settlements between enterprises, resulting in the declining macroeconomic indicators. 1.3 Ineffective and unreasonable valuation of shares, declining liquidity of securities, reducing scopes of transactions on sales and purchase of securities, resulting in the reducing amount of investment resources. 1.4.1 Impossibility to use the discount rate as an effective instrument of monetary and credit policy, resulting in the recession of the production sector. 1.4.2 Impossibility for a user to have full information on the performance of an enterprise, resulting in disruptions of financial equilibrium in the latter's work 1.5 Failure of main functions of the stock exchange market, of which the central one is valuation of free capital.

Source: compiled by the authors.

Market of securities plays an important role in economic development of a country. As far as Ukraine is concerned, in spite of the bank-focused model of the financial market development, the share of the market of securities is gradually increasing in the structure of the national capital market. The issue of effects from this segment of the economy on the financial security of a country becomes even more important given rapid expansion of the market of securities. Because the Ukrainian market of securities has peripheral status in the global capital market, even a minor change in the flow of capital held by foreign portfolio investors has negative effects on it, which is confirmed by data for 2008 and 2009 (Figure 1).

According to the Ukrainian State Commission of Securities Market, the main reason for rapidly decreasing market capitalization has been intensive outflow of foreign speculative capital from Ukraine, estimated as nearly

30,000,000 USD (during 2008-2009), and speculative short selling of stock exchange traders. Yet, quite often the massive leave of foreign investors is supposedly related with several factors that have negative effects for the investment attractiveness of Ukraine, of which the main ones are: unprotected rights of minority investors; underdeveloped secondary market' poor qualification of professional participants; bad infrastructure; signing agreements mostly at non-organized market; "pouring out" of insider information, entailing hidden redistribution of assets and hostile takeover of enterprises and ruining in a way not only the system of property instruments valuation, but the overall socio-economic stability. The current tendencies at the capital market have also changed the dynamics of loans market in Ukraine.

Because prior to the crisis (in 2005-2007) international markets featured excessive liquidity, against financial resources deficit at the Ukrainian market, foreign banks were willing to give loans to their Ukrainian "daughters", and large Ukrainian banks tending to lend capital also had full access to international capital markets. However, the amount of short-term consumer loans, which was used by individuals to buy foreign household goods, exceeded the amount of long-term loans, which was borrowed by enterprises, and as the result of it the state does not have enough money for the real sector of economy development. Also, bad audit of a potential borrower applying for a loan enhanced the risk of the degrading quality of investment portfolio at commercial banks in Ukraine. The next problem was foreign currency loans delivered to individuals. Although Ukrainian people have no permanent income in a foreign currency, no regulatory restrictions on foreign currency loans to individuals were made. A situation like this would be attractive for banks when it's born in mind that their large part is controlled by foreign capital, but it threatens the financial security of the country.

Data in Table 2 show the increasing amount of distressed loans in 2008-2009, against the reduction in the total amount of loans. It should be also emphasized that the share of distressed loans grew four fold in 2009 in relation to the previous period. However, according to experts, the amount of distressed loans is much higher. According to the international agency Fitch Rating, the share of distressed loans reached 33.9% in 2009. It should be noted that Fitch Rating adds restructured loans to this amount. According to the "TEKT" Group, there are banks where the share of distressed loans amounts from 30% to 40%, or, sometimes, even 50%. Also, a large share of distressed loans is confirmed by the increasing amount of reserves for reimbursement of potential losses from transactions with loans. Main reasons behind the growing amount of distressed loans include: bad risk management in banks; the borrower's negative creditworthiness; overrated value of mortgages; abuse while delivering loans; the borrowers could not return debts.

So, distressed loans could appeared and rapidly grow not only as a result of the crisis and absence of external sources, but also due to serious managerial mistakes in the banks.

Figure 1:
The dynamics of the Ukrainian equity market capitalization

Source: compiled on the basis of data from the World Bank.

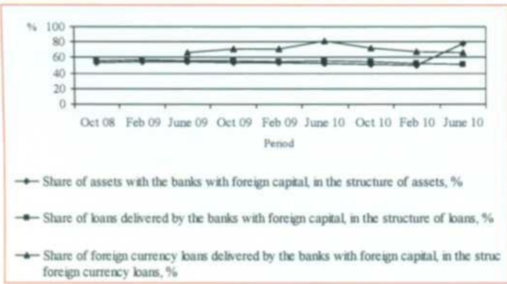
Table 2:
Dynamic of distressed loans in Ukraine

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Loans delivered, (million UAH)	23637	32097	46736	73442	97197	156385	269688	485507	792384	747348
Distressed loans, (million UAH)	2679	1863	2113	2500	3145	3379	4456	6357	18015	69935
Share of distressed loans in the structure of loans, %	11,3	5,8	4,5	3,4	3,2	2,2	1,7	1,3	2,3	9,4
Reserves for reimbursement of potential losses from loans transactions, * (million UAH)	2336	2963	3575	4631	6367	8328	12246	18477	44502	99238
Share of reserves for reimbursement of potential losses on loans transactions in the structure of loans , %	9,9	9,2	7,6	6,3	6,6	5,3	4,5	3,8	5,6	13,3

Source: data of the National Bank of Ukraine.
* The legal act of the National Bank of Ukraine on the procedure of the provision formation and use of bank credit operations potential losses.

It was financial crisis that could clearly show dependency of the Ukrainian loans market on foreign capital and its negative effects for the stability of the national economy. However, in spite of the problems occurring in 2008-2010 at the national loans market as a whole and within the bank system in particular, adequate conclusions haven't been made (see Figure 2).

Figure 2:
Loans deliveries by banks with foreign capital



Source: compiled on the basis of data of the National Bank of Ukraine.

Data in Figure 2 show the increasing pressure by banks with foreign capital on the loans market: while the share of assets at the banks with foreign capital was 53.5% as of 01. 10. 2008, in the following two years it grew up to reach 77.7%. The average share of loans delivered by the banks with foreign capital from 01.10.2008 till 01.10.2009 was more than 55%, whereas the share of foreign currency loans delivered by this group of banks was nearly 70%. It should be noted that more than 60% of loans delivered by largest banks classified in the 1st group of banks and controlled by foreign capital are foreign currency loans. According to data from the National Bank of Ukraine, the share of foreign currency loans in "Raiffeisen Bank Aval" exceeds 65%, whereas in banks such as "UkrSibBank" (BNP Paribas Group), "Ukrsotsbank" (UniCredit Group), "OTP Bank" (OTP Group, Hungary) "VTB Bank" (Ukrainian affiliation of the Russian Foreign Trade Bank (VneshTorgBank)) this share is nearly 80%.

A situation like this does affect the financial security of Ukraine, because of the increasing dollar pressure on the economy and the national currency, and the increasing dependency on change in foreign currency rate. It's clear that the problem requires regulatory measures with respect to control of lending procedures and their linking to foreign currency.

Apart from this, loans market in Ukraine features the explicitly unsatisfactory performance, as a major part of banks are tending to credit transactions with short cycle, and only some are engaged in long-term investment. The transmission role of banking sector must force the regulatory body (the National Bank of Ukraine) to more responsible consideration of all the problems of the loans market, in order to avoid crisis in the production sector.

The above mentioned tendencies show how strongly Ukraine depends on external financing. Therefore, ensuring of the financial security is quite important at the current phase of the Ukraine's development.

CONCLUSIONS

The global financial and economic crisis, apart from suppressing the Ukrainian economy, revealed main negative tendencies in the development of the national capital market. Political instability and unfavorable investment climate pushed portfolio investors off the national bonds market, which resulted in fall of FSETS[1] index and declining capitalization at enterprises and organized equity market, and, eventually, in the overall economic recession. At the same time, shrinkage of the credit portfolio that constitutes a source of risk and a source of income for banks disrupted financial stability of the national banking system, which affected the overall financial security of Ukraine. The increasing share of assets in banks with foreign capital and the increasing share of foreign currency loans is an evidence of imperfect regulatory policies, which bears new threats for the financial security of the country.

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1) FSETS is the First Stock Exchange Trading System. FSETS index is the main Ukrainian stock exchange index, estimated daily by the results of FSETS trading, on the basis of average weighted price of traded shares. FSETS index can be estimated on-line on hourly, daily and weekly basis. "Index basket" includes most liquid shares of 19 enterprises that are publicly traded. The list of shares included in the index is revised monthly.

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