THE ROLE OF A FINANCIAL MARKET AND ITS INFRASTRUCTURE IN THE STABILITY OF A COUNTRY'S FINANCIAL SYSTEM

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Introduction

In today's world the stability of the economic system is primarily the stability of the financial system and the national currency. In the ideal market financial system is in equilibrium, as financial institutions and investors consistently experience two opposite aims - to get a high income and avoid high-risk. If the prevailing desire is to obtain high income while reducing attention to risks, the financial system stability is threatened. And in this case, government intervention is required to reduce the risks with the least effort.

The main way to increase revenue in the current context - is to increase the leverage, which by itself increases the risks. Moreover, in connection with the development of the OTC derivatives market, the expansion of cross-border transactions and offshore operations, the risks become out of sight of regulators. Actually, in the long run the previous crisis has been associated with too much risk, which in previous years has been taken upon banks, inflating the amount of credit issuance and scope of operations with derivative financial instruments. Therefore, during a crisis a response becomes urgent to develop new mechanisms to control risks.

A financial market of a definite country plays a substantial role in the stability of its financial system. Consequently, the financial market effectiveness is significantly predetermined by the level of its infrastructure development and by the quality of interaction of financial market operators and institutional investors with its elements. Financial market development is ultimately made on the basis and the development of its infrastructure [1, p.14].

In this regard, a financial market infrastructure is proposed to be understood as generality of elements (institutions, organizations, technologies, rules, systems) that provide, regulate and create conditions for normal, continuous, multi-functioning financial markets, and as the interaction of its subjects based on sales of financial assets.

Considerable contribution into the study of the role of a financial market and its infrastructure in the stability of a country's financial system were made by the following national and foreign scientists: O. Baranovskiy, V. Geets, A. Zadoya, V. Korneev, I. Liutyi, V. Mischenko, A. Filipenko, A. Chuhno, V. Yurchishin, L. Gitman, S. Veber, H.M. Markowitz, S.C. Mayers, W. Sharpe, E. Pozner, G. Stiglitz et al.

However, questions about the impact of the financial market on the financial stability of the country is not well studied so far. Consequently, this sphere of study requires comprehensive analysis and development, which has stipulated the topicality of this article.

The purpose of the article is to determine the role of a state financial market stability, to identify the major problems and trends in the financial market development, and to provide resources for the problem solving.

The role of a financial market in the stability of a financial system

It should be noted that in the modern world, a significant portion of investments in domestic companies is carried out by foreign investors, and, of course, this is a significant risk factor. But this does not mean that the markets should be closed to capital inflows. Ukraine now needs foreign investments. Such an involvement will allow our country not to remain on the sidelines of the global market, and to solve the problem of the economic development.

It is the high time for Ukraine to solve its urgent problem of the domestic financial market development. National financial market should become a strong, centralized and highly capitalized structure. According to our beliefs, among the urgent goals are: facilities for Ukrainian financial market participants developing; clearing, payment and deposit services providing on the international basis.

This issue is being discussed by the state and infrastructure organizations (exchanges, depositories, clearing organizations). In particular, measures designed to ensure the capitalization growth of infrastructure organizations, including the ways through loans and guarantees of the state. This will help to build a centralized and efficient risk management system that substantially increases the reliability of the Ukrainian financial market and its resistance to crises.

But the problem is that definite measures of monetary policy may have the opposite effect as for the account of current operations and the capital account. An economy's saturation with money, what is happening now in many countries, may adversely affect the financial sector, and as a result of these actions, money is depreciated relatively to the real sector. Therefore, the support of the financial market at present is particularly relevant.

In addition, the financial system can reduce risks by diversifying a system that affects a long-term economic growth by changing the distribution of resources and interest rates; it means that financial markets, allowing risk diversification can influence the decisions of investors to invest in long-term investment projects. A diversification has positive influences on technology: market agents are constantly trying to get technological advantages, enabling them to take an advantageous market position [2, p.89].

In the modern extremely competitive conditions only a financial market model which refers to the main demands of globalization could survive: the one which covers the widest territory possible, and the one which trades with the help of one system of different financial tools quickly, effectively and with minimal costs.

Infrastructure as a major component of the financial market

In general, the direction of the financial market infrastructure is clear. International experience and the recommendations of leading experts can unify the trends of domestic financial markets development. These principles are general and can be implemented in different national markets. However, any national market has its own development history, its specifications, and in this sense a path of national markets development is always unique.

In order to reflect national circumstances, legal regulations, the current market situation, it is necessary to analyze all the applied and tested approaches to move most effectively towards the target – the improvement of the functioning of the Ukrainian financial market.

An infrastructure organization of a segment depends on the development of the market itself, its speed, the character of its participants and instruments traded in it. However, there are some common features of infrastructure segments, repeated in the market infrastructure as a whole. They are determined by infrastructure problems, which could be formulated in two main ones:

1. Risk management in the financial market.
2. Reduction of unit costs of operations.

The Role of an infrastructure in risk management is to:

1. Separate different types of risks item by item, other than to allow to load certain risks on it;
2. Identify a responsible for the implementation of risk person;
3. Realize the responsibility of participants for any of their losses.

If we speak about the infrastructure of the financial market of Ukraine, we often take the foreign markets as examples. While in the situation described our foreign colleagues consider the problem infinitely more complex than we are having.

The infrastructure of the European Union's financial market now includes 30 stock exchanges, 20 organizations that perform centralized clearing and settlement, about 40 custodians, and about 50 controllers, which supervise the market.

The task of centralizing securities accounts is very difficult for the Eurozone countries. Single platform TARGET 2 Securities (T2S) should be established by 2013, and the European Central Bank will become its operator. It is assumed that both national central banks and the national central depositories (CSD) will become the members of that system [3, p.4].

Legal and information risks in the infrastructure after the unification of market practices in the European market are estimated by experts to be extremely high. A financial market of a definite country plays a substantial role in the stability of its financial system. Consequently, the financial market effectiveness is significantly predetermined by the level of its infrastructure development.

Contrary to popular belief, the infrastructure of the Ukrainian market is significantly less fragmented than the EU market, and consists today of 10 stock exchanges, 3 settlement depositories, nearly 190 registrars and about 390 custodians, 360 asset management companies, 734 broker / dealers and 176 banks.

Analysis of the components of the financial market of Ukraine

Considering that the financial market of the country includes the main segments of the money market and stock market, its current prevailing trends should be noted.

The state of the monetary market

Money market allocates money flows and short-term means of payment. In our country the market for means of payment is not as developed as in European countries. For obvious reasons, cash is perceived as the most reliable tool. Therefore the demand for them is observed, and the inflation rate is present, which in 2011 was more than two times higher than the average in Europe. For the 2011 in Ukraine the index of inflation becomes 4,6 % (the lowest figure over the past 9 years (except for 2002, in which the annual deflation was recorded)), Russia – 6,1 % in the Euro area - 2,1 %. Inflation is one of the factors that significantly affect the level of development of the banking sector and financial markets. Indicators of financial sector development are higher in the countries that quickly achieved macroeconomic stability, primarily by reducing inflation. Based on the current rate of inflation, the current situation in the money market of Ukraine should be given a positive assessment.

The situation in the money market remained stable and predictable in the year. The monetary policy was in line with macroeconomic developments in the country, which made it possible to slow down the rate of CPI inflation.

Banking system liquidity dynamics in the current year were determined by monetary policy objectives. Here mention should also be made of increased foreign economic risks to the economic development of Ukraine directly related to the world market instability. In 2011, the risks became evident in stronger foreign exchange demand and weaker bank deposit growth. With a view to offsetting the risks, the National Bank of Ukraine took preventive measures by pursuing a harsher monetary policy.

The stability of the monetary unit of Ukraine contributed to the following:

1. bank lending growth in domestic currency to the real sector of the economy. The national currency loans increased by 21,6 % from the start of the year. Both loans to households (by 34,2 % over from the start of the year) and loans granted to legal entities (by 19,1 % over from the start of the year) demonstrated growth. At the same time, the total loans almost remained unchanged in December 2011, remaining at the previous month level – UAH 793,2 billion. Stronger corporate lending accounted for the total lending growth. One of the contributors to it was the increased solvency of economic entities resulting from the improvement of their financial standing;
2. an increase in bank deposits, which climbed by 17,6 % over from the start of the year to UAH 486,8 billion, including in the national currency by 17,0 % from the start of the year and in the foreign currency by 18,5 % (tabl. 1).

Tab. 1 : Main indicators of the money market in January-December 2011

Main indicators	As of: 01.01. 2011	01.12. 2011	01.01. 2012	Changes: for December 2011 (UAH million)	for December 2011 %	for 2011 (UAH million)	for 2011 %
1.Monetary base	225692	231061	239871	8809,9	103,8	14179,3	106,3
2.Money supply - total: incl.	597872	653536	682701	29165,2	104,5	84829,4	114,2
- cash	182990	184164	192614	8450,0	104,6	9624,5	105,3
3. Correspondent accounts	16726	17435	21952	4517,8	125,9	5226,7	131,2
4. Deposits total: incl.	413851	466135	486781	20645,6	104,4	72929,8	117,6
- in national currency	239918	262142	280588	18445,4	107,0	40670,1	117,0
- in foreign exchange	173933	203993	206193	2200,2	101,1	32259,6	118,5
Legal entities deposits total: incl.	142062	163242	179357	16114,6	109,9	37294,7	126,3
- in national currency	99946	108 265	122623	14358,3	113,3	22677,7	122,7
- in foreign exchange	42117	54 977	56734	1756,4	103,2	14617,0	134,7
Natural persons deposits total: incl.	271789	302 893	307424	4531,0	101,5	35635,0	113,1
- in national currency	139972	153 877	157964	4087,2	102,7	17992,4	112,9
- in foreign exchange	131817	149 016	149459	443,8	100,3	17642,6	113,4
5. Loans granted to economy - total: incl.	724005	793548	793192	-356,1	99,96	69186,4	109,6
- in national currency	386686	464626	470054	5427,6	101,2	83367,4	121,6
- in foreign exchange	337319	328922	323138	-5783,7	98,2	-14181,0	95,8
Loans granted to legal entities - total:	519603	594207	596983	2776,1	100,5	77380,5	114,9
- in national currency	324523	382769	386612	3842,8	101,0	62089,5	119,1
- in foreign exchange	195080	211438	210371	-1066,7	99,5	15291,0	107,8
Loans granted to natural persons - total:	204403	199341	196209	-3132,1	98,4	-8194,0	96,0
- in national currency	62164	81857	83441	1585	101,9	21278,0	134,2
- in foreign exchange	142239	117484	112767	-4717,0	96,0	-29472,0	79,3
6. Monetization level (calculated)	49,6	48,5	49,6		1,1*		0*
7. % rate on loans in national currency: (average monthly)	15,0	18,9	17,2		-1,7*		2,2*
% rate on loans in foreign exchange: (average monthly)	10,6	8,1	8,4		0,3*		-2,2*
Integral % rate on loans	14,0	15,3	14,5		-0,8*		0,5*
% rate on deposits in national currency: (average monthly)	8,1	11,5	11,1		-0,4*		3,0*
% rate on time deposits in national currency (average monthly)	8,9	13,2	12,4		-0,8*		3,5*
% rate on deposits in foreign exchange: (average monthly)	6,0	5,2	5,7		0,5*		-0,3*
% rate on time deposits in foreign exchange: (average monthly)	6,8	5,9	6,6		0,7*		-0,2*
Integral % rate on deposits	7,4	9,6	9,6		0*		2,2*

* – changes in percent points

Source: internet page - http://www.bank.gov.ua/doccatalog/document?id=101115

December 2011 saw a 4,6 % increase in the cash outside banks (by 5,3 % from the start of the year) to UAH 192,6 billion, which is typical for the last month of the year.

When regulating the money market in December, the National Bank of Ukraine used various monetary instruments. The volume of refinancing transactions conducted by the National Bank of Ukraine from the start of the year totaled UAH 28.8 billion.

December saw a decline in the value of national currency funds and a concurrent increase in the value of foreign currency funds. Thus, the average weighted value of national currency loans went down from 18,9 % in November 2011 to 17,2 % in December 2011, whereas that of foreign currency loans went up from 8,1 % to 8,4 %. The average weighted value of national currency deposits declined from 11,5 % in November 2011 to 11,1 % in December 2011, whereas that of foreign currency deposits increased from 5,2 % to 5,7 %.

In the reporting period, the foreign exchange market demonstrated divergent trends. In January - April 2011, the foreign exchange market experienced a steady increase in foreign exchange earnings fueled by the favorable dynamics of world prices for Ukrainian traditional exports and active external borrowing.

In May 2011, the net foreign exchange earnings decreased, with a net foreign exchange outflow evident already in June. It entailed, among other things, higher demand for foreign exchange compared with the supply of foreign exchange in the interbank foreign exchange market.

The traditional seasonal rise in the demand for foreign exchange which took place in September was greatly intensified by negative marked expectations relating to both external and internal factors. This lead to a foreign exchange deficit in the domestic market in September which was not even offset by net foreign exchange earnings.

The settlement requires foreign currency loans as well. Currently Ukraine has a moratorium on granting loans in foreign currency, but experts highlight the importance of such lending and the need to restore it.

To finally improve the above mentioned trend, it is necessary for the state to protect creditors with the help of the law. And most importantly is to establish a clear mechanism for implementation and writing off hopeless debts.

The state of the stock market

We cannot ignore the stock market of Ukraine as one of the major segments of the Ukrainian financial market.

The main objectives of developing an effective stock market are its liquidity, reliability and transparency forming. These objectives include: upgrading of existing and introduction of new financial tools, creating a central depository and the development of the Internet trading, improvements in regulation and supervision, improvements in financial literacy and promoting market equity, creating conditions for collective investment institutions, primarily - pension funds, etc.

It is necessary to highlight that the national stock market indexes and market capitalization decreased significantly in 2011. Market capitalization to GDP ratio is 10 % that is far lower than in pre-crisis period (in 2010 – 22,6 %). The part of shares in total in the total stock market trading and the number of dealers who operated with these securities reduced. Stock market was characterized by significant volatility and reduction of free float (part of company' free circulated shares).

But at the same time, the volume of realized stock market contracts with securities on organized platforms was UAH 235,84 billion in 2011, it is almost twice more (for UAH 104,55 billion) than in 2010 (UAH 131,29 billion). The volume of realized stock market contracts on secondary market was 75,94 % in total volume, and on the primary market – 24,06 %.

The largest volumes of realized stock market contracts were among state internal loan bills – UAH 99,13 billion (42,03 % of total volume) and shares – 79,43 UAH billion. (33,68 %).

However, as noted above, the financial market is a multi-dimensional structure, and its condition and development assessment must go beyond simple indicators of the size and growth rate. Such countries as Pakistan have big but inefficient financial markets. Performance indicator of the Russian market, calculated by the World Bank Group using statistical methods, is 32 (the higher the score, the lower the efficiency is). In Germany it is 11, in France - 15, in India - 46. An efficient market of shares, in particular, implies that stock prices reflect the maximum information on companies. Lack of disclosure of state companies and, consequently, low provision of information for investors (where the rights of minority shareholders are poorly protected, and managers and majority shareholders do not have special occasions to share information) leads to the fact that small investors are mostly guided by hearsay and own intuition. As a result, rates of specific companies are greatly liable to external influences and market sentiment in general [4].

Conclusion

To conclude with, we can highlight that the current Ukrainian financial market condition is characterized as inadequately developed in many of its segments, and by its liquidity shrinking.

Influenced by the global crisis the flow of IPO from Ukrainian companies is significantly reduced, following by the global capital markets the conditions of borrowing on the domestic debt market are deteriorated. The stock market is insufficiently diversified. It has also a small part of freely traded shares (free float), high dependence on foreign capital. At the same time, a considerable potential of the Ukrainian financial market cannot be overemphasized. The use of derivatives and securitization of bank funds are marked increased. At a time when many companies feel lack of funding, further development of key market segments could contribute significantly to the country's economy. The potential of the market is at stake for a long time, but until now the country cannot truly become a beneficiary, even taking into account the fact that many foreign investors are willing to take risks of the Ukrainian financial market infrastructure .

To raise the efficiency of financial markets of Ukraine and its financial system in general, conditions for facilitating foreign investors should be created as well as the emergence of new financial instruments in the stock market in order to increase trading volumes of exchanges to a level that meets the scope and objectives of the economy, and also to create a legal framework to stimulate IPO of Ukrainian companies in the domestic regulated market.

The abolition of currency restrictions and liberalization of foreign exchange markets are advisable to create more suitable conditions for interaction with international capital markets.

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The role of a financial market and its infrastructure in the stability of a country’s financial system

Summary

The role and impact of financial market and its infrastructure for financial stability are discussed in this article. Provided description of the current state of the main components of the financial market − monetary and stock market of Ukraine.

Key words: financial market, infrastructure, financial system, banks, stock market

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