Financial Markets Conference Has Brought a Number of Interesting Findings

Konference o finančních trzích přinesla řadu zajímavých poznatků

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On 1 – 2 June 2011, Vysoká škola finanční a správní, o.p.s. (University of Finance and Administration), in cooperation with the Czech National Bank (CNB), organized its already fifth international conference entitled “Financial markets and their regulation in the situation of a fading financial crisis”.

Papers presented at the conference may be classified into three thematic groups: monetary policy issues, impacts of the crisis on financial markets, and issues associated with the financial market regulation.

Vladimír Tomšík, CNB Vice-Governor, analyzed various moments of the current financial stability development in his keynote speech entitled “Monetary Policy and Financial Stability in the Czech Republic in 2011”. In the first part of the presentation, he addressed in detail the new macroeconomic outlook of the CNB as part of the macroeconomic environment analysis. The second part of the opening piece was dedicated to the analysis of the financial markets development in the Czech Republic. He stated, among others, that the share of nonperforming loans had stabilized in the nonfinancial enterprise segment in the past months, while slightly increasing in the household segment. Consumer loans are continuing their downfall. However, credit terms and conditions are improving. The tranquility on the monetary market confirms very low interest in liquidity within the existing supply facility of the CNB.

In spite of the partial recovery of the economy, increased risks to stability prevail in the euro area: there is a risk of an adverse loop forming between fiscal imbalances, economic growth, and financial sector; there are still concerns in respect of the banks’ ability to acquire sufficient market funds to finance their activities in the years to come. Banks in the Czech Republic show a high ratio of deposits to loans (highest within the EU). Positive external assets of the bank sector confirm that the Czech banks are in the net creditor position vis-à-vis their parent banks in the Eurozone. Unlike in other countries of the Central and Eastern Europe, the Czech households have virtually no loans in foreign currencies. In January 2011, the capital adequacy amounted to 15.4% (Tier 1 capital adequacy of 14%). Capital resources of the Czech banking system are sufficient within the international comparison. Lowering of the capital cushion due to higher dividend payments in the light of expectations of restored economic growth could pose a risk.

Third part of the report are related to the issue of stress tests, with the presentation of two scenarios of future development in this area. The first scenario (identified as the Basic scenario) is derived from the official prediction of the CNB for February 2011. The second,
adverse scenario – labeled as “Unexpected recession” assumes sudden decrease in both domestic and foreign economic activity in the second half of 201 due to a foreign shock induced by another increase in the sovereign risk of indebted Eurozone countries. Should this scenario materialize, it would result in increasing uncertainty, risk aversion, exchange rate depreciation, and falling prices of government bonds.

Several other presentations addressed the monetary development issues. M. Hrnčíř (“Will the Global Financial Crisis be a Division Line in the Monetary Policy Theory and Practice?”) focused on the development of theoretical opinions in respect of the interaction of monetary policy and financial stability as well as on the impact of the global financial crisis on the formation of approaches to monetary policy and its new form. These deliberations lead to a conclusion that price stability is and will continue to be a predominant monetary policy target in the medium term. A certain weight is newly given to the financial stability criterion; however, solely as a temporary switch to this modus in situations of exceptional risks to financial stability. There is a move away from a mere ex-post reaction (to clean) to ex-ante reactions within the process of increasing risks to financial stability (to lean against the wind).

K. Brůna (“Monetary Policy and Absorption of the Banking Systems’ Liquidity in Transition Economies”) sees the following attributes, among others, as the serious problems in the drawing on liquidity on the part of the banks during the financial crisis: liquidity absorption rate in respect of the growth dynamics of the currency in circulation, selected rate of the foreign exchange reserves sales with no impact on the exchange rate, costs of sterilizing excess liquidity, elimination of the state budget funding on the part of the central bank, and limitation of the minimum reserves volume increase due to an increase in primary deposits.

A number of the conference participants addressed various aspects of the global financial crisis, its impacts on the financial markets, on important financial institutions, as well as its implications for the Czech financial market. It has been confirmed, among others, that the impact of the global financial crisis on the banking market in the Czech Republic was not overly significant, even though it was associated with a certain decline in corporate credits due to a limitation of business activities (e.g. in the construction industry) as a result of the real economy crisis.

However, the financial crisis has had virtually no effects on the Czech insurance market. “In principle, the financial crisis has not affected the insurance market structure and quality; some impacts were brought about the ongoing economic/social crisis. The insurance as a whole grew during the crisis as well, and it is safe to assume this trend will also continue this year, i.e. in 2011. It is a vigorous market, with development potential both in respect of structure and quality.” (V. Křivohlávek)

The analysis of the financial crisis impact on the payment system in the Czech Republic has resulted in a rather surprising outcome: it is apparent from statistical data that the financial crisis caused a decrease in the average volume of payment transactions; however, the number of transactions did not decrease. The aforementioned conclusion may be traced both in the area of domestic payment services as well as in the area of Eurozone countries.
One of the factors, which could contribute to the number of transactions remaining stable, is the fact that the number of card transactions did not go down during the financial crisis (O. Schlossberger).

The financial crisis, which naturally resulted in the increase of bank risks associated with the imminence of nonperforming corporate and consumer credits, stirred up the need for certain changes in the area of risk management: banks started to analyze in more details the risks of credit default. In this connection, the quality of credit registers has significantly improved; however, their importance was underestimated during the financial initial stages of the financial crisis: external data from the registers, which indicated an oncoming crisis, were ignored. The data were not even used as one of the possible indicators of a financial crisis. Consequently, data from the registers should not be underestimated or even ignored in the future. However, the role of credit registers has shifted as a result of the crisis – from a mere supplier of data to a provider of services with added value. The crisis contributed to an accelerated development and use of new products, such as portfolio monitoring, etc. (P. Kučera).

One of the factors limiting the burden of impacts of the financial crisis on the Czech economy included the measures applied by some of our government institutions, for example EGap (Export Guarantee and Insurance Corporation). The measures of EGAP in support of export during the crisis had anti-cyclical effects, resulted in an increase of the government guarantee for the obligations of EGAP, strengthening of insurance funds by the government, expansion of insurance coverage, and reduction of insurance premiums for certain products. The promotion of Czech export brings twice the effect compared to Germany (M. Šimáček).

Global financial crisis has also contributed to a number of institutional changes on capital markets – namely in the area of securities exchanges. The formation of the so-called Multilateral Trading Facilities (MTF) introduced competition for stock exchanges, with pressure on the prices of stock exchange services, which – based on the FESE statistics – has resulted in the decline of transactions executed on regulated markets by more than one third since 2007. Regulated stock exchanges deal with this by forming their own MTF, more attention to communication with issuers, market education, as well as inspection quality. These changes have also affected the Prague Stock Exchange, among other by the fact that a central securities depository has finally been established in the Czech Republic. The establishment of a central securities depository with two-stage records has put the Czech Republic on par with other EU countries with standards, terms and conditions in the area of securities settlement (J. Opletal, H. Čacká).

One of the new facts, which have changed the Czech financial market, was highlighted by M. Knapp (OVB Allfinanz). It is the increased importance of financial consulting on the domestic retail market: the role of a financial advisor and agent on the retail market has been increasing, hand in hand with the requirements for technical and professional profile of a financial advisor. The financial consulting product structure has changed. It is necessary to distinguish more between non-commodity products, individualizing client's needs, and products that combine several aspects- i.e. combined actuarial and financial products.
Given the developments on the global financial market during the summer of 2011, it seems that those, who claim the financial crisis is not over, may in fact be right. The answer to the question of whether the financial crisis has actually faded away depends, among others, on the point of view in question. From the long-term perspective, it is certain that the economic evolution is changing: the knowledge society is being constituted, relying on the provision of productive services enabling the acquisition, retention, and use of human capital. This change is associated with the momentum shift in the perception of the evolution of society, with predominant investments in the social position to the detriment of investments in the development of skills. Game theory may be used to resolve partial crises, the occurrence of which can be expected. Game theory enables to see why people behave the way they do (R. Valenčík).

It is not a coincidence that almost one fourth of all presentations related to the financial market regulation and supervision. The common feature of the presentations in this area was a critical comparison of regulatory measures, which have already been applied, as a result of the global financial crisis, also in the Czech Republic, as well as measures, the introduction of which is under preparation as part of the effort to mitigate risks on the financial markets, thus preventing future crises.

It is worth mentioning that most speakers fear excessive emphasis on regulation, which – in their view – is already imminent in some segments of the Czech financial market. This is the case, for example, of Act no. 277/2009 Coll., on the Insurance industry; the preparation for an adoption of Solvency II brings significant danger of regulation, because it will result in the inception of a substantial number of regulatory measures (V. Přikryl, Ministry of Finance of the Czech Republic). It has been stated, among others, that the most regulated intermediary market on the Czech financial market is the insurance broker market (M. Voharčík).

One of the important motions of system nature is also the remark that principles known from the area of bank deposit insurance should not be mechanically extended to the area of securities investments. The pressure on accelerated adoption of new legislative measures from the EU level, and subsequently in the Czech Republic, without thorough assessment of implications of their adoption may have serious adverse effects for securities traders (J. Hart).

The need to respect specificities of various segments of the financial markets is an urgent requirement for further regulation of the insurance markets. For example, it is a problem that the draft amendment to Act no. 38/2004 Coll. contains a number of systemic changes, which had not been consulted in a sufficient manner and their potential impact had not been objectively assessed. The failure to respect or understand such specificities of the insurance sector may burden insurance companies and policy holders with excessive costs (J. Síkora).

L. Žalman (Raiffeisenbank) reiterated that periods of regulation tightening and deregulation have been taking turns in the history of bank regulation. It is a clash of two contradicting tendencies: even though regulation brings higher degree of security and promotes competition and competitiveness, deregulation reduces the costs of business activities.
in the area of banking, promotes financial innovations and new products; however, at the same time, risks may increase. The analysis of the existing situation of the banking regulation leads to the finding that its tightening will lead to limited access to credit in the medium term. The banks’ shareholders are not in for anything positive from the perspective of return on their investments. It seems that nobody has learned any lessons from the crisis. Some causes of the crisis (sovereign debts) are not being addressed. Overly detailed regulation is not beneficial – less would be more.

The current approach of the CNB to the preparation of further regulatory measures on both domestic and international level can be seen as a positive and promising fact. P. Vacek (CNB) stated in this regard that the CNB emphasizes the need of thorough testing of all proposals for further intended measures in order to prevent inadvertent adoption of regulation with unpredictable impacts; this also applies to the proposals prepared and currently discussed under Basel III.

With 110 participants, the course of this year’s conference of the University of Finance may be seen as very successful, due to a significant interest on the part of academic employees of both public/private universities as well as on the part of prominent experts with practical experience in the given fields.

The symposium from this year’s conference is published in the traditional printed form (A4 paper size), with an enclosed CD-ROM.

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