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“Ukrainian academy of banking  
of the National bank of Ukraine”

# The Problems and Perspectives of the Banking System Develop- ment: a Glance into the Future

Global financial crisis  
and its national specific features

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## THE GLOBAL CRISIS AND ITS IMPACT ON THE UKRAINIAN'S FINANCIAL SECTOR

There are many aspects which are caused by today's global financial crisis. But we'd like to draw your attention to the most important of them according to our point of view: on the one hand, its boom and bust in the housing market and its impact on the financial market. The crisis began with the bursting of the United States housing bubble which peaked in 2005-2006 approximately. Let's discuss two vicious cycles at the heart of the subprime mortgage crisis. The first cycle is within the housing market. Voluntary or involuntary foreclosures increase the supply of homes, which lowers home prices creating further negative equity. By September 2008, average U.S. housing prices had declined by over 20 % from their mid-2006 peak. This major and unexpected decline in house prices means that many borrowers have zero or negative equity in their homes, meaning their homes were worth less than their mortgages. As of March 2008, an estimated 8,8 million borrowers – 10,8 % of all homeowners – had negative equity in their homes, a number that is believed to have risen to 12 million by November 2008. In this situation borrowers have an incentive to “walk away” from their mortgages and abandon their homes, even though doing so will damage their credit rating for a number of years. The reason is that unlike what is the case in most other countries, American residential mortgages are non-recourse loans; once the creditor has regained the property purchased with a mortgage in default, he has no further claim against the defaulting borrower's income or assets. As more borrowers stop paying their mortgage payments, foreclosures and the supply of homes for sale increase. This places downward pressure on housing prices, which further lowers homeowners' equity. The decline in mortgage payments also reduces the value of mortgage-backed securities, which erodes the net worth and financial health of banks. This vicious cycle is at the heart of the crisis. The second cycle shows that foreclosures reduce the cash flowing into banks and the value of mortgage-backed securities (MBS) widely held by banks. Banks incur losses and require additional funds (“recapitalization”). If banks are not capitalized sufficiently to lend, economic activity slows and unemployment increases, which further increases foreclosures.

On the other hand, as one of the main causes of the crisis we outline financial institution debt levels and incentives. In other words, many financial institutions, investment banks in particular, issued large amounts of debt during 2004-2007, and invested the proceeds in mortgage-backed securities (MBS), essentially betting that house prices would continue to rise, and that households would continue to make their mortgage payments. Borrowing at a lower interest rate and investing the proceeds at a higher interest rate is a form of financial leverage. This is analogous process to an individual taking out a second mortgage on his residence to invest in the stock market. This strategy proved profitable during the housing boom, but resulted in large losses when house prices began to decline and mortgages began to default. Beginning in 2007, financial institutions and individual investors holding MBS also suffered significant losses from mortgage payment defaults and the resulting decline in the value of MBS. Banks faced increasing liquidity needs due to commitments arising from the relationship entered into with the issuers of the ABS/MBS/CDO's programs. The result was a dramatic liquidity problem for a number of banks, that you can see on the slide.

All in all, during a period of strong global growth, growing capital flows, and prolonged stability earlier this decade, market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence. At the same time, weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage combined to create vulnerabilities in the system. Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, pace keeping with financial innovation, or taking into account the systemic ramifications of domestic regulatory actions.

Now let me turn to the second part of our report. In the context of the global financial crisis the results for Ukraine were as follow:

- Ukraine is vulnerable due to *a combination* of large short term debt repayments, high current account deficits, and banking weaknesses due to non-performing loans and high foreign currency bank liabilities;
- separately, each of the above factors looks manageable, but their confluence amid a deteriorating world economy, easing of steel prices, imminent energy price increase, and turbulent domestic politics have notably affected investors risk assessment of Ukraine;
- reflecting these risks, since mid-2008 the premiums for Ukrainian Credit Default Swaps have risen to over 2,600 basis points in the mid-October;

- high risk perceptions of emerging markets translated into a decline in portfolio capital inflows to Ukraine: the inflow of portfolio capital declined from US\$3.3 billion in the first half of 2007 to only \$ 350 million in the same period of 2008;
- partly as a result, the PFTS index has declined by more than 75 % year-to-date (as of October 22, 2008), one of the largest declines in the world.

So the most important task for Ukraine is to work out a long-term policy with the purpose of preventing inflation growth and current balance deficit, optimizing state budget expenses, and improving state investment policy.

And now – lessons to be learnt. In other words, what can government, the NBU and business do. Concluding all above information, we'd like to give some advices.

What can the government do? As to the given risks of reductions in export-oriented production due to weakening global demand and problems with payments under export transactions, the government should work to stimulate domestic demand for the group of export goods and, thus, enhance the role of domestic production. It can start with launching a new infrastructure and residential construction projects funded from the state budget. The government should prevent a sharp decline in grain prices by urging the Agrarian Fund to purchase grain of this year's harvest. It will provide agricultural producers with sufficient resources to prepare and carry out the sowing campaign. It will also support, directly and indirectly, the development of metallurgy, coke production, the mining industry, oil refining, the chemical industry, the food processing industry, trade and transport.

In order to manage the financial instability risk, it is strongly advisable to revise the draft 2009 budget so as to increase capital expenditures, including in construction, without increasing the budget deficit. It is also important to set up a Stabilization Fund that will cover all governmental guarantees, which will gain more confidence in the governmental commitment to pursue a well-balanced and sound budget policy.

During the financial crisis, the government's strategy is to encourage investments into the real sector of the economy. Consequently, alongside with accelerating the implementation of projects related to Euro-2012, we should unblock privatization processes. The government cannot do that alone, we need support from the Verkhovna Rada to get the State Privatization Program adopted. The Parliament should also pass a package of laws drafted by the government and geared towards boosting Ukraine's investment attractiveness.

What can NBU do? In order to prevent a banking crisis, NBU should establish principles of refinancing commercial banks that have short-term liquidity problems for the period of financial crisis. A currency crisis can be averted with a series of measures precluding the exchange rate destabilization by speculators. NBU should continue to pursue the policy of increasing the rate volatility in order to reduce risks to the balance of payments.

What can businesses and investors do? Given the limited financial resources inside the country and shrinking access to foreign loans, businesses face a difficult choice: either to suspend production and lose markets, maintaining high prices in expectation of better times, or to reduce prices trying to restore demand and keep consumers. The later option is for those manufacturers who care about their future, expansion and economy of scale; the former is for profiteers who make large money quickly and drop the production.

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## FRACTAL ANALYSIS OF WORLD CAPITAL MARKETS IN THE CONTEXT OF THE GLOBAL FINANCIAL CRISIS

The modern financial theory and methodology of researches develops extremely fast rates, but paradigms, models and principles which it offers in scope of modern scientific analysis, not always precisely and authentically describe the sophisticated complex processes. Therefore it is especially actual for the modern scientist – theorist or practicing one – resolving an imperative problem of optimization and transformation of existing directions of researches for more exact and deep researches concerning the dynamic processes in the world financial markets.

Classical methods of the analysis of the stock markets development (and share indexes as its key category) not always precisely and unequivocally describe such dynamic processes. First of all, it is related to, initial optimization and simplification of nonlinear models to level of the linear.

For a quite long time in the modern theory of the capital markets, so-called “efficient market hypothesis” and “random walk theory” dominates. As a matter of fact, these theories are not represented from a position

of the analysis of the stock market as they contain a number of incorrect postulates (which incorrectness is proved empirically), namely:

1. Disinclination the investor risk.
2. Super confidence of the investor of own optimality.
3. Linearity of reaction of the investor on external changes.
4. Prevalence of rationality of the market over rationality of each its separate participant.

These and a whole number of other positions have only one purpose – to justify application of the calculations and linearity in the market analysis (including the share analyze). At the present stage development the efficiency of the nonlinear models is proved and substantiated by analyzing of the market, which in turn gives deeper and as much as possible exact results.

Within the bounds of this research we have carried out the nonlinear analysis of share indexes of leading world trading platforms and indexes of Ukraine and the Russian Federation, which, in our opinion, to a full measure contain and display a condition, dynamics and prognostics characteristics of the world and domestic capital markets.

Our research is based on nonlinear fractal analysis of dynamics of aforementioned share indexes from the position of the theory of chaos and “fractal market hypothesis”.

The role of critical background basis of “efficient market hypothesis” in the given work play the theoretical analysis of standard deviations of indexes on the basis of empirical comparisons of normal distribution with distributions of their dynamic numbers acts, and the practical analysis based on the use of R/S – analysis and calculation of Hurst factors, the entropy and correlation indicators, and also some other parameters which unequivocally characterize and define nonlinear character of dynamics of investigated indexes.

“Persistence of index memory” estimations and predicted estimations of dynamics of investigated numbers in prospects with different terms are made.

The carried out research shows an inconsistency of modern methods of fundamental and technical analyses from a position of their unauthenticity and low level of correlation of the results received on the basis of their modelling use, with real data.

Summarizing, the carried out research shows expediency and rationality of the theory of chaos application and methods of fractal analysis in comparison with quantitative likelihood methods by estimation and forecasting of dynamics of share indexes and in researches dealing with capital markets.

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## PROBLEMS OF USING A DISCOUNT RATE AS MONETARY REGULATOR

Against the world financial crisis the problem of the importance of a discount rate as monetary regulator becomes more actual. The Central Banks change the refinancing rate to stabilize the rate of national currency or to grant more beneficial credit terms for the national manufacturers, however the following actions do not lead to a positive effect.

In many countries a discount rate is reduced up to zero point, as in Japan (0,1 %), Great Britain (1,5 %), the USA (0-0,25 %) (see fig. 1). According to analysts of *Alora* and *Moneyfacts*, these actions of the Central Banks of leading countries of the world do not yield the expected results, and the importance of a percentage policy thereby decreases. A discount rate, and consequently, the rates of the loan capital makes essential impact on rates of economic growth that is marked in researches of such scientists as M.Kennedy, A.S.Galchinsky, M.Porter, etc.

Dynamics of discount rates for the last 8 years is given in figure 1. Schedules show that the discount rate throughout 2001-2007 was relatively stable in Russia, Great Britain and Japan. Up to 2006 the Fed consistently lifted discount rates in series as economic growth in the country was steady. Since September, 2007 the Fed has started to reduce rates because of problems with liquidity at local banks. At present the rate is at level of 0-0,25 %. To change sharply this key economy indicator, the Fed was pushed by the world-wide share index fall and by the necessity of going out of the recession.

Following the Fed, the Bank of Japan lowered the discount rate to 0,1 % for the first time during the last seven years. The main reason was the negative effect of the fast growth of Japanese yen exchange rate on the export industries such as motor industry. The bank of England has in turn lowered a discount rate to 1 %.

At the same time the Central Bank of Russia unlike the Central Banks of the majority of the countries did not lower, but raised a discount rate to decrease the capital outflow level from Russia and to restrain the inflationary tendencies. The NBU also lifted a discount rate to 12,5 %. The NBU employees noticed that there were no economic preconditions to decrease a discount rate, as during the discount rate calculation, the high inflation influence was taken into account.

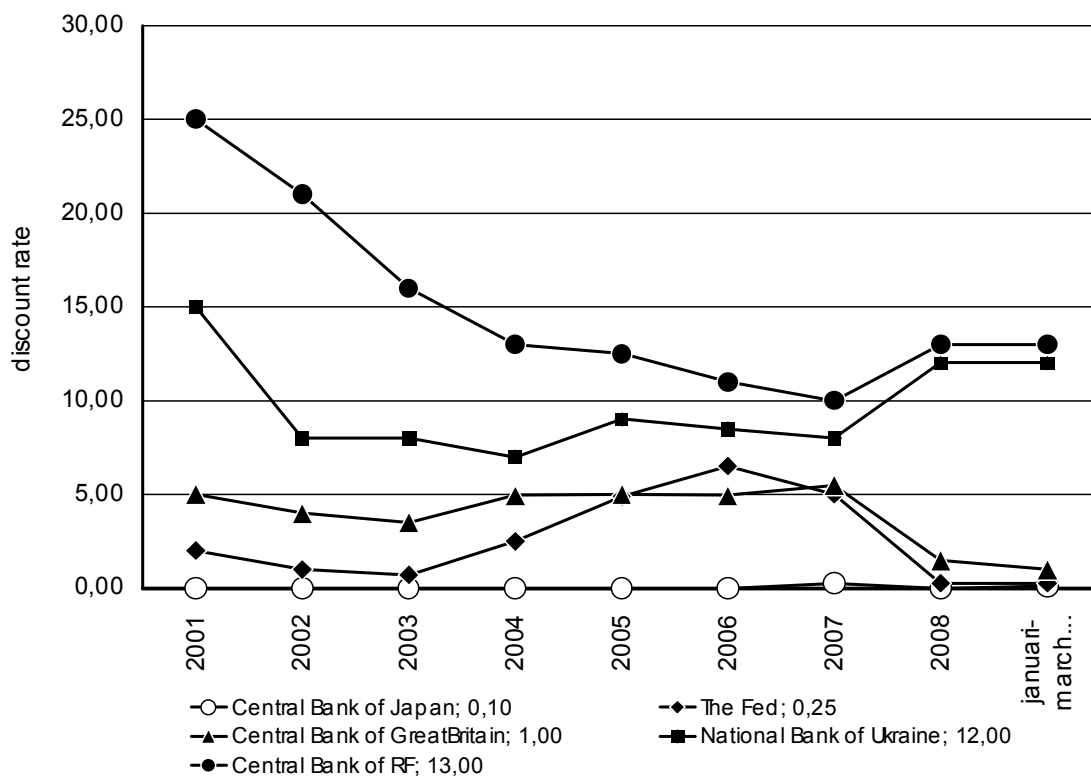


Figure 1. Dynamics of the discount rate of Russian Federation, Ukraine, Great Britain, USA, Japan during the 2001-2009

Despite the Central Banks actions of changing the discount rates, the economy of the countries listed above has entered the recession or are already close to it. So, it is possible to draw a conclusion that the use of only this monetary tool is not enough to lead the country out of the financial crisis or at least to stabilize economic conditions.

However it is possible to develop such monetary and credit policy when the most important industries of the country will develop. In other words, it is possible to develop the program of preferential crediting of privileged national programs. For example, the Central Bank will give preferential credit resources to commercial bank. This bank in turn will finance the enterprises which are letting out production which of 65 % is made in the territory of Ukraine under the low interest rate. So, it is possible to provide employment and essential growth of income for both population and small businesses.

Thus, the government should develop such monetary and credit policy when national manufacturers will be involved as much as possible and as result new workplaces and tax proceeds will be provided. That is why, the important role belongs to the National bank of Ukraine and its interaction with the government.

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## THE PROBLEMS AND PERSPECTIVES OF THE BANKING SYSTEM DEVELOPMENT: A GLANCE INTO THE FUTURE

Financial industry is one of the most dynamic developing industries since the Second World War. The banks as institutions are also evolving. The financial innovation has increased the competitive environment for the banking industry and is causing fundamental changes in it. Although institutions have grown in size, competition has substantially increased. This was caused by regulators, who have relaxed their rules and have allowed banks to offer new products, and, over the same period of time, to enter new markets and new business activities. Many risks arise from the fact that today's banks are engaged in a wide range of activities. They trade with all types of cash instruments, as well as derivatives such as swaps, forward contracts, and options – either for their own account or facilitate customer transactions.

After the Great depression, the banking system was highly regulated and there was no room for profit and funds for the industries. The banking system faced a significant change in its focus by 1972 – from social and conservative, to more risk taking and profit – oriented. The process of liberalization begun with Walter Riston, head of the “First National City Bank”. His highly educated professionals brought unprecedented profit by the more entrepreneurial usage of the financial capital. It was by that time, when new innovative financial instruments were introduced into the banking system. Attracted by heavy profits, the bankers reached, what was then considered to be the limit of the safe leverage. This led to a total abandoning of the fundamental social role of the banks. Genetically implemented in the early banking institutions in Italy. The Federal Reserve Bank estimates that in 1996, US banks possessed over 37 trillion of off-balance-sheet assets and liabilities, compared to approximately only 1 trillion dollars only 10 years earlier.

Current a crisis began in the USA with their housing bubble, which peaked approximately 2005-2006. High default rates on “subprime” and “adjustable rate” mortgages began to increase quickly thereafter. Lax regulation, deregulation of government policies and investment from the private sector had greatly increased Wall Street's involvement in higher-risk lending. Subprime mortgages increased 292 %, from 2003 to 2007. An increase

in loan incentives such as easy initial terms and a long-term trend of rising housing prices encouraged borrowers to assume difficult mortgages in the belief they would be able to quickly refinance at more favorable terms.

At the moment, the banking system has liquidity problems and central banks are too busy with issuing money and they can not see the long-term effect of this activity. One of the most important decisions from FDIC was the bailout plan in which central banks saving falling business and financial institutions. At the moment, “The Bear Stearns Companies”, “Fannie Mae” and “Freddie Mac”, “American International Group”, “Citigroup”, “Bank of America”, “Fortis bank” and many other companies have already received a bailout. The effect of this process is nationalization and more money in cash. Thus, an acute part of crisis will become quiet, but secondary effects from it, from now on, will appear. Other decision is to become bankrupt. This leads to restructuring of the banking system.

In future banks have to reconsider the trade with high – risk instruments by diversification of the risk to their portfolios. If the risk, which banks undertake was lower against lower profit, they wouldn't have these liquid problems. Banks should be highly regulated from regulators. Banks must generate a profit from treasure bonds and the difference between the level of interest they pay for deposits and other sources of funds and the loan interest rate. This difference is referred to as the spread between the cost of funds and the loan interest rate. They shouldn't trade with shares, derivatives, forwards, options, swaps. These activities must be split between other institutions – funds, investment corporations, insurance corporations.

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## MODERN PROBLEMS OF THE INVESTMENT BANK LOANS

One of the most important functional forms of bank credits is an investment. Commercial banks, mortgage banks, development banks and some other credit and financial institutions provide investment to entrepreneurs for the implementation of various innovative projects. This form of bank credits plays a crucial role in the development of a market economy.

In developed countries, such as the United States of America, more than half of investment projects are financed by bank loans. On the other hand, Russian financial institutions are only providing 10-12 % of those

loans. Obviously, today Russia is far behind in investment and economic development of the market in comparison with other developed countries.

The serious lag in economic development in Russia may be explained by the lack of favorable investment environment in the entire marketplace of the country, the inadequacy of the basic practices of risk assessment for projects, and enormously expensive bank loans. These factors result in a gap in interest rates on loans and the profitability of most businesses that are focusing on meeting domestic demand. Furthermore, in Russian Federation we observe the lacks of considerable tax incentives for banks that are working with entrepreneurs by lending to investment projects. As a result, unfavorable environment for entrepreneurs and bank loans with high interest rates together with lack of adequate risk assessment arise in the long payback period investments. The low level of intermediation of the investment sector of the Russian banks is affected by the extremely high credit risks. High credit risks are associated with financial instability in most sectors of Russian economy, lack of long-term borrowers with good credit history, reliable mortgage, and other secured loans. In addition, the lack of appropriate investment insurance along with legislative and judicial risks make investments even less attractive for banks.

As a result, in current economic situation investment lending is a high risk, complex and quite expensive activity. Risk factors adjusted to the investments prevent the dynamic development of these areas of banking activity. Integrated assessment of the investment projects performed by credit organizations will help to eliminate this barrier. Issues of quality of risk management and administration of credit process play the particular relevance in these circumstances.

The share of long-term resources in the resource pool of the banking system of Russia is growing during the last few years. However, the demand for investment resources is still relatively low, which does not allow the upgrade of the quality of Russian industry and the economy as a whole. The bulk of loans to real sector is short-term in nature and primary aimed at the working capital of enterprises. Nowadays the national economy especially requires the long-terms loans (over 3 years); however, the fraction of these long-term loans is just slightly more than 8 % in the advances portfolio of Russian banks. The portion of bank credit in financing investment has increased from 3-4 % in 2004 to 9-9,5 % in 2008 in Russian Federation. Consequently, the investment bank lending is playing an increasingly important role in the functioning of individual economic entities as well as the country's economy as a whole.

Most banks have stopped issuing long-term loans as a result of the Global Financial Crisis. Only leading members, such as the Savings Bank

of the Russian Federation and VTB Bank, issue loans today. Despite of the difficult economic situation, the credit investment activities of banks are necessary and very important. Government of the Russia has a number of important challenges for the national banking sector: financing for sustainable long-term growth of the Russian economy and its development through innovation. A number of transformations and qualitative changes in the economy are required for these purposes. These transformations and changers include improving of the business environment and creating a favorable investment climate formation. Also these changes should include development of the national financial infrastructure, which focuses on effective long-term investment financing, launching mechanisms of innovative activity of companies, and active transformation of savings investment in the domestic economy.

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## MANAGEMENT RISKS IMPROVEMENT AS A KEY FOR THE CRISIS OVERCOMING

Financial crisis creates shift in strategic priorities. At the first sight, the current predicament appears to stem from the pursuit of revenue growth in the world of easy credits. The reality in fact is more complex and a number of causes emerge from the survey findings: weaknesses in risk culture and governance; gaps in risk expertise at the non executive Board level; lack of influence of the risk function; lack of responsibility and accountability of those on the front line; a compensation culture mostly oriented at year by year profit increases; business models that were over reliant on ample market liquidity.

The current economic crisis has exposed inherent weaknesses in risk management, forcing banks to improve their risk governance processes, increase the collaboration between risk and finance functions, and make instilling a risk culture a true priority.

In order to create and instill a culture of risk awareness within banks, risk management must become everyone's business.

Banks and other financial institutions have been leaders in the Ukrainian market with respect to initiating, building and evolving their risk management functions and instilling a risk-aware culture within their organisations.

This is due partly to the nature of the banking business itself but also due to the close coordination and regulation by the central bank of Ukraine.

Risk management functions in Ukrainian banks are receiving ever increasing levels of attention and executive management support, especially as the Ukrainian market goes through various stages of challenge and evolution.

Shareholders, executive management and all stakeholders are demanding more comprehensive, timely, collaborative and forward-looking risk management information and analysis of all parts of the business sector.

Poor data quality, gaps in the data flow, and the sheer volume of data are just a few challenges which banks face with.

The banking system needs to strengthen forecasting by developing more formal processes and more forward-looking risk assessment tools. This includes more frequent executive risk committee meetings implementation, in order to monitor issues and events, creating detailed scenario modeling, and mandating periodic portfolio reviews to monitor leading risk indicators.

The crisis is already acting as a catalyst by dismantling silos, promoting more dialogue between risk and finance, and stimulating broader discussion of risk as a core issue.

The risks to which a bank is particularly exposed in its operations are as follows: liquidity risks, credit risks, market risks (interest rate risk, foreign exchange risk and risk from change in market price of securities, financial derivatives and commodities), exposure risks, investment risks, risks relating to the country of origin of the entity, operational risks, legal risks, reputational risks and strategic risks.

All risks are interconnected. The crisis has also driven home the interdependencies in the global banking system, both at a micro level within organizations and at a macro level across the industry.

The top priority for Ukrainian banks now is to manage the liquidity and reputational risks.

Liquidity is a key factor for the soundness of the banking sector. Liquidity risk can best be described as the risk of a funding crisis.

In any case, risk management here centers on liquidity facilities and portfolio structure. Recognizing liquidity risk leads the bank to recognize liquidity itself as an asset, and portfolio design in the face of illiquidity concerns as a challenge.

Reputational risk is the risk of loss caused by a negative impact on the market positioning of the bank.

Overcoming these types of risks the banking industry can renew the confidence of investors and depositors and survive the financial crisis with smaller losses.

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## ASSETS AND LIABILITIES STRUCTURE PROBLEMS OF UKRAINIAN BANKS

It's widely known that Ukrainian economy especially the banking system is experiencing considerable stress nowadays caused by the global financial crisis. Ukraine's economy has grown very rapidly since 2005 expanding by more than 7 percent in average. Such progress was based on the utilization of large excess capacity and increasing productivity supported by a series of structural reforms. Economic growth started in 2005 has been provided by real domestic demand, namely a credit boom driven by strong capital inflows and income policy that redistributed large trade profits in favour of population. The number of operating banks increased considerably – from 160 in 2005 to 184 in 2009 among which 17 banks with foreign capital.

Real consequences of economic overheating have been already noticeable by mid-2008 in different fields. Credit growth exceeded 70 percent, CPI inflation exceeded 30 percent, wage growth settled in the 30-40 percent range, a buoyant demand on the property market pushed valuations to high levels. At the same time problems in banking system are determined by assets and liabilities structure problems among which the most essential are the following.

1. Reduction of the high liquid assets share. Comparing the ratios in 2005-2008 one can notice the substantial reduction of high liquid assets share in net assets (8,96 % drop) though absolute values grew almost 3,5 times and amounted 79 702 million hryvnias. Such situation is explained first of all by the worsening of assets quality.

2. Expanding credit portfolios. During the last 4 years the volume of loans granted increased from 97 191 million hryvnias in January 2005 to 792 384 in January 2009 that is 8 times growth. This structure change is determined by banks having money resources, lowering of loan interest rates and mitigation of credit procedures.

3. Increase of problem credits. Having analyzed the amounts of credit problems, it has become clear that the increase in this field has appeared recently (in January-April 2009). The period 2005-2009 was characterized by the reduction of credit problems (five times) though absolute values showed active growth and amounted 18 015 million hryvnias that is 14 870 million hryvnias more than in 2005.

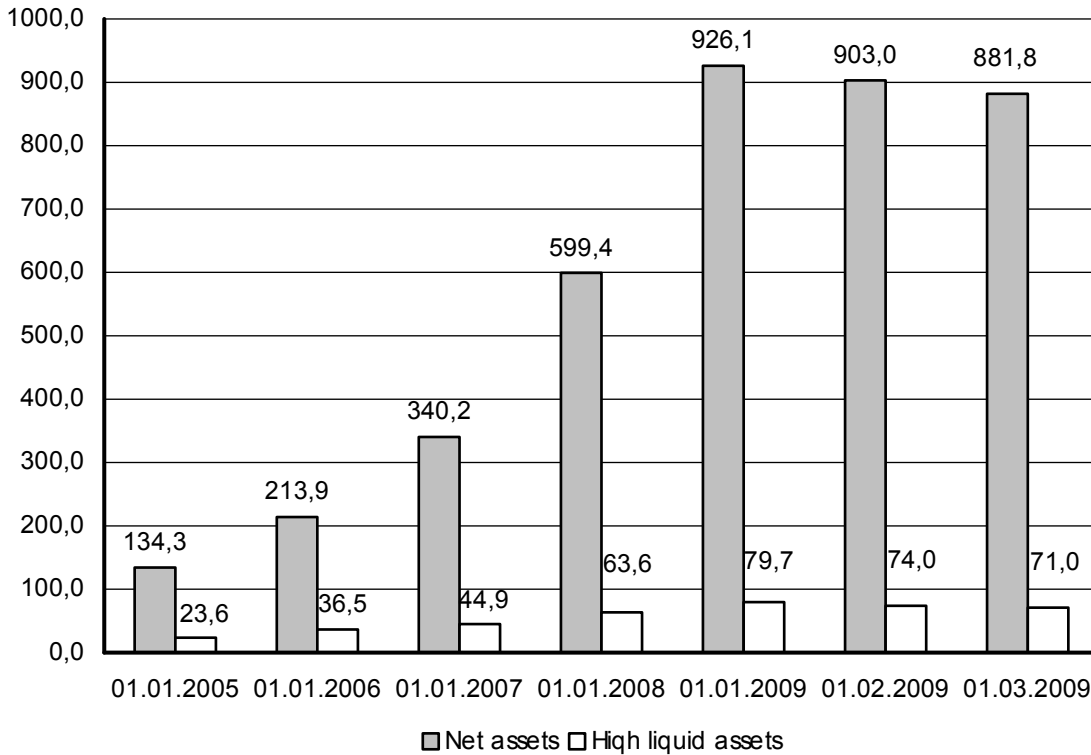


Figure 1. Dynamics of high liquid and net assets, 2005-2009 (mln. UAH, %)

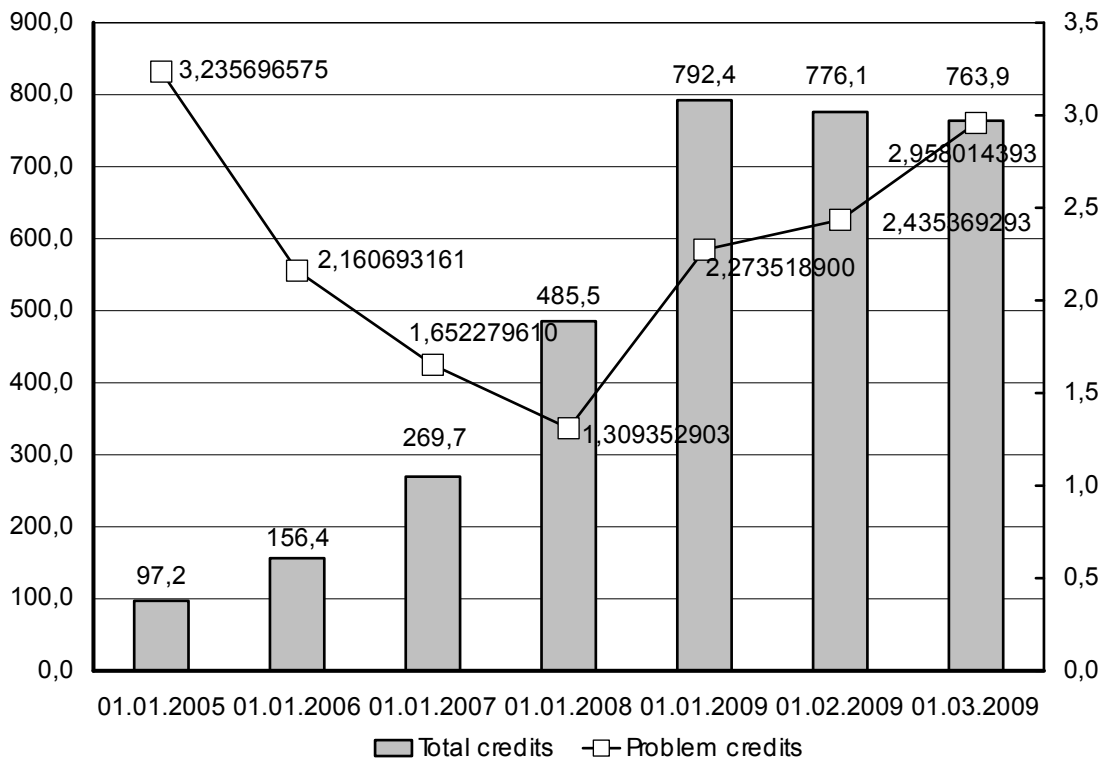


Figure 2. Dynamics of problem credits share in credit portfolios, 2005-2009 (mln. UAH, %)

4. Cutback of people deposits in total liabilities. Situation with private deposits have taken a tendency to slump at the beginning of 2006. In January 2006 people deposits accounted 72 542 million hryvnias (38,50 % of total bank liability) while in January 2009 this figure was 213 219 million hryvnias (26,43 % of total liabilities). The main reason for this is the diminishing of private income and growing discredit of the banking system. People began to spend their savings on current consumption and payment for their earlier loans. At the same time the share of people deposits in total liabilities descended in relative measurement to the point of 17,84 % (of total banks liabilities) in 2009 while in 2005 this ratio was 34,61 %.

5. Decline in ROE ratio. During the period of 2002-2008 banks had a positive return on equity that grew intensively till the end of 2008 but began to decline in January 2009 and reached – 9,65 % in March 2009. Such situation is caused by the business activity diminishing and capital money outflow.

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## PROBLEMS OF BANK PERFORMANCE EVALUATION IN CONDITIONS OF THE CRISIS

The global financial crisis has highlighted the importance of banking systems in the countries and determined its weaknesses and problems. Today banking system of Ukraine has problems in organization's activity, adequate regulation and supervision, necessity of recapitalisation etc. To our view, problems of methodical character are no less important in the conditions of necessity of increase of the national banking system stability.

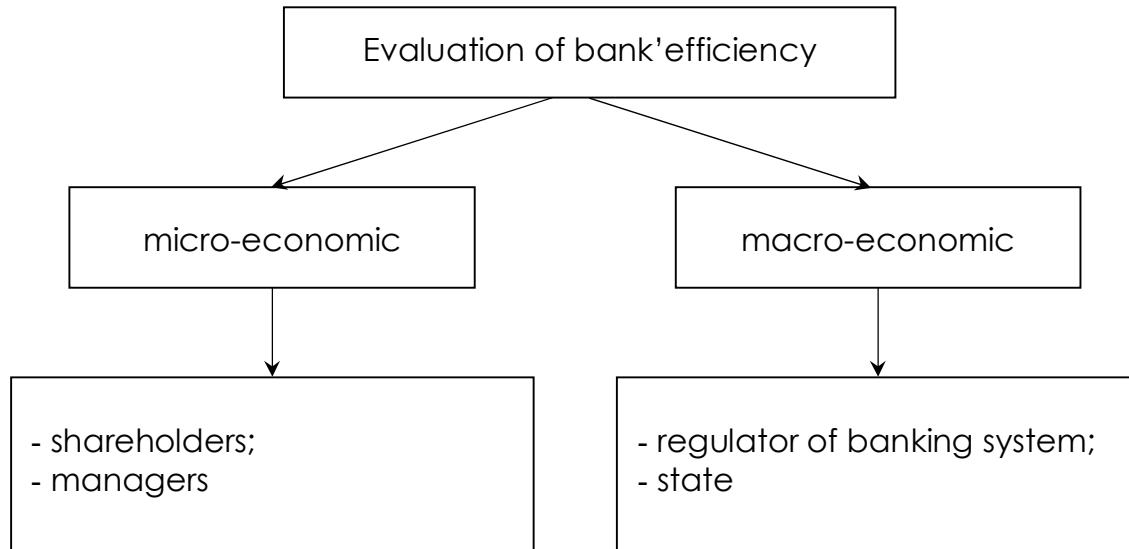
The basic tasks of research were the followings:

- understanding the concept of “bank’s efficiency”;
- research of the possible approaches of its evaluation;
- basis for the model of bank’s efficiency as financial intermediaries evaluation.

Problems of evaluation of bank’s efficiency are key questions not only in practice but also in theoretical economic science. Taking into account multidimensionality of the “bank’s efficiency” concept in specific literature, it is possible to define two basic determinations:

- a measure relating a quantity or quality of output to the inputs required to produce it;
- accordance of the received results with the given aims.

As a matter of fact, “bank’s efficiency” is variable from one subject to another. For this reason we had proposed the following approaches for evaluation:



So, microeconomic approach reflects bank’s interests, in particular – shareholders, managers. Banks have devised several ratios to gauge their financial performance, with measures such as Return on Equity or Return on Assets often being quoted in annual reports and analyst statements. The purpose of these ratios is to enable comparisons to be made between different banks or financial groups.

To our view, macroeconomic approach is more important in conditions of crisis and necessity of providing of the economy growth in Ukraine. Exactly from this point of view, the state bank’s efficiency means ability to provide transformation of savings for an investment with the least transaction expenses.

For this purpose, we had proposed to use a model, which presents the bank as “black box”, which has inputs and outputs, and production function which is maximizing the output of services at the fixed expenses. The offered model describes the optimization options for every bank and allows to estimate relative efficiency of every bank.

Overall, it is a well-known fact, that the banking system of Ukraine shows a gradual improvement in their efficiency levels during the last seven years. The model used shows that a number of determinants like bank size, industry concentration and the investment environment have a positive impact on bank efficiency.

The paper offers new insights to policy makers on the relevance of a number of driving factors of bank's efficiency that might help them to improve the performance of the banking system and enhance the quality of services provided.

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## ADVANTAGES AND LACKS OF INFLATION TARGETING

Inflation targeting is becoming the monetary policy framework of choice in a growing number of countries, including emerging market and developing countries. Today the mode of inflation targeting is considered to be one of the most progressive monetary modes. However the analysis of international experience shows not only advantages, but also risks connected with application of this mode. Speaking about advantages it is necessary to note the following of them:

- accurate identification of purposes and monetary and credit policy priorities;
- inflation targeting in most cases helps to lower inflation quickly, to support its low rates effectively and as a result to provide steady and balanced economic growth;
- inflation strengthens targeting of the central bank independence, accurately focusing it on the one purpose (decrease of inflation and its stabilization at a low level);
- inflation targeting introduction demands an increase of professional level from workers of bodies of monetary and macroeconomic policy, transparency, the information openness, and also a new level of the macroeconomic analysis.

The IMF data about monetary modes accepted in different countries of the world, show, that from 192 surveyed countries only 13 % use the mode of inflation targeting, and about 47% – the mode of exchange rate targeting. So, why almost half of the countries in the world use the mode which considerably concedes to inflation targeting in a long-term prospect?

The matter is that simultaneously with application of this mode a number of problems appear. It is necessary to allocate the following of them:

- difficulties with the exact realization of the set inflation objective resulted from the influence of different difficulty with predictable external factors;
- difficulties connected with uncontrolled exchange rate. Rather rigid modes of exchange rate formation and absence of capital convertibility demand carrying out the mode of targeting of the exchange rate. In

such situation transition to a free exchange rate formation mode only to apply inflation targeting effectively seems inexpedient;

- difficulties connected with formation of a new channel of transmission under the interest rate which becomes the core. In a number of the countries inflation dependence on changes of interest rate is not caught for the reason of weak influence of the rate of interest on behavior of economy subjects in conditions concerning high inflation, or administrative pressure in decision-making sphere. For example, in Belarus financing of some branches of economy occurs at the expense of soft loans of banks. Hence, level of interest rates does not render direct influence on credit activity of such subjects of economy.

At the same time, there are countries or circumstances where inflation targeting may be unsuitable as a monetary policy framework. F.i., in some small, low income economies, where the operational capacity of the central bank, and the degree of financial system development may be very limited, or in small, highly open economies, where domestic wages and prices may be almost fully determined by foreign prices and the exchange rate.

Besides, usually in order to receive full introduction and analytical development of strategy of inflation targeting at least 2-3 years are required. Absence of the fact sheet at the beginning will interfere with formation of mathematical forecasting models which demand time series of data in comparable conditions. Here it is inevitable to face the certain contradiction. Construction of working analytical and forecasting models is impossible before full introduction of this strategy; otherwise their key parameters will reflect logic of the previous strategy.

Therefore the inflation targeting application requires a high degree of coordination of the basic monetary, budgetary and industrial parameters in conditions of possible external shocks, to introduce well-developed analytical capabilities and infrastructure, and also to generate the effective channel of transmission under the interest rate. But it's also important to make sure, that inflation targeting is really expedient.

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## THE GLOBAL CRISIS AND THE ECONOMY OF UKRAINE

Ukraine, as well as most the world countries, in the second half of 2008 to full global financial crisis, overgrown in the crisis of the real sector of national economy. It excessive dependence of production and consumption of commodities and services was in a great deal instrumental in on a situation on national markets – both for exporters and for importers.

As a most problem for effective development of economy of Ukraine and providing of its “vitality” in the conditions of distribution of the global crisis phenomena it should be noted base factors and, foremost, ineffectiveness of institutes of power, macroeconomic instability, commodities and services of markets development low efficiency, business-environment ineffectiveness and ect.

Characterizing changes to GDP it is possible to say that a basic contribution in growing of GDP was brought in by such sectors of economy, as rural and forest economy, and also transport.

It should be noted that during a year commodities issue structure and services in the types of economic activity in actual prices change took place. So, processing industry had most specific gravity, after a sphere of trade and domestic services (including repair of cars). Contrary to the downstream in the field of building, specific gravity of industry in GDP was increased. But agriculture makes most weight (including hunt and forestry).

Otherwise speaking, the GDP structure change in favor of agriculture will allow providing food safety of Ukraine population in the conditions of the crisis phenomena deepening in the real and financial sectors of economy.

A world financial crisis substantially influenced on external sector of Ukraine economy development: the considerable trade foreign volumes falling by commodities and services, diminishing of investments, stable weakening of national currency exchange rate.

The high rates of export growth are stipulated by the friendly to the Ukrainian export price state of affairs on commodity markets, and also by considerable internal demand for the imported goods of the consumer and investment setting.

Generally reduction of demand under influence of economic crisis and devaluation of grivna was a result of an import volume decreasing.

Evaluating a situation in the Ukraine economy during 2008 it should be noted that objective information of national statistics though testify to considerable influence of world economic crisis during the last quarter of year can not be catastrophic.

In my opinion, the real sector of economy had and has considerable potential of “vitality” that is conditioned by the high level of “adaptability” of subjects of entrepreneurial activity to the terms of conduct of business in an unstable institutional and political environment.

The depth of the crisis opened out that Ukraine financial and economic environment fully depends on quality, timeliness and adequacy of the anticrisis methods and instruments developed and applied by authorities.

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## CORE DIRECTIONS OF THE CRISIS INFLUENCE ON UKRAINIAN BANKING SYSTEM MINIMIZATION

The most important factor of world economy development in 2008-2009 is the global financial and economic crisis. Its influence on all industries and economies is difficult to be overvalued. The aggregate demand has fallen dramatically in major countries, most goods markets have felt the structural changes of demand as well as supply, stock markets have declined more than twice, derivatives markets have almost dropped down. Being an integral part of the global economy Ukraine was heavily affected by the crisis. Banking system of our country was one of the mostly influenced fields. The crisis rapidly resulted in broad deposits outflow, the substantial rise of interest rates, massive speculations on exchange market and with all this going on we had inflation increasing with even more severe inflation expectations. All mentioned rapidly spread to the real economy.

In this situation the banking system is such element of the national economy that on the one hand felt the most severe crisis influence and on the other can become the basis for economy recovery. Taking this into account only the direct and considered monetary policy could lead to optimal level of banking system development under crisis and promote crisis influence minimization.

To our mind the core directions of crisis influence on Ukrainian banking system minimization are the following.

1. Strengthening the banking system credibility. We mean first of all the confidence of people who trust their savings to banks in the form of deposits. Even in the most powerful economy the banking system won't be able to return the holding if all of them will be demanded at the same time. That is the issue of a great psychological importance. The similar situation was observed in Ukraine. In the last quarter of 2008 the total deposits fell by 13,7% (31,8 bln. hryvnias) and at the same time the total deposits of individual depositors dropped by 14,8%. The more people trust the banks the greater the chances to easily overcome crisis negative influence. This point implies not only the prevention of deposits outflow but also promoting people savings in order to transform them into deposits.

2. Decrease of speculating pressure in the foreign exchange market. This measure is extremely important since some banks transferred their refinancing

resources not for deposits returning and their capital structure balancing but for speculations with dollar, that brought about particularly the weakening of hryvnia to more than 8 per USD. The regulating policy of NBU must be tough in this sense.

3. Reduction of the level of economy dollarization. Such step will obviously cut the dollar demand thus promoting hryvnia strengthening. The crisis caused the change of the dollarization level reduction trend that was observed in 2007. It increased in 2008 from somewhere 23 % to almost 31 %.

4. Lowering the inflation pressure. The measures aimed at monetary base restriction should be undertaken. The monetary base growth in 2008 was 31,6 % that is too high for current conditions. The growth rate must not differ significantly from the economy growth rate. On the other hand it would be not sound to cut the monetary base growth rate rapidly since it will bring about even greater macroeconomic disproportions. The optimal rate for 2009 to our mind will be somewhere around 10-14 %. A great portion of inflation pressure lowering measures lies under authority of other regulators besides NBU such as Ministry of Finance, Ministry of Economy etc.

5. Optimal balancing between short- and long-term measures. Here we mean first of all that strategic long-term objectives must be of the highest priority. It does not of course diminish the importance of current policy measures though long-term banking system stability is the core task in this sense.

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REGIONAL BANKING SYSTEM POTENTIAL:  
FINANCIAL AND ECONOMIC CRISIS DEGREE  
OF INFLUENCE ESTIMATION  
(ON AN EXAMPLE OF KURSK AREA)

The modern crisis state world and national economy advances objective necessity of an estimation of a regional banking system potential, as integral condition of working out of optimum strategy of minimization and overcoming of consequences of financial and economic crisis both for a banking system, and for all economy as a whole.

In view of integrated character of a banking system potential, it is possible to advance it, as set credit, investment, institutional and other possibilities

of a banking system to satisfy growing requirements of economy. In this connection, it is possible to allocate following kinds of potential:

- the credit potential represents real possibility of a banking system for a limited period of time to increase weight of active money by granting new loans to the organizations and physical persons, and also the state. The technique of its estimation is in detail considered in I.N. Rykova and N.V. Fisenko's works;
- the investment potential means ability of the credit organizations system on economy long-term crediting. Settles up as the sum product of the credit a net worth organizations and the means involved for term over 3 years, on the money multiplier;
- the institutional potential characterizes a level of a region banking system development. To compare it is possible to use the technique of regions developed typology by the Russian experts in a development banking level;
- the financial potential is expressed by financial and economic activity efficiency of the region credit organizations system (financial results of their activity, profitability, liquidity, quality of an advances portfolio etc. are evaluated).

Following the results of the potential conducted analysis a of Kursk area regional banking system in the conditions of a financial crisis it is necessary to have talk about following both positive, and the negative moments:

1) despite the occurring crisis phenomena, credit potential has grown for the last year on 12,1 % and for January, 1st, 2009 has constituted 81,9 billion rbl. Thus operating ratio of credit potential (the relation of the issued credits volume to potential size) has reached 86,1 %;

2) the investment potential a of Kursk area banking system has considerably increased from 114,9 to 171,4 billion rbl., or in 1.5 times. However level of its use for the present remain low enough – 7,3 % on 01.01.2009;

3) in the relation institutional potential it is necessary to stress on insufficient development of a region bank infrastructure (0,21 units of the credit organizations and their branches on 10 000 population at optimum significance 1 unit), and during the same period of time, material effect for a condition and development of regional economy;

4) financial potential indicators are better than others reflect a condition of a regional banking system in the conditions of crisis. So, at growth on 5 % of a fiscal effect of the region credit organizations activity (10,9 million rbl. on one credit organization (branch)) some decrease in the efficiency, operations conducted by them is observed. The separate attention is deserved by advances portfolio deterioration of quality: the share

of bad loans in total amount of credit investments for January, 1st, 2009 has constituted 1,9 % (growth – 0,65 %).

Thus, the potential of a Kursk area regional banking system, despite current financial and economic crisis, continues to grow. However in connection with a worsening economic and of region social situation, the credit organizations have already appeared in a situation of uselessness of the potential accumulated by them.

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## THE MAIN PROBLEMS AND DEVELOPMENT DIRECTIONS OF NONTRADITIONAL BANKING SERVICES

Modern commercial banks are multifunction establishments, which are engaged in practically all types of operations, related to maintenance of economic activity of economic subjects.

Except for traditional banking transactions, such as a credit, deposit, calculative, investment, security-related and currency operations, banks give a number of additional nontraditional services. It is predefined by the necessity of expansion of sphere of activity, increase of competitiveness of banks, growth of profits, and of clients' necessities satisfaction improvement.

Nontraditional banking transactions include: leasing, factoring, forfeiting, buying and selling of securities after the requests of clients, placing of capital issue, delivery by the bank of guarantees, agent, trust, confiding services and the same.

An origin and subsequent development of nontraditional banking transactions and services is predefined by many reasons. In particular, it:

- decline of traditional banking transactions and services profitability level;
- competition sharpening between banks and nonbanking organizations by financial and credit establishments, and also between commercial banks;
- the customers service upgrading necessity;
- bank profits diversification, in particular by an increasing the part of noninterest-bearing profits, including commission profits;

- commercial bank liquidity and solvency increase necessity;
- risks diminishing necessity, traditional transactions linked with realization and by the traditional services grant;
- bringing in new clients with the purpose of expansion and perfection of commercial bank resource structure base.

In the list of operations of the Ukrainian banks in modern terms non-traditional operations occupy insignificant part. Low demand on most non-traditional banking services is explained by that they are only on the stage of forming. Principal reasons of such situation are insolvency of banks to give all spectrum of services and low demand of clients; imperfection of the Ukrainian legislation and absence of the proper legislative base, what would regulate bank activity in the proper spheres; insufficiency of resources and absence of wide connections of most banks with other credit-financial establishments; high riskiness of services separate types.

Active development and expansion of banks activity in the field of nontraditional services requires the lineation of priority directions introductions of new services, among which it is possible to mark: trust operations for physical and legal persons, consultative and informative, intermediary and agent services. Also factoring and forfeiting services need expansion.

Directions of nontraditional banking services development market are considered can be instrumental in expansion of commercial banks activity sphere in Ukraine, their adaptations to the new terms of market growing requirements of clientele in valuable complex of services, adequate to the requirements of the economy modern state.

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## INTERNET-BANKING: DEVELOPMENT AND PROSPECTS

One of the most typical peculiarities of financial services market is necessity of financial institutions permanent aiming at widening diversity of services are provided by them, ensuring attraction of their services for customers and timely reaction on market's change.

Keeping pace with information technologies, the market of financial services got started to integrate into internet and defining it like platform for doing business.

It caused emergence of such term as “internet financial services” that distinguishes from regular financial services by remote relationships between bank and client, interaction on real-time basis and with many client at the same time.

There are a few types of internet financial services: e-banking, e-trading, e-insurance. The rhetoric around “e-banking” category lies in interpretation it as usage of internet like remote channel for delivering services of actual-existed bank and as independent virtual environment that comes into the world branchless, only-internet-existed banks.

Functional classification of internet banking: informational, transactional and communicational.

Two approaches to e-banking: the concept of “e-branches”, which are virtual divisions of actual-existed banks and the concept of “e-banks”, which implies pure only-internet bank.

The “e-bank” concept impersonates the evolution of “home remote banking” to advanced internet channel with available audio, video, text forms of communication and establishment 24/7/365 regime of availability for customers.

The “e-bank” concept entailed “internet revolution” in late 1990s in developed countries. E-banks have gained significance and popularity due to possibilities they presented: cost reduction, clients’ loyalty, internet profits generation, attraction of high-income customers. On the other hand, e-banks act in favor of clients, which are able to get more beneficial conditions of service, additional services and convenience.

Internet revolution has attenuated because of tough competition within e-banks and actual banks as well, asperities in attraction clients and couple only-internet issues (reliability, legitimate, organizing, technical, and even philosophical). The question of early 1990’s “virtual or actual” has transformed into “how virtual and actual are about to joint collaborate.

In terms of global credit crunch and financial mess, question of e-banks crops up in very urgent manner due to main peculiarity of e-banking – cutting of costs and opportunity to attract high-income customers.

Background of internet banks prospects: steady growth of electronically-made transactions and payments, which entrails huge demand for clearing interstate systems, sustainable rise of internet users, especially in developing and transforming countries, stagnancy of regular banking business and looking for new channels of distribution and cross-borders serving the customers and business.

Countries that have endured early stages of internet revolution are apt to intensive usage of internet channel in role of add-on to regular banking, which has no problems in attracting new customers, who are mainly

non-internet, but lapse to being served actual bank, to whom they have strong confidence, on internet. Developing and transforming countries are observing other trends: rapid development of e-branches and somewhere establishing new only-internet-banks (Russia, Israel).

Moreover, such internet payments systems like PayPal, Portmone, Webmoney, which de-facto are cross-borders banks, but highly specialized on clearing operations, are getting more complex and might be switched to some kind of e-banks.

The more tough competition on market is the more chances for e-banks are. There are a few probable scenarios of prospects in terms of financial meltdown: the way of extensive development through M&A and opening new branches is used up and banks are seeking ways of growth organically, that can be achieved exceptionally through structuring cost-effective business and e-banks with their low marginal costs per transaction, facilities- and staff-exempt costs, opportunity to provide customers with better rates are perfect strategically tool for meeting organically growth.

Moreover, globalization is on its peak and global institutions are supposed to act globally. Establishing global internet banks is like establish national bank if eliminate legitimate issues.

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## THE IMPACT OF THE WORLD FINANCIAL CRISIS ON THE BANKING SYSTEM OF UKRAINE

The analysis of financial crisis presently is very actual and will be the same for a long time, and, can be, always, because it is the next to impossible that in the nearest future the economists can smooth out cycles to minimum amplitude of vibrations. The basic and unique reason for collapse crisis of the world economy is an overproduction of basic world currency dollar of the USA. Now Ukraine is in the state of deep financial-economic crisis that began in the third quarter of 2008. The Ukrainian banks appeared unable to refund credits. It is possible to list external and internal factors influencing the depth of crisis in Ukraine. External factors, negatively affecting domestic economy – it is a collapse of demand and prices in the world metallurgical market, that resulted in currency hunger in Ukraine, and information about a crash financial-credit establishments abroad, that caused the distrust of population to the Ukrainian banks. Internal factors: the protracted fixing of currency national exchange rate during the last five

years, when grivna absorbed actually a hundred-per-cent price advance at the internal market, though remained outwardly stable; the insufficiently considered imported policy; the population of Ukraine lately began to live “on credit”; the acquisition by banks “problem” credits in great numbers; the unbalancing of the banking system, the increase of credit rates and registration rate of NBU from 10 to 12 % annual; the unprecedented high percents at the interbank market, the low liquidity of the banks, a hard monetary policy, sharply intensification fight for depositors – banks offer too high, economic unjustified interest rates on deposits.

Present “part crediting” of economy can bring to the second wave of crisis. The clients of banks haven’t money, a lot of manufacturing will stop, and as a result they will have nothing to pay off the already attracted credits. The Ukrainian economy can become simply insolvent. In addition to the deficit of credit facilities, there was an active satiation of internal market by the imported commodities, as a result of entering our country in WTO and using by government the import as an instrument of suppression of inflation. So, a national producer was forced out by importers from his sale markets. Therefore the deficit of payments balance is expected to start next year.

It is necessary to undertake measures to overcome the consequences of crisis, and then finally to go out of it. The bringing in foreign countries credits which maximally guarantee the prospects of the complete and direct returning; the grant of saving capital on the government side; the government must not acquire “toxic” or problem assets at price higher than market prices; every bank the board of directors must hire, motivate and provide independent administration, not civil servants, to work in a bank; there must be a clear and invariable time-limit for banks on an appeal after the governmental saving financing; the temporal freezing of forfeiting right of buying the stopped up property back; the co-ordination of lowering registration rates at the global, world level.

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## THE PROBLEMS AND PERSPECTIVES OF THE BANKING SYSTEM DEVELOPMENT: A GLANCE INTO THE FUTURE

Banks generate a profit from the difference between the rate of interest they pay for deposits and other sources of funds and the level of interest they charge for their lending activities. This difference is referred to as the spread between the cost of funds and the loan interest rate. Banks have developed their activities in financial instruments through financial market operations such as brokerage and trading and become big players in such activities. The problems of the banks include: liquidity risk – where many depositors may request withdrawals beyond available funds; credit risk – the chance that those who owe money to the bank will not repay them; and interest rate risk – the possibility that the bank will become unprofitable if rising interest rates force it to pay relatively more on its deposits than it receives on its loans. In order to secure its liquidity the bank maintains a given level of bank reserves and a part of them are obligatory minimum of 5 to 15 % which is set by the Central Bank. The upper limit of the reserves is set by the commercial bank and determines their optimum use. The difference between the total reserves and the obligatory ones is called excess reserves.

Banks' role in the economic system makes their bankruptcies extremely dangerous for the development of some companies, institutions, and for the economy as a whole. Banks' bankruptcies lead to depositors and shareholders losses, they have a negative influence over debtors because they restrict the possibility of taking credits, and last but not least – they shake the society's trust into the financial-credit system. This is why the research on controlled parameters of the bank is of such a great importance.

On macro-level the trust in the system of banks is a substantial condition for the directing the savings of the economic towards bank channels. Depositors' trust is of a paramount importance for the normal functioning of the banks in a market economy. Banks' losses have an effect on almost all sectors of economy. This is the reason why banks should all the time take into account the responsibility they have both themselves and depositors on one hand and the economy as a whole on the other.

For the last few years the bank system has become stronger concerning the requirements of the bank monitoring. This conclusion has been

confirmed by researches conducted by some international financial institutions as well. A considerable change in the attitude of the commercial banks can be seen namely in their becoming more cautious about giving credits. This results into quick increase of the liquidity in the bank system and improves the parameters for capital adequacy and profitability.

In the USA banks have taken the risk to try to get to the poorest class: former prisoners or people who were not employed for a long period of time whom nobody would give a credit. The banks knew that those people wouldn't be able to return their loan and in one or two years the banks would be able to get their houses and to sell them on high price. But the rising tendency of housing price inverted at the beginning of 2006 and the banks have taken big losses. In future banks have to reconsider the trade with high-risk instruments by diversification of the risk to their portfolios. Thus they will contribute to a considerably more stable economic system.

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## THE WORLD FINANCIAL CRISIS 2008: THE REASONS AND LESSONS FOR THE RUSSIAN ECONOMY

Economy of the USA can be compared to the huge octopus, entangled the feelers all planet: branches of the American corporations are opened almost worldwide, the American dollar, securities of the USA traditionally represent itself as the financial guarantor for other countries which with their help are protected from any risks. Therefore crisis of hypothecary crediting in the USA has responded financial "pain" to all world, and Russia including.

The reasons of modern world financial crisis are connected with events on one of segments of hypothecary crediting of the USA – a segment of non-standard crediting. It is necessary to understand process of delivery of hypothecary credits as non-standard crediting to borrowers who cannot obtain standard hypothecary credits, i.e. the credits which are given out under standards "Fani Mej" and other agencies of the USA supported by the government. The given category of credit is more risky for creditors since they stand out to borrowers to not satisfying traditional criteria because of a bad credit history. In 2007 non-standard credits in the USA have made 25 % from all given out volume of credits, while in 2002 it was only 6 %.

As a result of the given actions those Americans who simply were not in a condition regularly have entered into a category of proprietors of hy-

pothecary habitation to pay bank charges back on credits. As a result the habitation almost in a mass order carried over banks, and a lot of people who would like to buy this habitation, was not. Thus, many private banks of the USA have gone bankrupt.

The Russian legislators should take lessons from the crisis which has occurred in the American economy, and accordingly for a non-admission of the similar phenomena in Russia it is necessary to eradicate the reasons, their generating. Firstly, it is necessary to carry out rigid restriction of products which are offered by the financial institutions, engaged risky operations and on which the investor can receive a guarantee of compensation in case of bankruptcy. Secondly, in the insurance system of contributions introduction of the differentiated scale depending on riskiness of the operations spent by bank is necessary (the more risk operations spent for it, the more transfer into insurance fund).

It is necessary to carry to a number of the major:

- 1) the permission to use a part of means of Fund national well-being on support of domestic bank sector in the conditions of world financial crisis;
- 2) possibility of reception of credits the Foreign trade and investment bank intended for repayment and service of foreign credits and loans for a total sum to 50 billion a dale is given banks and not financial organizations;
- 3) the law on increase to 700 thousand rbl. of the size of insurance compensation under contributions of physical persons to banks is passed;
- 4) the right to compensate to banks a part of losses is given by Bank of Russia. Arisen at them as a result of crediting of the credit organizations at which the licence for realisation of bank operations have been withdrawn.

Thus, the taken measures will allow to keep economy of Rossi at stable level and to meet world financial crisis with the minimum losses.

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## STOCK MARKET TRADING AT EMERGING MARKETS: THE EQUALITY ESTIMATION AND IMPROVEMENT

At the markets of capitals there are a lot of different indices with the same meaning, but, in fact, for market participants it's much more convenient to deal with only one index. "Which one?" – is our question. Now the sphere of using stock indices is wider than it was hundred years ago, formulas and methodologies are more difficult. Indices' authors tell only about advantages and strong characteristics of calculation methodology. For the last 10 years indices become goods. Trade indices stock is one of the biggest segments of finance market in American and European stock exchanges. That's why the quality requirements for stock indices are growing.

In order to deal with this problem such quality characteristics as accuracy, adequacy and reliability can be calculated on the base of Jacobi procedure, which calculates in MS Excel and VBA eigenvalues and eigenvectors of covariance matrix for the five Ukrainian stock indices: PFTS-index, PFTS-Cbonds, PFTS-Cbonds/TR, SB50 and KP-Dragon. Then with using this matrix we can easily find matrix of latent indices and standard stock indices values.

In this research, accuracy of stock indices is the difference between its actual and true value and measured with the series of errors. According to calculations the highest level of accuracy has index KP-Dragon, it's average relative error is 1,11 %. Also high levels of accuracy have PFTS-Cbons/TR (1,19 %) and PFTS-index (1,64 %). The biggest average relative error has index SB50.

On the other hand, adequacy of stock index is the level of accordance the values of stock indexes to the character of the market events. The low value of this index means the low adequacy of stock index. If  $A < 0,75$  there is no practical use of this index. Adequacy index for the PFTS-Cbons/TR is 0,87887. It means PFTS-Cbons/TR shows 87,887 % of the total variability of standard stock index.

To determine the reasons of low PFTS-index quality and prevent instability and uncertainty at financial sector, linear model of factors which influence PFTS dynamics is used. Among 8 variables the best explanation of PFTS dynamics is provided by only two: deposits rate in national and foreign currency.

Further directions of studying this topic are estimation the third characteristic of quality – reliability, determination the influence on the stock indices quality such factors as input data, market capitalization, branches set for the calculation the index base, index formula, foreign issuers, representativeness of sample, volatility and liquidity. Also in the net studies we plan to make recommendations on construction an efficient stock index for emerging market.

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## NATIONAL BANK POLICY IN OVERCOMING THE CRISIS PHENOMENA IN THE BYELORUSSIAN ECONOMY

1. The distinctive feature of the year 2009 will be the work in the conditions of the world financial crisis. The peak of it is expected exactly this year.

The country and its bank system particularly face a range of global new problems, demanding urgent solution.

A lot of measures are taken to prevent the increase of crisis phenomena in the national economy. Emphasis is placed on the strengthening the bank system and on the creation of the so-called “safety pillow”, that means the increase of official reserves by means of attraction the international loans of other countries and international organizations.

Thus Russian Federation has allocated credits to Belarus the amount of 3,5 billion USD for the last two years. Belarus has also received the first tranche of the 2,5 billion USD credit from the IMF to the amount of 800 million USD and expects to receive the second one of 1 billion USD in April. A currency swap with China was made to the sum of 20 billion CNY (nearly 2,8 billion USD). The Republic of Belarus carries on negotiations to receive additional loans guaranteed by the state from Russian banks to the amount of 2 billion USD.

2. Other arrangements are also made to attract the investments in the bank system of the Republic. Particularly, the refinancing rate of the National bank was raised from 12 to 14 % on the 8 of January of the current year. It is expected to promote the more thrifty usage of financial resources of commercial banks. Moreover it will attract the public to deposit in the national currency due to the rise of deposit interest.

3. The share of presence of foreign capital in the bank system was increased from 25 to 50 %. It allowed to attract additional investment and to raise the volume of bank capital. It rose the last year from 6,5 trillion to 11,3 trillion BYR (approximately 4 billion USD) or relative 73,3 %. It is also planned to open three new banks in the nearest future. More than 10 million USD has been already generated for the statutory fund. Nowadays there are 31 active banks in the Republic, 25 of them are created with the help of foreign capital and 8 of the last are completely foreign.

4. National bank cooperates actively with central banks of Russia, Ukraine, Latvia and Lithuania. The attention of the cooperation is focused on the elaboration and realization the measures on the reduction of crisis phenomena of world economic crisis. An interdepartmental group of experts was created to study and analyze the world experience of overcoming the consequences of world economic crisis.

5. A new currency policy has been introduced since 2 January 2009 to prevent the negative influence of the considerable changes of BYR to EUR and RUB. This policy is much more flexible and it provides the mutual stability of exchange rate to the currency basket of three currencies including EUR, USD and RUB. The possible deviation of basket price during the year is presumed not to exceed 5 %. With the introduction of a new currency policy BYR was devaluated on 20 % to each of the currencies in the new basket. It was done according to the agreement with the IMF in order to receive the credit.

6. In an effort to overcome the crisis the government gave the task to organize the most possible favorable business and investment climate in the Republic so that it will be able to get in the list of thirty countries with the most favorable conditions for foreign investors.

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## INFLUENCE OF THE FINANCIAL CRISIS ON ADVERTISING ACTIVITY

In modern conditions of globalization and increasing international competition, advertising activity is the main instrument of promotion goods and services at foreign and interior markets. Moreover, advertisement is a very important part of industrial communications, being a very powerful stimulant for activation of industrial processes. Advertising is one of the most important elements of marketing mix that has very strong and direct influence on people's behavior.

Problems of enlarging effect of advertising activity were contemplated in works of following Ukrainian and foreign scientists: M. Izenberg, U. Arens, D. Bernet, K. Bove, I.A. Golman, O.V. Simonyan, S. Moriarty, K. Rotuel, C. Sendige and others. Foundations and principles of advertising business, problems of leading and planning of advertising campaigns are described in works of V.L. Muzykant, F.G. Pankratov, S. Rozhkov, T.K. Seryogina, O.A. Feofanov, E.A. Utkin, A. Deyan, L. Persi, J.R. Rossiter, W. Wells and other researchers.

In conditions of the financial crisis, consumers demand for most goods and services that are not vital necessary, decreases sharply. This process is leading to serious detriments in most spheres of national economics, so advertising activity is shortening. However, the full reduction of advertising budgets of most companies leads to more serious decrease of consumers demand, and even to bankruptcy of enterprises. In crisis conditions it is necessary to create the specialized complex of actions, which would stimulate advertising activity.

According with data given by largest agencies of outdoor advertisement in Donetsk region (Golfstream, Mediamaster, Mediahouse), workload of bill-boards for January, February and March of 2009 reduced at 57 percent in comparison with level of 2008. This was caused by the fact, that most companies have not yet prepared advertisement budgets. Also, important role plays politics of expense economy and impossibility of using credit resources. In this case advertising agencies have to decrease salaries of their staff, or even to fire some workers. Also, there is a tendency of refusal to inculcate and to use the innovative methods of advertisement.

In these conditions, state should improve law and institutional bases, connected with regulating of advertising business. First, some restrictions,

connected with advertising of alcohol and cigarettes, should be changed during the crisis. Second, it is necessary to stimulate and encourage social advertisement. Third, state should decrease the level of taxes and obligatory payments for advertising companies.

During the period of crisis, enterprises should, first, make courses and trainings for improvement of qualification for their workers. Second, advertising companies should regulate in effective way their prices to ransom some of their expenses. Third, in some cases enterprises activity restructuring is strongly recommended. For example, some outdoor advertising agencies should sell bill-boards with low work-load.

In financial crisis advertising business is becoming more complicated, that is connected with advertisement budgets decrease. Therefore, increase of advertising companies effectiveness will be a result of internal reserves realization, state politics and improvement of strategic development of advertising enterprises.

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## THE PROSPECT OF ADAPTING THE SWEDISH MODEL OF SAVING THE BANKING SYSTEM DURING THE CRISIS IN UKRAINE

Banking services are an integral part of today's market. The aims of the operation is raising the income of banks and improve customer satisfaction, increase their purchasing capacity, which in turn promotes the development of national economy, especially during the crisis. But achieving this goal requires the use of scientific principles and effective management of banking services.

Swedish banking crisis was part of the great financial crisis that hit Swedish economy in 1991-1993. Its origin is connected with the financial liberalization of the mid 1980's that led to the lending boom. Fixed crone exchange rate allowed using monetary policy to mitigate the boom by raising interest rates. Boom quickly turned to collapse, especially in the banking sector. Thereby, a Swedish model for resolving the crisis for banks was invented. It includes the following key features.

1. Political unity, which led support a fixed exchange rate policy for crone, which lasted throughout the crisis.
2. Provision of guarantees of bank deposits and liabilities.
3. Proper legal framework based on open distribution of funds.
4. Full disclosure by banks.
5. Differential policy of maintaining the banks and prevention of moral hazard.
6. The role of macroeconomic policy in the completion of the crisis. The fall of a fixed crone exchange rate after speculative attacks was an important step towards recovery. After crone was floating, it sharply devalued, creating an incentive for rapid export growth. The fall in interest rates weakened the pressure on the banking system.

Swedish model for solving the banking crisis was successful, and the Swedish banking system remained stable. It continued to operate without any threats to the banks and without any signs of the credit crisis. It still remained mainly in private ownership and became profitable soon after the crisis.

To use the Swedish experience it is necessary to compare the Swedish crisis of 1990's and current financial crisis in Ukraine. These two crises are caused by financial crises and the same forces – weak monetary policy and lack of financial supervision.

On the other hand, there are significant differences. The Swedish crisis was a local phenomenon. As a small open economy, Sweden has been able to abandon the fixed rate and achieve a significant devaluation of its currency, which contributed to rapid recovery. This option is unlikely to be possible for individual countries today because the current crisis is global.

Moreover, in Sweden there is a substantial tradition of public confidence in national institutions. Such social capital creates the possibility to achieve fast and lasting agreements on strategic activities.

Despite some differences, the Swedish experience is instructive. Solutions must be implemented within a coherent and comprehensive strategy, which has strict legal frameworks. Support in beneficial terms of financial openness, which will ensure the solvency of the financial system. Furthermore, support should be designed so that the public perceived it as honest and fair.

The Swedish case shows that the problem of the taxpayer is to serve as a source of capital or investor of last resource for recapitalization of financial system, thereby providing a deterrent effect on the decline in the real economy.

Swedish formula can not be imported to other countries because of institutional differences. Nevertheless, its main principles can be applied out-

side of Sweden today, primarily in four areas. Firstly, Swedish experience shows that the threat of bankruptcy or nationalization must be real, because it forces the private sector to find appropriate solutions. Secondly, the Swedish model shows that banks, at the brink of bankruptcy, which will be nationalized, to be divided into good and bad banks, to encourage the financial system quickly earn again more precisely, the bad assets should be removed from the balance of banks. Thirdly, solution to the banking issue has helped principle of public financial commitment of the Government. Finally, political action must be swift and decisive to stop the cycles that occur during a financial crisis.

Summarizing the outcome, Swedish model should be used as a general template for countries that are faced with a financial crisis, but these countries will need to adapt the details of its implementation, taking into account their own conditions.

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## THE MORTGAGE CRISIS IN THE USA AND THE DEVELOPMENT OF THE WORLD CURRENCY SYSTEM

The main reasons of the mortgage crisis in the USA of 2007 are examined in this work. Also the role of the basic reserved currencies in the financial area and the world currency system development forecasting is given with the formation of regional economic unions.

Nowadays the most actual is a problem of dollar exchange rate instability which results in the gradual rejection of it in the international calculations and as a result to the passing to the other currencies. In this case there is a revision of the basic reserved currencies role in the financial world.

The starting-point of the essential changes, connected with the fluctuation of the of dollar exchange rate in March-October of 2008 is a mortgage crisis in the USA, which is seriously struck on the housing building, and also on the banking system, financial and fund markets of the whole world. For the last 40 years 62,5 million units of habitation were built in the USA. Their general area is about 12,5 milliard square meters. It makes over 40 square meters calculating on the one habitant. During the last 15 years there was a permanent growth of the building volumes. In 2005-2006 there were almost for 2 million units annually, such volumes were the most for

the last 23 years. The scoring system (an estimation of the solvency of borrowers) was excessively simplified because of necessity of amount considerable increase of the given out credits. The mortgage credits were given to the non-standard borrowers with the high risk of credits irretrievable. Their part formed only 6 % of all volume of the given out credits in 2002, while 20 % in 2006. Actually over 90 % of the able to work citizens, including disabled categories of population, make use of the mortgage.

In the conditions of the mortgage crisis Federal Reserve System was realized the policy of “cheap” money, which was expressed in the not ending emission of dollar, it caused an excessive suggestion, and became the reason of instability of dollar and changes of its course. A lot of states began to carry losses in the foreign economic activity cause of decline of dollar exchange rate and were forced to work out measures which would counteract the development of the negative tendencies in a financial sphere.

For this purpose the majority of countries worked out the policy of association in the economic unions with the following emission of reserved currencies, for which essential and steady demand is needed from the side of country-importers on the exchanges and international banking market, and also the use in the international trade, in the foreign economic activity, at the loan capital market.

The possibilities of regional currencies with their status of reserved acquisition are so tempting that aspiration to forming the regional unions with the creation purpose of such currencies and receipt access to the new source of riches is irresistible. Nowadays the question of regional currencies creation is worked over in a number of countries: by the countries of South Africa ( Namibia, Swaziland, Lesotho, Botswana), six countries of the Persian bay, which decided to introduce the new international currency in 2010, – “kalidji” or “dinar of the Bay”, the countries of Asia and Pacific pool are working over a question about creation of the common Asiatic currency ACU, by the countries of Latin America, and also by Russia which has an enormous potential to give ruble the status of reserved currency.

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## REFORMATION OF DOMESTIC MOTOR INDUSTRY IN THE CRISIS CONDITIONS

Domestic market of cars requires real changes. World financial crisis demonstrates faults of developing strategy about domestic automobile industry.

As an initial step towards stabilizing this troubling scenario, governmental agencies should seek to establish a plan to implement the direct purchase of automotive machinery and components from domestic suppliers. Such a move would serve to support both the fragile automotive industry while providing a much needed boost to the ailing economy.

For example ZAZ collaborates with 827 Ukrainian factories to support itself. Lanos is a leader of sales in sector of new sedan cars for three years.

Ukraine existing machine-building enterprises are like engines for the economy which supports most players of the industry. One job at the ZAZ factory provides not fewer that 10 jobs all over Ukraine.

The import stopped at all because of demand reduction and creating of 13 percent tax for imported card. We should use this situation for sales increasing in condition of crisis.

This downward spiral could potentially lead to an irreversible collapse of this vital industry with subsequent repercussions to the economy-at-large. As an illustration current demand statistics signal an 83 % reduction in assembly production.

Biggest part of using cars in government sector is made abroad. It should be changed. Subsidizing or formulating partnership models with large scale international conglomerates such as GM or FORD and utilizing their modernization practices, marketing models and management styles, it would be a catalyst for rapid-fire changes and success. In lock-step we should develop, design and market our own domestic models under the auspices of these banner companies. This would make a result in national brands which would not only be cost-effective to produce, but which would open our markets to international review and acceptance.

Consumers with financial assistance through low interest marginal loans would increase sales. We must also remain vigilant in our efforts to foster solutions to the current barriers imposed by the WTO specifically these which relate directly to the custom duty rates. By embracing this prescribed recipe for change by resolving to adjust to the changes required in a

global market and especially by remaining committed to the sacrifices of the designed plan changes along the way, our automotive industries can not continue to exist, but prosper in the world setting.

National banks should be integrated in these reforms as participants and start with credits for modernization and of course in consumer lending.

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## THE WORLD ECONOMIC CRISIS “EPIDEMIC”

Today the entire world is embraced by economical crisis, which has seriously influenced practically all vital spheres. Undoubtedly, it comes from the USA. The reasons of the crisis can be classified as follows:

- European currency “EURO” became a real competitor to the American currency “Dollar”. When euro appeared it had almost crushed the golden period of dollar monopoly presence;
- USA external expenses have increased especially due to the arms. According to some experts’ opinion, arms expenses in Iraq have exceeded 2,5 trillion dollars, which is about half a trillion annually;
- American industry level fell in comparison with other states. The volume of American participation in world trading has reduced. While earlier America dominated over 40 % all world trading volume, now it has reduced to 20 %;
- other factors, which affected it, became bankruptcy of insurance and mortgage companies caused by high interest, accommodation credits in particular. Thus more than 3 millions of Americans use these credits.

Actually the American economy suffers real economic crisis now, but not an imaginary one. The forecast is that crisis will cause a great stagnation worldwide even more dangerous than the one occurred in 20ies of the last century.

Beside the fact, that financial crisis in USA caused serious difficulties within the country, it has also influenced the world economy and caused world economic crisis.

There is no practically either one country in Europe not infected by crisis by the moment. The reason is that Euro Union economy is tightly connected with the financial system of the USA, first of all due to the dollar dependence.

Island was the first one to suffer from crisis. The thing is that Island is the European off-shore zone with the exemption taxing. When crisis came, there started money outflow from Island, which caused Island economy crashing.

There was a wave of recessions in Europe after Island. The production and personnel reducing started. Automobile and construction spheres were also reduced. Banks suffered bankruptcy. Great Britain has nationalized the largest banks of the country because of the financial crisis. For instance,

Great Britain's GDP was reduced for 1,5 % during the fourth quarter of 2009 due to the world financial crisis. Judging by the GDP reducing indexes of other European countries, the economy is in deep recession now.

Ukraine was also infected by the world's crisis following Europe. Ukraine has probably suffered from the world's financial crisis most of all. It happened due to the fact that the country has dollarized economy since 1990 as well as the significant involvement in globalization processes of world economical and financial systems, which is supposed to take all the events of outer world to the domestic economy, both positive and negative ones.

According to the UNO experts' data, Ukraine is the head-liner in the list of countries that are supposed to have a default in 2009.

Economical crisis in Ukraine can be characterized by the following factors:

- external debt increase (which especially concerns private banks and corporations) up to 100 billion USA dollars by the half of 2008. The state debt has increased from 7,6 % of GDP in 2007 to 13,1 % in 2008;
- according to the official data the level of unemployment in Ukraine will be 9 % in 2009. Thus, according to the majority of experts' forecasts, it will be 25 % of inhabitants, able to work which comes to 5 million people;
- hryvna's devaluation for 4 months has depreciated country's currency for more than twice regarding USA dollar. In December 2008 it was more than 10 hryvnas per dollar, while in August of the same year, before the crisis started, it's cost was 4,5 hryvnas;
- bond gaining at the debt market, which is calculated as the difference between the margin of securities of any country and American exchequer bonds, in 2008 for Ukrainian bonds came to the record 27,38 percent points. During 4 months this index has three times increased;
- massive capital export from Ukraine caused financial support of affiliated companies break up;
- panic at the financial market caused the mass get down of resources from the accounts, which in turn caused the threat of banks' bankruptcy.

As far as the crisis became a global problem today, the scientists all over the world work out the ways to overcome it. It's impossible to propose the common anti crisis way, because it's individual for each country.

For Ukraine it is first of all regaining of the bank system activity, returning the investors' trust. Holding the state protection policy will give the opportunity to improve trade national currency dependence from dollar as well as making balance and the level of employment. It is also minimizing

stabilization foundation. It is also necessary to reduce state expenses (of state and local authorities). We can't help mentioning that the crisis is escalated by political instability of the country. The main clause of the way out from crisis is consolidating all political forces on the way of its getting over.

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## THE UKRAINIAN TICKET

Before discussing future implications of the global financial crisis for Ukraine's economy, let us consider if it has already affected us. The national economic system is integrated into the world economy closely enough to be involved in the global processes. The eroded macro-stability of international markets could not but impact internal developments in Ukraine. The global financial crisis of 2007-2008, as any other, has been unfolding in several waves. We have survived the first two without great losses, although not without mistakes.

The first wave rose in 2007, when stock indices of the world's leading banks and financial institutions went down. Under the circumstances, risk capital looking for stable yet high-profitability markets moved from developed to emerging markets, which continued to show high growth rates and profitability. According to financial experts, the risk to profitability ratio in those emerging markets was fairly attractive. As a result, stock markets in respective countries grew in 2007, China and Ukraine being leaders of such growth.

The inflow of credits was also substantial: in 2007, Ukrainian economy borrowed USD 24,3 billion in middle- and long-term credits.

The second wave started in early 2008, when the ongoing fall in the world stock markets re-directed cash flows from one class of assets to another, in particular to commodities and energy resources. These assets became more marketable, and commodity prices soared up. In January-July, average metal prices in eight regions of the world rose by 81 %; "Brent" oil price rose by 32 %. By the time first favorable forecasts appeared as to the global gross grain harvest in 2008/2009 marketing year, wheat prices (USA, FOB) for 2007/2008 marketing year had grown by 79 %, on average.

Ukraine's economy responded to the challenges, mentioned above in the following way.

The overall inflationary background intensified. Inflationary spiral, set spinning in 2007, has been in motion in 2008. Political instability affected economy. Over the first eight months of 2008, industrial manufacturers' prices grew by 36,5 %, especially in such sectors as mining of mineral resources (except for fuel-and-energy ones) by 70,4 %; metallurgy and metal works by 68,1 %, coke production by 64,3 %; and the chemical industry by 55,9 %. All of these sectors are oriented towards foreign markets or towards servicing export-oriented production.

The convergence factor (resulting from openness of the Ukrainian economy to global trends, e.g. to the 2008 consumer price rise in most countries of the world) also accelerated inflation processes in the domestic consumer markets. In September CPI amounted to 101,1 % (in January-September it amounted to 116,1 %), but it was much less than in 2006 and 2007, when it grew by 2,0 % and 2,2 %, respectively. So in general, in Q3 Ukraine had the lowest rate of price rise in the last four years – as low as 0,5 %. The overall inflation was driven, first and foremost, by rising prices (tariffs) for services.

The role of export-oriented production in the country's economic growth increased. In early 2008, production growth in export-oriented sectors accelerated, and the financial resources of the national economy were re-distributed, in particular through the banking system, from other sectors into commodities and export-oriented ones. Thus, in the first seven months of 2008, production growth in metallurgy was 3,5 %; in the chemical industry it was 5,2 %. It accounted for relatively high growth rates in industry at large – 7,3 %.

Over the same period, the share of profitable companies in the total number of enterprises increased from 65,1 % in January-July 2007 to 66,9 % in January-July 2008, and their profits boosted by 71,7 % as compared to the corresponding period of 2007. Leaders of profitability growth were coke production and oil refinement (by 5,7 times), the mining industry (by 2,2 times), and chemical and petrochemical industries (by 2,5 times).

Lending also increased, especially in such sectors as agriculture (135,1 %), coke production and oil refining (132,5 %), machine building (132,1 %), chemical and petrochemical industries (130,6 %).

In early 2008, the Ukrainian economy remained attractive for foreign investors. The growth of total foreign capital investments in the national economy was 2,7 times as rapid as in the corresponding period of 2007. And again, most essential capital investments went to well-performing sectors: agriculture (149,7 %), banking and financial activity (142,1 %), coke production and oil refining (123 %).

Against a backdrop of positive balance of payments and excessive supply of hard currency, the official exchange rate of hryvna to the US dollar decreased by 3,96 % to reach 4,85 UAH/USD in late August. In January-August, foreign currency reserves augmented by USD 56 billion – to USD 38,1 billion.

The second wave of the global financial crises set off ripples in the Ukrainian stock market. The PFTS index lost 43,5 % in the first seven months of 2008, primarily due to the withdrawal of some foreign investors (the so-called “jobbers”) from Ukrainian, as well as from the global, markets and to political instability in Ukraine.

Almost all companies listed on PFTS suffered a decline in share and securities prices. Under the conditions of free capital flows, the Ukrainian economy demonstrated market-driven tendencies to seeking super-profits, which enhanced its export-oriented and commodity components, especially given intensified commodity drivers in the global markets.

The third wave of the global financial crisis is unfolding before our eyes.

It has already caused a series of bankruptcies of the world’s leading financial companies and financial crisis rollover to the real economy sector, drop in demand on global markets and, as a result, plummeting commodity prices and stagnation of leading economies. In August-September, average metal prices in eight regions of the world fell by 18,3 %, and oil prices fell by 26,5 %.

The Ukrainian economy has not yet felt the consequences of the third wave in full. At this juncture, it is hard to estimate their severity and duration, but some impact has been obvious.

Thus, in August, for the first time since October 2002, industrial production decreased by 0,5 % (y-o-y), in particular in metallurgy – by 8,6 %, the chemical industry – by 9,1 %, and coke production and oil refining – by 4,9 %.

In other words, a set of external shocks, coupled with the export-oriented companies’ strategy geared towards searching out niches in foreign markets while underestimating domestic ones, slowed growth, which, in the first eight months of 2008, was as low as 2 % in metallurgy and 3,5 % in the chemical industry. In general, rates of industrial production growth fell to 6,3 % in the first eight months of 2008.

The PFTS index continued to go down, losing another 43 % in the last two months. Bad news from mining industries and metallurgy had an adverse impact on the PFTS index, too.

In view of the above, the GDP growth of 7,1 % was achieved at the expense of other sectors, chiefly, agriculture, where the harvest was unusually rich.

Devaluation processes became manifest in the currency market, and in September foreign currency reserves reduced by USD 0,6 billion. Negative inflation expectations contributed to the overall turmoil. A negative balance of sale/purchase of cash foreign currency by the population amounted to USD 1,321 million.

The third wave of global financial crisis forced governments in the world's largest economies to revise their policy vis-à-vis financial markets. In particular, the governments of the USA, the UK, Germany, Russia, the Benelux States and other countries decided to support some of the troubled financial institutions.

In light of the escalating global financial crisis, the government and National Bank have taken a number of measures allowing for the reduction of the risk of its profound destructive influence. They include a package of anti-inflation initiatives, steps to enhance banking sector stability and to minimize the impact of the global financial crisis on Ukraine's economy. In early 2008, the National Bank passed a resolution toughening requirements to calculating the banks' regulatory capital adequacy (long-term asset transactions with time of floatation exceeding the time of funding should be additionally risk adjusted at 50 % rate and so on), which enabled banks to adjust and improve their position.

In addition, Ukraine has an "insurance police" of sorts in the form of Euro-2012. If the planned scope of work is fulfilled, the country will get a guaranteed inflow of foreign direct investments, mid-term and long-term loans, because investors worldwide view such events as image-building, promotional projects with low financial risks.

As a popular saying goes, hope for the best and prepare for the worst. The current challenges and threats require that public authorities and the private sector address them effectively and take additional preventive measures.

What can NBU do? In order to prevent a banking crisis, NBU should establish principles of refinancing commercial banks that have short-term liquidity problems for the period of financial crisis. A currency crisis can be averted with a series of measures precluding the exchange rate destabilization by speculators. NBU should continue to pursue the policy of increasing the rate volatility in order to reduce risks to the balance of payments.

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## TRANSFORMATION OF COMMERCIAL BANKS' FUNCTIONING STANDARDS IN GLOBALISATION CONTEXT

Throughout recent years Russian economy entered a new stage of development. From the country with transition “catching up” economy it became one of participants of the international economic and financial relations. Along with other countries showing the tendency to accelerated growth of economy in last decades, such as China, Brazil, India, Russia has entered the world financial market. For successful performing on international level Russian financial institutions should observe the universal rules that absorb codes of best practice. Russian entities should be able to perceive, and also to give the adequate and comparable information.

The present stage of Russian financial system development, shown in convergence of national standards and the best international practice, is accompanied by considerable unsettling of its institutional bases that interferes with achievement of national financial stability in the conditions of globalization.

All it predetermines the necessity of revealing of new approaches to the research of theoretical and practical problems of convergence of national financial institutions functioning standards in globalization context.

For unobstructed participation of the Russian entities in the international economic activities the conventional international standards should be accepted on the national level. Now Russia is at a stage of gradual adaptation of international standards: some standards are already actively applied by Russian entities, others are at a stage of introduction and are gradually entered into the practice, some standards were considered in creating domestic norms, requirements and laws. In Russia there is a process of gradual transition to the international standards. The most appreciable is introduction of the International financial reporting standards (IFRS/IAS) as the overall performance, both of separate financial institutions, and the state as a whole, is reached only if there is real and comparable information.

In recent years the quantity of standards in the financial sphere has considerably increased, they are devoted to various aspects of financial institutions' or financial market activity and developed by the international

organizations (the International Monetary Fund, the Organization of economic cooperation and development, etc.). However the international standards represent principles of institutional organization of certain financial market sectors, or the best practice and behavior rules.

At the same time, undeservedly little attention is paid by the economic science to the development of national or internal standards of financial institutions activity, though these formal and informal rules represent the unified minimal requirements which are developed both by regulators, and by the self-adjustable organizations. The role of internal standards is to be further analyzed by the international organizations, systematized and then to pass selection and be extended as the best practice worldwide.

One of priority problems of the Russian Federation at present stage is development of optimum forms of financial and economic integration. Harmonious integration of Russian financial system into world financial architecture assumes necessity of preliminary achievement of steady and long-term convergence of Russian financial institutions' functioning standards with international standards, and also expansions of possibilities of flexible adaptation of national economy to consequences of financial globalization, including carrying out institutional reforms by the government. However it is necessary to understand, that the establishment and a recognition of the international standards itself cannot guarantee financial stability to the country; it is only condition and means which creates background for financial system strengthening, and additional potential of economic growth.

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## THE REASONS OF NECESSITY TO SUPPORT THE LIQUIDITY OF BANKS IN UKRAINE AND WAYS OF ITS IMPLEMENTATION

Intensive movement of financial streams and the relative ease of raising funds in the banking sector stimulated the development of system of living at the expense of the large amounts of external borrowings.

Following the situation today, one can't argue that external loans and commitments have a significant impact on liquidity of the banking system. By 01.01.2009, banking assets, liabilities and capital increased by 50, 52,4,

73,7 % (in nominal rates). According to the National Bank, our banking system has total foreign debt of \$ 39,424 bn.; in fact, foreign lenders wanted to see increasing banking capitalization, to be sure that the banking system can return the debt. This has served as one of the reasons for growth of total bank capital in the last year by 73,7 %, but even with such level of growth debt overcomes in 2,5 times the capital.

Analysts of IC Phoenix Capital, believe that in 2009 the total amount of debt payments to foreign bank loans (including loans of foreign parent companies to Ukrainian daughters) will constitute \$ 16 bn., when only \$ 3,236 bn. were announced by banks. We noted that the banking system needs liquidity support due to three main reasons:

1) internal sources of attracting finances to the bank circulation are weak. So according to the National Bank data there is rapid withdrawal of funds from bank deposits during the past 4 months. Even despite the moratorium of the National Bank, as of March 1, the amount of liabilities of banks decreased by 6 % (55,6 bn. UAH). But the proposal of transferring money from time deposits to the category of transfer payments (the so-called contribution “active money”) significantly reduced the loss of liquidity by banks;

2) against the backdrop of recession the population becomes insolvent. The loans to the population in total loan portfolio last year were 34 %, half of which is consumer and was issued during the boom in mortgage lending, which will not return the loan in case of property condemnation (disposal). According to collectors, bad loans for consumer loans constitute 30 %;

3) there is dollar deficit in the Ukrainian monetary market, which complicates the search of foreign currency for repaying debts and, in our opinion, probably will lead to increasing of instability in the foreign exchange market and the rapid spending of foreign currency reserves of the National Bank (which during January and February decreased by 16,1 % to the level of \$ 26,459 trillion) in order to support UAH rate on the interbank market and refinancing problematic financial institutions. Also a use of UAH issuing loan from the National Bank can cause the acceleration of an inflation rate (the refinance funds only for October, November and December was 92,8 bn. UAH. That is 18 % of M3).

As an implementation of the following actions, in our opinion, all banks should be separated into three categories. The first will include banks with foreign capital (53), which will be supported by borrowings from the parent structures, the second – small banks, the third – to be 100 % supported

by the NBU. After analyzing the practices of liquidity support of banks in crisis, we have several mechanisms:

- 1) implement law creating a system that would consist of the insurance fund, for example: SFSA (U.S.) or Arco (in Russia); and two corporations: financial and trust that would perform the role of regulator in the market. Also it would be important to initiate the establishment of the National Regulation Organization in consumer and mortgage loans;
- 2) asset securitization. This instrument needs confidence from the side of investors, what is almost impossible because of provocation in the media and negative assessments of international rating agencies;
- 3) bank consolidation. This method will allow banks to concentrate capital, but instead, each of them will lose the independence of action and the same may lead to reducing the range of banking services.

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## THE INFLUENCE OF THE WORLD CRISIS ON THE UKRAINIAN FINANCIAL SECTOR

The possible global financial crisis was predicted back in 2007. The Economist Intelligence Unit experts considered that the difficulties at the financial markets, caused by the hypothecary crisis in the USA, would last from 12 to 18 months. Its influence on the world economy was estimated under the several scenarios, one of which has been realized already. Its probability made only 10 % because of the predicted possibilities of national economies on crisis prevention. Unfortunately, the world economy has paid the least attention to this scenario of crisis development. In Ukraine in 2007 the academicians of Economic Forecasting Institute advised the Cabinet of Ministers and National Bank to introduce a complex of anti-recessionary measures: to constrain import and consumer crediting, to cut down social expenses of the budget. Standard & Poor's experts in the middle of 2008 put in question the stability of Ukrainian banks. According to their calculations, the indicator of problem actives in credit portfolios of the banks made 75 %. Besides, Standard & Poor's made negative forecast for the Ukrainian state obligations: it means that the credit rating of the country tended to fall. As of July, 1st, 2008 the external debt of bank sector exceeded \$ 38 billion, obligations of other sectors of economy – \$ 46 billion.

In 2009 banks and the companies need to pay about \$ 45 billion of debt, although the solvency of many debtors is doubted. The main problem for Ukraine is the present state of the economy. Therefore the key problem now is the downswing in production and reduction of crediting of real sector of economy. Sharp depreciation of securities in the bank portfolios has taken place as well as reduction in price of credit portfolios. These problems put pressure both on capitalization, on liquidity, on profitability of bank system, and in future – on their development. Decrease in a sovereign rating of Ukraine (Fitch Rating Agency) definitively closes the foreign credit markets for domestic financial establishments. Reduction of depositary base and growth of credit risks have led to sharp deterioration of situation in many banks. Following the results of January, 2009 deposits were reduced by 5,1 %. In Ukraine more than half of banks belong to the local capital, however the government supports only the state banks. Among the possible ways of solution of the Ukrainian bank system problems it is necessary to allocate the following: creation of the state agent through which the help to financial establishments will be provided. It is necessary to pay special attention to large system-forming banks and socially significant financial establishments. For banks with the foreign capital it is necessary to create the tool which will allow to hedge currency risks. The market of currency forwards and swaps should be created. Formation of the free currency market will allow avoiding devaluation at any crisis phenomenon. The cores task of financial establishments now is preservation of credit portfolio quality, decrease in ruptures of liquidity and reduction of superfluous expenses. National Bank has to limit credit expansion (in Ukraine over 80 % of actives are credits), to give sufficient level of refinancing to banks (in January, 2009 refinancing was practically not given), together with banks it is necessary to define whom to finance and on what conditions in order to minimize risks. Problem banks can raise capitalization through sale of new actions to foreign investors or the state. It is possible to minimize the negative consequences of defaults of the companies and banks by means of the effective mechanism of bankruptcies. According to the forecasts of experts, quantity of banks in Ukraine will be considerably reduced, the role of banks with the foreign capital will grow. The present crisis situation can be used to improve the controllability of bank system through strengthening of the role of the state banks. To financial sector predict growth of non-returns under credits, record losses and a train of bankruptcies. The corporate sector can refinance about 40 % of the bank debt and 50 % of the interfirm credits arising in the course of international trade. Even at a present unstable situation in the financial market companies and banks continue to involve credits.

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## KEY FACTORS OF SURVIVAL OF SMALL AND MIDDLE BANKS IN POST-CRISIS TERMS

Huge amounts of government assistance have been poured into the global economy during the recent crisis. But even unsophisticated observer would note that all that assistance goes to the largest corporations and banks, while the majority of smaller market players are left alone with their problems.

Leaving behind the issue of ethics in curing the results of unbounded financial appetites of world's largest companies, I would like to focus on the problems of small and medium-sized banks, which prove to be the capillaries of national financial systems of almost all countries, compared to the large systematic banks, which we used to associating with backbone or heart.

It has been traditionally stated that micro, small and medium-sized enterprises are important ingredients for stable and equitable growth in any national economy, since they are more labor-intensive, more socially responsible, more innovative and flexible etc. Support of micro, small and medium-sized enterprises has become cornerstone of many national policies in both developed and developing countries. Still in many cases those companies would lack good access to financial resources if not small and medium-sized banks.

In a general case, modern bank is a set of mathematical formulas that earn revenues from spreads of dual pricing such as borrowing and lending rates, wholesale and retail rates, as well as from commissions. At the same time, bank costs are very similar to other servicing companies, being directly proportional to the complexity of products and adversely proportional to their standardization. The latter factor forced many banks to offer a variety of standardized products, which are customized only for the largest clients.

Dealing with small and medium customers are often perfunctory, via call-centers or internet sites, while they are the very group of clients that require personalized services and customized solutions to keep risks under control. That brings to the scene small and medium-sized banks, which have the same business philosophy and approach and are willing to deal in persons with much smaller customers.

In addition, smaller banks are often more specialized in servicing its customers and are able to react faster to changes in business environment and customer demands. Therefore, despite providing more expensive services, they in fact can lower total costs of banking for small and medium-sized companies.

Unfortunately, in Ukraine the situation is largely different. According to the National Bank of Ukraine, there are 120 small and 24 middle-sized banks in Ukraine as for 1<sup>st</sup> January 2009. Altogether they constitute 79 % of total number of banks in Ukraine, but operate only 20 % of its capital.

Small and medium-sized banks are mostly captive banks, used by large enterprises to gain access to cheaper interbank and foreign funds, as well as for servicing only corporate transactions. The examples of such banks are Kredit-Dnipro (associated with EastOne corporation of Viktor Pinchuk), Megabank (Energy Standard of Konstantin Grigorishin), Accent-Bank (Privat Group of Igor Kolomoyskiy and Gennadiy Bogolyubov).

Second large group of small and medium banks consists of regional banks. They are mostly universal banks with activities focused on one or several regions. Such banks are Poltava Bank, Marine Transport Bank (Odessa), Familniy (Donetsk), Bazis (Kharkiv).

The third group consists of specialized banks, focused on niche services. Most of them appeared during the flourishing of real estate and were active in real estate financing and mortgages, which was stimulated by specialized legislation. Examples are International Mortgage Bank, Arkada etc.

The fourth group includes banks that were created for sale or conduct market testing activities for foreign banking institutions prior to full market entrance.

As one might see, Ukrainian small and medium sized banks just entered their path towards performing their most appropriate functions. Still, current crisis made them face several very serious dangers, which are sometimes even higher compared to their large competitors.

Collapse of one of the most profitable business lines of Ukrainian small and middle-sized banks (namely mortgage financing and real estate project financing) forced some of them to close down or move operations to other sectors. That is not easy under crisis conditions but still provides chances for survival. Thus for example, International Mortgage Bank was renamed to Platinum Bank and enlarged its operations in consumer loans at the cost of mortgage financing.

The second problem, in order of appearance not in importance, is the absence of available financial resources. Interest on overnight loans, used

as a proxy indicator of the health of financial system, has increased to 60 % and sometimes to 100 %, making them very expensive for most banks, while lenders became very careful concerning giving money to smaller banks.

National Bank of Ukraine provides long-term refinancing (above 1 year) only to the banks with more than 500 million UAH in statutory capital, which is not the case of small and medium-sized banks. Moreover, largest banks can count on support from international organizations and their own head offices, while smaller banks can not.

The third danger lies in the global trend to increase supervision and regulation of global banking system. Regulatory measures aimed at increasing capital and liquidity requirements will hit independent small and medium-sized banks with all their destructive power.

We should admit that small and medium-sized banks were lucky to avoid one danger that moves the current crisis in Ukraine. Due to their nature and inability to use complex financing instruments, small and medium-sized banks avoided accumulating large amounts of foreign debt, denominated in foreign currencies. That fact that was a disadvantage in the era of unlimited growth becomes a survival factor nowadays.

Still, small and medium-sized banks will have to look for active strategies to fight the current crisis successfully. One is to follow the global trend of renaissance of classic banking and the movement towards universal banks. That will require them to enlarge the assortment of services to the maximum possible extent. Of course, they will not be able to become truly universal banks, but partial diversification of services is highly possible.

At one hand, following that trend will put them in competition with the majority of other market participants, but at the other hand it will allow diversifying their activities and manage specific risks of being focused on limited product line, economic sector or customer group. Such approach will also allow increasing deposit base, which is becoming the major source of capital for small and middle-sized banks. But in order to become successful, they will have to improve existing banking model, introduce strict control over expenses and invent unique and distinctive features that can become competitive advantages.

Another possible strategy is to follow the example of airlines by creating strategic alliances of specialized non-competing banking institutions to cover various sectors of banking services. Such form of cooperation is not common in the banking industry, but it will enable small and medium-sized banks to conduct cross-sales of products, minimize customer attraction costs, improve efficiency of operations and generate revenues from operations

of other partners. Ideal banking alliance would cover the majority of specialized banking services and products, while individual partners will:

- provide basic banking services to its own customers under agreed pricing policy to avoid competition;
- concentrate on specific advanced services and products where it has competitive advantage over other market participants;
- generate profits on commissions from client forwarding to its strategic partners.

Mergers of small and medium-sized banks can become an implementation form of such alliances, when individual banks that participate in the merger will keep their specialization but will be managed from a single center of authority. Although mergers bring issues of proper evaluation of merging banks, which is not possible under crisis, and will create multiple grounds for conflicts between shareholders, which are not the case of strategic alliances.

And of course, traditional acquisitions of banks will take place in Ukraine, as in other developing countries, with small and medium sized banks being purchased by enterprises and investors from other industries with still positive cash flows, such as mining and resources, metallurgy, retail etc. Analysts tend to estimate that in the absence of other form of consolidation of Ukrainian small and medium-sized banks, 30-50 % of them will not survive the current crisis, being either closed or acquired by more healthy competitors or investors from other industries. In any case, all those sales of banks will not be beneficial for current owners, since the value of banks decreased significantly and in many cases is not even above 1 dollar of symbolic payment.

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## BANKING CRISIS IN UKRAINE AND WAYS OF ITS OVERCOMING

The negative influence of the world financial crisis on the economy and financial sector of Ukraine has already clearly appeared and will continue during rather long period of time.

The unavoidable social and economic consequences of such crisis can turn into stagnation or recession of the production, sharp devaluation

of national currency and high inflation, drop of living standard of population, unemployment and etc. The main threats at the present moment are overgrowing the banking debts of the state but also with external debts of the private sector and also mass bankruptcies.

In order to overcome the consequences of financial and economic crisis it is necessary to interact between financial and non-financial sectors of the economy to coordinate actions of all economic bodies.

The economy of Ukraine needs large-scale financial infusions into banking and real sectors of the economy as it is made in all developed countries which will give an opportunity to monetary issue, proceeding from the acute needs of the nation economy and borrowings. In order to achieve this it is necessary to use anti-crisis measures, for example, to create national stabilization reserves, the funds of which should be used for credits allowings, credits returning and service of the credits, received by domestic banking institutions and by the subjects of economy from foreign creditors to finance investment and instructional projects of the state significance to credit projects of small and medium-size business connected with creating new job opportunities to foresee the funds in the state budget to reduce interest rates for crediting agrarian and industrial complex, small and medium-size business which will develop the products, to improve the exchange rate policy of the state etc.

The main state support must be directed at those sectors of economy, production of which has solvent demand on the home and foreign market.

For support of liquidity of banks the National Bank provided the banks with credits of refinancing for the total sum of about UAH 105 billion including the credits “overnight” for the sum of UAH 43 billion.

On the legislative level it is necessary to carry out measures to stimulate banks merging, their enlargement and consolidation that will help to avoid bankruptcy of small and medium-size financial institutions.

Since the future of banking system is directly connected with the macroeconomic situation for overcoming the negative affects, it is necessary to concentrate economic power and to create politically independent monetary centre.

In crisis situation it is imperative to bind the aims of monetary and credit policy and financial regulation to national structural problems. Such interaction is possible owing to:

- ensuring correspondence of mechanisms of monetary emission to the aims of structural development of economy according to the investment active plan;
- close interaction with monetary policy, budget policy and regulation of financial markets for combined overcoming of market failure

in the financial system and providing effective fulfillment of the function of savings mobilization, relational capital allocation and risk control;

- developing the mechanisms of cooperation with the state of those financial institutions which receive state support including long-term credits of refinancing.

It is important to concentrate on the support of system banks which control 60-70 % of banking service market in order to avoid the crisis of system character not only in finances but in the economy as a whole.

Thus at the present stage of development the domestic economy and banking system require introduction of changes in their activity. Following the world experience, both positive and negative, it is necessary to strive for greater independence of financial institutions and rise of their stability.

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## THE PROBLEMS OF CREDITING BY COMMERCIAL BANKS IN UKRAINE

One of the most important categories of market economy which represents the real copulas and relations of economic life of society is a credit. A credit always was and remains an important lever in stimulation of development of production and shows by itself economic relations concerning reverse motion of the lent cost. A credit provides transformation of money capital in a loan and expresses relations between a creditor and borrower. With this help free money of enterprises, private sector and state is accumulated, growing into the borrowed capital which is passed to the physical and legal persons in the temporal use for a pay. A credit in a market economy is needed, foremost, as an elastic mechanism of transfusion of capital from one industries of production in other.

The theme is considered actual because of the fact, that effective crediting of economy on the whole and population in particular is one of the most important and the most actual tasks of the banking system of Ukraine. To bank institutions in particular, credit operations seem to be the most profitable ones and their result depends greatly on the choice of exact methods of grant and repayment of credits. Among the credit operations of commercial banks considerable part is occupied by crediting of population. In the last years crediting of physical persons caused considerable development the commercial banks of Ukraine. At the same time,

in this sphere there are problems among which it is possible to select the following:

- limitation of volumes of credit resources;
- high interest rates;
- a low level of population' trust to the banks;
- low level of bank management and others like that.

Here, a very important aspect in credit activity of a bank is planning and prognostication. It is difficult to over-estimate the importance of prognosis, taking into account the basis for drafting of perspective plans of credit activity of bank. The choice of method of prognostication depends on a few important factors:

- purpose and tasks to the prognosis;
- degree of information about credit activity being detailed;
- volumes of prognosis;
- the period of prognosis (month, quarter, half-year, year and etc).

Today, in the situation of economic and financial crisis, a question of allotting credit by commercial banks is problematic. The reason of it is that considerable part of the Ukrainian banks today does not allot credits because of the absence of free financial resources. Another condition of halt of crediting in commercial banks is low debt liquidation after credits in connection with inflation and diminishing of profits of population. This time commercial banks are given credits under high rate of interest or raising a mortgage on property and securities in terms of high risk of failure credit's return.

Consequently, nowadays in the context of overcoming of financial crisis a problem of crediting of economy is extraordinarily important and needs the special attention of the bank institutions as well as of the state.

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## DEVELOPMENT OF THE BANK TECHNOLOGIES IN UKRAINE. INTERNET-BANKING

The tasks which the financial organizations face nowadays are mostly the same – the integration of new systems through the structure of local and global networks. It helps banks find new means of relations with client and getting a profit.

In this research I studied different banking technologies, for instance, a system of production and delivery of bank products for the target audience for the purposes of fulfilling requirements.

Analysts say that new technologies are actively introduced by investment firms and then by banks. Researches of the global Insight shows that electronic technologies (in payment system) are considerably cheaper (on the average on 40 %) than paper systems, and considers that cost of cash services transfers save 18-20 % of banks' expenses. I'd like to underline that cost of bank services with the use of modern high technologies such as Internet-banking, mobile banking, phone banking, is about 20 times less than in usual bank branch. Besides, clients have round-the-clock access to their bank accounts.

New perspective technologies which successfully develop in the world markets now are always or with a long delay inserted in the domestic banking system. Certainly banks on their own are not capable to solve all problems of bank system such as high credit rates, low income, and risk on liquidity of mortgages only with the help of introduction of corresponding financial technologies. The developed operating market is needed and it will provide the demand among investors on corresponding services.

The basic directions of innovative changes in foreign banks are:

- the virtual financial technology – management of the bank accounts cash calculations, digital signature, and conclusion of contracts;
- the virtual finance organizations (banks, stocks);
- new automatic machines of self services (mono and multy functional information);
- gathering, storage and analytical processing of the inner information.

So as I have mentioned, the Internet-banking is the most widely spread technology. The number of Europeans using services of Internet-banking during the last few months of 2009 increased from 25,6 to 30,6 million users. Thus as turned out the volume of the use of online banking in each of the European countries is not identical. So occurred that the Internet-banking is mostly popular in Swiss and Finland, where 65 % users of financial sites use services of Internet-banking.

The interest of development of computerized banking systems is determined mainly by strategic interests. As practice shows investments in such projects begin to bring profit through a certain period of time (personnel training, adaptation of the system etc.).

In Ukraine the law about bank and bank activity declares possibility of granting of the financial services which is on adequate level in developed countries, however in practice possibilities of the Ukrainian bank sector remain to be limited. At the present stage there is a considerable backlog of Ukrainian financial establishments.

National features of the Ukrainian system of Internet-banking in most cases are taken only to inform client about the condition of current account. The majority of banks do not provide payments by mean of Internet-banking. But in such banks as “Aval”, “Privat Bank”, “Ukrsib Bank” and few others represent such technology. But for example in “Privat Bank” 1,3 % of the clients have an opportunity to use Internet-banking.

Under forecasts of some Ukrainian banks the realization of the project of Internet-banking will allow to extend client base on 30 %. They promote creating of system modern and in full accordance with protection of the information and speed realization of operations in Internet-banking. On the average the cost of development and introduction of similar system is about of 3-5 million dollars. Of course there are such problems as absence of legislative base.

Thus we can assert that services of “removed” banking gradually but not confidently get on the Ukrainian bank market. All business is in low level of use of the Internet. The quantities of clients of Internet-banking by most optimistically set estimations do not exceed 3 % of population of our country. Most widespread so far are systems of type “client bank” but mainly legal entities use this system.

To summarize I’d like to say that according to all available information more than 1 500 banks already render services of Internet-banking worldwide and 26 banks work only over the Internet. Such technologies can influence not only the speed of operations but reduce cost of services. In order to promote widespread system of banking services especially Internet-banking, Ukraine needs to:

- populate the Internet activity of persons;
- provide the policy of conquering the trust of users of Internet-banking;
- create a strait legal base;
- create secure usage of Internet-banking;
- modulate the investments on governmental level.

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## TRANSPARENCY OF INFORMATION DISCLOSURE IN BANKS' FINANCIAL REPORS

Research topicality. The annual report, including the annual financial statements, is a key for any commercial bank to meet its accountability ob-

ligations. These statements reveal the results of the bank's activities on its balance sheet as well as the use of resources at its disposal.

Purpose of research is to discuss the issue of the lack of transparency in financial reporting of banks and their consequences.

Research results. For most transition economies, Ukraine in particular, the accounting profession and the standard-setting framework in terms of market-based disclosures are still evolving. This can create potential problems for the production of internationally credible financial reports. Those who are not market participants and who have a conflict of interest, such as maximizing taxable revenue, may control standard setting. Experience repeatedly shows that the best defense to criticism is through open and transparent disclosure, since this removes the risk of the hugely damaging consequences that occur when it is revealed that disclosures have been less than total. It is difficult to overstate the importance of the role of transparency in discharging bank's accountability obligations.

Transparency in modern financial reporting is considered to be crucial in enabling users to understand and reach their own conclusions about businesses. The volume of information available has reached levels not previously seen and continues to grow as reporting requirements become more extensive and voluntary disclosures are made for a variety of reasons. It is generally accepted that this long-term tendency is appropriate in today's business world with greater emphasis on corporate governance issues, driven by more demanding shareholders and other interested parties. Major corporate scandals or crises, such as Enron in the USA and many banks' bankruptcies worldwide, show the necessity for increased transparency in financial reporting, although it is not obvious that reforms reduce the extent of such events.

Disclosure and the resulting transparency have not always been considered desirable. The banking sector of Great Britain can be viewed as a good example, where banks enjoyed, at first through custom and later through legal regulation, such reporting requirements, which permitted them to avoid reporting 'true' profits. The maintenance of 'inner' or 'hidden' reserves allowed banks to smooth their reported profits and understate their capital strength, thereby reassuring depositors and shareholders of their financial soundness and prudent behavior through conservative accounting.

Currently the framework of banking regulation is extensive and there is a clear international consensus that transparency in banks' financial reporting is desirable. Thus, the transparent and timely provision of information is intended to allow more effective operation of market discipline by the providers of capital, investors, and other market counterparties.

But while disclosure and transparency are considered fundamental in modern financial markets, significant international differences in these

areas have been recognized. For example, banks in Germany have been considered less transparent in their reporting than those in the UK. However, international comparability should be enhanced by moves towards greater uniformity in financial reporting such as the adoption by EU-listed groups of International Financial Reporting Standards in 2005.

The banking crises in the 1990s are commonly related to the regulation of disclosures made by banks. Disclosure in banking can be classified into two categories: ‘transparency-stability’ and ‘transparency-fragility’. From the ‘transparency-stability’ view, disclosure increases transparency and improves information flows. It helps market discipline and leads to the more efficient allocation of resources. The ‘transparency-fragility’ view assumes that disclosure creates ‘negative externalities’. These include the possibility that disclosure would stimulate bank-runs when particular banks faced financial difficulties. Therefore, it would destroy the banking system as a whole and have wider negative economic consequences.

Conclusions. One does not need to look far to see our Ukrainian reality examples of misusing the banks’ financial reports by politicians and economists to launch criticisms of both the government and central bank monetary policy. We believe that the ability to question performance of any business entity and any bank is an essential component of accountability. Those who prepare annual financial statements carry the responsibility of presenting them so that they provide an accurate and reliable picture of the financial results of the bank operations in such a manner that can be defended in terms of an internationally credible framework. Reliability of financial reporting framework contributes greatly to judgments about the integrity and stability of the national financial system.

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## CORPORATE SOCIAL RESPONSIBILITY IN THE CONTEXT OF ECONOMIC CRISIS: WORLD AND UKRAINE

A term of Corporate Social Responsibility (CSR) “born” in the middle 50s by A. Keroll is now under heated discussions especially during the period of global economic crisis, when we lack money and are forced to economize our costs. According to the vision of Philip Kotler, “Corporate Social Responsibility is a commitment to improve community well-being through discretionary business practices and corporate resources”.

In other words CSR aimed at ensuring responsibilities for the impact on the different areas such as: environment, consumers, employees, communities, shareholders, members of public sphere; and at the same time getting profit as the reward for it. The background of this corporate model is triple bottom line or 3BL, which stands for: people, planet, profit. This concept implies that a company can become successful only via keeping in mind these 3 stones, what even proves the wrong treatment of CSR as the charity.

There are numerous examples of successful companies, which have been showing a master-class of getting benefits from CSR. Otherwise, it wouldn't have been one of the basic issues of UN Global Compact and UN Millennium Development Goals (which lots of countries including Ukraine have already signed in). And really it goes without saying that such classical schemes of enriching from CSR as company's image and reputation, customers' reliability, governmental loyalty whatever do work on practice. No doubt we can follow these ideas through different classic resources and persuade ourselves in benefits from the ideal model of corporate governance. But there is another side of a coin, which is well seen especially in the context of crisis, the side, which goes along with the problems while implementing social activities and is aggravated by the consequences of crisis.

The key idea is that during the crisis the CSR budgets will be among the first to be trimmed. On the one hand it's against the Friedman's will about not stopping the CSR support. However, in the context of current global financial situation companies can't spend extra-money, because they are barely breaking-even. This decrease leads to the freezing of the projects and corporate programs, what negatively influences the reputation and consumers' loyalty. We've come up with another question whether company thinks about short-term period of time (which is not typical for the companies with strategic planning) or long-term one. We think that crisis is a good indicator to see.

Another point is money laundry, which is of the highest importance here in Ukraine. Due to the lack of reporting system in the sphere of CSR, money aimed at social goals, can be used "privately and corporately" enough.

So as we might mention the CSR performance in the context of crisis doesn't look picturesque. But evident enough that we can't stop CSR funding even in crisis, cause people are not very much keen on breathing dirty air, drinking technical water, buying low-quality goods etc. That's why there are alternative ways of CSR implementation, which can be fruitful even in crisis.

The main aspect here is to economize, thus investments into such CSR projects as energy saving programs, recycling, web 2.0 and social media for PR, youth projects etc. can really matter. Another important direction is to continue CSR in the area of quality not to lose the market share among the target audience.

To sum it all up, corporate social responsibility is a powerful instrument of doing business, which should be kept in mind even during the crisis.

*Наукове видання*

ПРОБЛЕМИ І ПЕРСПЕКТИВИ РОЗВИТКУ  
БАНКІВСЬКОЇ СИСТЕМИ УКРАЇНИ:  
ПОГЛЯД У МАЙБУТНЄ

**Світова фінансово-економічна криза  
та її національні особливості**

Збірник тез доповідей  
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