

UZBEK AND GERMAN BANKS IN SECURITY MARKETS

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Abstract: *This article deal with special aspects of bank security markets in Uzbekistan and Germany. Main types of security activities of Uzbek and German commercial banks are compared and discussed. In addition to this, the paper shows the main trends of security activities of our banks during the period 2015, 2016 and 2017. Last but not least, we showed some issues defined by our analyses and gave some recommendations to improve further security activities of banks in Uzbekistan.*

Аннотация: *Ушбу мақолада Ўзбекистон ва Германия банклари қимматли қоғозлар бозоридаги фаолиятининг асосий жиҳатлари ёритилган. Ўзбекистон ва Германия банкларининг қимматли қоғозлар билан боғлиқ операцияларининг асосий турлари таққосланган ва муҳокама қилинган. Шунингдек, мазкур мақолада 2015-2017 йиллардаги маҳаллий банкларимизнинг қимматли қоғозлар билан операциялари ўзгариш динамикаси таҳлил қилинган. Хулоса қисмида, Ўзбекистон банкларининг қимматли қоғозлар билан боғлиқ операцияларидаги мавжуд муаммолар ўрганилган ва уларни бартараф этиш бўйича илмий таклифлар ишлаб чиқилган.*

Аннотация: *В этой статье рассматриваются основные аспекты рынка ценных бумаг банков Узбекистана и Германии. Сделан сравнительный анализ и обсуждены основные виды операций с ценными бумагами узбекских и немецких банков. В том числе, в данной статье анализирована динамика роста операций банков на рынке ценных бумаг в период 2015-2017 гг. В заключении изучены проблемы банков Узбекистана на рынке ценных бумаг и разработаны научные предложения по устранению существующих проблем.*

Key words: *securities, commercial banks, assets, bank-based financial system, market-based financial system*

Introduction

After the collapse of the Soviet Union, the modern banking system has been created step by step in Uzbekistan. Like many transition economies, Uzbekistan started its banking reforms with creating a two-tier system that included the central bank and commercial banks. Central bank conducts monetary policy and regulates commercial banks. Commercial banks in Uzbekistan are universal banks. To be more precise, they have services for bank customers such as deposit, credit and transaction services. It is also allowed by law to participate in financial markets, especially security markets without any obstacles. Although commercial banks are main participants in Tashkent Stock Exchange

Market, all commercial bank investments on this market make up only about 0.4% of overall bank assets in 2017. This means that commercial bank security business has not developed yet in Uzbekistan.

Furthermore, Central bank of Uzbekistan is unable to use Open Market operations as an instrument to expand or contract the amount of money in the Banking system. One of the main reasons is that government securities purchase was stopped on 1st of January in 2013. Here may appear question if the government does not emit securities, the Central bank can use other instruments such as corporative bond, bank deposit certificates. However, the open market operation is implemented with only government securities. Government authorities show the government budget surplus as the main reason for not allowing government security business. Another reason for under developing of this market, there is little scientific research which is dedicated to the improvement of bank security markets in Uzbekistan.

For the last two years, the government of Uzbekistan has made reforms on the economy in order to accomplish tasks put forward by Strategy Action for the development of Uzbekistan in 2017-2021. One priority direction of Strategy Action is liberalization of the national economy. Development of short and long-term financial markets is one main subsection of the liberalization of the national economy [2].

Another important decree of President Shavkat Mirziyoyev PD-5177 about “Priority Measures for Liberalizing Foreign Exchange Policy” on 2nd September 2017. One of the directions of this decree is dedicated for development of government security markets. Importantly, President Republic of Uzbekistan Shavkat Mirziyoyev made a resolution on 13th September in 2017 about “Further development of the monetary policy of Central bank of Uzbekistan”. One section is devoted to the development of the national financial market, including the government security market in the medium and long-term prospect so as to establish effective monetary policy.

Above-mentioned shortcomings and achieving strategic goals indicate the importance of article’s topic and require new scientific investigation which is based on foreign experience. The model of the financial system in Uzbekistan is close to German financial system that’s why German banking system is chosen to compare security activities of both countries.

Literature review

Commercial bank security markets are analyzed by many scientists and economists. One of the professors who made a research Uzbek financial markets is Alexandr Akimov and Brain Dollery. Akimov states that open market operations are a monetary instrument widely used in developed economies to influence monetary aggregates. However, it had not been effectively employed by the Central Bank of Uzbekistan. The CBU offered very limited scope of securities (chiefly zero-coupon short-term Treasury Bills) to a small group of financial institutions (almost exclusively banks). However, these securities had two major problems. Firstly, they yielded negative interest rates in real terms up to 2003. Secondly, they were often not re-paid in cash upon maturity. Instead, new issues were used to replace old ones. At some stage, the situation worsened to the point that the CBU forced some state-owned commercial banks to purchase Treasury Bills (Akimov 2001) [7].

Another well-known scientist who researched security operations of banks is L. Butikov. As he mentioned that banks participate in three directions in security markets.

The first direction is emission operations. Banks raise capital by emitting a variety of securities such as stocks, bonds, derivatives. The second direction is investment activities. He states that banks participate in security markets to get profit by selling different securities of other financial institutions (Butikov 2003) [6].

German banking system is bank-based financial system which means banks have dominant role to mobilize savings and allocating capital. On the other hand, financial system of USA and England is market based which means financial markets plays an important role to free capital from people to investors who are in need (Asli Demirguc-Kunt and Ross Levine 1999) [8].

The first key distinction is the extent to which German banks have evolved beyond the traditional primary bank function of providing commercial finance (short-term credits for inventory and trade) and developed an extensive capacity to provide industrial finance, that is, long-term capital for financing fixed assets (plant and equipment) (Sigurt Vitols 1998).

Banks play an important role in corporate governance of non-financial firms. In all this respect, bank dominance is evident in Germany at least around the turn of century (Schmidt and Tyrell 2015) [10].

Research Methodology

In the preparation of this article, we have studied the current theories, which are proposed by foreign scientists and local scientist. Then, we analyzed factors that influence security activities of banks in financial markets. In addition to this, we tried to answer how to solve these negatively impacting factors to improve security operations of banks in security markets. During preparation research, many different research methods are used comparative assessment and scientific abstract methods. Data is collected from many difference sources. We used annual reports of Central bank of Uzbekistan and commercial banks. Furthermore, annual reports of “Axbor” rating agency are used for writing the article.

Analysis and results

The role of banks in the securities market is different in many countries. There is no obstacle for Uzbek commercial banks as a participant of Security Markets. Our banks can be member of Tashkent stock exchange market with the general license which given for activity of commercial banks. There is no need to get another license from Central bank.

According to the current legislation, commercial banks of Uzbekistan can carry out the following operations in the securities market:

- emission operations;
- investment operations;
- investment institution operations.

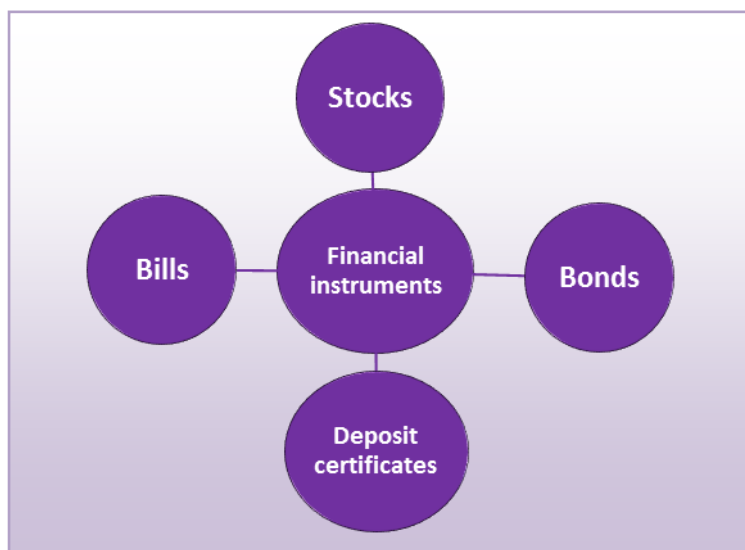


Figure 1. Issuing instruments of banks in Uzbekistan [6]

Emission operation of commercial banks of Uzbekistan. One of the main activities of commercial banks of Uzbekistan in security markets is emission operations. Special feature of commercial banks in security markets is that they may participate as an issue, investor or underwriter bank in this market.

Banks of Uzbekistan also participate as an investor in security markets. The figure below shows the types of instruments which Uzbek banks can invest.

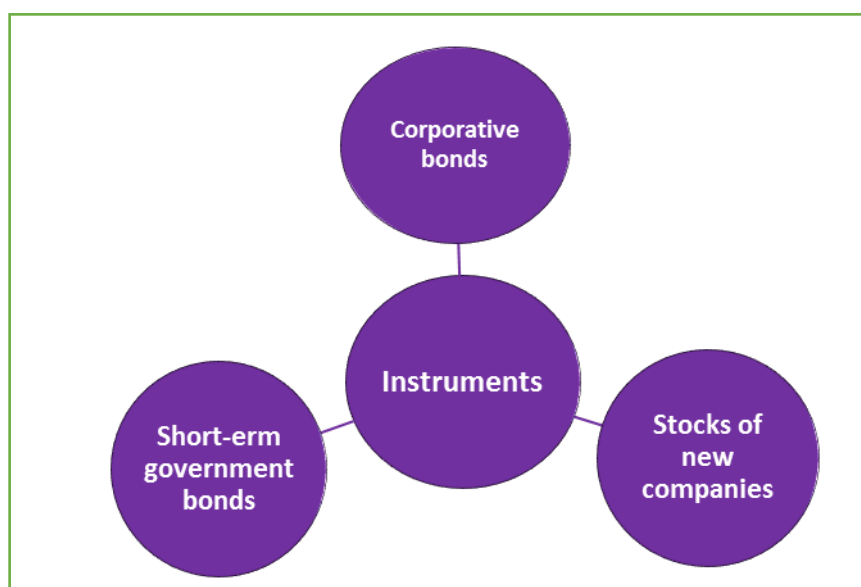


Figure 2. Investment instruments of Uzbek commercial banks [6]

In our country, banks are not divided commercial banks and investment banks that's why all commercial banks can function of investment bank's activities. Commercial banks participate on security markets with general license, which is given by Central Bank of Uzbekistan in order to deal with banking activities. Our banks are investment institutions as well. They participate as a broker and dealer in security markets. Most of our banks

paid more attention to this until 2000. At that time, only commercial banks are allowed to be intermediary to trade government short-term bonds. Another important function was registering transactions of participants. They send all the information to government agencies such as Ministry of Finance and Central Bank of Uzbekistan. However, it has not well-developed in our banks to be intermediary.

As we mentioned above, German banks are main part of financial system because majority of funds are moved through banks. In order to compare Uzbek banks with German banks in security markets, we first start by comparing banking systems of both countries. We made a table which shows these differences.

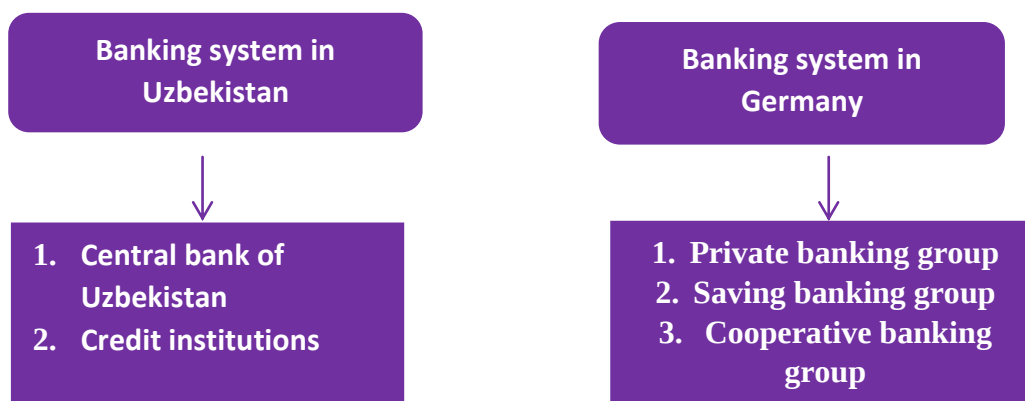


Figure 3. Comparison of banking system of Uzbekistan and Germany

Source: The figure is made by author according to available literature.

It can be clearly seen from the figure above, banking system of Uzbekistan has two tiers. The first tier is the central bank of Uzbekistan and the second tier is credit institutions such as commercial banks, microcredit institutions and others. Banking system of Germany consists of private banking group, saving banking group and cooperative banking group.

Now we compare security operations of banks in Uzbekistan and Germany. We can see from the table below the main characteristics of security activities in Uzbekistan and Germany.

Table 1.

Security operations of Uzbek and German commercial banks

Security operations of Uzbek commercial banks	Security operations of German commercial banks
Issuance of security	Issuance of security
Investing to security	Investing to securities
Broker and dealer	Global custodians (safe keeping securities)
Security lending	Brokers and dealers
	Buy-side and sell-side
	clearing and settlement
	Security lending

Source: The figure is made by author according to available literature.

As you can see from the table above, Security operation of German banks are broader in comparison with security operations of Uzbek commercial banks. Safe keeping

securities and clearing and settlement operations have not developed yet in practice of commercial banks of Uzbekistan. In addition to this, security lending is the most popular types of German bank's operation.

In order to make our comparison clearer, we decided to analyze practical data of security activities of Uzbek and German banks.

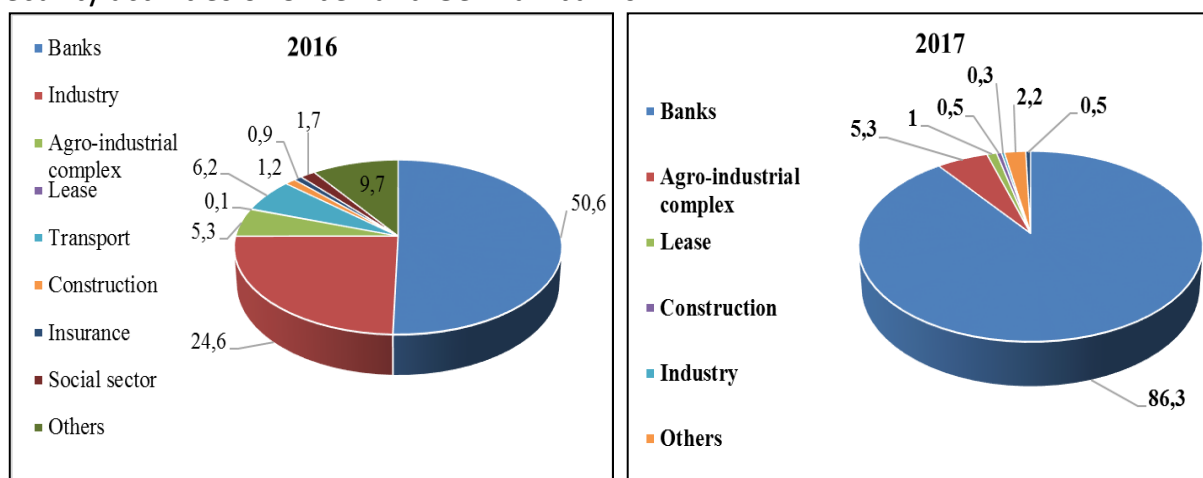


Figure 4. Commercial bank's share in the structure of the Republican Stock Exchange "Tashkent" in 2016 and 2017 [15].

A glance at the pie charts below reveal changes Uzbek commercial banks change in the structure of the Republican Stock Exchange "Tashkent" in 2016 and 2017. As it can be clearly seen from the charts provided, the share of commercial banks in the stock exchange market had dramatic expansion in 2017.

The share of enterprises of the financial sector of the economy accounted for 87.8% of the exchange turnover or 262.2 billion sums and banks - 86.3% of the exchange turnover or 257.6 billion sums, insurance companies 1.5 billion sums (0.5%) and leasing companies - 3.1 billion sums (1.0%). In 2016, the share of the financial sector was 50.6% or 154.8 billion sums, the share of the agro-industrial complex - 9.2% or 27.3 billion sums (in 2016 - 5.3% or 14.9 billion sums); In addition to this, second place in term of percentage was share of industry sector with 24.6% in 2016. This was equal 73.7 million sum. However, industry sector made up only 0.3% of market structure and accounted for 0.9 million sums in 2017.

The proportion of commercial banks as investor made up 1.3% of total investors in the Republican Stock Exchange "Tashkent" in 2016. However, this trend changed negatively in the coming year, making up only 1% of investors. Here may appear questions, proportion of Uzbek commercial banks in the Republican Stock Exchange "Tashkent" is 50% but they made up only 1% of investors. It shows that investment operations of Uzbek commercial banks have not developed yet in security markets.

In order to compare with other participants, we decided to analyze other players share as investors. As you can see from pies, the biggest proportion of investors in the Republican Stock Exchange "Tashkent" in 2016 was foreign investors with 50.1%. This trend has seen a sharp increase in the coming year, accounting for 63% of all investors or 127.6 billion sums. Similarly, share of individuals increased from 16.2% (48.6 billion sums) to 32.2% (96.2 billion sums).

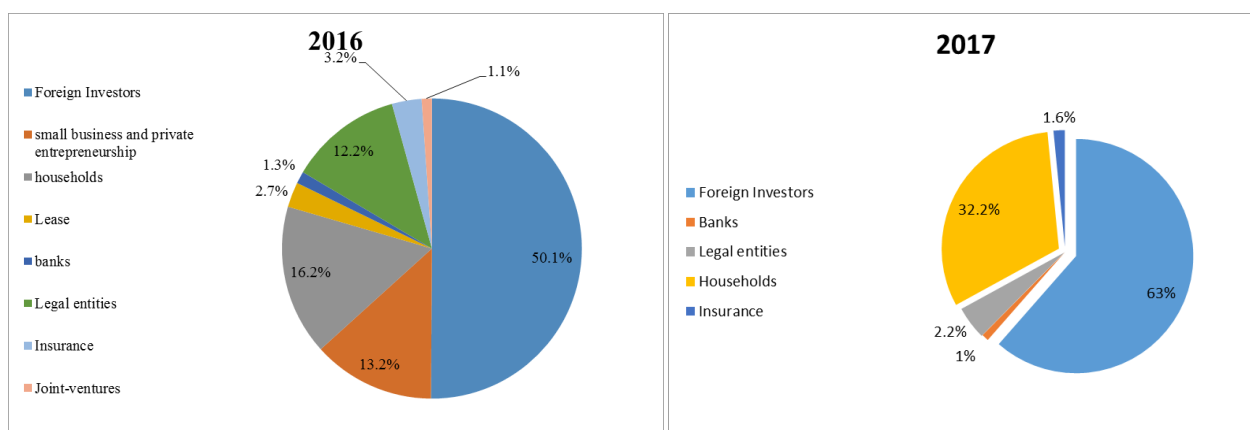


Figure 5. Structure of the Republican Stock Exchange “Tashkent” by investors in 2016 and 2017[15]

In order to analyze more, we look at accumulated balance sheet of Uzbek commercial banks in three different years 2015, 2016 and 2017. Why do we need to look at balance sheet? There are some indicators which are belonging to security operations of commercial banks of Uzbekistan. Firstly, we are going to look at asset side of balance sheet. We can get information about how much money are directed or invested to securities of other financial institutions by commercial banks. It also shows the proportion of invested money to total assets.

Table 2.

Asset structure of commercial banks of Uzbekistan in 2015 2016 and 2017[14]

	01.01.2016		01.01.2017		01.01.2018		Change in (%)
	Amount in billion sums	Share (%)	Amount in billion sums	Share (%)	Amount in billion sums	Share (%)	
Assets							
Cash and cash equivalents	12.11	1.91%	1336	1.6%	4841	2.9%	162.4%
Money reserves in Central bank	94286	14.8%	11958	14.2%	14909	8.9%	24.7%
Due from banks	73.18	11.5%	10869	12.9%	25060	15%	235.3%
Investments and securities	4433	0,7%	2 621	3,1%	4 115	2,5%	57,0%
Loans	39067	61.64 %	52 045	61,9%	108 467	65,1%	108,4%
Equipment and intangible assets	1645	4 %	1 794	2,1%	2 335	1,4%	30,1%
Interest earned on assets	452	0.7%	593	0,7%	1 413	0,8%	138,3%
Other private property	764	0.1%	386	0,5%	298	0,2%	22,7%
Other assets	3770	2.6%	2 474	2,9%	5 193	3,1%	109,9%
Total assets	63383	100%	84 075	100 %	166 632	100 %	98,2%

Source: <http://cbu.uz/uzc/statistics/bankstats/2018/01/100519/>

The table above authentically deals with giving information about components assets of commercial banks of Uzbekistan in 2015, 2016 and 2017. As it can be clearly seen

from the table, big proportion of assets consisted of loans and money reserves and the least proportion of assets are cash and other properties in both years.

Turning to the details, the largest amount of assets is loans, making up 61.9% in both 2015 and 2016 increased to 65.1% in 2017. However, money reserves in Central bank of Uzbekistan made up 11958 (14.2%) billion sums in 2016 before reaching to 14909 billion of sums in 2017. As our aim is researching or discovering securities operations of commercial banks, we tend to more focus on investments to securities. All investments of commercial banks of Uzbekistan accounted for 2621 billion sums which is only 3.1% of total assets in 2016. However, this trend had a slight fall on the coming next year. 2.5% of all assets are directed to buy securities of other companies by commercial banks of Uzbekistan in 2017.

Table 3.

Liability side of commercial banks of Uzbekistan in 2015 2016 and 2017[14]

		01.01.2016		01.01.2017		01.01.2018		change in (%)
		Amount in billion sums	Share (%)	Amount in billion sums	Share (%)	Amount in billion sums	Share (%)	
	Liabilities							
Deposits		32287	50,94%	36 341	48%	58668	40,2%	61,4%
Amounts due to the Central bank of Uzbekistan		235	0,3%	263	0,4%	537	0,4%	103,9%
Due to other banks		2443	3.8%	3994	5%	5762	4%	738.1%
Borrowed loans and lease operations		24574	32%	26 786	36%	72 819	50%	171,9%
Issued securities		987	0,7%	1 058	1%	1 100	0,8%	4,0%
Interest rates payable		257	0.4%	375	0,5%	1 049	0,7%	180,0%
Other liabilities		5607	7.2%	6 276	8%	6 019	4,1%	-4,1%
Total liabilities		68254	100%	75 094	100,0%	145 956	100,0%	94,4%

As you can see on the liability side, the percentage of issued share accounted for only 1% of total liabilities or 1058 billion sums in 2016. In spite of the fact that commercial banks are main players of Tashkent Stock Exchange, their operation in terms of amount is very low. It can be seen this case in 2017 as well. Banks more prefer to accumulate funds by attracting deposits that of issuing shares in securities markets. All attracted funds by issuing stocks made up only 0.8% of all total liabilities or 1100 billion sums.

Conclusion

To conclude, Uzbek commercial banks participate in security markets in three directions such as emission operations, investment operations and investment institution operations. German financial system is bank-based financial system means bank deposits have important role to turn savings into investment.

By researching security activities of banks, we found some issues related to these activities. These issues are as follows:

1. Issues related to the enforcement of legal acts related to the activities of commercial banks in the securities market;
2. Low profitability of securities issued by commercial banks;
3. There are not popular stocks issued on foreign currency in Uzbekistan;

4. Absence of the ability of our country to sell securities of commercial banks in international markets;

The following measures are proposed to address the above-mentioned issues:

- strengthening the legal framework regulating the activities of commercial banks in the securities market;

In doing so, it is primarily to enforce legislation protecting investors' rights and to establish institutions that protect investor's rights.

- improvement of the dividend policy of commercial banks;

- revision and development of securities issued in foreign currencies;

- encouraging and improving the integration of the stock market in the international financial markets.

Implementation of these measures will be a major support for the development of commercial banks in the securities market.

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