

The New Approach in the Integration of the Financial Markets. The Case of the Balkan Countries¹

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Abstract: *The lack of tradition and financial culture for using of the financial markets as a medium for financing of business which is coming as a heritage from the past where the financial markets were non-existent is the main reason why the financial markets in the Balkan countries even in the post transition period are still undeveloped facing massive liquidity problems. Also, the difficulties are caused from the fact that each financial market in all the countries in the region is small not only in comparison with the world's main financial centres but also with average financial markets in the EU capitals. Taking into consideration the common problems and similar market preferences the best possible solution for the fragmented markets in the region would be an integration on the markets which will provide more opportunities for investors and in some way will help in solving the liquidity problem. In this respect, the three stock exchanges in the region, Bulgarian, Macedonian and Croatian stock exchange have decided to take a step in connecting of the financial markets in the countries by establishment of a company SEE Link with one main goal to increase turnover of the participating exchanges and potentially increase of their economic value. The aim of the SEE Link is to create regional infrastructure for trading of securities listed on the Macedonian, Bulgarian and Croatian market. Thus, the integration of the financial markets in the region will be achieved with lowest possible costs i.e. without merger or corporate integration but with using technology. This integration approach provides that the stock exchanges remain independent while providing investors with market access in all of the participating Stock exchanges. Four stock exchanges, Belgrade, Ljubljana, Banja Luka and Athens stock exchanges have also applied for membership in the SEE Link. This paper is going to present the current model of connecting the financial markets in the Balkan countries and will offer an analyses of the future prospects of the integration process.*

¹ The paper is based on the author's presentation at the 2nd Annual Monetary and Economic Scientific Conference: Economic Lessons, Perspectives and Challenges from the Balkans, organised by Monetary Research Center, Sofia 13-14 October 2016. The last update on the data used in this paper is the conference day.

Introduction

The financial market is in the core of the economic system. Due to different integration processes, regional and global, it is impossible to isolate the national financial markets from the global trends. Everything is interdependent while each move on one market has effects on the others. Usually, the financial markets have good information and what happens there shows what will follow in the real economy². Well-developed financial market is *conditio sine que non* for well-functioning and good performance of the economy. However, it is still unclear whether advanced real sector creates sound financial system or is vice versa.

The lack of tradition and absence of financial culture for using of the financial markets as a medium for financing of business, coming as a heritage from the past where the financial markets were either non-existent or undeveloped, is the main reason why the financial markets in the Balkan countries, even in the post transition period, are still underperforming facing massive liquidity problems. While the EU financial markets are deeply integrated in all segments with ongoing reforms for further improvement of the market efficiency and creation of conditions for their resilience of crisis³ financial markets in the Balkan region are quite fragmented. Also, the difficulties are caused from the fact that each of the financial markets in all the countries in the region is small not only in comparison with the world's main financial centres but also with average financial markets in the EU capitals.

The ability to cope with market pressures and the capacity for absorption of the consequences coming from different shocks on the markets is another strong difference between the financial markets in the Balkan countries and the financial centres in the EU. The inability for “recovery” is well illustrated during the period post 2008 crisis where differences might be underlined.

The paper will discuss the situation in the post crisis period as on the global financial markets as well as on the selected markets from the Balkan region (I) and will explain the possible solution to the problems facing the regional financial markets (II).

² For the interaction between the real and financial sectors see: Konstantinos Tsatsaronis, Investigating the relationship between the financial and real economy, BIS Papers No 22, April 2005, pp. 1-4, available at: <http://www.bis.org/publ/bppdf/bispap22a.pdf>

³ For the recent development in the financial integration in the EU and the current reforms see: ECB, Financial integration in Europe 2006, available at: <https://www.ecb.europa.eu/pub/pdf/other/financialintegrationineurope201604.en.pdf>

I. Post 2008 recovery – what the main stock exchanges indices have to say?

The financial crisis in 2008 is perceived as the most severe one since the great depression from the late '20 of the last century. The start of the crisis was the US *subprime* credits crisis that had negative effects through the global financial system. The deep integration of the financial sector has contributed to spread the problems through the national borders of the developed countries. However, the recovery from the 2008 crisis has been different in the world financial centres in comparison to the local markets which are fragmented and less developed, as are the markets in the Balkan countries. The following part present data's from the global main stock indices (1) and the principle indices of the stock exchanges in Sofia, Skopje and Zagreb (2).

1.1. World's main stock exchanges indices

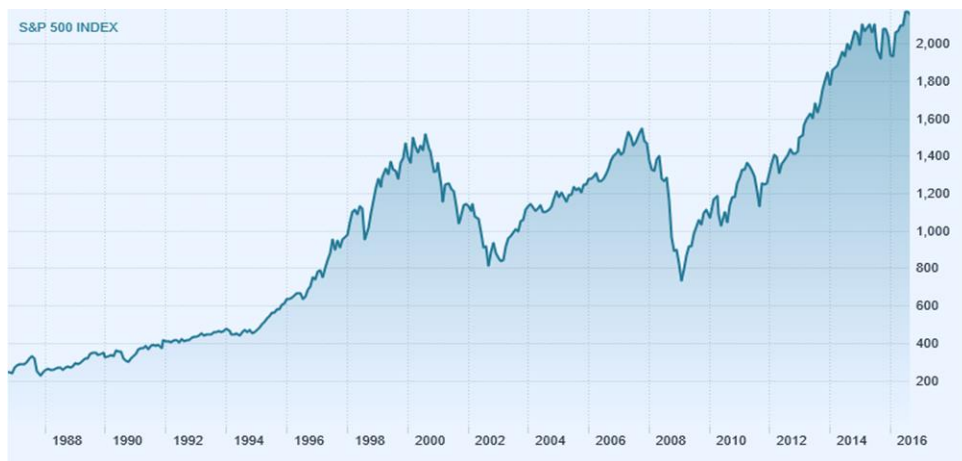
The world's major stock indices have been recovered from the 2008 crisis and are now in historic high values. The principal lesson from the 1929 crisis, used as a remedy for the crisis in 2008, was that the aggregate demand should be supported in order a great depression to be prevented. There were many factors affecting the aggregate demand in this period, in different counties and in different times⁴. Thus, because of that strategy, now in 2016, the level of the public debt has significantly increased in all developed countries while the central banks principle interest rates are close or even below zero. This has led to negative interest rates in real terms on some of the most traded government bonds, as the German one, while the stock market indices are in historic high levels. Sometimes the values of the shares are not perceived adequate for the expected return. The cheap money and the low returns of the government bonds are pushing the stock prices to their historic heights, well above their values in the pick of the 2006 and 2007, years described as a bull market preceding the 2008 crash. The best score of the America's Dow Jones industrial average index are far beyond the level of 2006.

⁴ See, Ben Bernanke, *Essays on the Great Depression*, Princeton University Press, Princeton, New Jersey, 2000, pp. 6-26



Source : <http://markets.ft.com/data>

The American S&P 500 index also sets new records with more than 400 points above the level of 2007.



The situation is alike on the global financial centres in the European capitals. Even in a political turmoil of the referendum and now certain Brexit the London stock exchange markets are in record highs.



Source : <http://markets.ft.com/data>

The uncertainties for the future of the Eurozone and the burden of the possible slipovers of financial problems coming from other European countries into the German financial system are making principle German indexes volatile, however well above the level of 2006.



Source : <http://markets.ft.com/data>

Considering the well-known proverb that “trees do not grow to the sky while the Exchange is made of the same wood” the question is where is the limit of the current stock prices. Or, are we heading towards a new “Minsky moment⁵” when a slide increase of the central banks interest rates of the ECB and the FED will lead to a sharp decline of the Stock

⁵ Minsky, Hyman P. Ph.D., "Can "It" Happen Again? A Reprise", Hyman P. Minsky Archive, Paper 155, 1982

market indices⁶. Will the remedy from the 2008 i.e. the cheap money that were used to support the aggregate demand, to avoid a severe recession and to prevent a possible depression has led us to a new bubble, bust this time not on the housing but on the financial markets? This is an open question....

1.2. Regional indices

The situation is completely different as far as the capital markets in the Balkan region are concerned. They are still not recovered from the 2008 crisis. The Macedonian The MBI 10 is far below its record of august 2007 then its value was above 10.000 points.



The Bulgarian SOFIX index is four times below its historic level of 1952.40 points in October of 2007.



⁶ The latest signals from the FED's officials is that the increase of the rates is very probable in near future. See, The Wall Street Journal, Fed Sends New Signals About a Possible December Rate Increase, available at: <http://www.wsj.com/articles/fed-sends-new-signals-about-a-possible-december-rate-increase-1478109738>

The situation is alike in Croatia where the CROBEX is far below the level of 2007 even if in the meantime the country has become member of the EU.



It is evident that the three principle indices of the Bulgarian, Croatian and Macedonian stock exchanges are far from being recovered from the 2008 crisis. Common problems are looking for common solutions. That is why the three Stock exchanges started an enhanced cooperation for joint action which will improve the conditions on the capital markets in these countries. Integration of the markets will mean more opportunities for investors, risk sharing while the local stock exchanges may increase their economic value. The new model for integration of the financial markets that should connect the markets in the Balkan region is presented in the next part.

II. The new model for financial market integration

There are several possibilities for market integration via different forms of stock exchange cooperation. Networks, alliances, creation of a joint stock exchange, merger of the existing stock exchanges even hostile takeovers etc.⁷. Each of the solutions brings high cost while there is no guarantee that the integration will improve the situation. Taking this into account the Bulgarian, Croatian and Macedonian stock exchanges have decided to integrate the regional equities markets without merger or corporate integration. The integration model is based on technology that will provide market access for investors for trading of securities listed on those markets while the stock exchanges remain independent.

Thus, the three stock exchanges: Bulgarian, Croatian and Macedonian stock exchange have established a limited liability company SEE Link organized and existing under the laws of the Republic of Macedonia with registered office in Skopje. There is an open possibility

⁷ See, Ekaterina Dorodnykh, Stock Market Integration, An international approach, Palgrave Macmillan, 2014, pp. 20-25

for joining the framework by other interested stock exchanges which is going to be subject of approval by the founding members. At present, four stock exchanges, Belgrade, Ljubljana, Banja Luka and Athens stock exchanges have also applied for membership in the SEE Link.

The main goal of the company is to provide possibilities for trading on the participant markets in a most simple and efficient manner. This is going to be achieved with free market access on the participant stock exchanges for all investors coming from the participant country via integration between registered brokers in those countries. The brokers are taking the central stage in the investment process. Also, banks that are licensed to perform investment intermediary services might be admitted as members. They are both entitled with trading rights on the local markets. Two kinds of brokers are included in the SEE Link: originating and executing brokers. The model works as follows⁸. Originating brokers are taking orders from clients and are contacting with executing broker in the partner member state market where the executing broker is forwarding the order on the proper market. This model provides that brokers in one participant country is able to perform an order in other country market without having direct access i.e. without acquiring membership on the market. This makes the entire operation much cheaper and simple. Brokers who are trading members of the three exchanges may become executing or originating brokers in the SEE Link. When applying for membership they have to declare its preferred type of membership, executing broker or originating broker, or both. For the first two years there are no fees or charges for brokers. What has to be done is signing contracts between SEE Link and brokers and contracts between executing brokers and originating brokers.

Another very important issues arising for the trading on markets in different countries are the question of clearing and the question of supervision. The settlement and clearing is provided via the executing brokers that are providing originating brokers with all the necessary information through the SEE link system while the supervision is conducted by the supervision authority of the market where the transaction is made.

Even if the SEE Link system became fully operational on the annual conference of the Macedonian stock exchange held on 29.3.2016 in Skopje when the bells rang meaning that the new order-routing system was officially launched we are still lacking official data about the achievements of the newly created system. The unofficial data which one may obtain

⁸ All the details concerning tariff or fees, participating exchanges, SEE Link membership, order routing, data feed or about the operation of the SSE link in general is given in the Operational rules of the SEE Link, adopted by the Shareholders of the SEE Link, available at: <http://www.see-link.net/UserDocsImages/documents/SEE%20Link%20Operational%20Rules.pdf>

from the interviews with brokers directly involved with the trading on SEE Link is that for the time being it is very successful. Most of the orders are coming from Macedonian and Bulgarian investors while Croatian are lagging. This is expected result if one considers the fact that Macedonian investors are not allowed by law to invest in other foreign markets⁹. The sole possibility for investment abroad is via investment in Investment funds which are entitled for investments abroad. Thus, the SEE Link is another small window for diversification of the investments on the Macedonian investors and that is why the SEE Link is more than welcomed and broadly used by them.

Conclusion

Different integration processes, regional and global have created an environment where it is impossible to isolate the national financial markets from the global trends. Integrated financial markets offer more opportunities for investors and more efficient allocation on the financial resources. The EU financial markets are deeply integrated in all segments while there are ongoing reforms for further improvement of the market efficiency and creation of conditions for their resilience on crisis. However, because of the lack of tradition and absence of financial culture for using of the financial markets as a medium for financing of business the financial markets in the Balkan countries are still undeveloped.

The difficulties are caused from the fact that each of the financial markets in all the countries in the region is small not only in comparison with the world's main financial centres but also with average financial markets in the EU capitals. The period post 2008 crisis has underlined the inability for "recovery" of the financial markets in the Balkan region. The analyses of the data of the principle stock indexes in Bulgaria, Macedonia and Croatia have shown that their values are far below the level prior to the crisis. On the contrary, the analyses shows that the world major stock indices are in historic high values.

Common problems are looking for common solution. The stock exchanges in Skopje, Sofia and Zagreb have launched a process for market integration without creation of a joint stock exchange or merger of the existing stock exchanges. In the core of the new model is a

⁹⁹ The current legal framework does not allow direct investments by Macedonian residents in foreign securities, shares or other financial instruments on the foreign stock markets. See: Law on Foreign Exchange Operations, Official Gazette of the Republic of Macedonia no. 34/01 and the Law amending the Law on Foreign Exchange Operations, Official Gazette of the Republic of Macedonia no. 49/01, 103/01, (32/03 - Decision of the Constitutional Court on repelling the amendments to this Law as published in "Official Gazette of the Republic of Macedonia no. 54/02), 51/03, 81/08, 24/11 and 135/11. Revised, unofficial text available at: http://www.nbrm.mk/WBStorage/Files/WebBuilder_Law_on_Foreign_Exchange_Operations_03022012.pdf

limited liability company SEE Link organized and existing under the laws of the Republic of Macedonia with registered office in Skopje which should provide possibilities for trading on the participant markets in a most simple and efficient manner. The new integration model is based on technology that will provide market access for investors for trading of securities listed on those markets while the stock exchanges remain independent while brokers in one participant country is able to perform an order in other country market without having direct access i.e. without acquiring membership on the market. Two kinds of brokers, originating and executing brokers, are taking the central stage in the trading process.

However, there are no official data about the achievements of the newly created system. The unofficial data indicates that for the time being the SEE Link it is very successful. Most the orders are coming from Macedonian and Bulgarian investors while Croatian are lagging.

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