CREDIT CYCLES IN THE TRADITIONAL AND ISLAMIC MODEL OF BANKING SYSTEMS

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The recent crisis phenomena and trends of the global financial and economic space allowed to obtain a conclusion concerning the absence of effective regulation of credit institutions by the state. Under the influence of globalization national banking systems become highly dependent on external factors and lose their ability to respond to changes in the global financial environment quickly and efficiently as well. However, most vulnerable link is the credit activity of banks, which significantly affects the economic development of countries. The uncontrolled credit movement under the influence of financial globalization caused a devastating impact on the world overall economic development in 2008-2009. Enhancement of the amplitude of the credit cycle led to corresponding fluctuations in the economy and ultimately to the overall financial and economic crisis. Thus, the countries with the traditional model of the banking system underwent a greater financial loss than the countries with the Islamic model. Our country, whose banking sector has not caught up with the rates of the pre-crisis growth up to the present time, is not an exception in this case.

Therefore it is necessary to define clearly the most effective instruments of controlling the credit movement on the basis of the traditional and Islamic models of functioning of banking systems. It actualizes the analysis of the main indicators of the bank credit activity and based on this identification of the main advantages and disadvantages of these models.

Scientific works were dedicated to the research on the cyclicality of the credit movement and its management in the traditional and Islamic models of the banking system by such foreign scientists as A. Erche, G. Horton, G. Kaminski, Ch. Kindelberher, N. Kiyotaki and J. Moore, L. Laeven, T. Makkalom, D. Burakov, K. Reinhart, L. Fernendes, etc.

The results of the global financial crisis in 2008-2009 indicate the vulnerability of national banking systems to the global crisis phenomena. Disability of the instruments of macroprudential regulation to effectively counteract the processes of financial globalization, which has led to the acceleration of the capital movement, information asymmetry, significant dominance of the financial sector over the real one as well as the emergence of many types of speculative trading, has led to major losses for the entire development period of the global financial space. However, the main driving factor of the global crisis was unsecured and inefficient use of bank credit resources that affected the fluctuating amplitude of the credit cycle. This led in its turn to an increase in cyclical economic environment and intensified the crisis even more.

The conducted comparative analysis of the traditional and Islamic model of functioning of banking systems based on performance of banks in the European Union, the United States and the Arab world shows that banking systems that operated on the traditional model underwent more loss, than those that operate on the Islamic one [1].

In the traditional model the market mechanism should ensure regulation on the credit market through incentives and restraining factors that create the conditions for making profit or loss. The main source of income in the traditional model for banks is the interest they receive through the mechanism of lending. Also losses occur when a borrower is unable to repay the loan and interest. Thus, to avoid unprofitable lending banks have to analyze the creditworthiness and solvency of borrowers. However, this protective mechanism that prevents excessive credit growth can be created only provided fair profit and loss spread (PLS), which in the traditional model of banking systems does not exist.

Instead of forcing banks and investors to share the risks of business, the traditional banking model almost exempts them from the latter. Thus, the market becomes unable to control its members, leading to an uncontrolled increase in bank loans, excessive leverage and providing loans to insolvent borrowers [2]. Due to these processes, the strengthening of cyclical fluctuations of the credit movement and its acceleration take place.

So, as a result of the analysis, it was found that the characteristic of the traditional model of banking is the close direct link between the economic growth rate on the step-up phases of the cycle and the growth of prices on the markets of goods, services and assets. The presence of such interrelation is the evidence of a dependence of the economic growth on price rising on different markets. At that the economic growth of developed and developing countries is largely characterized by the formation of bubbles on different markets, which not only enhance the economic growth in the short term, but also reinforce the price pressure on several markets. In 2008 the indicator of the credit depth of the European Union was up to 1.17 pp. indicating the excess of amounts of the financial sector over the real one by 17 %. As for the United States, the figure was 1.98 pp., which is twice as much as the GDP, and shows unsecured functioning of the economy [3].

Another important feature is a direct link between the economic growth and the credit market both at the recovery phases and at the phases of recession. So the growth rate of economics and lending the countries of the European

Union in 2008-2009 amounted to a negative value of 10.66 pp. and 4.4 pp. respectively [3].

The Islamic model of operation is more resistant to the crisis, because the regime agreement is used in it. Wherein money is not a commodity and has no internal value, even if it is spent. The only advantage of money is to convert its monetary function into the economic function either by trade or by investment. Thus, the Islamic bank, as a follower of the Sharia principle can not invest in any product that it needs.

The Islamic bank doesn’t sell the debt and it does not invest in distressed assets and mortgage-backed securities. As a result of comparative studies, it was found that during the crisis of 2007 and 2008 the profitability of both Islamic and conventional banks decreased. However, the profitability of Islamic banks decreased by less than 10% and the profitability of traditional banks underwent a decrease of more than 30% [3].

Smaller investment portfolios, lower measure of leverage and commitment to the principles of Sharia, which did not allow Islamic banks to engage in financing or investing in the kinds of instruments that adversely affected their traditional competitors - everything contributed to the achievement of better results compared to traditional banks. In most banks internationally a sharp reduction in credit followed by rapid growth in lending as soon as the crisis began, in contrast to Islamic banks, which lending retained positive dynamics. Thus, lending in Arab countries has increased by 17.4 % since 2008-2009 [3]. Also assets of Islamic banks have grown up fast. It was found that on average, this growth was twice as fast as the growth of traditional bank assets in 2007-2009.

Also, unlike traditional models, fluctuations in the credit and economic cycles in Islamic countries are more proportionate and balanced. In the traditional model, we can see a relatively low rate of the economic growth with a deep fall in the GDP growth during the crisis, indicating the presence of imbalance between the economic and financial spheres. The interrelation between economic expansion and inflation is positive. Unlike the traditional model, the Islamic financial model does not make a significant impact on the formation of bubbles on markets of goods, services and assets, because there is no speculation.

The traditional practice of banking mediation provides extensive use of credit and transfer of risks, while Islamic banks offer financial services that are based on joint investment activity and risk sharing, which in turn prevents a significant increase in the cyclicality of the credit movement. Respecting religious principles of Sharia Islamic banks made it impossible to invest financial resources in speculative instruments, which were the main factors of increase of the amplitude of the credit cycle of current global economic crisis in banking systems with the traditional model. Thus, in the period of 2005-2007 the average profitability of Islamic banks was lower than traditional banks, that is explained by a much lower level of risk of Islamic banking operations that are based on respecting religious Sharia norms.

The same happens to Ukrainian banks. The effects of the global economic crisis in 2008-2009 and the political crisis in 2014 affected the development of the national banking sector negatively. Taking into account the faults in macroprudential regulation of previous years and basing on the main benefits of the Islamic and traditional banking models, Ukraine needs to develop an effective system of countercyclical regulation of the banking sector, by means of which rational management of the credit movement and processes of granting loans would occur.

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