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FINANCIAL STABILITY, WAYS TO ENSURE IT AND ITS SIGNIFICANCE

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Abstract. *As anyone who has tried to define financial stability knows, there is still no universally accepted model or analytical framework for assessing financial system stability and studying policy, like economic systems and other disciplines. The reason for this is the analysis of financial stability. Compared to, for example, monetary or macroeconomic stability analysis, sustainability is still at a nascent stage of development and practice. In the rare cases where financial systems are rigorously represented, they form one or two equations in a much larger macroeconomic model with typical macroequilibrium and macrostability conditions. In this article, we will discuss several aspects of financial stability and its maintenance.*

Key words: *financial stability, means of provision, different forms of financial stability, financial instability*

INTRODUCTION

A stable financial system is a system that ensures the continuous flow of funds between financial intermediaries, markets and market infrastructure, savings and investors, and thereby promotes the growth of economic activity. On the contrary, financial instability is a serious disruption of the intermediation process, with potentially damaging consequences for the real economy. From this point of view, ensuring financial stability seems to be a forward-looking task - it is aimed at identifying weaknesses in the financial system and, if possible, taking mitigation measures. Some of these vulnerabilities have a macroeconomic dimension, such as changes in household and corporate sector balance sheets, and changes in credit and asset markets, all of which can affect the level and distribution of financial risks within the economy. Other vulnerabilities relate to the way financial intermediaries and financial market participants assess and manage their various risks. Furthermore, a sound financial system is one in which well-designed crisis management mechanisms are in place to manage troubled financial institutions in a way that does not undermine confidence in the financial system[1].

Financial stability can be defined as "a state in which the financial system is not unstable" and can also mean a state in which the three components of the financial system - financial institutions, financial markets and financial infrastructure - are stable:

№	Different views of financial stability	Description
1	Stability of financial institutions	refers to a situation where individual financial institutions are strong enough to adequately perform their financial intermediation functions without the assistance of external institutions, including the government.
2	Stability of financial markets	a serious violation of market operations means a situation where the price of financial assets has not deviated significantly from the economic fundamentals, thus allowing economic entities to reliably attract funds and use them.
3	Stability of financial infrastructure	To ensure the continuous functioning of the market discipline, the financial system is well structured, the financial safety net, and the payment and settlement system are working effectively.

In addition, financial stability can be defined more broadly as “a condition in which the financial system is able to smoothly facilitate real economic activity and to eliminate financial imbalances caused by shocks[2].”

On the one hand, in the absence of a set of models for a stable financial system or even a concept of equilibrium, it is difficult to conceive of a definition of financial stability that economists generally require and use. Nevertheless, financial stability can be divided into several principles as follows:

The first principle is that financial stability is a broad concept that includes various aspects of finance and the financial system - infrastructure, institutions and markets. Both private and public entities participate in markets and important components of the financial infrastructure, including the legal framework and formal framework for financial regulation, supervision and control. Governments borrow in markets, hedge risks, operate through markets to conduct monetary policy and maintain monetary stability, and own and operate payment and settlement systems. Accordingly, the term "financial system" can be seen as covering the monetary system with its formal concepts, agreements, conventions, and institutions, as well as the processes, institutions, and conventions of private financial activity. At any given time, stability or instability may be the result of private institutions and actions or formal institutions, either simultaneously or iteratively.

A second useful principle is that financial stability implies not only that finance adequately fulfills its role in allocating resources and risks, mobilizing savings, and facilitating wealth accumulation, development, and growth. It should also mean that payment systems across the economy function smoothly across formal and private, retail and wholesale, formal and informal payment mechanisms. To do this, central bank money and its close substitutes such as demand deposits and other bank accounts can adequately fulfill their role as a universally accepted means of payment and unit of account and, if necessary, requires as a short-term store of value. In other words, financial stability and what are generally considered important parts of monetary stability overlap to a large extent.

The third principle - the concept of financial stability is not only the absence of real financial crises, but also processes related to the ability of the financial system to limit, contain and eliminate imbalances before they threaten the economy itself or economic development. In a well-functioning and stable financial system, this happens in part through self-correcting, market-disciplined mechanisms that build resilience and prevent problems from multiplying and becoming system-wide risks. In this regard, allowing market mechanisms to work to address potential difficulties may involve a policy choice between rapid and effective intervention, for example by injecting liquidity through markets, to restore risk and restore stability. it can. Thus, financial stability includes preventive and corrective aspects.

The fourth important principle is to define financial stability in terms of possible consequences for the real economy. Disruptions in financial markets or individual financial institutions should not be considered a threat to financial stability unless they are expected to harm economic activity as a whole. In fact, random financial institution closures, increased asset price volatility, and sharp and even turbulent corrections in financial markets are the result of competitive forces, the efficient input of new information, and the self-correcting and self-educating mechanisms of the economic system. can be That is, unless there is a high probability of contagion and systemic effects, such changes can be considered desirable, if not healthy, from a financial stability perspective.

The fifth principle - consistent with those discussed above and the actual dynamics of finance - is to consider financial stability as occurring continuously. A more obvious example is the health of an organism, which occurs along a continuum.

Also, financial stability in a broad sense can be considered in terms of the capabilities of the financial system[3]:

❖ efficient distribution of economic resources, both spatially and temporally, and ensuring the efficiency of other economic processes (for example, wealth accumulation, economic growth) and, ultimately, social well-being;

❖ assessment, pricing, allocation and management of financial risks;

❖ it is considered to maintain the ability to perform basic functions, even under the influence of external shocks or imbalances - primarily through self-correcting mechanisms.

A definition that fits this broad view is:

A financial system is within a range of stability when it is able to facilitate (rather than hinder) the functioning of the economy and to eliminate financial imbalances that arise from endogenous or severe adverse and unexpected events.

In addition, it will be necessary to explain the meaning of several phrases in ensuring financial stability.

First, the concept of a range of stability represents the concept of a continuum as a basic building block. The continuum of financial stability can be considered as multidimensional and occurring in many observable and measurable variables. A set of variables measure how well finance supports economic and financial processes such as savings and investment, lending and borrowing, liquidity creation and distribution, asset pricing, and ultimately the accumulation and growth of wealth, although should include a subset that attempts to quantify, albeit imperfectly.

Financial stability as a continuum, as with other concepts of equilibrium and stability in some disciplines, can be seen in practice somewhat broader and more precisely than the ability to return to a single and stable position or time course after a shock or disturbance (including economics).

In assessing the joint stability of financial markets and financial institutions, a combination of interest rate volatility (as a possible market source of stability) and banking system capital (as an institutional source of shock absorption) can be identified, and these are effective ongoing financial resources to facilitate the efficient allocation of resources. compatible with the system. Similarly, other combinations that are inconsistent with stability may be identified. The former constitutes the range of stability and the latter extends beyond this range[4].

The second phrase that needs some explanation is facilitating (rather than hindering) the functioning of the economy. This phrase means, among other things, that finance contributes to, rather than hinders, the efficient allocation of real resources, the growth rate of production, the processes of savings, investment and wealth creation, and at the

same time economic vision may include other observable and measurable aspects of performance.

Third, the term "removal of financial imbalances" refers to movement along a continuum toward stability, such as volatility in asset prices and portfolio flows, through self-correcting mechanisms. Such adjustments include the entry and exit of market participants, such as financial institutions or non-financial entities acting on behalf of others, or individuals acting directly in the markets. There are other aspects of the definition that deserve attention. The proposed definition leaves open the possibility that the financial system can endogenously impede the functioning of the economy even in the absence of unexpected events, such as asset mispricing and the accumulation of other market-induced imbalances. This is consistent with much historical evidence that financial systems, particularly banking systems, are prone to imbalances such as credit risk concentration or liquidity and even instability. Banks contain weaknesses related to their liquidity characteristics and are therefore prone to instability themselves. Banks, other financial institutions, and even markets can be seen as social structures or clearinghouses for pricing and trading, which necessarily involve uncertainty and risk, including uncertainty about the fundamental element of trust in financial contracts. Social structures and institutional features of economic systems try to contain the possible negative consequences of negative externalities associated with the vulnerability of human trust. The definition also assumes that there are financial aspects that include negative or positive externalities. In this sense, an improvement in the ability of finance to assist, rather than hinder, economic processes is an improvement in well-being, especially over time, in terms of financial stability, resource allocation and pricing efficiency. Some argue that a continuum of financial stability promotes greater welfare and productivity than others, and that some points on the continuum of instability should be avoided at all costs.

A stable financial system is a system that increases economic efficiency in many ways, and an unstable financial system reduces economic performance. The definition of financial stability also includes a number of complexities of practical importance in terms of assessing risks to the good functioning of the financial system and the contribution of public policy to ensuring financial stability. For example:

Changes in financial stability cannot be summarized by a single quantitative indicator. For example, unlike price stability, there is currently no clear unit of measure for financial stability. This reflects the multifaceted nature of financial stability, as it relates to the stability and stability of financial institutions, as well as the stable functioning of financial markets and settlement systems. In addition, various factors should be considered in terms of their potential ultimate impact on real economic activity[5].

Forecasting the development of financial stability is naturally difficult. The assessment of the state of financial stability should not only take into account the occurrence of disturbances, but also indicate the risks and vulnerabilities that may lead to such disturbances in the future. Therefore, a forward-looking approach is needed to

identify the escalation of risks and imbalances and to account for transmission delays in policy instruments. The problem is that financial crises are difficult to predict because many factors can be involved, such as contagion effects and poor relationships between the components of finance. In addition, risks to financial stability often reflect the far-reaching consequences of unexpected events.

This means that the focus should be on the entire distribution of possible outcomes or states, not the mean, median, or mode. Furthermore, the distribution of possible outcomes may be subject to more fundamental uncertainty than traditional macroeconomic forecasts, reflecting a lack of knowledge about the true shape of the probability distribution. This means that financial stability forecasts may be less reliable than monetary or macroeconomic stability forecasts, for which well-developed and reliable models and timely and useful data are available. Thus, in the large set of financial indicators currently used by central banks and international financial institutions, the relationship between indicators and conditions of financial stability may not be strong or robust enough to be reliable for assessment and prediction. possible Nevertheless, there may be scope for improving the ability to monitor and assess financial stability in the future by looking at a wider range of indicators, developing better frameworks and using sophisticated statistical tools.

The development of financial stability is only partially controlled. The policy instruments that can be used to ensure financial stability are usually to protect the interests of depositors (in the case of prudential instruments), to ensure price stability (in monetary policy) or to ensure rapid stability. have other main purposes, as well as calculations of financial transactions (in policies regulating payment and settlement systems). In addition, changes in financial stability further limit controllability of exogenous shocks—from natural disasters to sudden changes in market sentiment.

Policies aimed at financial stability often involve a trade-off between resilience and efficiency. Measures to improve financial stability often involve balancing the pursuit of an efficient allocation of financial resources with the ability to avoid or absorb shocks in the financial system. This implies a risk judgment that is difficult to make completely objectively. For example, in the area of prudential policy, higher solvency requirements reduce the risk of a bank not being able to absorb a negative shock, but also mean capital costs and foregone investment opportunities. Similarly, currency restrictions may reduce or eliminate some of the risks associated with international capital flows, but may also limit the efficiency of domestic financial markets[6].

Policy requirements for financial stability may not be timely. Because the use of some public policy instruments to ensure financial stability bypasses market forces, gains in short-term stability may come at the cost of a loss of long-term stability. In particular, measures such as lender last resort financing or guaranteeing deposits can disrupt market discipline and thereby create moral hazard or adverse selection. This interperiod trade-off is a key issue in the development of financial system policy.

In conclusion, from the above concepts, financial stability can be defined as follows:

• the financial system enters a series of instability when there is a risk of hindering the functioning of the economy;

• the financial system is in a state of instability that impedes performance and threatens to continue to do so.

Accordingly, financial stability is dynamic and depends on the rational functioning of many parts of the system. What may represent stability at one time may be more or less stable at another time, depending on other aspects of the economic system, such as technological, political, and social changes. In addition, financial stability can be viewed in accordance with various combinations of its component conditions, such as the strength of financial institutions, the state of financial markets and the efficiency of various components of the financial infrastructure, etc.

In addition, we understand that financial stability is not only price stability, the policy goal of the central bank, but also an important requirement for the healthy development of the economy, because financial instability requires large costs for the economy, because the price volatility in financial markets increases, and financial institutions or corporations can go bankrupt.

Today, attention to financial stability is increasing, because recently new factors that can cause financial instability have appeared, including the strengthening of financial sector connections between countries and the rapid development of complex financial instruments.

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