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EXCHANGE-TRADED FUNDS AND STABILITY OF EUROPEAN FINANCIAL SYSTEMS.

Abstract:

The main aim of the paper is investigation of the potential contribution of exchange-trade funds (ETFs) to the instability of the European financial systems. The paper begins with presentation of the key theoretical concepts with regard to ETFs and financial stability. We discuss the key attributes of ETFs as the innovative category of investment funds, their hypothesized impact on the financial stability as well as briefly describe the European ETFs markets, focusing on the between-country differences. Subsequently, we present the results of our study, conducted by applying the selected composite index of the financial stress - Country-Level Index of Financial Stress (CLIFS) provided by the European Central Bank. The core indicator of the development of the ETFs markets is the turnover of the shares of ETFs on the local stock exchange (in order to facilitate comparisons all values are expressed in USD). Time period of the analysis is January 2004 - August 2017 and monthly data are used. Research methods include correlation and nonparametric analysis. Results of our analysis demonstrate that the threats to the European financial systems linked to the expansion of ETFs are minor, above all due to the low size of ETFs markets in most European economies. Moreover, for some ETFs markets with the highest turnover (such as United Kingdom) we identified the positive impact of ETFs to the stability of financial system.

Keywords:

exchange-traded funds; ETFs markets; Europe; financial stress; financial stability; synthetic ETFs

JEL Classification: G23, G11, G01