ANALYSIS OF FOREIGN DIRECT INVESTMENT IN THE CZECH REPUBLIC

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Introduction

Investment is in general economic theory allowed to be the economic activity, at which a subject gives up the current consumption forward-looking on increasing the product. Investment can be a positive factor stimulating higher growth especially for countries, where there has been higher demand for investment than savings are. Abreast international capital flows are distinguished partly credits and partly foreign investment, at which is assumed the assets takeover in other country (acquisition).

The attention is in this paper given to direct foreign investment, which in contradistinction to portfolio investment is not linked with the purchase of short-term bonds, but with long-term relation based on holding of shares. Foreign investors so acquire long-term control over their companies (branch stores, sister companies and affiliations) abroad. Often there are found subsidiaries in order to produce goods and services, which were imported to the mother country in the past.

Conclusion

The Czech Republic is an open economy and welcomes foreign direct investment in all sectors. It has been one of the region’s most successful nations in attracting foreign direct investment with over USD 15 billion worth of foreign direct investment recorded since 1990 to 1997. Since 1997 the Czech Republic has sustained record flows of foreign investment of USD 6.2 billion each year. The trend for foreign direct investment in the Czech Republic suggests increasing foreign investor confidence in the stability of the Czech economy and in the possibility of long-term growth in Central and Eastern Europe as a whole. The better conditions for investors thanks to the system of incentives are having positive effects in the form of the development of green field projects.
Positive effects of entrance FDI to the region are indisputable. Foreign owned enterprises operating in the Czech Republic acquired much higher efficiency and return on equity than the enterprises in the hand of domestic owners. Negative mark can be reduction of staff in consequence of new technologies that usually decrease the consumption of live work and fact that investment enters less sophisticated branches, which usually create a low share of the value added.

Steadily strengthening position has got the Czech foreign investment in abroad. They are orientated not only on trade organizations but also on companies worked in manufacturing or energetic industry.

Key words: foreign direct investment, theoretical factors, data of disposition, inflows, outflows

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CREDIT DERIVATIVE AS A TOOL FOR TRANSFERING CREDIT RISK

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The credit derivative is an important and relatively new mechanism for transferring credit risk. It is a tool for transferring credit risk between two parties by means of bilateral agreement. In real life a variety of foundations have natural needs to manage or reduce their credit exposure. The parties to the agreement have different motives for taking a positive or a negative position at a particular time. The fundamental feature of the credit derivative market — since the application range of the traditional instruments such as bonds and loans is limited and they do not offer the appropriate level of flexibility — is that the parties to the agreement can easily alter their credit risk without actual asset transfers.

The credit derivatives market was originally created in the early 1990s in London and New York. According to the April 2007 report of the International Swap and Derivatives Association (ISDA) the estimated size of the market was $35.1 trillion in 2006. The credit derivatives market experienced rapid growth in recent years. Nowadays, it is facing instability caused by the developments in the US real estate market.

One of the most significant developments in financial markets in recent years has been the creation of liquid instruments in the credit market. The base among these instruments is formed by CDS index tranches. The main traded CDS indices are consolidated into a single family under the names DJ CDX and DJ iTraxx and managed by International Index Company. Every sixth month a new rebalanced index is launched and associated “on-the-run” securities are issued. The indices are created for main currencies, investment grade and non-investment grade credit and the main regions. The securities on the main indices are available at five and ten year maturities.

CDS index tranches are synthetic collateralized debt obligations (CDO’s) based on CDS indices, where each tranche references a different segment of the loss distribution of the underlying CDS index. The main advantage of index tranches relative to other CDOs is that they are standardized.

The determination of credit portfolio loss distributions is significant for the valuation and risk management of a credit derivatives portfolio. Default correlation is one of the main drivers for portfolio loss. To evaluate default correlation two popular credit risk models are widely used: the Reduced Form Model and the Structural Model. Since the default of one obligation may affect another, we use a normal copula function approach to model the dependence structures between defaults of the obligations, assume $N$ obligors, constant correlation matrix with the only parameter $0 < \rho < 1$ for all assets.

The Reduced Form Approach models a time of default $\tau$ as a time of the first jump of Poisson process. In this setting the fundamental object of modeling is the stochastically varying instantaneous rate of default $\lambda(t)$. Having the marginal default probabilities of all times of defaults and using the normal copula function, we can estimate the default distribution for obligors by generating $N$ independent uniform random variables $U_i$ on $(0,1)$ from $N$-dimensional Gaussian copula. Given individual spreads and recoveries we calculate instantaneous rates of defaults and therefore the survival function looks as follows:

$$\gamma_i(t) = \ln S_i(t) = -\lambda_i t$$

and the simulated default time for each obligor is

$$\tau_i = \inf\{t > 0 : \gamma_i(t) \leq \ln U_i\}$$

The Structural Approach assumes that the assets of the different firms or companies follow a correlated stochastic process, representing the total value of assets. When the value of an asset falls below a certain threshold, the firm is considered to be in default. We assume that the firm value of each credit is driven by two main components: systematic risk $Z$ that represents general state of the business cycle and idiosyncratic risk $\epsilon_i$ that reflects the events linked to the credit itself.

Therefore the risk driver of $i^{th}$ credit in the portfolio is