Volodymyr V. Korneev *(Economic Research Institute under Ministry of Economic Development and Trade of Ukraine, Kyiv, Ukraine)*

FINANCIAL SYSTEMS STABILIZATION: COMPARATIVE ANALYSIS OF MONETARY POLICIES OF CENTRAL BANKS

The paper deals with the issues of ensuring stability of foreign and domestic financial systems. The efficacy of monetary tools used by central banks to restore economic development is analyzed. The resulting estimates and expectations with the emphasis on necessary stabilization measures in Ukraine have been grounded.

Keywords: *financial system; banking system; monetary policy; central banks; stabilization; loans; interest rate; bonds.*

Володимир В. Корнєєв *(Науково-дослідний економічний інститут Міністерства економічного розвитку і торгівлі України, м. Київ, Україна)*

СТАБІЛІЗАЦІЯ ФІНАНСОВИХ СИСТЕМ: КОМПАРАТИВНИЙ АНАЛІЗ МОНЕТАРНОЇ ПОЛІТИКИ ЦЕНТРОБАНКІВ

У статті розглянуто питання забезпечення стабілізації зарубіжних і вітчизняної фінансових систем. Проаналізовано дієвість монетарного інструментарію центробанків щодо відновлення економічного розвитку. Обгрунтовано результуючі оцінки та очікування з акцентацією потреби в реалізації необхідних стабілізаційних заходів в Україні.

Ключові слова: *фінансова система, банківська система, монетарна політика, центробанки, стабілізація, кредити, облікова ставка, облігації.*
Літ. 10.

Владимир В. Корнеев *(Научно-исследовательский экономический институт Министерства экономического развития и торговли Украины, г. Киев, Украина)*

СТАБИЛИЗАЦИЯ ФИНАНСОВЫХ СИСТЕМ: СРАВНИТЕЛЬНЫЙ АНАЛИЗ МОНЕТАРНОЙ ПОЛИТИКИ ЦЕНТРОБАНКОВ

В статье рассмотрены вопросы обеспечения стабилизации зарубежных и отечественной финансовых систем. Проанализирована действенность монетарного инструментария центробанков по восстановлению экономического развития. Обоснованы результирующие оценки и ожидания с акцентом на необходимиости реализации стабилизационных мероприятий в Украине.

Ключевые слова: *финансовая система, банковская система, монетарная политика, цетробанки, стабилизация, кредиты, учетная ставка, облигации.*

Introduction. Stabilization of financial systems under the recovery of capital formation in the real sector of the economy is determined by the effectiveness of means to support business activity, and in particular, financing in loan markets. For the time being this is one of the main tasks of governments and central banks around the world. The above requires strengthening the regulatory monitoring framework, consistent valuation and revaluation of financial assets, the gap between yields of financial transactions and transactions in the sphere of non-financial corporations, the expected utility and return of the funds advanced.

Lessons of the last crisis have once again demonstrated the collapse of speculative economy fed through unsecured credit expansion. Risks of new threats while maintaining critical development imbalances remain significant (probability of the "second wave" of the crisis, budget problems in the countries on the South of the Eurozone). OECD forecast published late 2012 was disappointing, characterizing the trend of the world economy as a downward one (Parussini and Hannon, 2012). That is why the current "financial instability means that the economic system, in varying degrees, allows for reproduction of crises" (Colander et al., 2010). Particularly acute crisis manifested itself in banking sector. According to the IMF estimates, the volume of bank assets write-offs only during the period 2007–2010 amounted to 2.2 trln USD (IMF, 2010). Despite the still unstable signs of the crisis overcoming, "the basic questions remain as to how banks operate and how they have been regulated" (White, 2011).

Analysis of the research and publications. Exploring the spectrum of questions concerning financial and, especially banking, systems' stabilization, belongs to constantly relevant and popular issues. Numerous publications of foreign and domestic economists give evidence of this. However, the full list of names of researchers, which is replenished daily, can hardly be exhaustive within the presented material. However, there is a need to study the peculiarities of the financial system in Ukraine under still unresolved consequences of the recent crisis and the new role of central banks in this process.

In the view of these, **the object and the aim of this research** are as follows: based on comparative analysis of the monetary policies implemented by foreign central banks to identify trends and tools to stabilize the financial system of Ukraine.

Main results of the research. A distinct feature to support economic development in recent years is the implementation by major central banks the soft monetary policy (stimulating monetary policy) that can be characterized by two key elements: a) holding low interest rates by central banks to restore loans circulation; b) buying government securities by central banks to finance state budgets.

Stimulating monetary policy, among other levers of government regulations of recovery processes, plays a special role as the characteristics of circulation of money largely determine the rates and proportions of economic reproduction. "Central banks have responded to the crisis by providing funding in foreign and domestic currencies. Strategic indicators were reduced countercyclical" (BIS, 2010a). Accordingly, there have been indicative changes in characteristics of credit operations of central banks (through interest rate and credit channel of the transmission mechanism) and the redemption of assets at the open market (through the channel of asset prices).

The monetary policy implementation by central banks in various countries during 2008–2012 has common and distinctive features. The ***US Federal Reserve System***, during the crisis and the initial recovery period, focused through monetary policy tools on easing the regulatory environment to encourage the development of the US economy. Such basic tools were the interest rate of the central bank and fixed income securities (mortgage and public) repurchase at the open market.

At the beginning of the crisis in 2008, the US Federal Reserve System implemented the first program of quantitative easing QE1 in the amount of 1.7 trln USD, which was recognized as effective (when liquidity injections resulted in US GDP growth up to 3.5% in 2009). However, after the deterioration of statistical data in the US in 2010, the second program of quantitative easing (QE2) of 600 bln USD was started, its results were not so obvious comparing to the results of QE1. In 2011, the US Federal Reserve System started the so-called "twist operations" – the replacement of short-term bonds with securities of longer maturities in its balance.

As in 2011–2012 some signs of crisis in the US and Europe were obvious and even deepened, a question on starting the third program of quantitative easing (QE3) arose; and it started in September 2012. The Fed, within QE3, prolonged expected period of low (almost zero) interest rates until mid-2015, and committed to purchase mortgage bonds in amount of up 40 bln USD monthly. Typical position of the US Federal Reserve System is to provide significant freedom in monetary control: "government interference in matters of monetary and credit policy of central banks is undesirable because it can cause further weakening economy and rising inflation" (Cbonds, 2010). The Open Market Committee of the US Federal Reserve System for a long time keeps base interest rate at the record low level – in the range 0.0–0.25% annually (from December 2008 to the present – January 2013). The programs of debt securities repurchase were of regularly renewable nature. Largely it made possible to hold the base and other interest rates at the low level.

The monetary policy of ***the Bank of England*** is characterized by the low interest rate and support to programs of government bonds repurchase as a part of the policy of quantitative easing. This policy also provides stimulating of business activity via corresponding monetary instruments.

In July 2012, the Bank of England increased its quantitative easing program, under which envisaged growth of reserves in the financial system to 375 bln GBP by purchasing government securities. At the same time, together with the government, it is envisaged to stimulate the banking sector on the condition that banks would more actively lend mortgages and other business projects.

From March 2009 the Bank of England holds interest rate at 0.5% and is not expected soon to tighten monetary policy in England.

Monetary policy of ***the Bank of Japan*** for a long time also remains soft. Since October 5, 2010, the interest rate of the central bank has been set in the range 0–0.1% and remains unchanged as of January 2013. It is expected that the Bank of Japan will keep key interest rate almost zero in the future – given the existing insufficient demand in the country.

The use of such a monetary instrument as purchase of government obligations to encourage the development became more active in November 2010, when the Bank of Japan has allocated 5 trln YEN (more than 62 bln USD) for immediate purchase of government securities. In August 2011, Japan's central bank decided to increase the volume of the program of repurchase assets (government and corporate bonds) up to 50 trln YEN (648 bln USD).

The European Central Bank (ECB) carries out the regionally consolidated interest rate policy, purchases obligations of sovereign and other debtors, provides loans secured by bonds issued by the member of the Eurozone. However, the combination of levers of monetary and fiscal policy on economic dynamics is not always a compromise; that gave grounds to the ECB representative in November 2011 to declare that adaptation of monetary policy to the fiscal policy was unacceptable (Cbonds, 2011). The ECB key interest rates remained at the historic minimum level of 1% for almost 2 years, from May 2009 to 7 April 2011, when the ECB raised it to 1.25%.

However, a few months later – in early November 2011 the ECB key rate was again lowered to 1%, and from July 7, 2012 – to 0.75% due to poor economic conditions.

Dynamics of economic activity in the Eurozone has been slowing down due to the tightening fiscal policy (as a consequence of the problems of the Southern euro zone – Portugal, Ireland, Italy, Greece, Spain – the so-called peripheral group "PIIGS"). Stabilization of the financial state of the countries with problems in public finance through purchase of sovereign bonds (Program of support of the financial sector of the EU countries implemented within the framework of the EU-IMF plan, volume – 750 bln EUR) provided the necessary liquidity of markets in the Euro zone. The European Financial Stability Fund (EFSF), which funded support to Portugal and Ireland, during 2012 – the first half of 2013 gradually transformed into the Financial Stability Mechanism (MFS). The MFS has to replace the EFSF – as an option to replace temporary mechanism with a permanent one.

From May 10, 2010, the ECB intervened in the markets of sovereign and corporate bonds of those countries where there have been high volatility of returns. Further on the ECB implemented a variety of tools to support liquidity. In 2012, when the situation at the markets of sovereign debt in peripheral euro zone countries obviously deteriorated, the ECB faced a dilemma: while it was necessary to continue to implement monetary anti-crisis measures, inflation risks increased.

The Central Bank of China (PBOC) devalued its currency in September 2008 and since then has kept the Yuan low against the US dollar and a stable exchange rate against the euro, while maintaining a fixed proportion of sovereign bonds of the EU countries in the portfolio of its international reserves.

Functioning of the world economy as a macrosystem is periodically accompanied by the so-called "currency wars", when exchange rate policies of some countries aimed to support their exports at the expense of balancing foreign economic interests. That is, both the US and China are moving in the same direction. A new term has been created – Chimerica – a symbiosis of the first letters of the names of the two countries – China and America. However, there is here also a parallel with the word "chimera".

The monetary policy of ***the Bank of Russia*** in 2010–2012 was directed at encouraging domestic demand through supporting the lending activity of banks and increasing the availability of financial resources for borrowers. At the same time, operations were carried to bind excessive liquidity in the banking system. In recent years, the refinancing rate of the Bank of Russia varied with the intervals of 25 bps and since September 14, 2012 is 8.25%.

In ***Ukraine***, the stabilization of the banking sector has been ensured by the NBU in the framework of indicative changes of monetary and exchange rate policies. These changes, in turn, were conditioned by the processes at both external and domestic financial markets. Regulatory vector of the NBU actions during the crisis was intended to support liquidity in the banking system of Ukraine; i.e. when the anti-crisis monetary policy shifts reflected in activation of refinancing mechanisms, curbing the outflow of funds outside the banking system with variable use of interventional tools, changes in reserve requirements and interest rate policy.

A discount rate, among the set of the NBU's interest rate tools, should play a more active role. Today the value of money in Ukraine is still mostly caused by the changing market conditions and risks, and to a lesser extent by the interest rate policy of the regulator. Therefore, changes in interest rate and refinancing rates in financial markets are not transformed directly and quickly into changes in the rates on bank loans and deposits. Refinancing rate "performs fiscal functions, goes after the market, rather than forming it" (Yershov, 2011). However, it is economic turmoil in recent years, and particularly the lessons of the financial crisis that demonstrated the need to enhance the role of interest rate policy: "the main channel of the money supply should be the refinancing of commercial banks and the main regulator – interest rate (refinancing rate)" (Glazev, 2008).

The reason why the discount rate in Ukraine insufficiently serves as "a guide price of money" and is a limitedly demonstrative indicator, lies in the peculiarities of the functioning of other segments of the financial market and the pricing of those assets. Thus, primarily this applies to opaque domestic securities markets (especially stock markets), resulting in the prices of the assets little corresponding to their values. Under existing irrelevant information, price for stock assets actually is a "thing in itself" and does not reflect the potential investment value of the assets. It should be noted also that banking systems of around the world more widely use trading with participation of central banks at the open market (i.e., foreign exchange interventions, repo agreements), where the role of interest rate policy is clearly subordinate.

Changes in the NBU discount rate in recent years geared towards the reduction of inflation risks, the need to encourage capital inflows into Ukraine and at the same time to curb its outflow, in general, to reduce the money supply and monetary constraints. However, money for many borrowers remains a deficit due to its high costs, as businesses and households suffer from the lack of working capital.

Conclusions. Financial systems are constantly in need of crisis monitoring – and primarily preventive one – which is in line with international practice (BIS, 2010b). The growth of markets (including loan basis) must be supported by and balance with real savings rather than speculative multiplication of assets value.

Despite the strengthening of the relationships in the context of globalization and increased institutional role of international summits (e.g., in the form of G-20), it becomes clear that each country should independently overcome the crisis and stimulate their economies according to their actual capabilities. Resource and institutional constraints of government regulation and recovery of financial markets (in terms of limits on funding stabilization programs by central banks at the expense of monetary resources and government budgetary resources while maintaining the disproportionate development of some Eurozone countries under a single institutional framework of the EU) remain significant factors in the development of financial systems in various countries.

Obviously, the Anglo-American and continental (Euro) financial models confirm to maintain their individual characteristics. Question of convergence of these models may not be comprehensive despite the increasingly widespread universalization of regulatory and business activities. Universal model of markets and banks showed the presence of clear warnings and restrictions of its operation since it bears the risks associated with the concentration of resources in a single financial center (conglomerate). Universal institutes' presence is justified under the stable conditions and is risky during the crisis.

Ukraine needs not fragmentary but systemic reform of the financial sector as a whole, e.g. banking system, non-banking institutions and business infrastructure. Given the limitations of funding from external sources (but not only this), the main emphasis should be made on the development of the domestic market of financial and other resources of long maturity, including securities market. An activity of the institutional investors should go beyond mediation and get investment catalyzing signs. This is extremely necessary for the normalization of loan and investment cycle and protection of the financial system against external threats of destabilization.

Due to the fact that the price of money as a resource is formed taking into account the peculiarities of development of related segments of the financial market, Ukraine requires effective measures to improve the functioning of financial markets, including stock market; in particular, the transparent pricing of fund assets and disclosure of information on implementation of trade agreements.

Purchase of government bonds by central banks should be considered as an exceptional and not a permanent measure. Otherwise, risks of budget management are transferred to responsibilities of the central bank through monetization of the budget deficit. However, central banks cannot be fire creditors of the first instance – they are institutional lenders of the last resort.

Loose stimulating monetary policy needs to be balanced by tight fiscal policy. In other words, increasing money supply through interest rate and loan channels of the transmission mechanism of monetary policy requires balancing the amount of money in terms of limiting the availability of funding through budget expenditures.

In Ukraine, resumed exports and stimulated and solvent domestic demand should be key factors in stabilizing the currency. This would allow to adjust the existing imbalances in the balance of payments (in terms of peculiarities of its current account and capital account). Given the still limited funding from external sources (but not only this), the main emphasis should be on the development of domestic market of long-term financial resources. The effective resolution of monetary tasks is possible in the mainstream of improving macroeconomic indicators of economic development.

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