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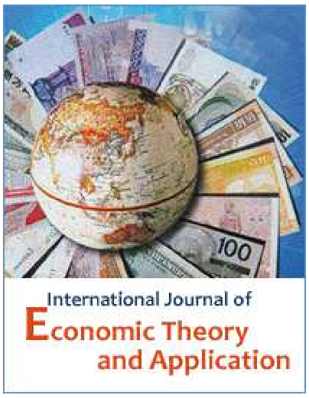

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Actual issues of the monetary policy in some post-soviet countries

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Abstract
In this paper author analyzed some theoretical and practical aspects of monetary policy of post-Soviet countries. Identified issues associated with the improvement of monetary policy in these countries. On the basis of the analysis there were developed research proposals to resolve these issues. In particular, the author offers more efficient management of excess reserves by paying interest on excess reserves and usage of bank bonds as open market operations of the Central bank.

1. Introduction

The ultimate goal of monetary policy of the most central banks in the world is controlling inflation rate, i.e. providing price stability in the society. As a results of the research by Research Center of Central Bank of England, in 30 years the number of the countries, ultimate goal of monetary policy of which was inflation benchmark, increased from 8 to 54 (*Sterne*, *1999)*. Also, research of M.Voskanyan shows that price stability is the ultimate goal of monetary policy of 44% out of 50 analyzed central banks (Voskanyan, 2012). Because of this, inflation rate remains relatively low, in many countries. According to the World Bank, at the end of 2012, the average annual inflation rate in the world constituted 3.9% (The World Bank 2013, January). Especially low level of inflation observed in developed countries (table 1).

Table 1. *Annual rate of inflation and deflation in developed countries*

Countries	2010	2011	2012
France	2.0	2.7	1.5
Germany	1.9	2.3	2.0
Italy	2.1	3.7	2.6
Great Britain	3.7	4.2	2.7
Switzerland	0.5	- 0.7	- 0.4
Japan	0.0	- 0.2	- 0.1

Source: World Bank Annual Report. (2013)

As can be seen from the data in Table 1, in 2012, in the developed European countries, the annual inflation rate was low. Switzerland and Japan experienced deflation.

2. The Impact of Inflation on the Economy

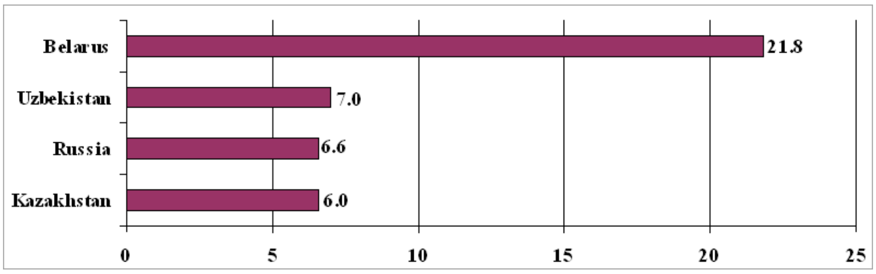
As shown by the results of research by L.Katao and M.Terronz, in countries with high inflation there is a direct relationship between the level of inflation and budget deficit. In those countries where the average annual inflation rate was 50%, reduction of the state budget deficit in relation to GDP by 1 percentage point would reduce the inflation rate by

8.75 percentage points (Catao L., Terrones M.). Therefore, in developing countries, much attention is paid to reduction of the state budget deficit.

In addition, inflation adversely affects the stability of macroeconomic growth. As shown by the results of research by G.Hess and Ch.Morris, even small price increase negatively affects economic growth.

Because small increase in prices raises uncertainty in the dynamics of inflation. And this, in turn, will lead to higher interest rates of commercial banks loans. This is explained by the fact that loan interest rate reflects not only the expected inflation rate, but also the payment for risk (6).

However, in post-Soviet countries inflation rate remains at relatively high level (Figure 1).

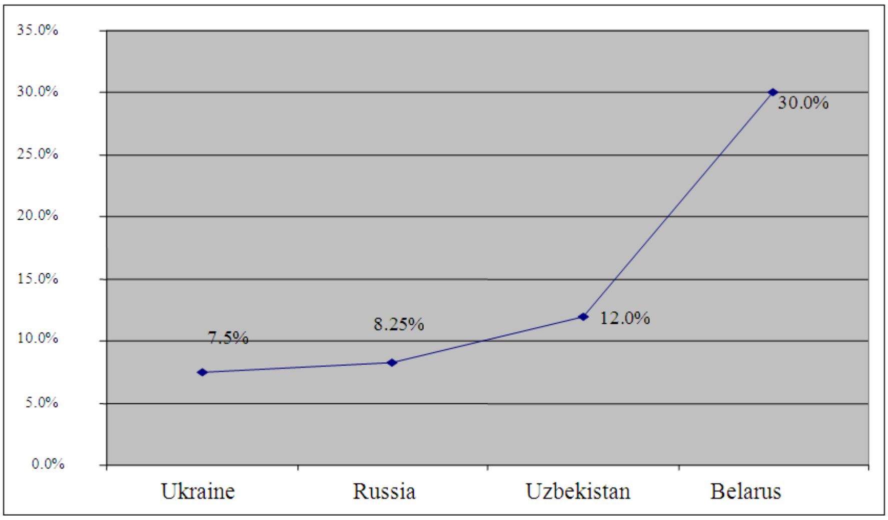


Source: Bank of Russia. Annual report for 2012. (2013)

Figure 1. *Annual rate of inflation and deflation in developed countries in 2012*

As can be seen from the data, in 2012, in post-Soviet countries inflation remained at a relatively high level. Therefore, Central banks have to maintain high level of refinancing rate, which prevents the growth of credits availability of banks for businesses and individuals. Policy of Central Bank refinancing is an important tool for maintaining the stability of interest rates of commercial banks loans.

In addition, high inflation reduces the real value of income of population, lead to a redistribution of income between groups to distort the structure of consumer demand.



Source: Annual report of Bank of Russia for 2012. (2013)

Figure 2. *Annual refinancing rate of Central Bank in Ukraine, Russia, Uzbekistan and Belarus in 2012*

As can be seen from the data, in these countries the annual refinancing rate remains at a high level, due to the relatively high levels of current and expected levels of inflation.

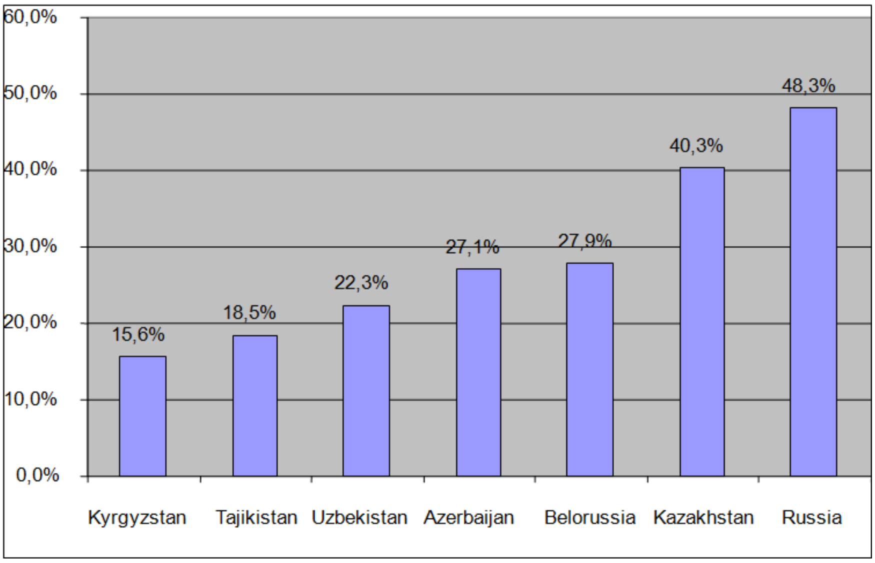
3. Monetary Factors of Inflation

Among the monetary factors of inflation, in the post-Soviet countries, high rates of money growth significantly stands out. Thus, in 2012 the annual growth rate of M2 in Russia was 11.9%, while in Uzbekistan - 27.9% (9). The possibilities of Central banks of post-Soviet countries to manage excess liquidity in the banking system are limited, yet. For example, in Uzbekistan from January 1, 2013, issuance of government securities has been suspended, because the State Budget of Uzbekistan, since 2005 has been running with surplus. While, in Russian Federation government securities have low share amount in total assets of commercial banks. For example, as of January 1, 2013, the share of investments in government securities in total assets of VTB Russia amounted only 0.1% (10). For comparison, as of January 1, 2012, the share of investments in government securities, in total assets of Bank of America constituted 9.9% (11).

It should be noted that in the post-Soviet countries there is a relatively high level of currency devaluation. For example, in 2008-2009 the level of devaluation of national currency in Ukraine against the US dollar was 65% (12).

Moreover, I would like to mention that in post-Soviet countries system of commercial banks, especially performance of their major service as credit facilities were developed at comparatively low level. Under this guidance, we suppose that one of the perspective objects of monetary policy of Central Banks in these countries should be stimulation and development of commercial banks' credit policy.

The below presented table obviously demonstrates that the proportion of credit portfolio of commercial banks in post-Soviet countries states relatively low rate to GDP (figure 3). On it's turns, this indicates a low level of bank's credit operations.



Source: Key indicators of monetary and credit system of Republic of Uzbekistan. Information - analytical review, 2014. – pg. 33.

Figure 3. *Credit portfolio of commercial banks relatively to GDP of post-Soviet countries, % (as of January 1st 2014)*

Historically proven, that credit facilities of commercial banks are the major source of clearance of current and investment expenditures of company. However, availability of bank's facilities is directly associates with the cost of credits, consequently Central Banks of post-Soviet countries should maintain stable and low interest rates on credits.

According to researches made in post-Soviet countries, it is difficult to provide bank credits at low rate under existing risks. Therefore, it is suggested to use compensations system on interest rates at state expenses (report of the President of the Russian Banks Association – Tosunyan G.A.//Money and Credit. – Moscow, 2009. - №5. – pg. 13.). In addition, banking system of these countries are highly dependent on external investment sources (Yudina I.N. Banking system in developing countries. – M.: Scientific publishing center - ИНФРА-М, 2013. - pg. 307.).

By the way, in developed countries Central Banks are widely implementing monetary policy instruments. This mechanism allows to Central Banks actively influence and control the interest rates of credits of commercial banks. For example, the Central Banks of United States and Japan are actively using the policy of refinancing credit institutions in order to influence the level of interest rates (Primary Dealers List of Federal Reserve Bank of New York. URL: http://www.newyork.org/markets/pridealers_current.html; The Bank of Japan's Eligible Collateral Framework and Recently Accepted Collateral// Bank of Japan Quarterly Bulletin. 2003. May.)

By contrast, in post-Soviet countries mechanism of implementation monetary policy instruments still far from to be perfect. They do not have an accounting policy in Central Banks, because there is no circulation of commercial bills – drafts. Also, not yet been developed open market operations of Central Banks, because of underdeveloped market of highly liquid securities, relatively high level of GDP deflator and devaluation of national currency are negatively effect to attractiveness of commercial papers.

For example in 2013, in Russia due to the disproportional distribution of commercial papers in banking sector, which are accepted by the Central Bank as a collateral for repurchase agreement, in addition at the result of insufficient distribution of funds in Russian money market observed demand for operations from credit institutions, where non marketable assets and guarantees were accepted as collateral (Annual report of Bank of Russia for 2013. Central Bank of Russian Federation, 2014. – pg. 64).

In such circumstances, in order to manage the excess liquidity of banking system, it is necessary to take the following measures:

1. Attract excess reserves of commercial banks to deposit accounts of Central Bank and pay interest on it at the rate that must not be lower than the rate in the interbank market. As a result, commercial banks will not sell the loans in the interbank market, and they will be placed as

deposits in Central Bank.

In December 2013, the annual average interest rate of Russian interbank money market constituted 6.4%, which was significantly higher than the interest rate of Russian Central Bank on the commercial banks' deposits (13).

In 2013, the average interest rate on loans in the money market of Uzbekistan was 9.9%. The average interest rate of the Central Bank on deposits of commercial banks in 2013 was 6.0% (14). In such circumstances, the deployment of credit resources in the interbank money market is more attractive than to the Central Bank deposits.

2. Bonds of the commercial banks, with a high rating of international rating agencies, must be used by Central Bank as the object of open market operations.

As shown by the results of the analyzes in the post-Soviet countries, the volume of government securities issues are limited. The government securities are the main objects of open market operations of central banks in these countries. In such circumstances, the use of bonds of commercial banks as the object of open market operations of the Central Bank can increase the volume of REPO transactions.

In developed countries, central banks actively use open market policy for withholding of excess liquidity amount in the banking system. There is an opportunity. Firstly, there is a large amount of government securities issuance in developed countries. For example, the U.S. government takes the first place among the issuers of securities in terms of emissions. Secondly, central banks of U.S., Japan, England, as an object of securities transactions use corporate securities.

There is a sufficient number of banks with high ratings in the post-Soviet countries. For example, as of January 1, 2013, 28 commercial banks have positive ratings from international rating agencies (13).

These banks are rated "stable" from leading international rating agencies such as Standard & Poor's, Moody's, Fitch Ratings.

3. In our opinion, Central Banks of post-Soviet countries must apply targeting of the money supply and inflation simultaneously, in order to suppress the inflation. Herewith, the targeting of the inflation should be applied in coordination with the Ministry of Finance due to the fact that in these countries the prices of goods and services of the state companies significantly affect to inflation. For example, in Russia in 2012, price increase of goods and services regulated by the state, significantly affected the rate of inflation (14). Also, in Uzbekistan, price increase of goods and services of natural monopolies is one of the important factors of inflation.

4. Conclusion

Relatively high level of inflation rate prevents the reduction of refinancing rate of the Central banks in post-Soviet countries and inhibits availability of bank credits to companies and individuals.

Undeveloped open market operations of Central banks of the post-Soviet countries, relatively high rate of monetary growth contributes to deepening of inflation processes.

In order to suppress the inflation rate, it is necessary to do the following: first, to attract the excess reserves of commercial banks to deposit accounts of the Central bank and pay interest on it; Central banks should use the bonds of commercial banks with high ratings from international rating agencies as object of open market operations; second, Central banks of post-Soviet countries should apply targeting of money supply and targeting of inflation, at the same time.

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