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DEFINING THE MONETARY BASE IN A DEREGULATED FINANCIAL SYSTEM

The monetary base in monetary economics is defined and measured as the sum of currency in circulation outside a nation's central bank and its Treasury, plus deposits held by deposit-taking financial institutions (hereafter referred to generically as "banks") at the central bank. More generally, the monetary base consists of whatever government liabilities are used by the public to purchase and sell goods and services, plus those assets used by banks to settle inter-bank transactions [1].

In implementing monetary policy, the NBU sets target benchmarks for regulation of money supply in circulation based on the choice of certain monetary aggregates. Commercial banks work within the limits of the money supply that is determined National Bank. Today, the search for new specific regulatory mechanisms, the money supply in circulation is extremely topical in Ukraine, as the management system the aggregate monetary turnover must comply with international standards and requirements, contribute to the stabilization of the national monetary unit.

It is worth adding that the imbalances of money circulation in Ukraine is also associated with an unbalanced structure money supply, when the growth of money supply in circulation is carried out at the expense of NBU funds issuance through stock and currency channels, refinancing channel and redemption of government bonds under government securities.

One of deregulation's aspects has been the erosion of reserve requirements as a factor constraining the behavior of banks, accompanied by a decline in the percentage of the monetary base needed by banks to satisfy reserve requirements.

The growing significance of banks' operational demands for base money relative to the demands imposed by reserve requirements is consistent with the downward trend of required reserve ratios.

The possibility that reserve requirements are not a significant constraint for most of the country's large banks suggest the nature of the immediate problem with empirical representations of the monetary base: The base is intended to gauge the money-supply impulse, which comes from the supply of base money relative to its demand. It matters not whether demand is created by regulation through reserve requirements, or through business needs for operational balances - only that there be a demand.

The monetary base is defined as the money-supply impulse originating from the stock of central-bank money. Deregulation poses a problem for this definition if it eliminates the demand for central-bank money.

In the pre-crisis period, base money developments largely reflected changes in currency in circulation and required central bank reserves [2, p. 142].

Monetary base (reserve money) in liabilities of Central Bank is connected with foreign exchange reserves in assets of Central Bank. The ratio of these components is determined by the chosen exchange rate regime, and this choice affects the ability of monetary authority to implement an independent monetary policy. Looking at the process of deposit and credit multiplication it seems that commercial banks actually create the majority of money. However, the bank can lend an amount equal to its excess reserves.

The new deposit is created when the borrower spends the money that was borrowed from the bank, and when that money comes back into the banking system. Here we can notice that the central bank can expand the volume of deposits in the banking system by increasing reserves, and can also contract the volume of deposits by reducing the reserves. Central Bank reduces reserves by selling securities in an open market sale. This action has an effect that is similar to deposit expansion in the banking system, but in the opposite direction [3, p. 7].

References:

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