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Banking system in monetary policy

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Abstract: Central banks play a crucial role in ensuring economic and financial stability. They conduct monetary policy to achieve low and stable inflation. In the wake of the global financial crisis, central banks have expanded their toolkits to deal with risks to financial stability and to manage volatile exchange rates. In response to the COVID-19 pandemic, central banks used an array of conventional and unconventional tools to ease monetary policy, support liquidity in key financial markets and maintain the flow of credit. Central banks need clear policy frameworks to achieve their objectives. Operational processes tailored to each country's circumstances enhance the effectiveness of the central banks' policies. The IMF supports countries around the world by providing policy advice and technical assistance. The global financial crisis showed that countries need to contain risks to the financial system as a whole with dedicated financial policies. Many central banks that also have a mandate to promote financial stability have upgraded their financial stability functions, including by establishing macroprudential policy frameworks.

Keywords: Global Financial Crisis, Monetary Policy, Monetary Economics, Statutory Monetary Objectives, Economic Fluctuations, Monetary Frameworks, Macroeconomic Environment.

A key role of central banks is to conduct monetary policy to achieve price stability (low and stable inflation) and to help manage economic fluctuations. The policy frameworks within which central banks operate have been subject to major changes over recent decades. The importance and effectiveness of monetary policy, the role of central banks and the conduct of monetary policy have all been recurring themes in the literature on monetary economics. Perhaps one of the most articulate among the central bank Governors and has spoken and written extensively on the issues confronting central banks and central banking. All his speeches and writings are marked by lucidity and clarity. At the same time they constitute a forceful presentation of his views. Today on `Central Banks, Monetary Policy and the Financial System, a theme which is of extreme relevance to us in India as well. The Indian financial system which comprises of an impressive network of financial institutions, instruments and markets has acquired considerable degree of maturity. The agenda of the structural reforms in the financial sector is also clear. We are relaxing the external constraints which have a bearing on banks` viability. The financial health of the banks is being improved and at the same time the banks are being required to conform to international standards of capital adequacy. A greater element of competitiveness is also being injected into the system. The exchange rate system has also undergone a radical change. The rate is no longer determined by us but is subject to the forces of supply and demand. This implies a close link between monetary policy and exchange rate management. We therefore look forward with great interest to the lecture.

Objective variables:

• Central Bank focus on price stability: measures to what extent statutory objectives do provide the central bank with a clear focus on price stability. Statutory monetary objectives may be potentially conflicting with price stability when objectives such as employment or growth are stated separately without being qualified by statements such as "without prejudice to monetary or price stability".

•Monetary policy strategies: these three variables (Exchange rate target, Money target and Inflation target) are dummies that equal one during periods in which targets for these variables were used according to the chronology of the Bank of England survey of monetary frameworks. Since it provides a chronology for the 1990s, we have complemented it with information from other sources for the previous years. Regarding exchange rate arrangements, we use classifications of exchange rate strategies. Data for monetary and

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inflation targets were complemented with the information. It should be noted that some judgement has gone into the classification of regimes.

•Central Bank Supervision of Financial System: this variable is a dummy which takes the value 1 for countries where the Central Bank is responsible for the supervision of the financial system and takes 0 otherwise. This variable is not time-varying; it stems from a survey conducted by the IMF in 1993 where all member countries were asked to inform of which institution was responsible for banking regulation and supervision in their respective countries.

In conclusion,

Many other factors, relating to legacy and structural problems, hold down bank profitability. Hence, a durable improvement in the prospects of the euro area banking system requires further efforts outside the realm of monetary policy. Most notably, a swift and stringent completion of banking union and additional adjustments in the banking sector towards greater cost efficiency and business models that remain viable in the new regulatory and macroeconomic environment.

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