

**Financial and Banking Services Market**

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**UKRAINIAN MONEY AND CREDIT POLICY
IN A CONDITION OF FINANCIAL CRISIS****Abstract**

In the given article theoretical aspects and general characteristics of money and credit (monetary) policy are described, basic internal and external causes of financial crisis in Ukraine are established, possible measures of monetary policy that are necessary for stabilizing the financial market condition are defined and systematized.

Key words:

Financial crisis, monetary policy, unemployment, money market, credit market, bank system.

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Introduction

Bankruptcy of the biggest American investment bank «Lehman Brothers» was the new stage of financial crisis that caused the fall of stock markets all around the world (30% drop in China, 20% drop in the USA, and 15% drop in the Western European countries, on the average). This led to decline in development of economies of the countries integrated into international financial system, bringing about recession condition. This problem didn't pass over Ukraine, thus, the national currency devaluation and the output fall continue, the rate of unemployment increases and the inflation rate is growing. One of the ways to solve these problems is the improvement of the money and credit policy, i.e. the object of analysis of the given article.

The following well-known foreign scientists were investigating monetary policy and developing theoretical foundation for modern systems of money and credit regulation: J. Keynes, T. Kramp, R. Mandell, J. Tobin, S. Fisher, M. Friedman, F. Myshkin, M. King, O. Roste, E. Hansen, etc. Among Ukrainian scientists dealing with this issue were the following: A. Halchynskyy, N. Hrebenyk, O. Kuznetsova, V. Lysytskyy, V. Mishchenko, V. Yushchenko, V. Stelmakh, O. Sharov, S. Bukovynskyy, A. Hrytsenko, T. Krychevska, etc. It is noteworthy, that money and credit policy undergoes constant changes since it is connected to political and economic situation in our country. Today, one should ascertain that the financial crisis is happening in Ukraine. That is why the state's monetary policy should be aimed at guarantee of stability of the national currency, prevention from further increase in unemployment rate, and hardening of the market, etc.

The objective of the article

The objective of the given article, defined after summarizing all the facts mentioned above, is investigation and systematization of money and credit measures that can be used to solve the given range of problems.

Problem definition

To investigate theoretical aspects and general characteristics of the money and credit (monetary) policy; to detect basic internal and external causes of financial crisis in Ukraine; to define and systematize possible measures of the monetary policy.

Results

The world financial crisis caused economic condition worsening in almost all of the countries: enterprises shut down, outturn falls, real personal income decreases, and bank system condition becomes aggravated. According to Eurostat data, by November 1, 2008 the unemployment rate in the countries of Euro area reached 7.7%.

Though Ukraine is not much integrated into the world economic area, it is among the countries, upon which the financial crisis has the biggest impact. It has already been in October that the index of the Ukrainian stock market «First Fund Trading System» (FFTS) decreased by 65.7%, which was the biggest drop among the other countries. Today, exchange rate of the US dollar towards the national currency is characterized by galloping increase; the number of bad loans is growing, the liquidity of banking system is decreasing, enterprises lack the opportunity to take on credits at commercial banks; metallurgical companies (that are providing 40% of all foreign currency receipts) use only one half of their production capacities, and the demand for their products has been decreased, etc.

In order to solve these problems different approaches of state financial policy are used, money and credit policy is among them.

Money and credit (monetary) policy is a complex of the governmental actions and measures in the area of money and credit markets, for example, regulation of inflation and national currency, guarantee of timely payments by means of regulation of banking system functioning, and of stability of money circulation by means of emission management and further extension of banks' clearing operations with physical persons in various consumer services, etc. [5].

The basic goal of money and credit policy is the support of economy to attain to common production level that is characterized by full employment and firmness of prices. Likewise, depending on the level of economic relations development within the country, the following three groups of money and credit policy goals are distinguished: strategic, transitional, tactical. Strategic goals always coincide with general economic ones; transitional and tactical goals complement and concretize strategic ones.

Strategic goals are the key ones in national economic policy. They consist in securement of the GDP growth and high employment rate, in inflation rate decrease, and in settlement of balance of payments. It is noteworthy that within the frame of monetary policy these tasks are incompatible and cannot be fulfilled simultaneously. For example, the pursuit of stabilization of prices in order to keep inflation down through decrease of money supply leads to increase in demand for money, thus, to increase in interest rates and decrease in demand for human resources, i.e. the rise of unemployment takes place.

Transitional goals are the changes in certain economic processes that aim at facilitating the achievement of strategic goals [2], for example, targeting of monetary aggregates, exchange rate, or inflation; absence of actual nominal constant. Since achievement of strategic goals depends upon the market conditions, transitional goal may consist in facilitating or containing changes in market condition, i.e. aggregate demand and aggregate supply.

Management of legal reserves, operations at the open and exchange markets, and refunding of commercial banks are the operative tasks of the banking system aimed at achievement of transitional goals that make up the tactical foundation for money and credit policy. This tactical foundation is formed in a short term and implemented exclusively by means of operational measures of the Central Bank. Along with multidimensionality of the tactical foundation, this complicates the choice and mechanisms for implementation of the given goals [2].

Monetary market and banking system are traditionally considered to be institutional foundation for monetary policy. The National Bank that develops the basic principles of the monetary policy is the principal agent of money and credit policy. The Government, the Ministry of Finance, the Ministry of Economics and the Supreme Council (Verkhovna Rada) are also engaged in the process of monetary policy design. They define macroeconomic indicators that serve as guidelines for formation of monetary policy goals: the GNP rate, the rate of budget deficits, the employment rate, the balance of payments, and the merchandise trade balance.

According to the article 8.7 of «Provisional Regulations on the Matter and Development Procedure of the Basic Principles of Money and Credit Policy and on Control over Adherence to These Principles», the National Bank of Ukraine determines the following:

- final and transitional goals of money and credit policy;
- mechanism for guaranteeing predicted inflation rate, predicted indicators of monetary base, monetary aggregates, and the rate of their growth;
- predicted behaviour of the national currency exchange rate towards the world's reserve currencies;

In order to execute functions mentioned above, the given financial institution uses the following instruments of monetary policy: instruments of direct and indirect impact upon monetary market and economic processes.

Among the direct instruments are the following: setting direct restrictions for issuing and cash operations, for crediting of commercial banks or the needs of the budget from the National Bank, and direct distribution of credit resources among the branches, industries, regions, etc. [4].

Using indirect methods, the National Bank influences on certain monetary indicators. With this purpose the following instruments are used: operations at the open market, regulation of legal reserve ratio, interest rate policy, refinancing of commercial banks, regulation of national currency exchange. All of these instruments have been taken into account when developing the system of measures aimed at improvement of the condition at the Ukrainian financial market.

It is noteworthy that in the process of development of this system of measures, the internal causes of financial crisis in Ukraine play an important role since they have great impact upon the current economic condition. Among the internal causes the following are distinguished:

First, constant increase in welfare benefits that doesn't depend on the indicators of efficiency of labor and commodity collateral increase for both, domestic consumption and export. As a result, exporters were «thrown out» of the world market right after the reversal of trade and the increase of consumer demand (that was also facilitated by increase in consumer crediting by banks) was more extensively covered by means of import.

Second, negative trade balance that may reach \$20 milliards since, according to the State Committee on Statistics, for January through October it accounted for more than \$14 milliards.

Third, the amount of international credits in the first half of 2008 reached \$85 milliards, i.e. it exceeds government reserves in 2.2 times. Moreover, in the context of financial crisis, commercial banks and enterprises have lost the opportunity to take regular external loans for canceling old credits. The idea is that this factor was the determining one in the IMF's decision to grant a credit to Ukraine.

The fourth cause is the misbalance between supply and demand for foreign currency that has lead to drop of the national currency exchange rate.

The fifth factor is the high level of the dollarization of economy (22.7% by October 1, 2008) that, in the context of galloping exchange rate of the US dollar, is threatening for the national economy. This limited the effect of the NBU's monetary policy instruments and made the condition at the domestic financial market dependent from that at the international financial markets.

With respect to external causes, it is noteworthy that they have yet facilitated the effect from the internal ones. Among them are the following: stock market, banking system, external trade area and the sphere of debts. Thus, the fall of stock market indices all around the world didn't pass over Ukraine. In so far as the Ukrainian Stock Market is not well-developed yet, this is not the key factor. Since the outflow of speculative capital takes place, the «First Fund Trading System» makes only a certain pressure upon foreign exchange market. The influence of banking system consists in the following: the share of foreign capital in financial institutions is rather big (according to the NBU's data, the share of foreign capital by November 1, 2008 accounted for 38.1%). Thus, in case foreign companies, the capital of which is available in the Ukrainian bank-

ing system, suffer losses and have problems with their liquidity, the agents at the Ukrainian financial market feel the impact of it. With respect to external trade sphere, the decrease in world demand accompanied with the decrease in investment demand, and in dynamics of construction volume are the results of the financial crisis. It causes reduction of prices for metallurgy and machine-building products. The debt factor proves key in this situation. By July 1, 2008 the external debt accounted for \$100.06 milliards, or 59.9% of the GDP. The IMF's credit adds extra \$16.4 milliards to this. The aggravation of liquidity of the world financial markets may cause essential slow-down of the Ukrainian economy crediting. As a result, Ukrainian debtors face difficulties in refunding their debt service obligations at the external markets.

Consequently, taking these problems into consideration, it is relevant to transform money and credit policy into more tough and consistent one in order to improve the condition of the Ukrainian financial market. In particular, the following steps should be taken:

- 5–6% should be taken off the rate of commercial banks refinancing (that accounts for 12% at the moment). This will make credits more available. At the same time, it is necessary to impose control over credits allotted by banks in order to avoid the situation when banks obtain 6–7% interest credits and allot 20–30% credits to enterprises. A part of gold and foreign exchange reserves of the state can be used for refinancing of banks;
- introduction of administrative control over interest rates in order to avoid corruption and abuse of power, establishment of 2–3% bank margin with regard to credit allotted by the state;
- the National Bank should act as «last hope» creditor and guarantee selective refinancing, depending on bank's contribution into the state's economy;
- it is necessary to tie monetary policy to the demand of enterprises, i.e. to increase refinancing of banks on bills of exchange;
- nationalization of problem banks' assets. For this purpose, a government-owned company for assets recapturing can be established on the model of the American Trust Fund RTC;
- guarantee of manageable floating exchange rate with gradual transition to free floating exchange rate. This will facilitate the increase of flexibility of the exchange rate of the UAH due to extension of the range of its possible fluctuations;
- establishment of control over external debt of the private sector (bank and corporate sectors) and its comparison with the possibilities for reimbursement;
- reduction of economy's dependence from foreign exchange risks;

- establishment of the system of tax advantages that will compensate provisional expenses of banks and stimulate capitalization of their earnings.

It is noteworthy that the foundation for stable functioning of Ukrainian financial market, as well as Ukrainian economy in general, is made up by the following: political stability, consent of all branches of power concerning the government state economic policy (that includes both, money and credit, and fiscal policies), abandoning of populism, decision making that may be unpopular among the citizens, however indispensable.

Conclusions

Thus, the world financial crisis showed how vulnerable Ukrainian economy is to exogenous (external) shocks. The Ukrainian Government and the National Bank should use all possibilities for regulation. The money and credit policy, in its turn, should use system-structural approach in order not to allow further exacerbation of the crisis, to avoid further devaluation of the national currency, to contain growing unemployment rate, and to increase reliance on the banking system.

It is also noteworthy that neither external markets nor foreign capital inflow cannot further be the basic sources for Ukrainian economy funding. Internal sources, long-term deposits of physical and juridical persons, and idle cash of the Pension Fund are of special importance in modern conditions. It is necessary to make anti-crisis measures consistent with economic development of Ukraine and improvement of public welfare.

The performed analysis does not give exhaustive information concerning improvement of money and credit policy. However, it is an attempt to systematize possible measures that are necessary to be taken in the conditions of financial crisis. Thus, in the context of constant change of economic condition in Ukraine further research of these problems is a long-range issue.

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