THE MONETARY AUTHORITY’S CREDIBILITY DETERMINANTS

Under the present circumstances, identification of economic agents’ credibility determinants to the monetary authority is an actual problem.

The determinant of “credibility” is important to implement monetary policy of the central bank. The level of credibility influences speed and quality of impulse transmission via the monetary transmission mechanism. Therefore, it is important to identify the main indicators of credibility level in central bank actions.

There are many institutional factors that influence the monetary policy effectiveness, with credibility being one of them. Generalized definition of “credibility” includes confidence in the currency, banking system, monetary policy, central bank and the state in general. As Ivan Nikolaev defines, credibility is quantitative dynamic characteristic of economic agent’s relations that are based on confidence in the integrity of each other among other things. [4, p. 8]

At a high level of economic agent’s confidence in the monetary authorities, the agents will open deposits and carry out investment activities. The central bank’s regulatory measures find a response in the financial as well as real economy sectors, as the monetary policy transmission mechanism will operate without interference.

However, if the confidence level declines, the monetary authorities’ competence is in doubt, anticipation of changes is opposite to those stated, pessimistic expectations of economic agents are formed, the monetary indicators that were declared are not perceived by them. It makes ability to predict future changes in both monetary and real sectors more complicated. Thus monetary policy effectiveness and financial stability level reduce, so economic growth slows down.

The level of confidence is influenced by the factors associated with institutional mechanisms that relate directly to the Central Bank, as well as those that are beyond its control. Y. Matskevich-Luzyak distinguishes such key determinants of trust as honesty records, transparency and independence. [1]

Honesty records show the predictability of central bank policy, which includes goals acceptable to economic entities and principles of monetary policy, implemented according to the statements of monetary authorities developed and announced for a specific period of time. These actions are the safest way to influence the level of confidence in the central bank policy, as economic agents form their expectations according to the retrospective analysis of the monetary policy’s results [2, p. 33].

The second factor - transparency, is known as the disclosure all central bank aims, its legal, institutional and economic framework, policy decisions and their rationale, data and information related to monetary policy and bank regulation, to all people who might be interested [3, p. 496].
The third determinant is the central bank's independence. The independence of the central bank does not mean complete lack of control over its activities that involve other political institutions. The central bank, as a special state authority, is delegated certain functions, the implementation of which must be controlled by the society. It ought to be considered that the society can set goals and objectives for the central bank via its political authorities [5, p. 37].

The economic agent’s assessment of the prospects of macroeconomic and monetary environment impacts on the level of trust. Negative assessment provokes devaluation expectations and reduce confidence in the national currency; low levels of financial literacy.

Besides the factors that influence the economic agents’ confidence, the indicators that show the level of confidence should also be defined. Scientists have identified a number of indicators of economic agents’ expectations regarding the future development of exchange rate. The higher the difference (in percent) between the official exchange rate of national currency to foreign currency and purchase rate on the interbank market, the lower the level of trust is. The share of foreign currency deposits in total deposits of economic entities and the share of loans in foreign currency in total loans to economic entities – the higher the level of dollarization of deposits and loans, the lower the level of national currency is.

The ratio of deposits attracted by banks to GDP reflects the tendency of the economy towards savings, and can characterize the level of confidence in the banking system.

GDP ratio of monetary aggregate M3 characterizes velocity of the entire money supply. There are two groups of factors that affect money velocity: the effective demand and aggregate supply. Growth of money velocity indicates decline in economic agents’ confidence.

If the share of cash in the money supply decreases, it indicates the increase in confidence in banking system and weakening of pessimistic expectations due to real income rise and growth of propensity for savings, reduction of dollarization and temperate growth of cash in circulation compared to the significant growth in deposits.

In our opinion, arc elasticity of deposits and loans should be considered as indicators of the level of confidence in the economy (the interest rate elasticity of deposits, the interest rate elasticity of loans). If arc elasticity of deposits and loans index is less than “1”, it indicates decline in economic agents’ confidence in monetary authorities. If the index is more than “1”, it indicates optimistic expectations to increase confidence.

The dynamics of official reserve assets has direct relationship with the level of confidence in the economy: the larger the amount of reserves, the greater the ability of the central bank to influence currency market and affect the stability of national currency.

There are some factors that reduce the level of confidence in the central bank: a negative past experience; residual effects of the crisis period; macroeconomic instability, negative trends in the main macroeconomic indicators of the country and low levels of financial literacy.
In order to increase the level of confidence in national currency, banking system, monetary policy, central bank and the state as a whole the following measures should be taken: to strengthen national currency by increasing international reserves; develop and implement training projects to enhance the economic literacy of society; improve the institutional framework; increase the level of central bank independence from the government.

REFERENCES


