

Adapting macro-prudential instruments to achieve monetary policy objectives

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Abstract

Monetary policy is used by governments to adjust financial market conditions to the needs of economic growth. But its application has certain limits, the biggest one being the interest rate limit on monetary policy instruments, which cannot be lesser than zero (although, at least in the euro area, this is already the case). Can monetary authorities use other instruments under these conditions? Currently, in the context of the COVID-19 crisis, most countries have injected huge sums of money into the financial market to maintain the consumption capacity of the population. Can macro-prudential policy instruments manage the existence of money supply to prevent it from entering the financial speculation market and inflate speculative bubbles / this article aims to analyze the behavior of macro-prudential policy, which can be used to achieve monetary policy objectives. The research is theoretical and contains reflections on the need for efficient use of macro-prudential policy instruments in optimizing monetary policy.

1. Introduction

Monetary policy starts from the quantitative approach to the needs of money in the economy and the ability to stimulate aggregate demand by impacting the volume of money supply (Friedman, 1998). The instruments it can use depend on the available transmission channels and have the effect of reducing or enlarging the available money supply. One of these instruments - required money reserves or split reserves, comes from the prudential approach of banking activities and can serve as an example of the takeover of regulatory instruments by monetary authorities. Thus, some central banks in the early stages of their creation required commercial banks to keep part of the deposits drawn from their clients to ensure their reimbursements (Kindleberger, 2007). Later, the Mandatory Reserve Requirements (MRR) become the traditional instrument of monetary policy, currently used in countries where qualitative channels of transmission of monetary policy do not work, especially in economies with emerging and developing markets. An increase in the MRR rate slows down the mechanism of money multiplication. It makes the money multiplier smaller (lesser) and vice versa. However, in the last two decades, several central banks in advanced economies have abandoned, de jure or de facto, this instrument.

Regulation in the banking and financial sector can have a similar, albeit sometimes less direct impact on the money multiplier. Most regulatory requirements limit the ability of banks to lend and respectively to create the monetary mass. An example of such limitations may be the liquidity coverage requirement (LCR) and the capital adequacy rate (CAR). If supervisory authorities increase the LCR limits, banks are obliged to maintain a higher volume of liquidity in accounts. In the case of fractional reserves, this requirement has a negative effect on the money multiplier and the broad creation of money. The CAR growth can also reduce the money multiplier at least in the short term, as the need to increase the capital and reduce risky assets will affect banks' lending capacity and reduce the monetary mass.

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