

Impact of Financial Instruments of the Bank of Russia for the Stability of the Banking System

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ABSTRACT

The subject of this research is the economic relations developing in the banking sector of the economy, where the role and application of the basic financial instruments of monetary regulation are fundamental to maintain liquidity, increase the reliability and business reputation of credit organizations. Purpose of the study: analyze the changes in the monetary policy of the Bank of Russia in the context of containing inflation at a low level, summarize the practice of applying its main financial instruments at the present stage, identify problems and develop proposals for the effective use of regulatory standards in order to ensure economic growth in the country. The methodological basis of this study was composed by methods of comparative and system analysis, methods of deduction and induction, grouping and comparison, detailing and generalization, systematization and classification. Key results: 1. An analysis of the evolution of the development of monetary policy in the context of containing inflation is presented. 2. The modern practice of applying financial instruments of monetary regulation is generalized. 3. The advantages and disadvantages of strengthening inflation targeting in comparison with other instruments of monetary regulation are revealed. 4. Proposals are submitted to state authorities and the Bank of Russia both in legislative acts and in the main directions of monetary policy. The authors justified the conclusion of the transition to a stimulating monetary policy, aimed at ensuring a more dynamic economic growth in the country. Key findings of the research: 1. The approaches to the formation and application of the main financial instruments of monetary regulation are systematized 2. The investment characteristics of deposit and credit instruments of the Bank of Russia are presented.

Keywords: *deposit and credit auctions, fine-tuning operations, a pawn list, refinancing*

1. INTRODUCTION. SETTING AND UPDATING THE GOAL

Monetary policy is a fundamental tool for regulating the country's economy. The inflation rate, employment, the quality of life of the population, and the overall stability of the financial system depend on its effectiveness. In practice, the Bank of Russia, in addition to these issues, also solves other current problems related to internal problems in the banking system itself.

There are different approaches to the definition of what the monetary policy of the Bank of Russia. According to the federal law N86-FL «On the Central Bank of the Russian Federation (Bank of Russia)»: «Monetary policy is a part of a unified state economic policy, manifested in the impact on the amount of money in circulation in order to achieve price stability, to ensure the highest possible employment population, as well as growth in real output».

Monetary policy is aimed at implementing the goals set for the credit regulator. These goals are:

- protection and ensuring the stability of the ruble,
- development and strengthening of the banking system of the Russian Federation,
- ensuring stability and development of the national payment system,

- development and stability of the financial market of the Russian Federation.

It is not explicitly indicated, but the achievement of the first goal can be achieved through inflation targeting. The development of the financial market should stimulate economic growth, on the one hand, and, on the other hand, ensure the competitiveness of domestic producers in world markets. Thus, goals are achieved using monetary policy instruments [7].

2. RESEARCH METHODOLOGY

The theoretical and methodological basis of the research was the classic and modern approaches in the formation and implementation of monetary policy.

Classifying monetary policy instruments into direct and indirect, the authors investigated the change in the influence of each of them on the country's economy.

The application of interest rates on Bank of Russia operations is necessary mainly to maintain a given level of inflation, as well as to influence interest rates that are formed on the market. The key rate is currently tied to the refinancing rate, depending on what level this rate is at, credit organizations set their interest rates on loans and deposits. Analysis of changes in the key rate and bank lending rates shows an ambiguous reaction of the inflation rate to a decrease in the key rate under the influence of other factors. If until mid-2018, a decrease in the rate of inflation over time was observed under the influence of the key rate and other factors, then in the future period an increase in

the rate of inflation over time was observed. The econometric model shows that the dependence of the inflation rate on the key rate over the past three years was non-linear [4].

In the second half of 2019 the main external factors began to testify in favor of lower values of the neutral key rate. At the same time, internal factors, on the contrary, do not form significant arguments in favor of such a revision. At the same time, a combination of external and internal factors is enough to revise the lower boundary of the neutral range in mid-2020, at least from 6 to 5.5% per annum.

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Ordinance of the Bank of Russia No. 4604-U of November 13, 2017, «On Mandatory Reserve Requirements», contains the required reserve ratios. Norms of required reserves directly affect the volume of money supply that are in circulation. With an increase in mandatory reserve requirements, the amount of monetary fund's of credit organizations is reduced, therefore, they begin to lend less to business entities and the public, and therefore there is a decrease in the money supply in the country. And there is another situation when the reserve requirements are reduced, then the amount of money from credit institutions is growing, since they begin to store less money in correspondent accounts with the Bank of Russia, therefore, they begin to issue more loans to business entities and the public [3]. Of particular importance in monetary regulation, the Bank of Russia attaches to open market operations, which, according to Art. 39 of the federal law of 10.07.2002 N 86-FL should be considered as "the purchase and sale of treasury bills, government bonds, other government securities, bonds of the Bank of Russia, as well as the conclusion of repurchase agreements with these securities, the purchase and sale of other securities subject to their admission to trading at stock exchanges or other organizers of trading on the securities market, as well as conclusion of repurchase agreements with the indicated securities.

These operations allow the Bank of Russia to regulate the liquidity level of commercial banks. These operations are classified as forward and reverse. The essence of direct operations on the open market is that the Bank of Russia begins to buy debt securities from commercial banks, as a result of which commercial banks receive additional cash or liquidity. There may be another situation, when the Bank of Russia withdraws excess liquidity from commercial banks.

A feature of these operations is that the securities that are used in the transaction can be traded on an exchange, i.e. they are in circulation. The terms for these operations may be the following: 1 day, 7 days, 3 months and 1 year. And also they can be carried out both on an auction basis and at a fixed rate.

Refinancing of credit organizations is the primary task of the Bank of Russia. According to Art. 40 of the federal law of July 10, 2002 N 86-FL of the form, procedure and conditions for refinancing are established by the Bank of Russia.

The Regulation on the procedure for the Bank of Russia to provide loans to credit institutions secured by a pledge

(blocking) of securities approved by the Bank of Russia 04.08.2003 N 236-P defines the procedure for the Bank of Russia to provide loans secured by a pledge (blocking) of securities to credit organizations. Loans of the Bank of Russia are secured by a pledge (blocking) of securities included in the so-called Pawn list [8].

The Pawn list is indicated in Ordinance of the Bank of Russia dated 10.08.2012 N 2861-U «On the List of Securities Included in the Pawn list of the Bank of Russia» [9].

Refinancing loans are provided only to those banks that can repay them, i.e. banks with high creditworthiness. The Bank of Russia has established the following standard requirements for potential borrowers:

- the bank should be classified as financially stable;
- a credit institution must not have underpayments to required reserves, unpaid fines for violation of required reserves standards;
- the bank should not have past due monetary obligations to the Bank of Russia.

The Bank of Russia provides loans for short periods. First of all, the provision of Bank of Russia loans is aimed at ensuring the continuity of settlements.

An equally important role is given to unsecured loans. The provision of unsecured loans was one of the Bank of Russia's main anti-crisis instruments since the end of 2008 to 2010 and in combination with other measures taken, it helped to overcome the systemic liquidity shortage of the banking sector and maintain the stability of the banking system as a whole. From January 1, 2011 unsecured loans were suspended on the basis of a decision of the Bank of Russia Board of Directors dated June 30, 2010 due to normalization of the liquidity situation in the banking sector. However, if necessary, the Bank of Russia has the opportunity to resume the practice of conducting these operations.

The transition to a floating ruble exchange rate somewhat weakened the practical significance of foreign exchange interventions. Currency interventions are determined in accordance with Art. 41 of the federal law of 10.07.2002 N 86-FL: "As an activity on the implementation by the Bank of Russia of the purchase and sale of foreign currency in the foreign exchange market to affect the ruble exchange rate and the total demand and supply of money". The Bank of Russia has the right to buy or sell foreign currency, as well as payment documents and obligations denominated in foreign currency, issued by Russian and foreign credit organizations (cl. 4 of Art. 46 of the federal law of July 10, 2002 No. 86-FL).

The establishment of benchmarks for the growth of money supply as an instrument of monetary regulation can be noted in Art. 42 of the federal law of 10.07.2002 N 86-FL. It follows from this article that the Bank of Russia can set benchmarks for money supply growth. These indicators include monetary aggregates - types of money with varying degrees of liquidity. Direct quantitative restrictions of the Bank of Russia in accordance with Art. 43 of the federal law of 10.07.2002 N 86-FL suggest the impact of the Bank of Russia on the activities of credit organizations through the establishment of limits on lending to commercial banks, as well as on the implementation by credit organizations of certain types of banking operations. The Bank of Russia uses this tool in rare cases, only on condition that they are applied to all credit organizations.

Thus, the methodology for using financial instruments is strictly regulated by regulatory legal acts, but the mechanism for using each of them, as a tactical task, directly depends on the art of the Bank of Russia.

3. RESEARCH RESULTS (PRACTICAL ANALYSIS)

The modern monetary policy of the Bank of Russia is characterized by a number of features. Inflation targeting, which reflects the Bank of Russia’s control over inflation control, is at the forefront. Inflation targeting reflects the

strategic end goal - price stability. The Bank of Russia has set a target inflation rate of four percent. The economy of the country and the banking sector is regulated through interest rates, in particular, the Bank of Russia key rate, interbank lending rates: MIACR, MIBID, LIBOR, etc.

Along with this, the Bank of Russia refused to regulate the exchange rate, i.e. The exchange rate is formed on the basis of supply and demand in the market.

The classic instrument of monetary regulation are the reserve requirements standards of the Bank of Russia.

Table 1 shows the average annual level of standard of the reserve requirements of the Bank of Russia.

Table 1 The average annual level of standard of the reserve requirements of the Bank of Russia [10]

Standards mandatory reserve requirements	01.01.16	01.01.17	01.01.18	01.01.19
For obligations to non-resident legal entities in the currency of the Russian Federation	4,25	4,50	5,00	5,00
For obligations to individuals in the currency of the Russian Federation	4,25	4,50	5,00	5,00
For other obligations of credit organizations in the currency of the Russian Federation	4,25	4,50	5,00	5,00
Weighted average reserve requirements,%	4,25	4,50	5,00	5,00

In order to draw objective conclusions, we present the volumes of required reserves, which are presented in Figure 1.

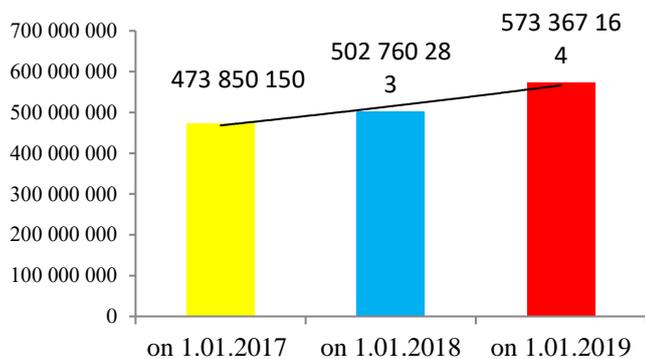


Figure 1 Amount of required reserves supported by credit organizations on correspondent accounts of the Bank of Russia, thousand rubles [10]

Based on the information presented in Table 1 and Figure 1, it can be concluded that a change in the required reserve ratios directly affects the amount of required reserves of credit institutions, which are stored on correspondent accounts (sub-accounts) of the Bank of Russia. So on 01/01/2018 the weighted average reserve requirements increased from 4.5% to 5.0%, the same trend can be seen in the amount of required reserves.

The key rate of the Bank of Russia is gradually coming to the forefront among monetary policy instruments. It begins to

really affect many parameters of the banking system: loans, deposits, interest income and expenses, as well as the volume of placement and raising funds.

For example, if in December 2014 the key rate was 17% per annum, and the average interest rate on loans provided by credit institutions to individuals in rubles for more than 1 year was 17.37% per annum, then in December 2019 at the key rate 6.25% per annum, a similar rate on loans was 12.05% per annum [10]. It should be noted that the key rate decreased by more than 60%, and the average rate on loans decreased by less than 30%.

Due to the current macroeconomic situation in 2014, the Central Bank of the Russian Federation had to switch to a floating exchange rate and abandon the approved exchange rate policy, which provided for a special mechanism for the use of foreign exchange interventions depending on the situation on the foreign exchange market. Nevertheless, the Central Bank of the Russian Federation reserved the right to conduct foreign exchange interventions in extreme cases, in order to adjust the national currency exchange rate and stabilize the financial situation. For example, already in December 2014, the Bank of Russia repeatedly used the mechanism of currency interventions to stabilize the ruble due to its significant deviations from the officially established level to stabilize the Russian economy and prevent excessive inflation. The last time the Bank of Russia conducted currency interventions was in July 2015. The purchase of foreign currency by the Central Bank leads to the expansion of the monetary base, the sale of foreign currency leads to a contraction of the monetary base in the country [2].

One of the effective instruments of monetary regulation is the deposit operations of the Bank of Russia.

Through deposit operations, the Bank of Russia manages liquidity in the banking sector (Figure 2).

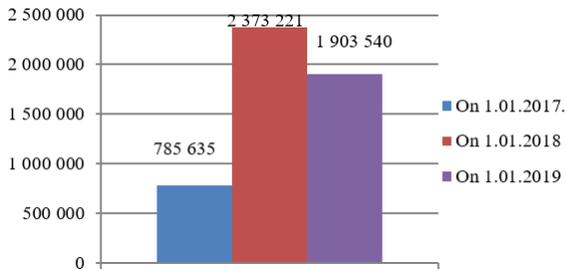


Figure 2 Volumes of deposits of credit organizations attracted by the Bank of Russia on 01/01/2017 - 01/01/2019, million rubles [10]

As shown in Figure 2, the volumes of temporarily free funds attracted from credit organizations to Bank of Russia deposits for the analyzed periods increased significantly, which confirmed excessive liquidity and its withdrawal. As of January 1, 2019, the volume of deposits of credit institutions attracted

Table 2 The structure of borrowed funds [10]

Term	The number of credit institutions that have placed a deposit with the Bank of Russia	The structure of attracted funds,% of the amount of funds attracted to the deposit									
		At fixed interest rates, by terms				On deposit auctions, by terms					
		Demand deposits	day	month	week	Fine-tuning operations (day)					
						1	2	3	4	5	6
On 01.01.2018	407	0,39	48,54	-	41,74	8,33	12,34	4,68	5,12	-	-
On 01.01.2019	382	0,11	26,12	-	60,12	8,94	2,52	2,97	3,12	2,61	2,31
On 01.01.2020	376	-	30,51	-	60,44	9,99	2,37	2,54	-	3,73	-

According to table 2, as of January 1, 2020, deposit auctions for the period of one week occupy the largest share of the amount of raised funds, their share is 60.44%, and as of January 1, 2018 it was 41.74%. The increase over the past two years is due to a decrease in the volume of deposit operations at fixed rates. Deposits at fixed interest rates on demand are practically not in demand.

Along with an increase in the volume of deposit operations of the Bank of Russia, the number of credit organizations engaged in these operations is also increasing. January 1, 2018 the number of credit organizations amounted to 407, and as of January 1, 2017 - 349. Despite the decrease in their number as of January 1, 2019, in general, the dynamics remain positive. Considering the volume and structure of Bank of Russia

by the Bank of Russia decreased to 1 903 540 million rubles or by 469 681 million rubles. in comparison with the same period of the previous year. This trend is associated with a decrease in the key rate. As of January 1, 2018, there was an opposite situation when the volumes of deposit operations of the Bank of Russia sharply increased by 1,587,586 million rubles compared with the same period of the previous year, confirming that at that time there was an excessively excessive cash liquidity. But if we consider the trend line for deposit operations as a whole, then we can say that it is positive. These volumes of deposit operations of the Bank of Russia also indicate that credit organizations are actively engaged in such operations. It should be recognized that the Bank of Russia deposit operations as an instrument of monetary regulation are working effectively.

Deposit operations of central banks as an instrument of monetary policy are the attraction of funds of credit organizations to deposit accounts opened for them for a certain period at a certain interest rate.

Therefore, it is advisable to consider the structure of borrowed funds by the timing of the total amount of funds attracted to deposits. This specific gravity is presented in table 2.

deposit operations, it is necessary to analyze the weighted average interest rates for these operations, which are presented in table 3.

For all types of deposit operations, there is a steady dynamics of their decline.

Given the current key rate of 6.00% (decision of the Board of Directors of the Bank of Russia on February 7, 2020), the annual average weighted interest rates will tend to this indicator. A similar trend applies to deposit operations on interest-bearing operations on an auction basis, where rates have decreased over the past three years from 9.05% to 7.29% per annum, as well as at fixed interest rates, where the decline was more significant - from 8.13% to 6.33% per annum.

Table 3 Weighted average interest rates on deposit operations of the Bank of Russia, including “fine-tuning” operations, in% per annum [10]

Terms and types of operations		On 01.01.2018	On 01.01.2019	On 01.01.2020	
For deposit operations at fixed interest rates with a maturity of cash	Demand deposit.	8,12	6,45	-	
	1 day	8,13	6,43	6,33	
	1 month	-	-	-	
For all types of deposit operations at fixed interest rates		8,13	6,43	6,33	
On deposit operations at interest rates on an auction basis with a term for attracting funds to deposit	1 week		9,06	7,39	7,29
	Fine-tuning operations	1 day	8,83	7,36	7,23
		2 days	8,24	7,34	7,73
		3 dsys	8,63	7,31	7,68
		4 days	8,68	7,34	-
		5 days	-	7,29	7,71
6 days		-	7,67	-	
For all types of deposit operations at interest rates on an auction basis		9,05	7,39	7,29	
For all types of deposit operations		8,88	7,31	7,20	

4. CONCLUSIONS

The active use of deposit operations by the Bank of Russia can be confirmed both by an increase in the number of credit organizations that participate in these operations, and by an increase in the volume of borrowed funds in these deposits.

A relatively new instrument of the Bank of Russia policy in addressing the regulation of banking liquidity are operations of "fine tuning" [1].

This tool received practical use on February 17, 2014. From table 3 it is seen that the operations of "fine-tuning" are carried out in the form of deposit auctions for a period of 1 to 6 days. The maximum rate at which these operations can be conducted is equal to the key rate. The fine-tuning deposit auction volumes of the Bank of Russia for the analyzed periods increased significantly, which also indicates excessive liquidity in the banking sector. So, as of January 1, 2018, the volume of "fine-tuning" operations increased by 4,066.5 billion rubles compared to the previous year. However, at 1.01. In 2019, they decreased by 1,458.3 billion rubles, which is associated with a decrease in the Bank of Russia key rate. Fine-tuning operations help absorb liquidity and remove excess free cash from the economy [5].

Thus, deposit operations greatly affect the liquidity of commercial banks.

It is recognized that high and volatile inflation negatively affects the economy. First of all, it complicates the implementation of long-term projects and investments. When financing investment projects, lenders are forced to consider the worst option - high inflation in interest rates on loans, because they want to receive income from investments. It is difficult for manufacturers to plan their activities and evaluate whether their investments will pay off. In addition, the high rate of price growth requires constant review of contract prices and wages, which is also associated with costs. High inflation without a compensatory increase in wages leads to a decrease in real incomes of the population. While maintaining high rates of price growth for a long time and a constant decrease in the purchasing power of money, an increase in social discontent and political instability is possible. Therefore, low and, most importantly, stable inflation is a necessary condition for sustainable growth and economic development [6].

But since inflation involves the depreciation of cash in the country and is associated with the predominance of a large amount of money in circulation, the Bank of Russia simultaneously uses other monetary policy instruments, for example, mandatory reserve requirements, which it raised to 5% points over this period of time. That is, on the one hand, evaluating the situation that has developed on the market, the Bank of Russia decided to soften its monetary policy by lowering its key rate, and on the other hand, to raise inflation, it raised the reserve requirements.

But, despite a decrease in the Bank of Russia key rate and an increase in lending to the national economy, its growth rates, as before, remain restrained.

One of the problems that is present in the monetary policy of the Bank of Russia is the inefficient use of excess liquidity in the banking sector. The Bank of Russia solves issues of excess liquidity by direct intervention through an increase in

regulatory values, and does not seek ways to effectively use excess liquidity by stimulating investment in the real sector of the economy. The created situation must be used for investment purposes: to increase lending to small and medium-sized businesses in parallel with this, continue the practice of financing state targeted programs. Stimulate the appeal of public Russian companies for financing to the open market, and medium and small businesses should receive priority lending through the banking system.

In the Russian economy, the conditions for long-term investments of commercial banks in projects with a short payback have not developed. The Bank of Russia refinances commercial banks, mainly for a short term. Very often these are overnight loans or intraday loans for a period of one day. All these loans are aimed at covering current gaps in the balance of payments of a commercial bank.

One of the key reasons is that despite the effective measures taken by the Bank of Russia to target inflation, high inflationary expectations on the part of the population remain in the society. At the end of February 2020 according to the information of the Bank of Russia, expected inflation was 7.9% with statistical inflation of less than 3% per annum.

Even in these conditions, the Bank of Russia should demonstrate the transition to a stimulating monetary policy and continue to reduce the key rate to a level close to the target inflation, the benchmark for the next 2-3 years is 5% per annum.

The cheapening of credit resources both for business entities and especially micro and small entrepreneurship, as well as for the population, primarily in the mortgage lending market, will reduce inflation expectations and create conditions for ensuring the growth of the country's economy.

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