## **Functions of Central Bank**

HS 202

### INTRODUCTION

Central bank plays a critical role in every transaction, business and daily activities, whether it is Economic activity or Individual activity (saving schemes or return matters)



## FUNCTIONS PERFORMED BY THE CENTRAL BANKS

- Assistance in the Conduct of Monetary Policy
- Supervision and Regulation
- **×** Government Services
- × New Currency Issue
- Check Clearing
- **×** Wire Transfer Services
- × Research Services



## **OBJECTIVES OF THE MONETRY POLICY**

- To influence the amount of reserve in the banking system...
- which affects interest rates and availability of credit and...
- ultimately affects the levels of employment, output, prices and inflation



## MONEY STOCK

- There are a number of measures of a nation's money stock (M).
- \* The narrowest measure is the sum of currency in circulation and the amount of transactions deposits (TD) in the banking system.



## MONEY MULTIPLIER

- Most nations require that a fraction of transactions deposits be held as reserves.
- The required fraction is determined by the reserve requirement (rr).
- This fraction determines the maximum change in the money stock that can result from a change in total reserves.



# RELATING THE MONETARY BASE AND THE MONEY STOCK

Under the assumptions above, we can write the money stock as the monetary base times the money multiplier.

$$M = m \cdot MB = m(C + TR).$$

\* The change in the money stock is expressed as

$$\Delta M = m(\Delta C + \Delta TR).$$

## **MONETARY POLICY TOOLS**

#### Open Market Operations

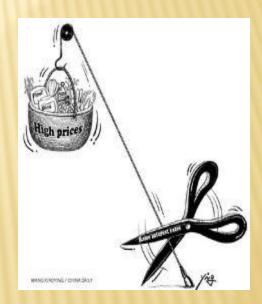
 primary determinate of changes in excess reserves in the banking system impacting the size of the money supply and/or interest rates

#### **×** The Discount Rate

 the rate of interest Central Bank charge on emergency loans to depository institutions

#### Reserve Requirements

+ determine the minimum amount of reserve assets that depository institutions must maintain by law to back transaction deposits held as liabilities



## CONT...

#### **Open Market Operations**

- + To change Reserves
- + To offset other factors affecting Reserves
- Typically uses repos & reverse repos: Open market transactions to purchase gov. Securities with an aggreement that seller will repurchase them in a predetermined time period.

#### Advantages of Open Market Operations

- 1. Central Bank has complete control
- > 2. Flexible and precise
- > 3. Easily reversed
- > 4. Implemented quickly



## **GOALS OF MONETARY POLICY**

#### Goals

- 1. Price Stability
- 2. High Employment
- 3. Economic Growth
- 4. Interest Rate Stability
- 5. Financial Market Stability
- 6. Foreign Exchange Market Stability

