

# Functions of Central Bank

HS 202

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# 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**

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- ✖ 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 MONETARY 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

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

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

- ✗ 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 agreement 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

