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INTEREST RATE CHANNEL OF MONETARY TRANSMISSION AND ITS USE IN UKRAINIAN BANKING PRACTICE

The effectiveness of the implementation of monetary policy in Ukraine is realized through the balanced implementation of monetary instruments, which further affect the macroeconomic indicators of the country as a whole – GDP, unemployment rate, inflation rate, etc. That is why studying the effectiveness of monetary transmission mechanisms is extremely important.

In general, the monetary transmission mechanism is a process during which particular sets of factors and instruments of the central bank's monetary policy operate through a network of channels and connections and directly or indirectly affect the country's economy during a specific period (so called, lag). The National Bank of Ukraine, using detailed analytical data and forecasts, tries to work ahead of the possible scenarios and send the necessary impulses through transmission channels.

In the economic literature, the following channels of monetary transmission are distinguished: interest rate, credit, foreign currency, and expectations channels. In this paper, we will consider the effect of the interest rate channel in Ukrainian practice in more detail.

The classical Keynesian model studied only one channel – the interest rate. That is why, historically, it is considered the main channel of monetary transmission. The instrument of such a channel is a key rate. Thus, a change in the central bank's key rate with a specific time lag affects the rates of commercial banks for economic entities, thereby affecting the intensity of capital movement between different segments of the financial market, savings, investment, and consumption, that is, the change in aggregate costs and demand, and therefore, – and on economic growth rates, employment, and inflation [1].

The following scheme can represent the action of this channel: the NBU determines the discount rate → the NBU sets the rate for certificates of deposit and refinancing operations at the level of the key rate → commercial banks perceive this rate as a guide for the cost of financial resources → commercial banks change the rates for deposits/loans to the clients → the volume changes savings, lending and investments → the volume of exports and imports, wages and price levels changes.

The change in the NBU key rate in one direction or another depends on the type of monetary policy chosen by the central bank. When conducting a restrictive policy, the goal is to limit the money supply. In this case, the growth of the discount rate stimulates the growth of interest rates on credit and deposit transactions. This leads to a reduction in crediting and possible investments of these credits in the country's economy, which in turn leads to a limitation of the growth of the money supply, a decrease in demand in the economy, and as a result – a reduction of inflationary trends.

With an expansionary policy, the central bank's goal is to increase the money supply. In this case, a reduction in the key rate leads to a decrease in interest rates for credit and deposit operations of commercial banks. In this case, the demand for credit resources on the part of economic agents increases. In the future, this will lead to an increase in the money supply in circulation. Such actions of the central bank can contribute to the revival of business activity in the country's economy.

Currently, the algorithm of the interest rate channel of monetary transmission looks as follows:

1) In the first stage, the NBU determines the level of short-term interest rates on the interbank market due to a change in the key rate. Thus, the NBU signals to the market what level of interest rates it sees as optimal for achieving the goals of monetary policy. For the market rates to be close to the desired level for the central bank, it ties its operations to the level of the key rate. For example, the basic operations of the NBU to regulate the liquidity of banks, which most affect the cost of resources on the interbank market, are carried out at the key rate. The influence of the NBU on short-term rates of the interbank money market is fast and effective, provided that it does not set additional restrictions on attracting or providing short-term resources;

2) the transmission of short-term rates into the long-term and the real sector of the economy takes place because the latter has a real impact on economic processes in the country. Long-term rates (both for loans and for deposits) are formed under the influence of both the level of short-term rates on the interbank market and the structural characteristics of the economy and financial stability (competition in the banking sector, the level of trust in banks, inflationary expectations, supply and demand, etc.). It should be noted that the relationship between short-term rates on the interbank market and banks' rates on loans and deposits significantly strengthened in 2016–2017. An indicator of the value of money and easy access to transactions with the NBU for managing own liquidity appeared on the market. In addition, there is an impact on long-term rates on the financial market – on the yield on government securities.

It was observed that the change in the NBU key rate effectively affects changes in the size of the inflation level after 9–18 months [2]. That is why the central bank changes the key rate at the moment when, according to the available data on inflation, the need for this is not apparent: for example, it is lowered during a period of rising inflation or raised when inflation is already falling. After all, the NBU conducts an active policy that considers current values and their most likely dynamics in the future [2].

It is worth noting that the weakness of the interest rate channel of monetary transmission was observed before the introduction of the practice of inflation targeting in Ukraine. From 1992 to 2015, the key rate was not very effective in Ukrainian banking practice. At the moment, this situation has fundamentally changed. The dynamics of the inflation level and the key rate from 2015 – to the beginning of 2024 are shown in Figure 1.

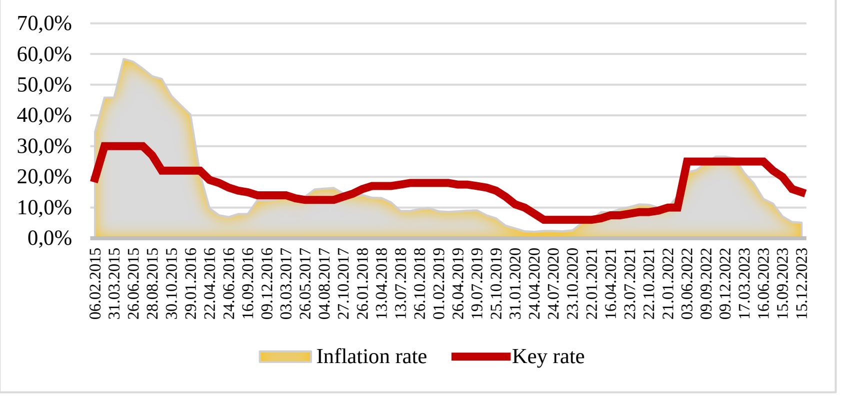

Figure 1. The dynamics of the inflation rate and the discount rate in 2015–2023

Source: compiled by the author according to the official website of the NBU

It is essential to analyze the effectiveness of this TM channel precisely at the beginning of the full-scale invasion of the Russian Federation into Ukraine. Thus, inflation began to rise rapidly starting from February 24, 2022. The annual inflation rate in 2022 was 26.6%. This indicator was higher only in 2015 at the level of 43.3% [3]. The central bank's reaction to the predicted further increase in inflation and the desire to return to the targeted goal was to raise the key rate in June 2022 from 10% to 25%. This level of the key rate remained until July 2023. At the same time, inflation decreased in March 2023, i.e., after nine months. And after 18 months, its level was already 5.1%. Thanks to the positive reaction of the inflation level to the change in the key rate, the regulator was able to reduce the latter. That is why, in July 2023, the NBU gradually reduced the key rate to 22%, in September – to 20%, in October up to 16% and in December the key rate reached the level of 15%. This practical example shows the maximum effectiveness of the interest transmission channel in Ukraine.

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