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RESERVE ASSETS AS SOURCES OF REPLENISHING RESOURCE BASE OF BANKING SECTOR AND IMPROVING ITS STABILITY

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Abstract:

The paper focuses on the importance of using reserve assets in order to increase the bank financial stability and the banking system as a whole. The essential requirements for reserving commercial banks have been presented. The methods of regulating the required reserves have been studied. The specific features of applying the required reserves in banking activities (reserve requirements and liquidity, monetary policy, reserve requirements as a monetary tool, reserve requirements as a fiscal tool) have been revealed. The schedule of averaging periods of required reserves for 2019 is being considered. The general principles which credit organizations are guided by when creating reserves are the following: obligatory availability of reserves for all credit organizations throughout their existence; forming reserves in relation to liabilities to legal entities and individuals; possibility of removing from the list obligations for which reserves have been created. It has been mentioned that the main objectives of the reserve requirement system are to provide banks with sufficient liquidity and to regulate the money supply. Particular attention is paid to the Central Bank as a reserve requirements regulator. In accordance with the changes of the Central Bank of July 1, 2019, the established standards on reserve requirements for deposits in national currency are set at 4%, in foreign currency at 14%. Manipulating the required reserve rate will provide the Central Bank with the opportunity to adjust the liquidity and solvency both of an individual bank and the entire banking system. The method of averaging required reserves includes the possibility for a commercial bank not to transfer reserves to the Central Bank based on a certain sum of money. The averaging coefficient is set at 0.25 to the standard volume of required reserves.

Keywords: Central Bank, banking system, reserves, requirements, stability.

1. INTRODUCTION

Reserve requirements, or mandatory reserve, reserve ratio, are a liquid asset, the minimum amount that banks must constantly keep in readiness to meet the requirements for bills and deposits [1]. Reserves are stored, as a rule, either as deposits in the Central Bank (CB), or as cash in the vaults of the institution to which they belong. The size of reserves is determined (or changed) by the regulator – the Central Bank represented by its board of governors. As a rule, the amount of reserves is determined through a certain percentage of bank deposits (both term deposits and ordinary deposits) [2].

Reserve requirements apply to commercial, savings, credit banks, associations, credit unions, regional corporations and contractual corporations. The bank can store the amount of the reserve either in its vault or as a deposit in its local reserve bank. If a bank does not have enough funds to cover its reserves, it borrows funds from other banks [3]. The bank can also borrow from the discount window of the Central Bank, i.e. use the loan of the Central Bank. The money that banks borrow or give to each other is subject to the fulfillment of reserve requirements, and banks make deductions to the Central Bank.

RESEARCH MATERIALS

Among the general principles that credit organizations are guided by in the formation of reserves are the following:

1) the mandatory availability of reserves for all credit institutions throughout their existence;

2) the formation of reserves in respect of obligations available to both legal entities and individuals, including foreign ones;

3) the possibility of exclusion from the list of obligations for which reserves are created:

− with a maturity of more than three years;

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− expressed in non−monetary form; - between separate divisions;
− to other credit organizations, an international financial organization established with the participation of the Russian Federation, Vnesheconombank, the Central Bank of the Russian Federation, the Deposit Insurance Agency, to investors who are not credit organizations;
− the need to form reserves in the currency of obligations, i.e. both in Russian rubles and in foreign currency;
− creation of reserves on accounts, opened in the Central Bank of the Russian Federation.

There are two main goals of the mandatory reservation system.

The first, as follows from the above, is to provide banks with sufficient liquidity.

Another important goal is the regulation of the money supply [4].

As a rule, mandatory reserves perform the main function – regulation of the structural liquidity of the banking system.

The first method of regulation is the manipulation of the mandatory reserve rate, which makes it possible for the Central Bank to adjust the liquidity and solvency of both an individual bank and the banking system as a whole.

The Central Bank has made changes to the standards of mandatory reserves of banks deposited with the Central Bank. The changes came into force on July 01, 2019. The standards for mandatory reserves for deposits in national currency are set at 4%, in foreign currency – 14% (Table 1).

Table 1 Standards for mandatory reserves

The currency of obligations	Term	After the changes (from 01.07.2019), %.	Before the changes, %.
National currency	More than two years	4	0
	From one to two years		2
	Other deposits		4
Foreign currency	More than two years	14	0
	From one to two years		7
	Other deposits		14

Source: Compiled by [5].

The second method is to average the required reserves. It is worth noting that this method is not used by all central banks that use mandatory reserves. Commercial banks at the level of national banking systems that use this mechanism can use some of the mandatory reserves in order to regulate their liquidity and financial stability. The essence of averaging is that a commercial bank gets the opportunity not to transfer reserves to the Central Bank based on a certain amount.

An averaging coefficient of 0.25 to the standard volume of mandatory reserves has been established. The average daily balance of correspondent accounts of banks for the storage period should be at least 25% of the volume of mandatory reserves, which, in turn, should allow them to effectively manage liquidity.

The last time the regulations were changed was in August 2018, when mandatory reserves began to be stored only in the national currency. The changes were aimed at reducing the level of dollarization in the economy, increasing the attractiveness of deposits in the national currency.

The graph of the averaging periods for 2019 looks as follows (Table 2).

Table 2 Schedule of mandatory reserve averaging periods for 2019

The averaging period for calculating the amount of mandatory reserves for the corresponding reporting period	Duration of the averaging period (in days)	For reference	
		Reporting period	Period of regulation of mandatory reserves
09.01.2019–05.02.2019	28	December 2018	22.01.2019–24.01.2019
06.02.2019–05.03.2019	28	January 2019	14.02.2019–18.02.2019
06.03.2019–09.04.2019	35	February 2019	15.03.2019–19.03.2019
10.04.2019–07.05.2019	28	March 2019	12.04.2019–16.04.2019
08.05.2019–04.06.2019	28	April 2019	21.05.2019–

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			23.05.2019
05.06.2019–09.07.2019	35	May 2019	17.06.2019–19.06.2019
10.07.2019–06.08.2019	28	June 2019	12.07.2019–16.07.2019
07.08.2019–03.09.2019	28	July 2019	14.08.2019–16.08.2019
04.09.2019–08.10.2019	35	August 2019	13.09.2019–17.09.2019
09.10.2019–05.11.2019	28	September 2019	14.10.2019–16.10.2019
06.11.2019–03.12.2019	28	October 2019	15.11.2019–19.11.2019
04.12.2019–07.01.2020	35	November 2019	13.12.2019–17.12.2019

Source: Compiled by [5].

FEATURES OF THE INTRODUCTION OF MANDATORY RESERVES OF THE BANK

1. *Reserve requirements and liquidity.* The system of reserves owes its appearance to the development of the banking system, the transformation of the latter into an important and large sector of the economy. If one bank has liquidity problems, then in general it can solve them through interbank borrowing. However, if a significant percentage of banks have problems at the same time, i.e. the banking sector as a whole, interbank loans will not solve the problem. This is where the system tool comes to the rescue – backup requirements [6].

The central bank is the regulator of reserve requirements, it uses reserve requirements to ensure the liquidity of a commercial bank. The main principles of effective operation of the bank are security, liquidity and profitability. The application of these principles is mandatory for banks in terms of their impact on stable and efficient banking performance. Reserves of primary and secondary banks serve to maintain liquidity as one of the conditions for successful banking productivity.

One of the main indicators of banks' liquidity is mandatory reserves deposited with the Central Bank. The rate of mandatory reserves is differentiated, it is determined by the Central Bank depending on the grounds on which it is calculated. The necessary reserve for bank deposit potential is an important springboard of monetary policy with a noticeable impact on financial flows through banks.

Liquidity in a bank is an indicator of its ability to easily find cash that may be required to meet requirements. Liquidity can come from cash securities that can be quickly sold with minimal losses; these are typical resources of highly creditworthy securities, including government accounts.

2. *Reserve requirements and monetary policy.* An extremely important function of the reserve system is the regulation of monetary circulation. The higher the percentage of reserves, the smaller part of their funds banks can direct to lending to their customers; this reduces the volume of money supply. Conversely, with a decrease in the reserve rate, banks' lending opportunities increase, which increases the money supply.

If the reserves are not adequately paid, the reserve requirement imposes an indirect tax on those financial assets to which it applies. Economic agents will try to avoid this tax by developing alternative instruments and means of mediation between borrowers and lenders. Even the concept of "bank" can become difficult to define. Thus, it may be difficult for the Central Bank to determine the monetary aggregate on which reserve requirements will be imposed, which remain in a stable relationship with prices and output volume. The more open and complex the financial system is, then the faster disintermediation will develop.

3. *Reserve requirements as a monetary instrument.* It is also possible to apply reserve requirements to change liquidity. With the growth of reserve requirements, banks are forced to buy liquidity from the Central Bank. This increases the costs of banks and, consequently, reduces their credit activity. At the same time, customer deposits are naturally reduced. The same mechanism also leads to the opposite effect – an increase in deposits while reducing the size of reserves [7].

Even minimal changes in requirements entail large adjustments in the portfolio of banks, and therefore certain early actions are necessary. While open market operations, for example, involve a voluntary exchange of securities, whereby prices are automatically adjusted to clear the market, changing reserve requirements is a unilateral action of the Central Bank. Changes in reserve requirements cannot be easily used to compensate for short-term fluctuations in the money supply, at least because of the lag in determining the reserve base and the duration of the ownership period [8].

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Other arguments regarding reserve requirements suggest that they should be set at some optimal level, which depends on the parameters of the economy, such as variance and elasticity of interest. This level, which can be called optimal, according to the established regime will be stable until structural changes occur.

The use of reserve requirements for the implementation of monetary policy means that they can deviate away from this optimal stable state, which leads to high costs. Therefore, fluctuations in reserve requirements are usually used to implement monetary policy as the second best approach when other instruments are unavailable or very expensive to use, for example, because there are not enough securities on which to conduct operations on the open market. However, in these conditions, when the Central Bank has no alternative to the changing reserve requirements for liquidity management, an asymmetry may arise. It is usually easy to introduce liquidity, for example, by providing advances to the Central Bank as a regulator of reserve requirements, the government or others.

There is often a desire to increase reserve requirements to tighten monetary conditions, but there are several cases of their reduction, so reserve requirements will tend to increase, which increases their cost. This can be achieved, but increasing the reserve requirements is an expensive procedure, which indicates the inefficiency of this procedure. There is no obvious solution to this problem other than to anticipate it, accept any increase in requirements reluctantly, and use the time limit to develop alternative tools.

4. *Reserve requirements as a fiscal instrument.* Finally, mandatory reserves as a component of the monetary base contribute to the income from the emission profit due to monetary expansion, and they can directly generate income if the Central Bank invests in profitable assets. Similarly, reserve requirements not only affect banks' response to unrest, but also reduce their profits to the extent that reserves are rewarded at a price below their opportunity cost. Currently, the formation of reserve assets is influenced by tax legislation. Its disadvantages are hidden in the underestimation of reserves that are transferred to bank customers, namely borrowers and lenders, in the form of a spread between lending rates and deposits. In general, the difference will positively affect reserve requirements and negatively affect the level of remuneration.

Reserve requirements are popular with governments as a way to increase revenue. The sole purpose of introducing very low reserve requirements is to finance its operations. From a political point of view, the advantage of reserve requirements as a fiscal instrument is that the tax is usually undefined; the scope of the tax is complex enough that the Central Bank can receive income for individual purposes and the central government without directly harming any particular group of voters. In addition, by law, central banks are often allowed to introduce reserve requirements and determine their remuneration, at least within the specified limits. Therefore, the requirements can be imposed and vary for financial reasons without thorough public scrutiny under the influence of the Central Bank's independent desire for monetary stability. Indeed, the availability of the Central Bank to an autonomous source of income can contribute to its independence.

CONCLUSION

Most central banks oblige deposit firms to hold minimal reserves against personal obligations, mainly in the form of balances with the central bank. Over time, the role of these reserve requirements has changed significantly. The overlapping of changing goals and practices leads to the fact that it is not always clear what the current purpose of the reserve requirements is, and this complicates the discussion about how the reserve regime should be structured.

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