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CHALLENGES OF GLOBAL INSTABILITY IN THE MONETARY SPHERE

ВИКЛИКИ ГЛОБАЛЬНОЇ НЕСТАБІЛЬНОСТІ У МОНЕТАРНІЙ СФЕРІ

Introduction. Under the influence of several waves of the consequences of the Global Financial Crisis of 2008, the COVID-19 pandemic in 2020 and the full-scale military conflict in Europe, the classical approaches to determining the goals and instruments of monetary policies in different countries of the world have undergone a significant transformation. This is manifested in the retreat from the priority of the inflation target, the expansion of the monetary supply with a gradual reorientation towards targeted financing programs for economic development.

The purpose of the article is to single out important factors that lead to the transformation of monetary policy approaches of the countries of the world and to determine the prospects for the further development of monetary policy and to propose possible measures for Ukraine.

Materials and methods. In paper have been used methods of system-functional, historical-logical and comparative analysis, methods of scientific generalization, induction and deduction. The theoretical and methodological basis of the article was made up of the works of the classics of monetarist regulation, the informational basis – statistical materials of international financial organizations and institutions (IMF, BIS, World Bank), methodological and regulatory materials of the National Bank of Ukraine for the period 2008-2022.

Results and discussion. The need to increase the effectiveness of monetary policy in the face of global challenges of financial instability is caused by such factors as the limitation of the effectiveness of monetary policy in conditions of close to zero interest rates, the growth of cross-border capital flows, debt burden and sudden changes in inflation trends.

Conclusion. The analyzed trends in the course of processes in the financial system under the influence of the identified factors highlighted the development of monetary policy. The direction of the transition is due to the use of expanded instruments, in particular targeted refinancing and reserve standards, control over international capital flows embodied in the framework of macroprudential regulation, as well as the corresponding interaction of the monetary regulator with fiscal authorities.

Keywords: financial instability, interest rates, public and private debt, international capital flows, central bank, currency policy.

Вступ. Під впливом декількох хвиль наслідків Глобальної фінансової кризи 2008 р., пандемії COVID-19 у 2020 р. та повномасштабного воєнного конфлікту в Європі, класичні підходи до визначення цілей та інструментів монетарних політик у різних країнах світу зазнали суттєвої трансформації. Це проявляється у відході від пріоритету інфляційного таргету, розширення монетарної пропозиції з поступовою переорієнтацією на програми цілеспрямованого фінансування економічного розвитку.

Мета статті – виокремити вагомі чинники, що спонукають до трансформації підходів монетарної політики країн світу і визначити перспективі подальшого розвитку монетарної політики і запропонувати можливі заходи для України.

Матеріали і методи. При дослідженні були використані методи системно-функціонального, історико-логічного та порівняльного аналізу, методи наукового узагальнення, індукції та дедукції. Теоретико-методологічну базу статті склали роботи класиків монетаристського регулювання, інформаційну базу – статистичні матеріали міжнародних фінансових організацій та інститутів (МВФ, Банк міжнародних розрахунків, Світовий банк), методичні та регуляторні матеріали Національного банку України за період 2008-2022 рр.

Результати і обговорення. Потреба підвищення ефективності монетарної політики в умовах глобальних викликів фінансової нестабільності зумовлена такими чинниками, як обмеження дієвості монетарної політики в умовах близьких до нуля відсоткових ставок, зростання обсягів транскордонних потоків капіталу, боргового навантаження та раптової зміни трендів інфляції.

Висновки. Проаналізовані тренди перебігу процесів у фінансовій системі під впливом виявлених чинників відображають розвиток монетарних політик в напрямі переходу до використання розширеного інструментарію, зокрема цільового рефінансування і резервних нормативів, контролю за міжнародними потоками капіталу, втілених в рамках макропруденційного регулювання, а також відповідного посилення взаємодії монетарного регулятора з фіскальними органами влади.

Ключові слова: фінансова нестабільність, відсоткові ставки, державний і приватний борг, транскордонні потоки капіталу, центральний банк, валютна політика.

JEL Classification: E52, E58, F33

Introduction. Fifteen years later, the global financial crisis that began in 2008-2009 did not reach its traditional conclusion in the form of a transition to the upward phase of a new economic cycle. Before the 2020 pandemic, about 85% of the countries directly affected by the HFK had not demonstrated robust growth. As well as 60% of countries that were not directly affected by it (Chen, 2019). The unfinished state of the previous crisis and the lack of a foundation for a new phase of uplift caused the global economy to be in an unstable state, prone to new upheavals. The significant impact of these contradictions largely determines the effectiveness of monetary regulation at this stage. In this regard, it is important to single out important factors that lead to the transformation of monetary policy approaches of the countries of the world and to determine the prospects for the further development of monetary policy and to propose possible measures for Ukraine.

Materials and methods. In paper have been used methods of system-functional, historical-logical and comparative analysis, methods of scientific generalization, induction and deduction. The theoretical and methodological basis of the article was made up of the works of the classics of monetarist regulation, the informational basis – statistical materials of international financial organizations and institutions (IMF, BIS, World Bank), methodological and regulatory materials of the National Bank of Ukraine for the period 2008-2022.

Results and discussion. A large number of researches are devoted to the issue of identifying the factors of instability of financial systems in modern conditions. The works of Amadeo K. and Boyle M.[1], Bergsten C. and Gagnon J. (Bergsten, 2017), Demertzis M. and Viegi N. (Demertzis, 2021), Gaspar V., et. al. (Gaspar, 2022), Ghosh J.[2].

The nature of the formation of financial markets in the 21st century had a number of factors that determined the preservation of economic instability for such a long period after the Global Financial Crisis (GFC) of 2008-2009. Under the influence of the pandemic, a number of significant contradictions that accumulated over a long period became even more relevant and caused a further change in the practice of monetary regulation. Among the most significant factors in the financial sphere, the following should be singled out:

– the growth of crisis potential as a result of the financialization of the world economy and the volatility of cross-border capital flows after the long-term practice of “quantitative easing”;

– limiting the potential of monetary regulation as a result of the transition to the inflation targeting regime and the drop in the level of key rates (“liquidity trap”);

– the formation of systemic risk as a result of the accumulation of debt in countries without economic growth, an increase in the weight of non-monetary factors of inflation, volatility of exchange rates;

There are a number of other factors that cause the global economy to be on the verge of instability (inequality, war, pandemic, disruption of logistics chains, climate change, digitalization, etc.), but the ones mentioned above are systemic in nature. In addition, these factors directly affect the effectiveness of the implementation of monetary policy in most countries of the world, and also form a number of derivative factors that determine its effectiveness.

Increasing financialization and volatility of ICF. Characteristic of the tumultuous period of overcoming the consequences of HFK in 2009-2021, caused by the process of financialization, the strengthening of the potential and volatility of the ICF is one of the most important components of global instability (Sokol, 2022). The policy of “quantitative easing”, which was implemented in developed countries, fueled the process of financialization of the world economy after the GFC. According to certain estimates, 8-9 trillion US dollars were issued on the markets of developed countries only during 2009-2013. More than 20 trillion more were issued during the 2020-2021 pandemic[1]. Given that these are indicators of the increase in the monetary base, taking into account the multiplier of the total volume of broad money.

The central point of the monetary policy of the pre-crisis stage was the regulation of economic activity by changing interest rates using inflation as a key indicator. A completely logical construction in the conditions of excessive financialization and changes in the characteristics of the financial sector of the economy has lost its functionality. At the post-crisis stage, it became noticeable that both the reduction of interest rates and the multiple growth of the money supply had no effect on inflation.

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1 Amadeo K., Boyle M. (2021). Explaining Quantitative Easing. The Balance. May 21. URL: https://www.thebalance.com/what-is-quantitative-easing-definition-and-explanation-3305881 (Accessed 4 May, 2023).

2 Ghosh J. (2021) The frickle charms of private global finance. Project Syndicat. June. URL: https://www.project-syndicate.org/commentary/fickle-global-capital-flows-to-and-from-emerging-markets-by-jayati-ghosh-2021-06 (Accessed 4 May, 2023).

And only the course of the pandemic provoked the reasons for its increase in inflation. The increase in interest rates is primarily aimed at reducing consumption and taming consumer inflation. However, research by the Federal Reserve Bank of San Francisco strongly suggests that current inflation is supply-side rather than demand-side. The consumer driver accounts for no more than a third of the growth rate of inflation (Shapiro, 2022).

The contradiction of such a process requires a separate study. However, due to the disruption of logistics chains during the pandemic, the change in the supply of goods exerted more pressure on inflation than the growth of the money supply. This weakening of the relationship between monetary expansion and inflation determines the expediency of revising the dominant approach to the introduction of the inflation targeting regime as a desirable element of monetary policy.

As a result of such a large-scale emission, the assets of financial institutions increased – according to the results of 2021, they exceeded 486 trillion dollars. USA, which in relation to world GDP was 504%. Compared with 368% in 2002. Thus, during the period 2002-2020, the assets of financial institutions grew by 360 trillion dollars. USA[3].

The consequence of the deepening of the financialization of the world economy in the period 2009-2021 was a further increase in the volatility of the ICF. The increase in the volatility of ICF is manifested by a decrease in the wavelength of their inflow and outflow (Kaminsky, 2019), an increase in amplitude and more drastic changes in the direction of movement. At the post-crisis stage, the share of short-term instruments – interbank loans and corporate debt – is noticeably increasing in the ICF structure, which reflects the predominantly speculative rather than investment nature of the ICF movement. At the same time, developing economies became more dependent on the stable inflow of foreign capital after the GFC and "quantitative easing" processes, since at the end of the ICF inflow-outflow waves, developing economies remain with practically zero indicators of net inflow of foreign capital (Golberg, 2018).

The volatility of the ICF is manifested not only in the form of an increase in the amplitude of their inflows and outflows, but also in a cyclical change in the direction of movement between developed and developing countries. In the first post-crisis stages, in 2020-2012, their movement intensified towards developing countries. In the conditions of liberalized regimes of capital flows in the period of "hyperglobalization", they translate the parameters of the monetary policies of developed countries that have reserve currencies to the markets of developing countries without obstacles, limiting the monetary sovereignty of the latter.

The GFC of 2008-2009 did not immediately lead to a change in the nature of the ICF movement, and therefore in the dominant approaches. If during 2005-2008 the average annual volume of FDI inflows to the countries of Central and Eastern Europe amounted to about 120 billion dollars. USA, then during 2009-2013 they amounted to not much less – 105 billion dollars. USA[4].

In these conditions, the importance of managing the exchange rate increases, which not only increases the probability of achieving the inflation target (Buffie, 2018), but also In general, the existing process can be characterized as a phase of transition from the era of pure monetarism to the era of new Keynesianism with the synthesis of acquired experience (Dalio, 2019).

As a result of the policy of "quantitative easing", there was again a boom in the inflow of foreign capital into developing economies, which supported the recovery of solvent demand in them, helped to balance budget and trade deficits, simplifying challenges for the monetary authorities. The implementation of financial rescue programs during the 2020 pandemic gave the process of financialization a new impetus. Known volumes of such programs in 2020-2021 reached 21.5 trillion US dollars (Cornish, 2021).

In the conditions of cyclical manifestations of inflow and outflow of cross-border flows of foreign capital, the authorities of many countries with emerging markets are concerned about the relatively high impact of ICF on exchange rate fluctuations, and the latter on inflation. As a rule, such fluctuations are accompanied by a negative impact of unhedged currency positions of domestic agents on financial stability. This is often a reason to tighten monetary policy when capital outflows begin,

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[3] STATISTA. Total assets of financial institutions. URL: Statista.com (Accessed 4 May, 2023).

[4] The World Bank Open Data. URL: https://data.worldbank.org/ (Accessed 4 May, 2023).

although an interest rate shock also depresses the national economy. Such consequences made us think about the acceptability of free-floating exchange rates for countries with underformed financial markets, weak institutions and open economies.

After the beginning of the crisis, one of the main consequences of which for the small open economies of the CEE were the significant fluctuations of the national currency rate provoked by the sudden outflow of the ICF, the attitude of monetary regulators to the stability of the exchange rate changed noticeably. After 2008, the indicator of exchange rate stability for most developing economies increased by 1.5 times. Indicators of monetary independence and financial openness decreased slightly.

In addition to the unannounced practice of managing the exchange rate and implementing measures to stabilize it, there are noticeable changes in the rhetoric of official institutions, which give reason to expect a departure from the dominance of free exchange rate formation. Currently, the IMF also recognizes that although a flexible exchange rate can mitigate the shock of a change in the nature of the ICF movement, it does not provide sufficient protection of the economy from external shocks, especially in the conditions of impaired access to global capital markets, which is observed in the conditions of the pandemic.

At the same time, the contradiction generated by the awareness of the need for stabilizing measures in relation to excessive fluctuations of the national currency, on the one hand, and the preservation of the priority of financial liberalization on the other, create an interesting paradox in which vital measures are implemented by latent methods. This can be explained by the fact that financial openness remains a desirable goal for developing economies in view of the need to attract foreign capital. Maintaining a high level of financial openness is encouraged by a generally cautious attitude towards the introduction of direct restrictions on transactions with the capital of large businesses and international financial organizations.

A characteristic feature of the unofficial use of currency interventions is accusations of currency manipulation for the purpose of obtaining trade advantages. During the last 20 years, an increasing number of countries, even such developed and open ones as Singapore or Switzerland, resort to currency manipulation. In particular, Switzerland, which has a fully liberalized capital account, has resorted to massive interventions in the foreign exchange market since 2009 in order to prevent the strengthening of the national currency (Bergshten, 2017). Only in the period July 2019 – June 2020, the net purchase of currency by the Swiss central bank amounted to 103 billion dollars. USA, which is equivalent to 14% of the GDP of this country.

For this reason, in December 2020, the US government recognized the Swiss central bank as a currency manipulator. Already in April 2021, Switzerland was excluded from this list, but referring to the provisions of the 2015 Act "On Trade Facilitation and Enforcement", China, Japan, the Republic of Korea, Germany, Ireland, Italy, India also remain under the close attention of the US Treasury, Malaysia, Singapore and Mexico. That is, all the main trading partners of the United States.

This nature of the processes emphasizes that currency interventions remain a widespread and, most importantly, an effective tool for regulating the exchange rate, regardless of the level of financial openness of the economy. And on the other hand, the stability of national currency exchange rates corresponds to the interests of international integration, and therefore the application of relevant measures also has the interest of economic associations and international development institutes.

The spread of negative interest rates. A new challenge for monetary regulation after the GFC was the spread of low and negative interest rates for the placement of financial assets. The primary reason for this was the policy of monetary regulators of developed countries to reduce interest rates in an effort to restore business activity. At first, rates fell below 0.5% in Japan and the USA, Great Britain, Eurozone countries, the Czech Republic, Sweden, and Switzerland, and later moved into the negative zone[5].

As a result of such a policy of large economies, the rates in Canada, New Zealand, Israel, and Chile have also dropped almost to zero. The pandemic significantly deepened this process.

[5] BIS Statistics. Central bank policy rates. URL: https://www.bis.org/statistics/cbpol.htm (Accessed 4 May, 2023).

Already in March 2020, the vast majority of central banks of OECD countries announced an additional reduction in reserve rates. The central banks of the countries of Central and Eastern Europe also lowered their rates: Romania (from 2 to 1.5%), Poland (from 1 to 0.1%), the Czech Republic (from 2.25 to 0.25%), Hungary (from 0.9 to 0.6%)[5]. Experts expected the continuation of the trend of zero and negative rates throughout the 2020s (Demertzis, 2021).

The main reason for the long maintenance of zero rates is the reduction of the cost of financial capital due to its low productivity and demand for money in the countries of the economic core. The global context of this phenomenon is formed by a long-overdue change in the technological order. The profitability of existing industrial enterprises, as the main consumers of financial capital, has decreased and does not attract investors. On the other hand, the prospects of new innovative industrial enterprises remain uncertain, which deters investors. This situation is aggravated by the tendency towards capital concentration, which solidifies the position of the conditional investor.

Lowering interest rates to zero or even to negative values has not had a noticeable effect in stimulating business activity. Moreover, there are studies that substantiate the counterproductive effect of the policy of low rates. In particular, in the work by F. Haider et al. (Heider, 2019) shows that zero and negative interest rates have a limited effect on the expanded supply of new bank loans. This is explained by the fact that institutions that in previous periods provided their own funding by attracting deposits, currently need assets with a profit that would compensate for the cost of these deposits.

Similarly, the reduction of mandatory reservation norms to zero for active operations did not have a noticeable effect. In addition to this, discovered in the work of H. Egertson et al. (Eggertsson, 2019) the gap between nominal interest rates, deposit and credit on the example of Sweden, leads to the assumption that the funding of commercial banks at zero rates disorients the traditional deposit-credit business model and further complicates the prospects of lending to small businesses and innovative projects.

The transition to the stage of growth of inflation indicators in 2021 was not accompanied by a natural increase in key rates for some time. Instead of raising key rates at the first signs of accelerating inflation, the central banks of the leading countries kept them at zero for quite some time. The reason for this was important, but known in advance. Economies have only just begun to recover from earlier shocks, and a rate hike by central banks would likely dampen weak activity.

However, already in 2021, according to the IMF, global inflation amounted to 4.7%, in 2022 – 8.8%, in 2023 it is forecast at the level of 6.5%, still remaining very high. This will have consequences, among others, such as the maintenance of high interest rates, the reorientation of capital flows to developed countries, as well as the deterioration of debt service conditions in developing countries.

In the conditions of the unwinding of the inflationary spiral at the post-pandemic stage, from 2022, developed countries were the first to raise interest rates. According to the BIS, 33 of the 38 central banks it monitors will raise their key rates in 2022. Raising the key rates of the central banks of the leading countries will mean not so much a fight against inflation, but a competition for free capital given the existing centers of capital: this is China. EU and USA.

This has already caused the opposite direction of ICF movement – from the markets of developing countries to the countries of the economic core. In such conditions, an additional factor of global instability is the transition to a multipolar world order.

The strengthening of disintegration processes is a long-awaited trend against the background of the halting of globalization. At first glance, this is confirmed by statistics: in the period from 2008 to the end of 2020, the volume of world trade in relation to global GDP fell from 61% to 51.6%. But already during 2021, the volume of global exports of goods and services managed to recover almost 3%[4]. In addition, the integral KOF Globalization Index calculated by the Swiss Institute of Economics[6], despite the long global economic recession, showed only a slowdown in the pace of globalization on the eve of the war.

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[6] KOF Globalisation Index. URL: https://kof.ethz.ch/en/forecasts-and-indicators/indicators/kof-globalisation-index.html(Accessed 4 May, 2023).

Such contradictory trends are explained by the fact that, despite economic stagnation, humanity supports the idea of globalization and, despite the isolating challenges of the pandemic, tries to preserve unifying achievements in other spheres of social relations. This gave reason to hope that this stoppage is temporary and that after overcoming the COVID-19 crisis, the globalization trend may resume. Especially if we take into account the shortcomings of the globalization process that provoked the recession and its increased impact on small open economies.

At the same time, geoeconomic fragmentation increases manifestations of global instability, as ICFs change directions of movement in accordance with the imperatives of defragmentation of the new global economic system. In the conditions of such defragmentation, there is an increase in protectionist measures, which are also a factor of financial destabilization.

Accumulation of financial debt. An important role in the formation of the financial landscape of the last twenty years is played by the tendency to accumulate volumes of global debt, which determines the self-reproducing process of financialization of world economies. According to the IMF Institute of International Finance, during 2015-2019, the total world debt increased from 206 to 257 trillion dollars. USA, accounting for about 350% of world GDP. The pandemic in 2020 added another 24 trillion dollars to the volume of global debt. USA[7].

During the GFC shocks and the COVID-19 pandemic, budget deficits increased and sovereign debt piled up much faster than in the early post-GFC years. According to the IMF's global debt database, borrowing jumped 28% in 2020 to 256% of GDP[5].

Despite the fact that the indicators of global debt decreased during the first quarter of 2021 by 1.7 trillion dollars. In the United States, the debt of developing economies increased by $0.6 trillion over the same period. USA. It was the purchase of debt securities of developing economies in April-May 2021 that accounted for most of the inflow of foreign capital to them, totaling more than $600 billion. USA[2.]

About half of this increase is in public debt, with the rest in private corporate and household debt. As of the end of 2021, public debt accounted for nearly 40% of global debt, the highest figure in nearly six decades (Gaspar, 2022).

Until recently, such indicators of the growth of global debt could be considered as generally acceptable, based on the calculation of their planned decrease in the following years. For a long time in the conditions of zero interest rates, the low cost of servicing the debt mitigated fears about the record high state debt of the countries. As long as real interest rates remained lower than real economic growth rates, there was an illusion of painless budget expansion. However, amid increased risks associated with rising inflation, energy prices, and war, the long-awaited tightening of monetary policy took place. As a result, the over-indebtedness of the situation once again came into focus.

The high level of public and private debt burden creates the preconditions for financial destabilization, which are already causing concern. The number of advanced economies whose debt ratios exceed the size of their economies has increased significantly. There is a risk that increasingly high debt levels will widen interest rate spreads in countries with weaker economic fundamentals, causing their borrowing costs to rise.

Although the available indicators of changes in inflation may lead to a reduction in the relative indicators of debt to GDP, hidden and delayed inflation will somehow lead to an increase in the cost of borrowing. This blow will be most painful for countries with short debt maturities. That is, in most developing economies with weak institutions.

In advanced economies, economic activity, primary balance, spending and income are projected to return to levels close to pre-pandemic projections by 2024. However, the situation in developing countries raises much more serious concerns. Both emerging market and low-income countries face falling GDP and incomes. This means that as a result, the costs planned as part of the transition to the goals of sustainable development will continue to remain at a lower level, which will make it impossible to achieve them.

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[7] IMF. Global Debt Database. URL: https://www.imf.org/external/datamapper/datasets/GDD (Accessed 4 May, 2023).

Although debt growth has cyclical waves and the last one is caused, in particular, by such global trends as GFC, COVID-19, fluctuations in commodity prices (Kose, 2020) However, there are noticeable differences in the characteristics of the growth of private and public debt across different groups of economies (see Fig. 1):

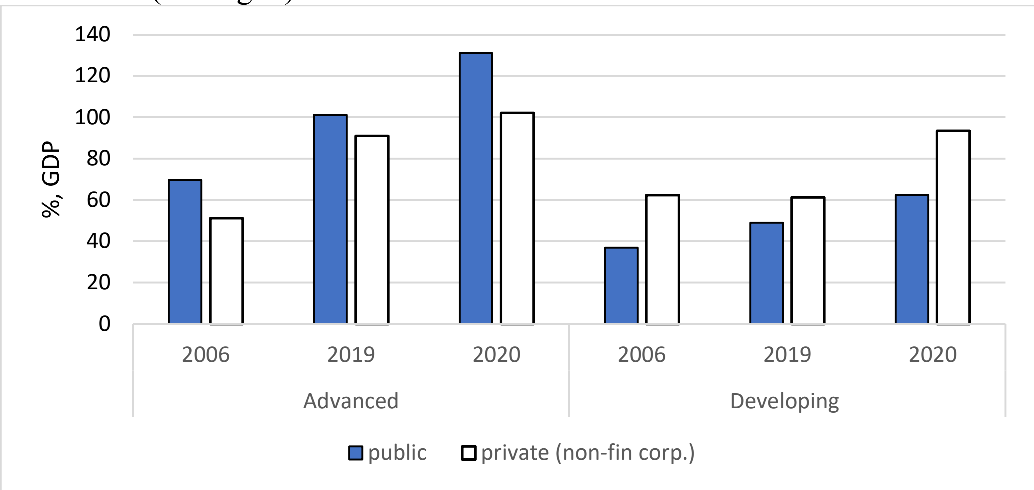

Fig. 1. Rising debt burdens in advanced and developing economies after GFC and COVID-19 pandemia

Source: IMF

Anticipatory growth of public debt in developed countries reflects their inherent advantage in financing the budget deficit. Among middle-income and above-middle-income economies, debt growth is ahead of the corporate sector, and in low-income economies, the state debt segment is growing almost exclusively.

Low-income countries are characterized by moderate levels of debt for several reasons. This is both relatively expensive borrowing and the preference of investors given to developed countries and economies showing high growth rates. On the other hand, investors prefer to avoid emerging economies that currently do not show sufficiently high growth rates due to the high level of uncertainty of long-term trends in the development of production factors. The logical consequence of these two factors is a restrained budget policy in such countries, the main goal of which is to ensure debt discipline to service the existing debt. This closed circle deprives emerging economies of the initiative in the field of budgetary stimulation. Despite the fact that against the background of ineffective monetary regulation, the role of fiscal policy is increasingly growing.

There are also many more factors of destabilization. The overall potential of digitalization processes cannot be underestimated. At the same time, the nature of these processes remains largely undefined (Eichengreen, 2022). Its deep drivers are formed not only by the financial or technical sphere, but also by social, psychological and market ones. Monetary regulators are unlikely to be able to lead these processes. However, their careful monitoring with the priority of protecting the interests of owners from financial losses and markets from abuses and excessive speculation is imperative.

Conclusions. The analyzed trends confirm that the GFC started, and the COVID-19 pandemic in 2020 deepened the transformation of approaches to defining the goals and instruments of monetary policies in different countries of the world. The main consequences of this process, which are currently visible, are the departure from the priority of the inflation target, the expansion of the monetary supply with a gradual reorientation to programs of targeted financing of economic development.

The increase in the effectiveness of monetary policy in such a context will occur through the expansion of control over financial transactions in the field of cross-border capital flows, the corresponding improvement of the tools for ensuring financial stability, as well as the strengthening of cooperation with fiscal authorities. Movement in these directions, among other things, will encourage monetary authorities to implement macroprudential policy. The functionality of this policy provides opportunities for such interaction, as well as regulation of financial transaction parameters in the interest of eliminating the systemic risk of financial instability.

Considering the above, monetary regulators in Ukraine need to take into account the above trends. The prospect is the modernization of the monetary regulation approach in terms of expanding the inflation targeting regime as well as limiting the volatility of the exchange rate by means of currency regulation and strengthening the structural direction of the macroprudential tools.

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