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MONETARY DETERMINANTS OF BANKING STABILITY

Monetary policy is mainly considered as a separate type of financial policy aimed at ensuring the stability of the national currency, in particular based on achieving the target level of inflation. A separate branch in the hierarchy of central bank goals is defined as ensuring the stability of the country's banking system. Various departments of central banks, and sometimes even various bodies, in particular in the EU, are responsible for the operational implementation of these goals. Accordingly, the question arises regarding the coherence of monetary and macroprudential policies, thanks to which it is possible to achieve a synergy effect. However, this problem has not found an adequate solution either in the scientific or practical realm. The answers to the questions of whether monetary policy takes into account the aspect of financial and banking stability, and vice versa, whether it affects the landscape of the banking sector, remain unclear. The channels of such interactive connection have not been established and the nature of their functioning has not been determined. The authors hypothesize that there should be a rational link between monetary policy and the policy of ensuring financial and banking stability, and the use of monetary policy instruments should take into account the functioning cycle of the banking system. In addition, the impact

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МОНЕТАРНІ ДЕТЕРМІНАНТИ СТАБІЛЬНОСТІ БАНКІВСЬКОЇ СПРАВИ

Монетарну політику розглянуто переважно як окремий вид фінансової політики, спрямований на забезпечення стабільності національної грошової одиниці, зокрема на основі досягнення цільового рівня інфляції. Окремою гілкою в деревині цілей центральних банків визначено забезпечення стабільності банківської системи країни. За операційну реалізацію цих цілей відповідають різні підрозділи центральних банків, а інколи й різні органи, зокрема в ЄС. Відповідно постає питання щодо узгодженості монетарної та макропруденційної політик, завдяки чому можна досягти ефекту синергії. Натомість ця проблема не знайшла адекватного вирішення як в науковій, так і в практичній площині. Нечіткими залишаються відповіді на питання, чи враховує монетарна політика аспект фінансово-банківської стабільності, і чи впливає вона на ландшафт банківського сектору. Не встановлені канали такого інтерактивного зв'язку та не визначено характер їх функціонування. Автори висувають гіпотезу, що між монетарною політикою і політикою забезпечення фінансово-банківської стабільності повинен бути раціональний зв'язок, а застосування інструментів монетарної політики має враховувати цикл функціонування банківської системи. До того ж має бути

of monetary policy on the stability of the banking sector should be assessed. To test this hypothesis, the study examined the relationship between the NBU discount rate and the financial stress index; the impact of reserve norms on the business activity of banks in different countries, and the sensitivity of bank deposit rates to changes in the NBU discount rate. For this purpose, the methods of grouping, correlation, and graphical analysis were used. The results indicate the need for greater consideration of the financial stress index cycle when forming accounting policy, giving preference to reflationary and disinflationary monetary policies over expansionary and restrictive ones, as well as broader use of instruments such as reserve norms of funds attracted by banks. These results can be used when applying monetary policy instruments by central banks.

Keywords: monetary policy, discount rate, reserve requirements, financial stability, banking stability.

оцінений вплив монетарної політики на стабільність банківського сектору. Для перевірки цієї гіпотези ув досліджено взаємозв'язок між обліковою ставкою НБУ і індексом фінансового стресу; вплив норм резервування на ділову активність банків у різних країнах, чутливість ставок за депозитами банків до зміни облікової ставки НБУ. Для цього використані методи групування, кореляційного, графічного аналізу. Результати свідчать про необхідність більшого врахування циклу індексу фінансового стресу під час формування облікової політики, надання пріоритету рефляційній та дезінфляційній монетарним політикам порівняно з експансіоністською та рестрикційною, а також ширшого використання такого інструменту, як норми резервування залучених банками коштів. Зазначені результати можуть бути використані центральними банками при застосуванні інструментів монетарної політики.

Ключові слова: монетарна політика, облікова ставка, норми резервування, фінансова стабільність, банківська стабільність.

JEL Classification: G18, G21, G28.

Introduction

Article 6 of the Law of Ukraine "On the National Bank of Ukraine" (1999) defines the main functions of the NBU, which encompass three components: ensuring the stability of Ukraine's currency, which is the goal of monetary policy, promoting financial stability, in particular the stability of the banking system, and sustainable economic growth. These components are considered comprehensively in the NBU's monthly inflation reports, which underscores the relevance of the issue of their synergistic unity, particularly regarding the nature of the impact of monetary policy on banking stability. The combination of these goals in a single list of central bank tasks encourages researchers to analyse their synergistic relationship.

Agénor and Pereira da Silva (2012) argue, that monetary policy should respond to financial instability. The authors note that the traditional Taylor rule, which focuses solely on inflation and the GDP gap, is insufficient to prevent financial crises. They also put forward the concept of the "Virtuousness Paradox", which describes a situation where successful low and stable inflation policy can inadvertently lead to excessive optimism, increasing lending and asset prices, thereby creating financial vulnerability. Maddalonia and Peydró (2018) provide empirical evidence on how monetary and macroprudential policies interact and affect the stability of the banking system, and conclude that both types of policies influence banks' risk-taking.

For their part, Grubisic and Ivanovic (2012) analyse how different monetary policy regimes affect the financial stability of Southeast European

(SEE) countries. The authors argue that countries with "hard" regimes (Bosnia and Herzegovina) ensure high macroeconomic stability, very low inflation, and exchange rate stability. However, this makes the banking system more vulnerable to liquidity shocks. The inflation targeting regime (Serbia) gives the central bank more flexibility in managing liquidity and fulfilling its role as a lender of last resort, which promotes financial stability but creates a risk of exchange rate instability.

De Graeveet al. (2008) provide convincing quantitative evidence that monetary policy and financial stability are interconnected. Their integrated micro-macro model demonstrates that central bank decisions affect the stability of the banking system mainly through the overall economic consequences of those decisions. This was an important step in recognizing that central banks should take financial stability into account when conducting monetary policy. Rubio and Carrasco-Gallego (2014), based on a study of the synergy between monetary and macroprudential policies, conclude that these two types of policies are complementary but have different objectives, and their coordination allows for better results than using either of them alone. Ahumada and Fuentes (2004) emphasize that the banking system is not simply a "passive conduit" through which monetary impulses are transmitted. Its internal structure, level of competition, regulation, and financial stability independently and powerfully affect how central bank policy reaches the real sector. Therefore, the analysis of monetary policy would be incomplete without a thorough study of the banking industry.

Akinci et al. (2013), based on an analysis of the 2008–2009 crisis, examined the unconventional approach of the Central Bank of Turkey, which combined monetary and macroprudential tools and had significant and quite unique effects on the banking sector. Instead of putting pressure on profitability, it promoted its growth through higher interest margins, while simultaneously fulfilling its macroprudential role of slowing down the credit boom.

In their article, Nikhil and Deene (2023) emphasize an important trade-off faced by central banks in developing countries such as India. Aggressively combating inflation by raising interest rates may “clash” with the need for a stable and profitable banking system. This confirms the necessity of using macroprudential tools to protect the banking sector from the side effects of monetary policy.

Boyarchenko et al. (2022) believe that ignoring financial stability when formulating monetary policy can be risky. Interest rate policy is a powerful tool not only for combating inflation but also for reducing systemic financial risks. This issue is also in the focus of the European Central Bank (ECB, 2024). His main thesis is that monetary policy and financial stability are closely interconnected. Although the primary task of the ECB is to maintain price stability, it must systematically take into account the

consequences of its policies for financial stability, since financial crises pose a direct threat to the fulfilment of its main function. Therefore, this topic is relevant not only for Ukraine.

In the current conditions, the topic of the impact of monetary policy on the stability of the banking system is extremely relevant. When making decisions, central banks simultaneously face two challenges: on the one hand, it is important to achieve price stability, and on the other – to prevent financial shocks. A tight monetary policy restrains the inflation growth, but at the same time generates significant risks for the banking sector due to the decline in the market value of assets that banks accept as collateral when issuing loans; it leads to an increase in funding costs; exacerbates the problem of transforming short-term liabilities into long-term investments; and potentially leads to a deterioration in the quality of the loan portfolio. On the contrary, prolonged periods of overly accommodative monetary policy encourage excessive risk-taking, the accumulation of vulnerabilities, and increase the likelihood of future borrower defaults.

The main objective of the article is to study the relationship between monetary policy and the maintenance of financial and banking stability in the following areas: the discount rate and the financial stress index, the impact of reserve requirements on bank activity indicators in the credit and deposit markets, and the speed and closeness of banks' responses in household deposit rates to changes in the discount rate of the NBU.

The main hypothesis of the study is based on substantiating the close relationship between the use of monetary tools and indicators of the stability of the banking system. In the course of the study, mathematical and statistical methods, comparative analysis, and synthesis were used.

The main part of the article consists of three interconnected sections: the first one examines the relationship between the dynamics of the NBU discount rate and the financial stress index, the second section explores the impact of changes in reserve requirements on the volumes of banks' credit and deposit operations, and the third one examines changes in the discount rate on household deposit interest rates (UIRD).

1. Synergy of the discount rate and the financial stress index

Let us consider the relationship between the NBU's discount rate and such a key integrative financial stability indicator as the Financial Stress Index (FSI), and, in particular, with its important sub-index, the Banking Stress Index (BSI). Theoretically, monetary policy decisions, particularly regarding changes in the discount rate, should be correlated with changes in the FSI: in the case of its increase amid inflationary pressure, raising the key rate is appropriate, whereas a decrease in the FSI would justify lowering it. At the same time, the result of the central bank's corresponding measures should be a reduction in the level of financial stress. To test this hypothesis, a dataset from the NBU (n. d.) on the discount rate for the period from

2014 was used, from which 47 instances of rate changes – both increases and decreases – were selected. For each date of the interest rate change, the values of the FSI published by the NBU ("Financial Stress Index", 2025) were matched, in particular on the first day of the month of the discount rate change and on the first day of the previous month–to assess the impact of the FSI on the rate decision; and on the first day of the following month and the month after it–to analyse the impact of the discount rate change on the FSI dynamics. As a result, linear correlation coefficients were obtained (*Table 1*).

Table 1

Relationship between the FSI and the discount rate, correlation coefficient

Indicator	On the first day of the month, rate changes	For the month until the rate change	By the first day of next month	On the first day in a month
Impact of the FSI on the rate	0.589030474	0.530881854	–	–
Impact of the rate on the FSI	–	–	0.605845625	0.427334518

Source: compiled by the authors based on (National Bank discount rate, 2025; On the Financial Stress Index, 2025).

The closest response of the discount rate to changes in the FSI was observed one month before the month of its change, and, conversely, the highest correlation values between the FSI and the discount rate were recorded based on the data for the first day of the month following the rate change. However, in all cases, the relationship remained moderate (since the correlation values did not exceed 0.7).

Based on the obtained results, a graphical dependence of the reaction of the discount rate on the value of the FSI on the first day of the month preceding the month of its change was constructed. The polynomial function proved to be the most optimal, unlike the linear or logarithmic ones (*Figure 1*).

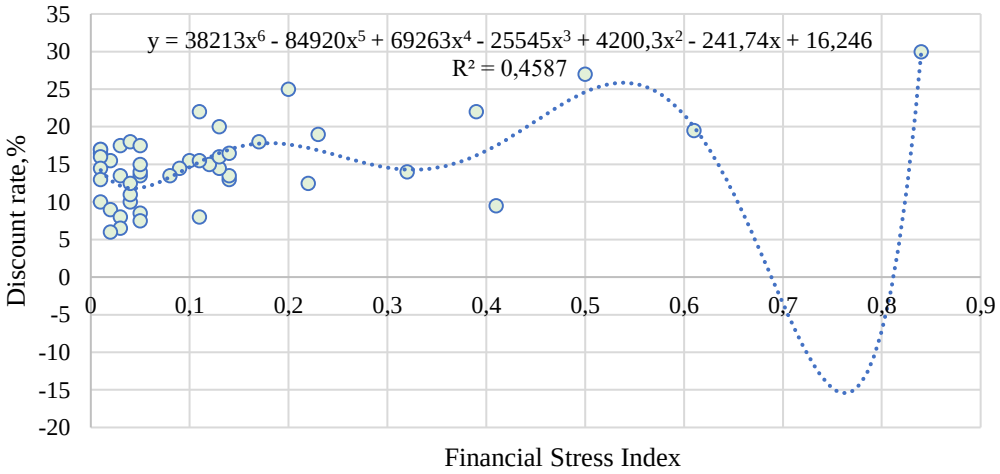

Figure 1. The impact function of the FSI on the decision to change the NBU discount rate

Source: compiled by the authors based on (National Bank discount rate, n.d.; NBU. On the Financial Stress Index, n. d.).

A coefficient of determination of 0.4587 is relatively small, which allows us to conclude that changes in FSI were not significantly taken into account when determining the size of the discount rate, nor was there a significant reverse effect of changes in the discount rate on the FSI.

To study the impact of the FSI on rate changes, the dates were selected when it changed most significantly, as well as the first date following a change in the discount rate. In total, 9 "extreme" values of the BSI were considered (*Table 2*).

Table 2

The relationship between the BSI and the NBU discount rate
for the period from 01.03.2014 to 29.08.2022

Date of BSI	BSI index, coeff.	Rate, %	Rate change date
01.03.2014	0.001	9.5	15.04.2014
18.07.2014	0.02	14	13.11.2014
09.04.2015	0.1	30	25.04.2015
27.07.2016	0.01	15.5	29.07.2017
22.12.2018	0.005	18	01.02.2019
01.04.2019	0.001	17.5	26.04.2019
01.03.2022	0.1	10	04.03.2022
01.08.2022	0.05	25	03.06.2022
29.08.2022	0.09	22	04.09.2022

Source: compiled according to (National Bank discount rate, n.d.; NBU. On the Financial Stress Index, n. d.).

Based on these data, the constructed correlation coefficient was 0.42825, which also indicates a minor influence of the BSI, as well as the FSI, on decision-making regarding the size of the NBU discount rate.

2. The impact of changes in reserve requirements on banks' business activity

A special instrument of monetary policy is the establishment of reserve requirements for banks' funds in the correspondent account at the central bank depending on the volume of clients' funds attracted. In the field of monetary policy, its effect is similar to changing the discount rate. Within the framework of a restrictive policy, increasing them, on the one hand, slows down lending, thereby restraining the growth of the money supply based on the increasing credit multiplier, but on the other hand, banks are not interested in resources with a high reserve requirement and set low deposit rates, thereby making clients more inclined to spend money rather than save, which can negatively affect inflation trends. However, these resources can be directed by the population and businesses into other areas, particularly the

foreign exchange market or – in the best case – the stock market. For banks, this means a compression of net interest income and a loss of profits, but maintaining a high level of liquidity.

The opposite situation occurs with an expansionary policy, when reserve requirements are lowered and banks are given the opportunity both to attract funds and to deploy them. Credit multiplication increases, the money turnover accelerates, which is beneficial for the economy but may also affect prices. At the same time, by expanding the scale of deposit and lending operations, banks' net interest income grows even if the margin level remains stable. Thus, this instrument has a dual nature: it simultaneously contributes to achieving monetary goals and strengthening the financial stability of banks through its impact on their liquidity and financial results (*Table 3*).

Table 3

The impact of reserve requirements
on monetary policy goals and banking stability

Indicator	Impact on monetary policy		Impact on banks
The equation of money circulation	Money supply x = Prices x Volume Velocity of production turnover		x
Increasing reserves	The money supply is stable, the velocity of circulation is decreasing	Prices and/or production are stabilizing	Lending volumes are not increasing, liquidity is rising, and incomes are decreasing
Reduction of reserves	The money supply and the velocity of circulation are increasing	Prices and/or production are increasing	The volumes of active operations (as well as credit risks) are increasing, profits are rising, and liquidity is decreasing

Source: compiled by the authors.

Historically, reserve requirements were not a tool of monetary policy but served as insurance reserves, acting as buffers in case of a liquidity crisis. This is exactly the function they performed in the United States after the creation of the Federal Reserve System in 1913 following the severe liquidity crisis of 1904. However, after the establishment of the Federal Deposit Insurance Corporation (FDIC) in 1933, this instrument ceased to be used both for ensuring banking stability and for monetary purposes, and today in the US, the reserve requirement is 0%. A similar situation exists in the European Union, where it is equal to 1% and practically unchanged, indicating its very limited use as a monetary policy tool.

However, developing countries use this tool more extensively, simultaneously addressing issues of both monetary policy and banking stability. An important feature of it is that it does not directly affect the cost of money, as the discount rate does, and has less psychological impact on businesses and society without losing its functional significance. Reserve requirements vary considerably depending on the country, and there is no

specific law or methodology for determining them, unlike the Taylor rule for determining the level of the key (discount) rate. Based on the data presented in *Table 4*, it is only possible to note a tendency for higher reserve requirements with a higher central bank key rate.

Table 4

Reserve requirements of banks in central banks of several countries (as a percentage of attracted deposits)

Country	Latest	Previous	Assessment date
Brazil	21	21	December 2022
China	11	11	January 2023
Czech Republic	2	2	November 2022
Hungary	5	5	December 2022
India	4.5	4.5	January 2023
Indonesia	9	7.5	September 2022
Malaysia	2	2	December 2022
Moldova	40	40	November 2022
Nigeria	32.5	32.5	January 2023
Poland	3.5	3.5	December 2022
Turkey	25	25	
USA	0	0	November 2022
European Union	1	2	

Source: (Trading Economics, 2023).

The study of the channels through which reserve requirements affect both the goals of monetary policy (in particular, the volume and structure of the money supply) and the ultimate goal-managing inflation – as well as indicators of banks' financial stability (liquidity level, profitability, volumes of asset-liability operations) is complicated by the lack of sufficient statistical data. Reserve requirements change infrequently, and statistics on changes in official reports are not accumulated. In addition, the statistical database of the international company SEIC regarding reserve requirements in different countries was used (SEIC data, 2025). The object selected includes several countries in Central Europe. In the first stage, countries where reserve requirements did not change in 2024 were studied, and how this affected indicators such as the dynamics of loans and deposits. These indicators largely characterize banking stability: if they increase, it can be assumed that stability is strengthening due to the growth in the scale and profitability of banks (*Table 5*).

Table 5

Dynamics of individual indicators of several Central European countries in 2024, %

Country	Reservation standards	Credit dynamics	Deposit dynamics
Czech Republic	2	–4.1	1.6
Poland	3.5	2.7	0
Bulgaria	10	10.5	0.5

Source: calculated based on (CEIC data, 2025).

The dynamics of loans and deposits in the countries considered in *Table 5* are diverse, and it is evident that a stable reserve requirement did not affect the dynamics of banks' asset-liability operations. To deepen the analysis, two countries were selected where reserve requirements were reduced, namely Croatia in the second half of 2022 and Moldova from May 2024 to January 2025. The results of the dynamics of reserve requirements, loans, and deposits of the banking systems of these countries are shown in *Figures 2* and *3*.

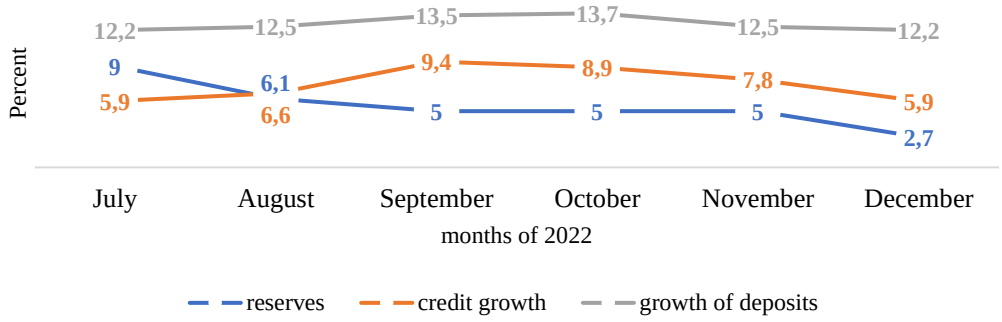

Figure 2. Reserve requirements, growth rate of loans and deposits compared to the previous year in the banking system of Croatia in 2022

Source: compiled according to (CEIC data, 2025).

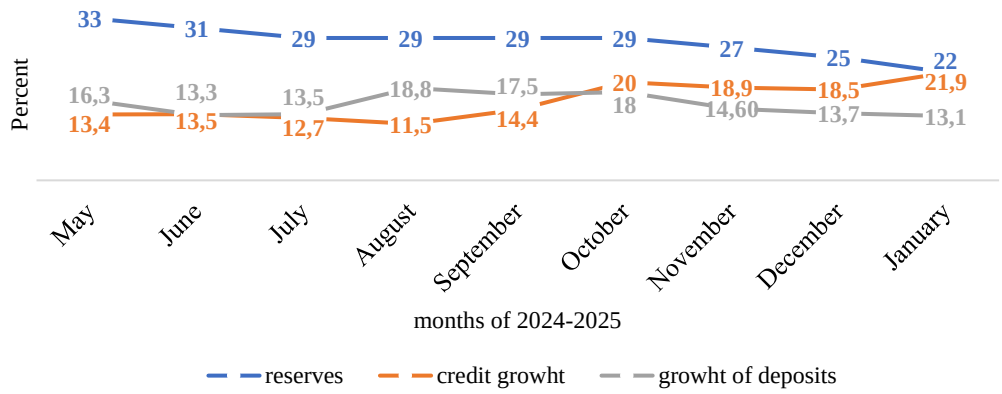

Figure 3. Reserve requirements, growth rate of loans and deposits compared to the previous year in the banking system of Moldova in 2024

Source: compiled according to (CEIC data, 2025).

As can be seen from *Figures 2* and *3*, especially at the first stage of the reduction in reserve requirements, there was a positive trend in loans and, to some extent, deposits. To test this hypothesis, a correlation analysis tool was used, which showed that the closest connection between the dynamics of loans and deposits in Croatia and reserve requirements was observed during the first three months, when the most intensive reduction of this indicator occurred. The correlation coefficient was -0.83224 for loans and

-0.84959 for deposits. In the banking system of Moldova, a close connection between the reduction of reserve requirements and loans was observed throughout the entire period: the correlation coefficient was -0.74265473. In contrast, no correlation was observed between deposit dynamics and changes in reserve requirements. This allows us to conclude – with some reservations due to the small set of statistical data – that banks' lending activity responds more strongly to significant changes in reserve requirements over a short period of time, particularly reductions, than to a slow change over time. As for deposit dynamics, it is not so closely related to changes in reserve requirements and also depends on changes in other factors, including the discount rate. Further research in this area requires the formation of a substantial statistical dataset and its purification from the influence of other factors, including changes in the discount rate.

The reserve requirement serves a similar stability function as contributions to the deposit guarantee fund, but it has three key advantages:

- it can be differentiated depending on the currency and terms of deposits, and possibly also on banks' business models;
- it can be adjusted quickly over time depending on monetary policy goals and challenges to the stability of the banking system;
- it can be linked to the quality of risk management; for example, banks with a higher share of non-performing loans (NPLs) may have increased reserve requirements as a liquidity buffer.

In the EU, the deposit insurance system has a commercial basis and is implemented, among others, by private companies. Moreover, the EU has a centralized bank resolution fund, the SRB (2025). Banks from 21 EU countries contributed about 1% of deposits to it, depending on the risk profile of their activities, and replenished it to the target level at the beginning of 2024. These contributions, along with the task of ensuring the stability of the banking system, also fulfilled an important monetary function – to some extent, they slowed the growth of lending volumes. All this indicates prospects for redesigning the deposit insurance system to solve monetary policy objectives and ensure banking stability with a single tool – reserve requirements combined with the creation of an insurance fund.

3. Analysis of the sensitivity of bank deposit rates to changes in the discount rate

The third element of the study was an analysis of the sensitivity of changes in rates on three-month household deposits in UIRD banks to changes in the NBU discount rate. The presence of such a dependence indicates not only the operation of the monetary policy deposit channel but also a transformation of the banking activity landscape. Banks attract more or fewer deposits, which accordingly change the volume and structure of the asset portfolio and financial results, and thus the capital and other indicators

that characterize the financial reliability of the banking system.

To conduct the study, statistical data were selected on: 47 cases of changes in the discount rate since 2014 and changes in the UIRD rate for each day during the 10 days following each discount rate change (including the day of the rate change). A correlation analysis was then conducted, according to the results of which the linear correlation coefficient between these rates was slightly above 0.5. If one rate change date is excluded, namely June 3, 2022, when it was raised immediately from 10% to 25%, the correlation coefficient (C cor.) increased to over 0.7 (*Table 6*).

Table 6

Correlation coefficient between the change in the NBU and UIRD discount rate for the period 2014–2025

Indicators/ days	Days									
	0	1	2	3	4	5	6	7	8	9
C correl.	0.558	0.565	0.567	0.561	0.555	0.569	0.563	0.568	0.561	0.563
C correl. without 03.06.22	0.708	0.713	0.718	0.712	0.705	0.712	0.706	0.711	0.706	0.705

Source: compiled by the authors based on (NBU, 2025; National Bank discount rate, n. d.).

The correlation coefficient remains stable throughout the entire 10-day period following the rate change (correlation may increase over a longer horizon). This indicates that banks were not in a hurry to adjust their deposit rates for the public after the change in the discount rate. However, the correlation coefficient increases significantly if the date of the significant rate increase from 10 to 25% on 03.06.2022 is excluded. Thus, bank deposit rates are more sensitive to slow changes in the discount rate than to its sharp fluctuations.

In order to determine when bank deposit rates responded more closely to a decrease or an increase in the discount rate, the entire period from 2014 to 2025 was divided into corresponding zones, and correlation coefficients were constructed for each of them (*Table 7*).

Table 7

Correlation coefficients for the period of increase and decrease of the NBU discount rate (2014–2025)

Period	C cor.
rate increase	
2014–2015	0.925
2017–2018	0.278
2021–2022	0.006
2025	–0.508
rate decrease	
2016–2017	0.881
2019–2020	0.868
2023–2024	0.438

Source: compiled by the authors based on (NBU, 2025; National Bank discount rate, n. d.).

Analysis of the data in *Table 7* shows that deposit rates responded more closely to a decrease in the discount rate (except in 2023–2024), whereas their reaction was weak during rate increase (except in 2014–2015). This indicates a multifactorial impact on banks when making decisions about changing deposit rates, which, in turn, reduces the effectiveness of the monetary policy deposit channel. A key factor among these is the level of banks' liquidity. During periods of excess liquidity, such as during the pandemic and martial law, banks were not in a hurry to raise their rates following the trajectory of the NBU rate.

The analysis of the UIRD rate dependency configuration on the second day after the key rate change identified the logarithmic function as the most adequate, with a coefficient of determination of 0.55, that is, a probability of 55% (*Figure 4*).

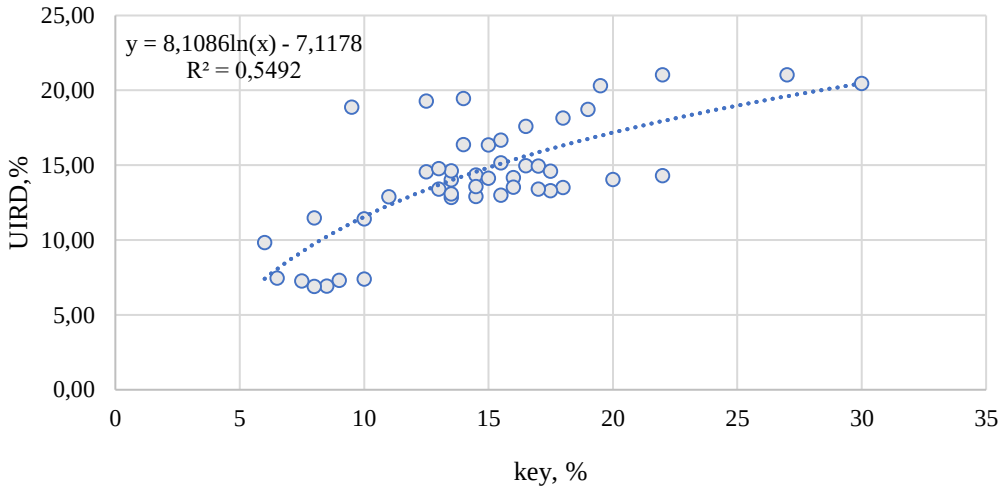

Figure 4. Dependence of the UIRD rate level on the second day after the change in the key rate (excluding the change on 03.06.2022)

Source: compiled by the authors.

These calculations can be used to study and predict the degree and timing of the impact of changes in the central bank's discount rate on the deposit rates of bank clients within the interest rate channel of monetary policy.

Conclusions

The research hypothesis regarding the close relationship between the use of monetary tools and indicators of the stability of the banking system, which should exist de jure, is not fully confirmed de facto based on statistical analysis.

The financial stress index and its sub-index of banking stress are important complex indicators of the stability of the financial and banking system, so they should be taken into account when choosing a monetary

policy regime, in particular, changing the discount rate. In addition, it is important to take into account the trajectory of their movement, and not just a static value, which will make it possible to more effectively influence economic processes with monetary policy instruments.

Reserve requirements as a monetary policy tool, which simultaneously performs the functions of regulating money circulation and ensuring banking stability, remain underestimated not only in Ukraine but also in other countries. At the same time, the NBU uses it more flexibly even than the central banks of developed countries. Its effectiveness is not inferior to the tool of changing the discount rate, and unlike the latter, it has a smaller psychological impact on businesses and society.

It is advisable to consider the possibility of using reserve requirements as an alternative, for example, to increasing the amount of contributions to the Deposit Guarantee Fund, which could focus more on problem banks.

It is important to enhance the effectiveness of the influence of the interest rate channel of monetary policy on banks' deposit and lending policies, in particular by taking into account the factor of their excess liquidity, including through the use of reserve requirements and the possibilities of placing it in certain liquid assets.

Monetary policy and the NBU's role in ensuring financial and banking stability have significant synergy. Without a stable system, it is impossible to effectively implement monetary policy, and conversely, monetary measures significantly affect the reliability of the banking system. Therefore, this issue requires further research.

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