

Monetary Policy and Money Markets

Zsolt Kondrat
OGResearch

Reference: Framework paper

European Bank
for Reconstruction and Development

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Capital markets

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With over 25 years of experience, the EBRD plays a significant role in the international capital markets

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- management of the Bank's capital, retained earnings and borrowed funds
- development of local capital markets and the provision of local currency funding
- structuring and advisory for client projects

The Bank has established conservative operational and lending guidelines, which are reflected in its [AAA/Aaa/AAA credit rating](#).

By maintaining prudent capital and liquidity levels, and with strong shareholder commitment, the EBRD offers its investors the highest quality assets.

Notice
Nothing in this site or any materials shall be construed, implicitly or explicitly as containing any investment recommendation or advice, and constituting an offer of, or an invitation by or on behalf of, EBRD to purchase or sell any securities.

About the Treasury

The Treasury team finances the EBRD's projects, conservatively invests the Bank's capital and liquidity, actively manages interest rate and FX risk, and provides structuring expertise for the Bank's loan and equity projects.

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Local currency issuance

Our local currency issues help to further capital markets development in EBRD's countries of operations.

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Contact the Treasury
Treasurer: Axel van Nederveen
Tel: +44 20 7338 7370
Fax: +44 20 7338 7335
Email: vannedea@ebrd.com

Deputy Treasurer & Head of Funding:
Email: laurenti@ebrd.com

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Framework for Developing Money Markets in Frontier and Emerging Market Economies¹

European Bank
for Reconstruction and Development

21 March 2016

¹ A collective of authors led by David Vavra (OGResearch) and composed of David Vavra, Barry Topf (formerly Bank of Israel), Zolt Kondrat (OGResearch), Axel van Nederveen (EBRD), Jim Turnbull (EBRD), Matthew Saal (EBRD) and Aude Pacatte (EBRD)

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The Prerequisites of Well-functioning Money Markets

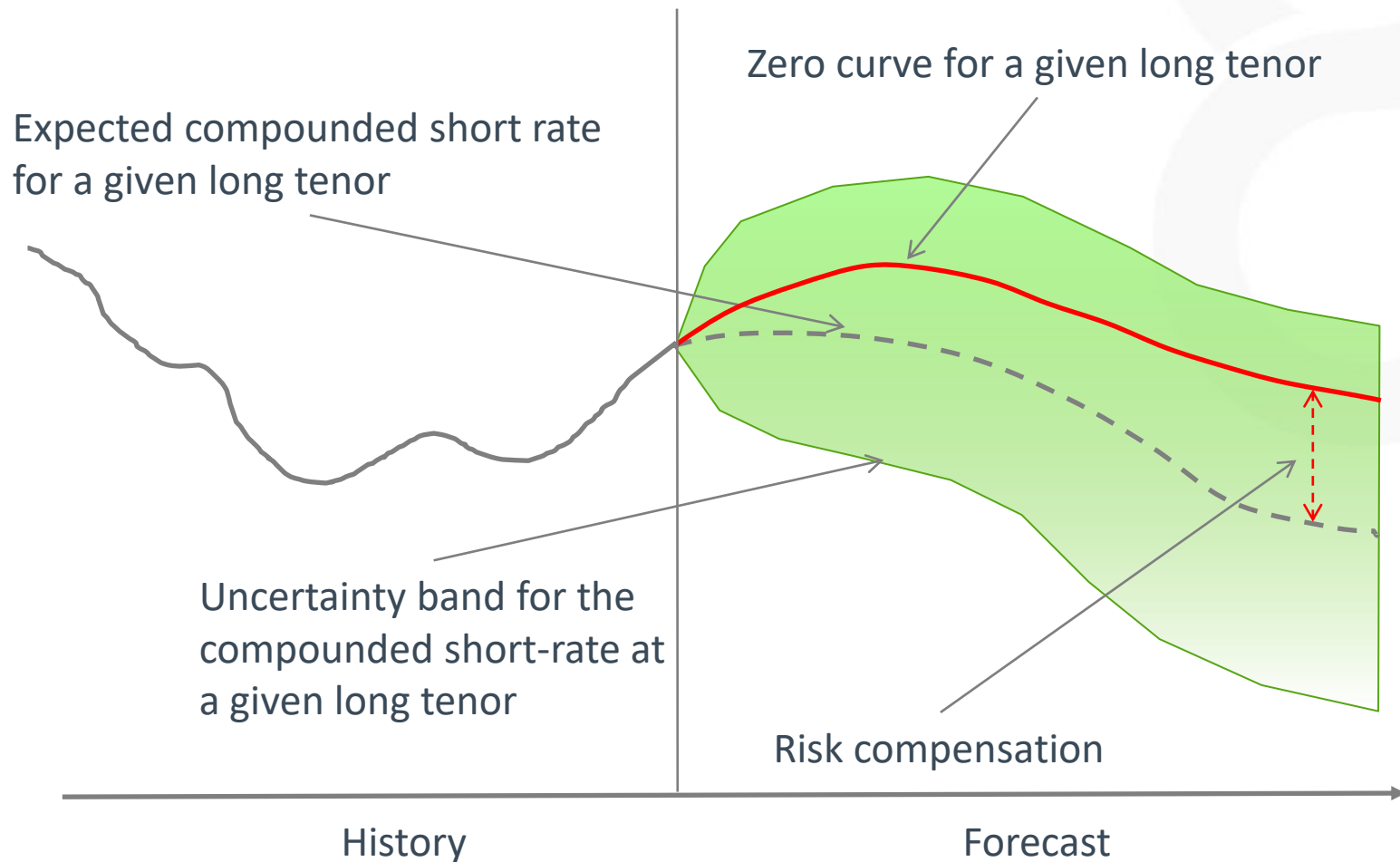
Main features of well-functioning money markets

- Liquid unsecured market with reasonable risk limits among banks with a diversified client base and business models
- Liquid secured markets with abundant collateral, including the FX and government papers
- Easy price-discovery with reliable benchmark rates on the money market and government securities market (yield curve)
- Low and managed volatility of money market rates
- Predictable movements of the benchmark rates based on a macroeconomic outlook and monetary policy objectives
- Reliable system of money market operations of the central bank acting as a safety net and policy transmission mechanism

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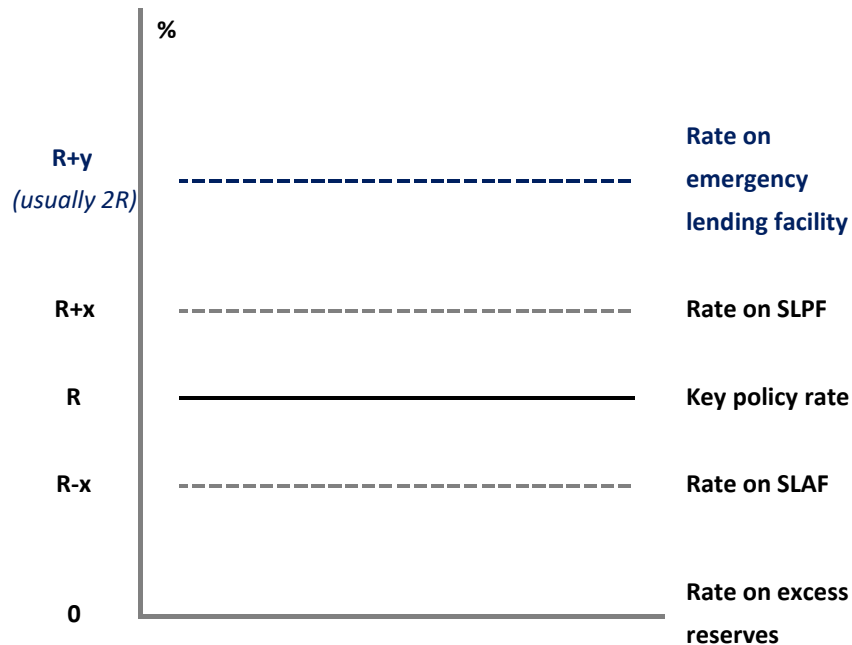
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Price discovery and transmission of MM rates to longer tenors



Main features of well-functioning money markets (II)

Rates on CB Instruments

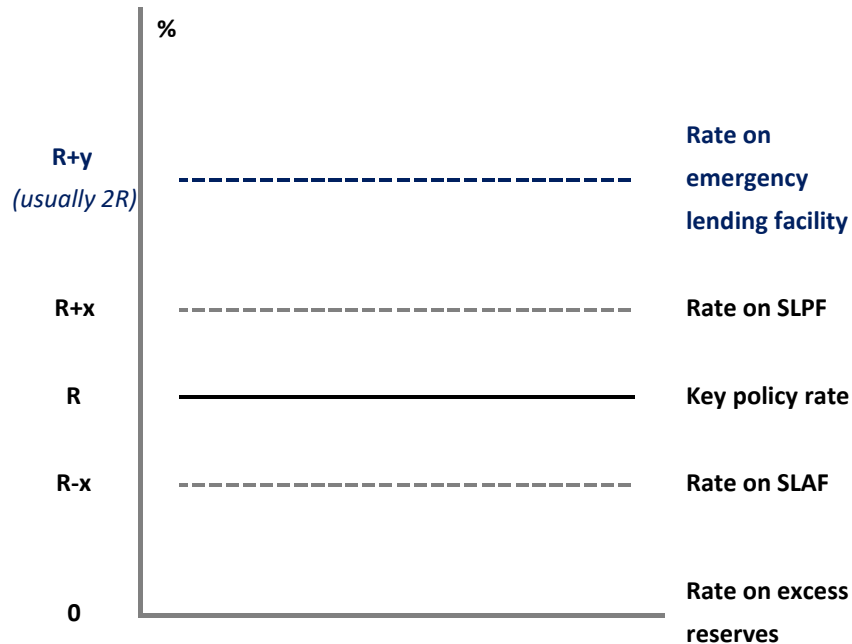


x: often 1 pp

y: often equals R , so that the emergency lending rate is $2R$

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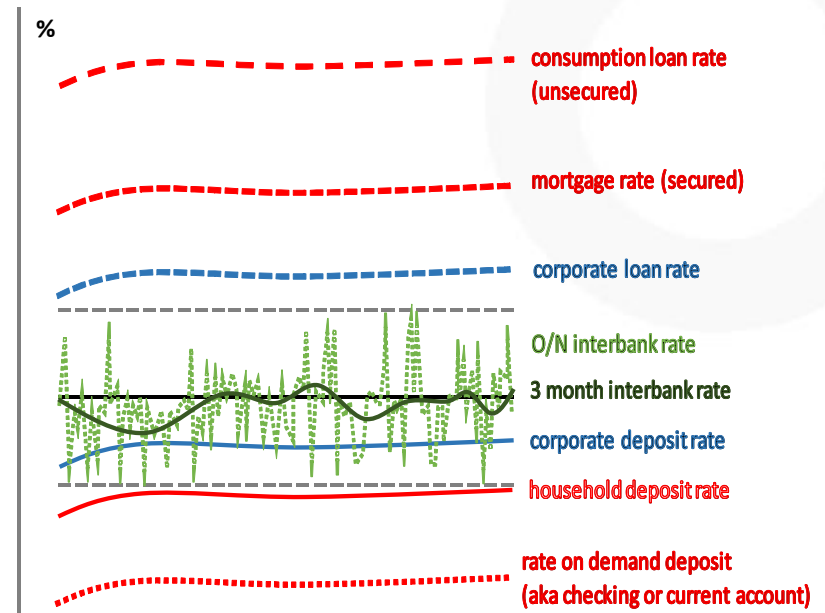
Rates on CB Instruments



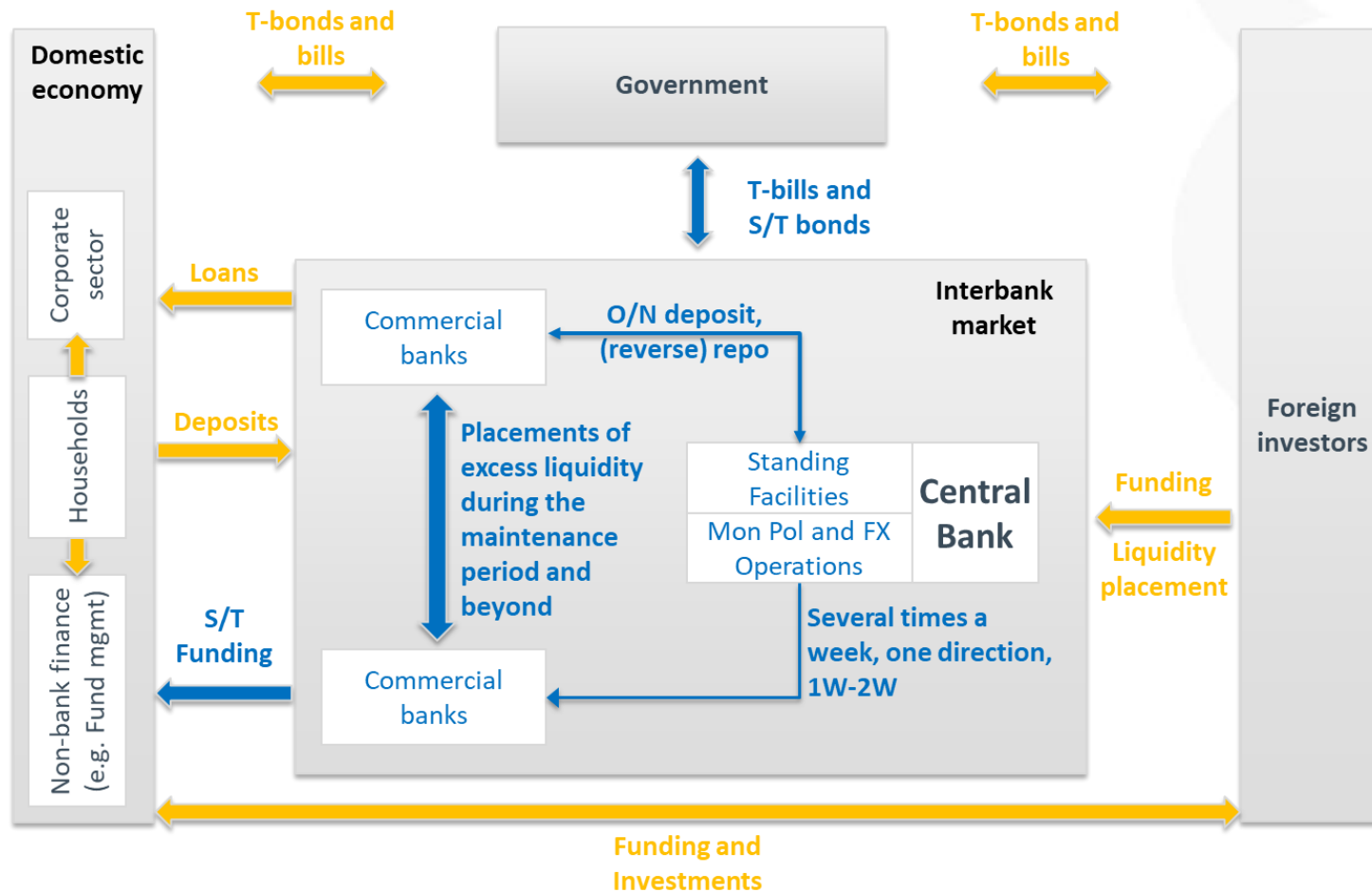
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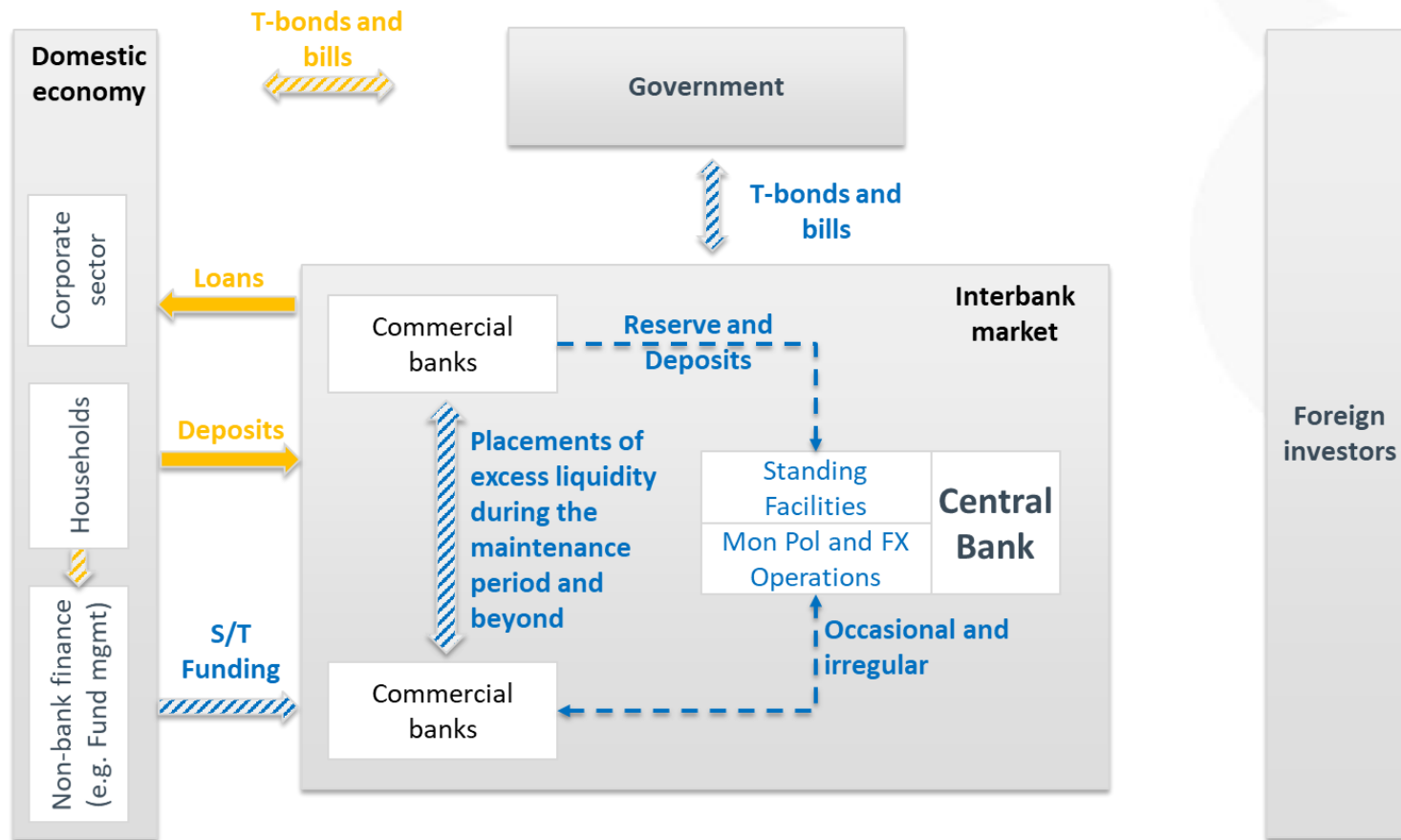
Market Rates



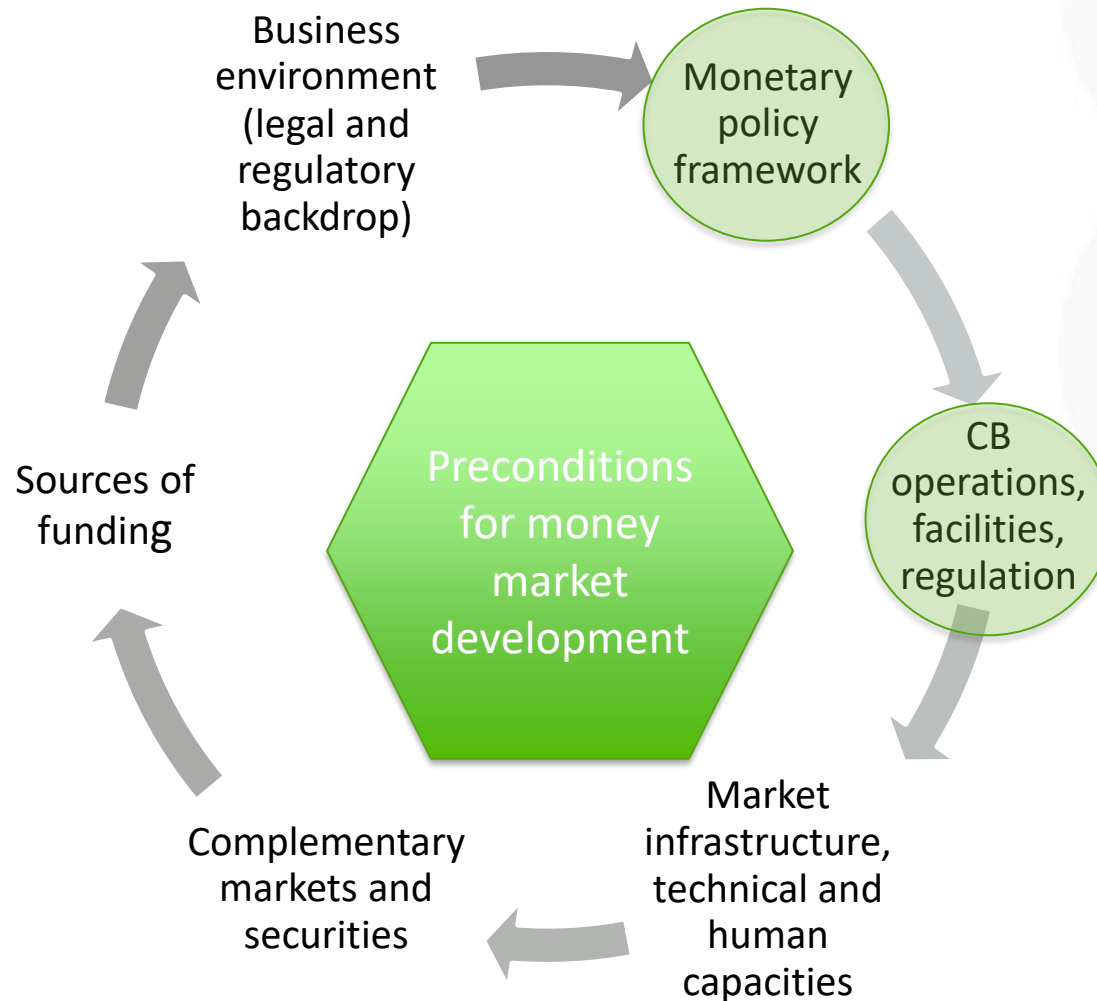
Money market in a developed financial ecosystem



Money market in a developing financial ecosystem



Money market grassroots



Monetary policy framework

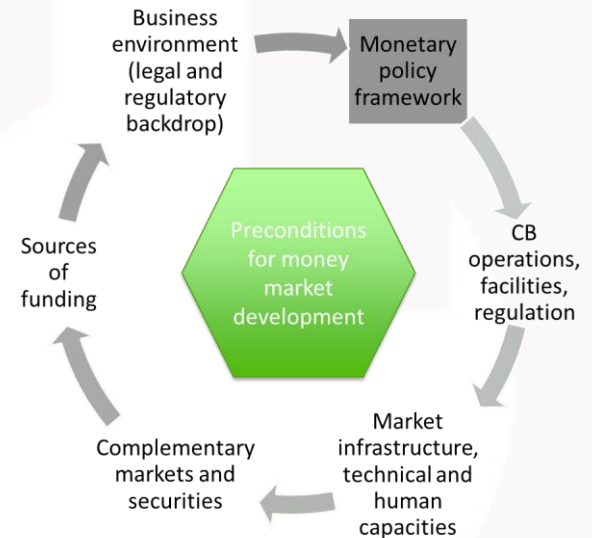
Well-functioning money markets start with a **resilient monetary policy framework** ...

... providing monetary stability ...

... using clearly defined **objectives and instruments**, ...

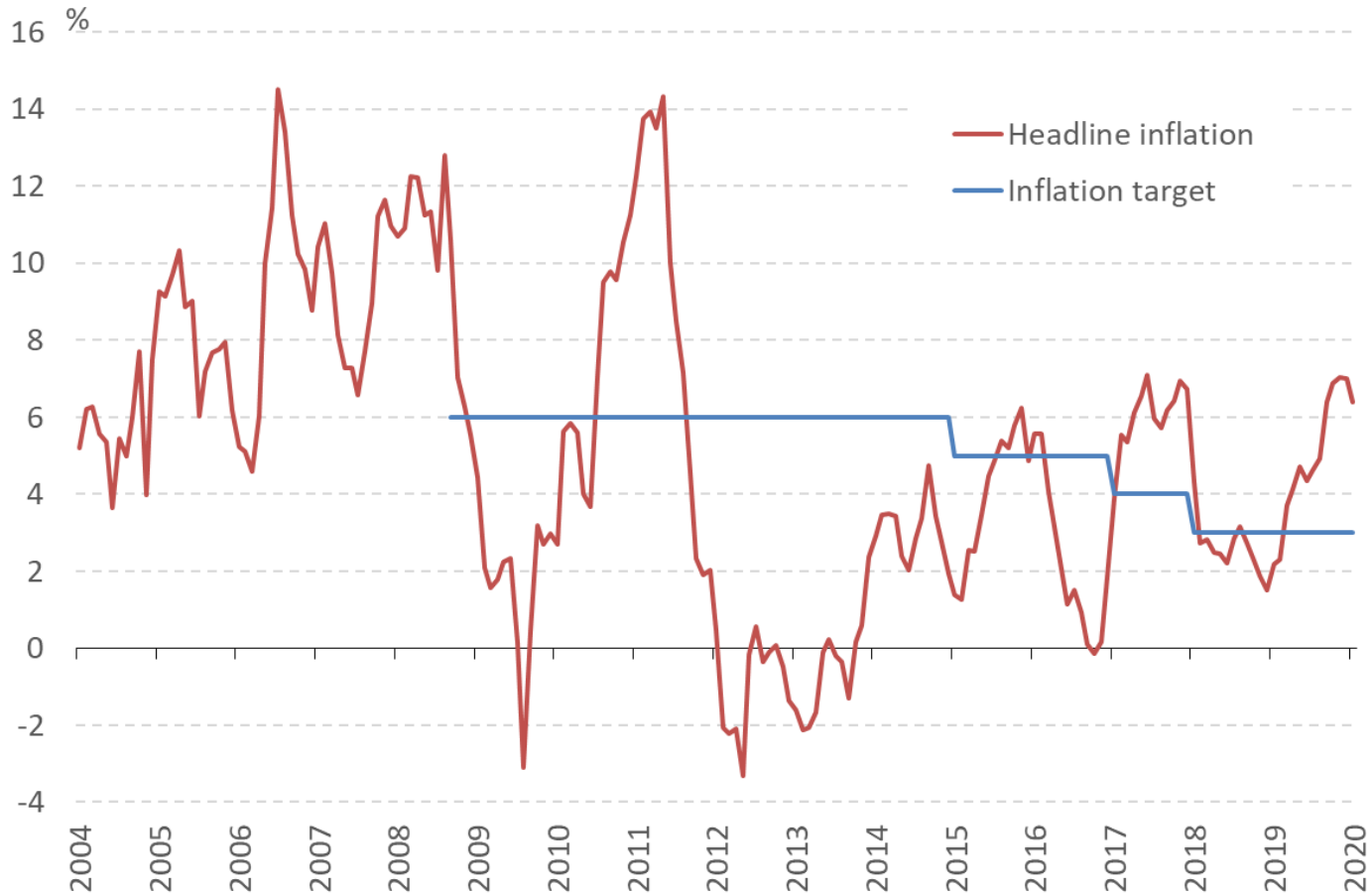
... which are well **understood by the public and the markets**, ...

... and effectively anchor their expectations and business activities.



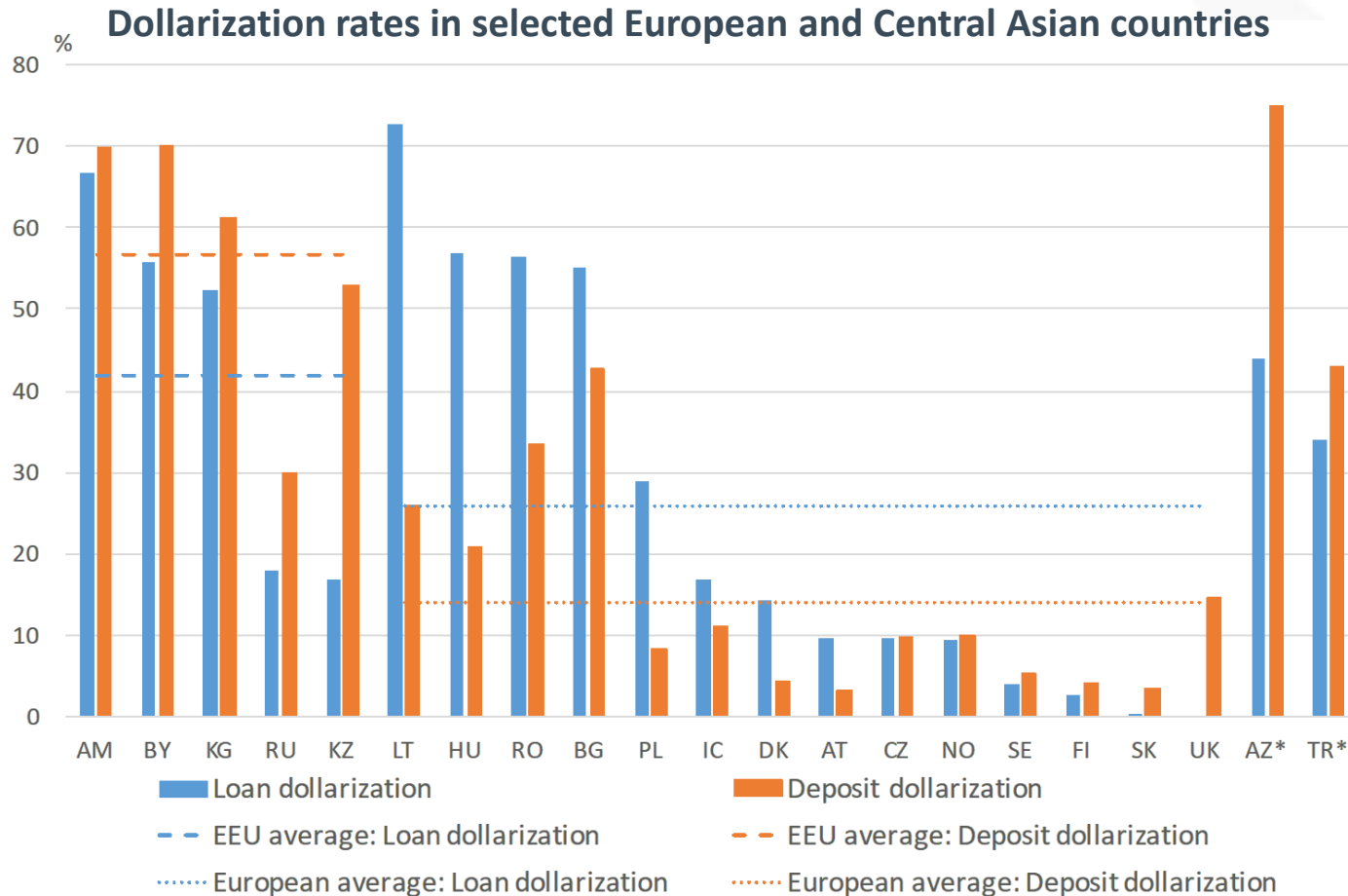
Inflation is often unanchored

CPI inflation and inflation target in Georgia (% YoY)



Source: OGRResearch

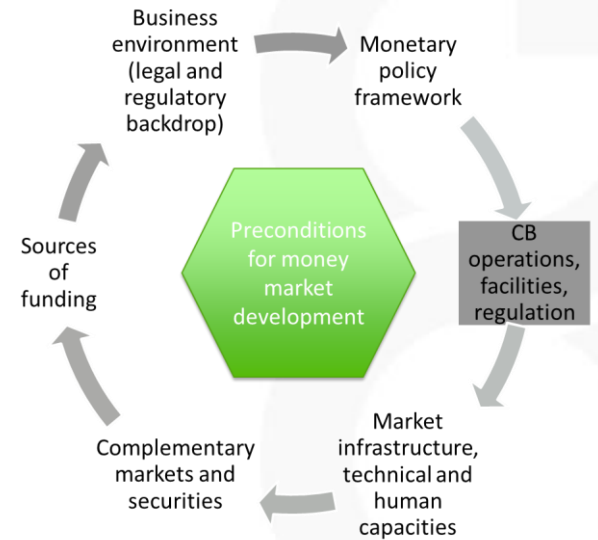
Typical issues: High Level of Dollarization



* Data for TR and AZ represents October, 2015 statistics. Rest is for 2014; Source: OGRResearch

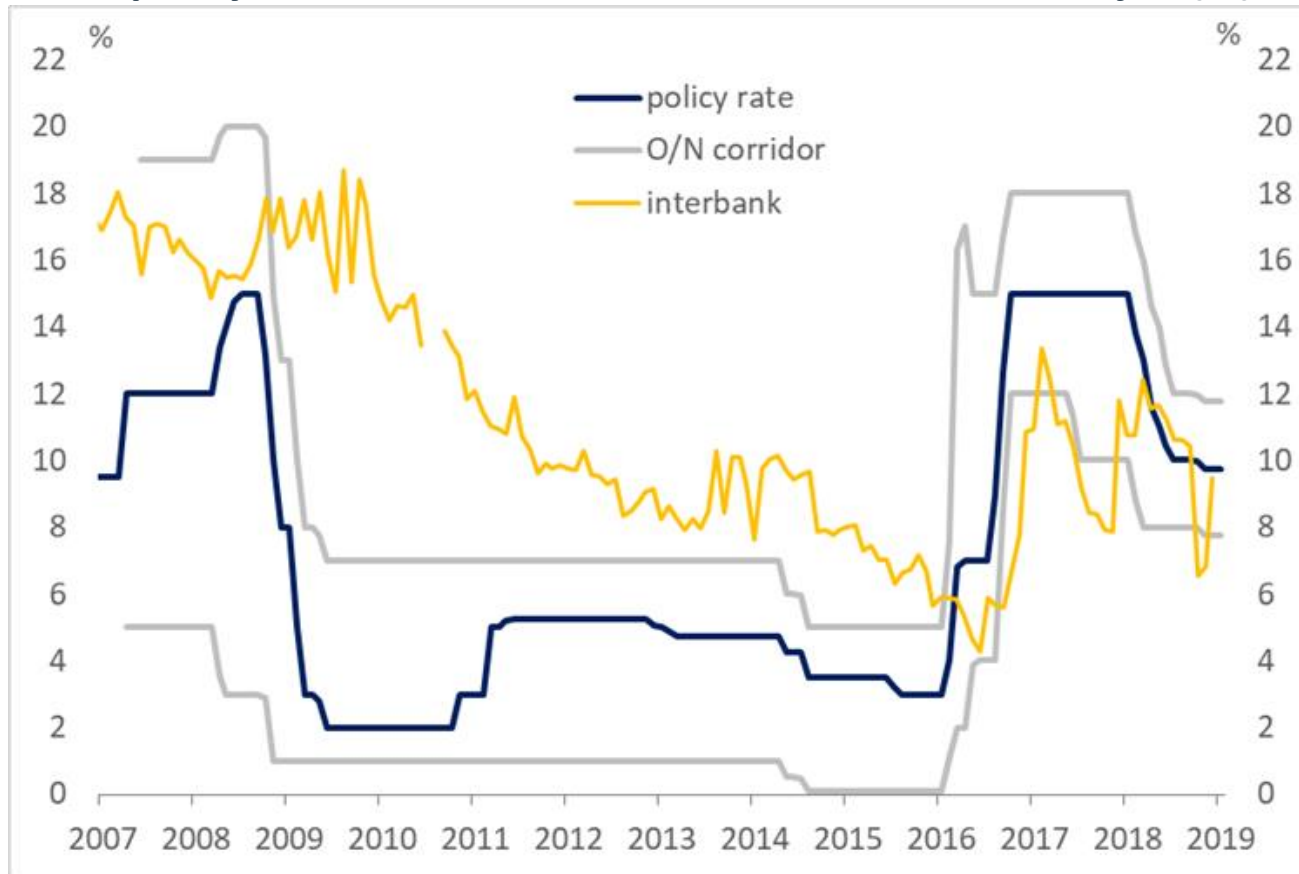
CB operations, facilities, regulation

- Flexible liquidity management by banks
- Decisions on the level of the operational target
 - Key policy rate
- Corridor of standing facilities
- Main instrument supporting the key policy rate
- Other (fine-tuning) tools of monetary policy



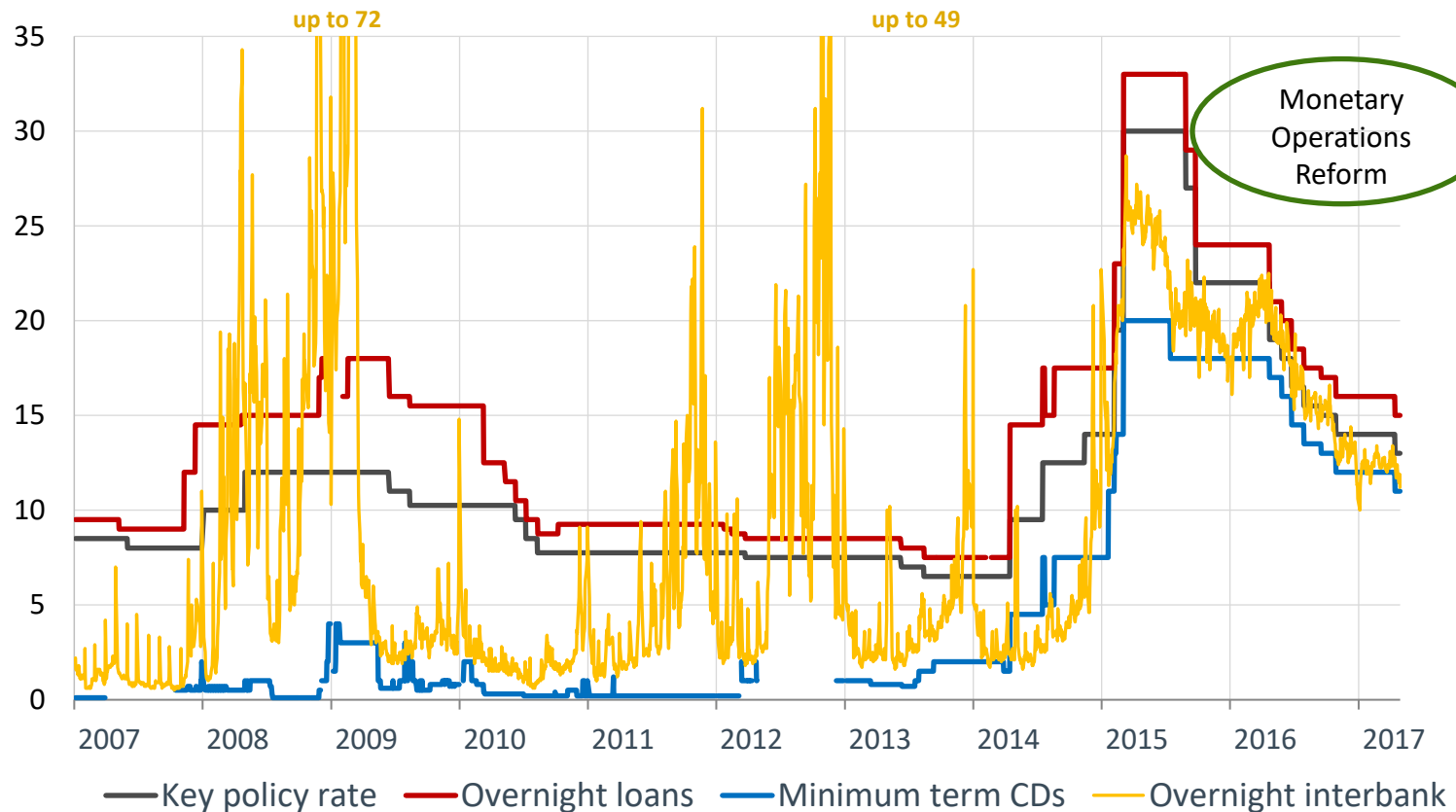
Policy rate is not what you say, but where market rates are

CB policy rates and the O/N interbank rate in Azerbaijan (%)



Typical issues: high volatility outside IR corridor

NBU policy and overnight interbank rates, % pa



Source: NBU

Zsolt Kondrat

Head of Financial Markets Advisory Division

zsolt.kondrat@ogresearch.com

www.ogresearch.com

The logo for OGResearch, featuring the letters 'OG' in a bold, green, sans-serif font, followed by the word 'Research' in a dark blue, sans-serif font.

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