

**INTERVENTIONS OF CENTRAL BANKS IN BALANCING ECONOMIC
STABILITY-A HISTORICAL REVIEW**

Dr.G.Ramaniah

**Professor, School of Management, Presidency University, Rajankunte, Yelahanka
Bangalore-560064**

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ABSTRACT

Central banks are critical elements of the current financial infrastructure, tasked with ensuring sustainable growth and maintaining economic stability. They have a role that is felt internationally, not just within nations, shaping global markets and financial systems. Through different means and policies, central banks strive to preserve price stability, employment, and create financial stability. This paper looks at the dilemma of central banks in ensuring economic stability through recent and historical case studies of the key global economies like the US, Europe, Japan, China, and India. This essay tries to offer a comprehensive insight into how central banks help to ensure economic stability in different situations by examining past and modern examples. It demonstrates how central banks functioned as world stabilizers influencing the course of economic developments in an interdependent and dynamic world. It underscores the necessity of an appreciation of the issues confronting central banks and the role of forward looking monetary policy. In the days to follow since the international economic stage will keep on changing, and central banks need to keep on being alert, engaged, and creative in the pursuit of economic stability

Key words: Central Banks, economic stability, historical events, global economies

INTRODUCTION

In all economies, the work of central banks is crucial for the preservation of financial stability and for the encouragement of sustained economic growth. Central banks utilize different tools and measures to regulate the money supply, inflation, and regulation of the banking sector. These are instrumental in ensuring stability and growth in any country's economy. They put in place monetary policy, monitor operations of banks, act as last moment lender, watch financial stability and intervene in currencies in the process of maintaining a resilient and healthy financial system. They have to set out goals in macro economic environment like achieving economic growth and price stability while framing monetary policy. Financial authorities can achieve these goals by utilizing tools like setting official interest rates, which influence borrowing costs.

Central banks employ tools both quantitative and qualitative that affect money supply and influence credit control efficiently to mitigate crisis and stimulate economic growth. Main quantitative tools used for affecting money supply by banks are reserve requirements, repo and reverse repo rates, discount rates and open market operations and qualitative measures that influence credit direction include ceiling, margin requirements etc. All these aim at lowering financial risks and maintain economic stability.

OBJECTIVES OF THE STUDY

1. To list and examine the past interventions of central banks in an effort to determine their effects on economic stability and recovery.

2. To assess the efficiency of recent central bank policies in governing economic stability, specifically targeting its reaction to the COVID-19 crisis, the trade conflicts, and new economic issues.
3. To recognize new trends and prospective future issues for central banks, such as the effect of technological breakthroughs, changing economic conditions, and realigning global dynamics.

CORE FUNCTIONS-LITERATURE REVIEW

Central banks as a last resort: In times of financial unrest or crisis, central banks typically serve as the last option, providing emergency funding to financial institutions that are temporarily short on liquidity. In order to avoid bank failures, which might result in more widespread financial instability, this function is essential. In order to discourage excessive risk-taking and to provide liquidity to solvent institutions that are experiencing a brief run on their deposits, central banks must impose a penalty rate, as noted by Bagehot (1873). This function supports the stability of the banking system and the public's ongoing faith in the financial sector.

.Regulatory and supervisory role: Central banks are responsible for creating and enforcing regulations to preserve the stability and soundness of banks and other financial institutions. Laeven and Levine (2009), opined that developing regulatory frameworks for maintaining capital requirements, risk management and operating standards are duties of central banks. Apart from these they also play supervisory role which include conducting inspections, checking compliances and taking corrective measures. In this way these banks help in ensuring safe and healthy operations of banking industry.

Monitoring financial markets: Central banks watch over the financial markets to identify systematic threats and weaknesses at an early stage. Allen and Carletti(2008) opined that analysing investor behaviour, liquidity and market conditions are to be done on continuous basis to identify any threat to the financial stability apart from tracking equity markets, debt and foreign exchange. By doing so central banks can quickly counter any upcoming risks and bring stability in markets.

Preventing Systemic Risks: To avoid systemic hazards, potential threats that could affect the entire financial system must be identified and mitigated. Kaufman (2003) emphasizes the importance of taking proactive measures to reduce risks such as market shocks, macroeconomic imbalances, and the interdependence of financial institutions. Central banks use scenario analysis, risk assessments, and stress tests to assess the resilience of the financial system and implement policies that reduce vulnerabilities and increase stability. These actions were crucial in fostering recovery and averting a more serious recession.

Currency Management:

When required they oversee the country's currency reserves and taken action in the foreign exchange market. The national currency is issued and managed by central banks.

Design and Printing of Coins and Notes: Ensuring the functioning and security of national money is contingent upon the design and production processes. In order to avoid counterfeiting, central banks supervise the production of coins and banknotes, making sure they adhere to

strict quality and security requirements. (Jong & Bordo, 1999)

Distribution: Making sure that money flows and its availability within the economy is part of currency distribution. Central banks work in tandem with commercial banks and other banking establishments to guarantee that the money supply is sufficient to satisfy the demands of the economy. Friedman (1969). This responsibility ensures the integrity and stability of the national currency (Rogoff, 1998).

As a Banker to the Government: The government relies on central banks to carry out vital tasks such as managing government accounts, which involve handling transactions and keeping track of balances (Buiter & Panigirtzoglou, 2001), facilitating the issue and management of government bonds in the process of issuing government debt (Gordon, 2012) and) providing support for the tactics used in debt management for the public sector (Elmendorf and Mankiw 1999)

Banker to Banks: For commercial banks, central banks offer vital services such as clearing and settling payments, which facilitate interbank transactions (Rochet & Tirole, 1996) and providing emergency finance to banks in times of financial trouble that is known as Lender of Last Resort (Diamond & Dybvig, 1983).

Foreign Exchange and Reserves Management:

In order to stabilize the national currency, central banks control foreign exchange reserves and have the authority to interfere in currency markets (Obstfeld & Rogoff, 1995). According to Calvo and Reinhart (2002), maintaining economic stability and international confidence is facilitated by the efficient management of foreign reserves and currency rate regulations. These roles support efficient government funding and the implementation of fiscal policy (Barro & Gordon, 1983).

EXAMPLES OF CENTRAL BANK INTERVENTIONS

1.The Federal Reserve

The Great Depression (1929–1933): The Federal Reserve is frequently blamed for its mistakes and lack of action during this time. Initially, deflation and bank failures were caused by Fed policy. More effective monetary measures, including tighter regulation and altered strategy, weren't implemented until the late 1930s.

The financial crisis of 2008: Federal Reserve system proactively ensured stability in financial markets and economic growth by introducing quantitative easing(QE), and reducing interest rate to almost zero and supply credit through Troubled Asset Relief Program(TARP). Ultimately these led to preventing economic crisis and promoting recovery.

2.Central Bank of Europe

Debt crisis during 2010-12: European Central Bank played key role in ensuring stability in debt market, bank's president Mario Draghi declared that it would do all required to protect the euro. The Outright Monetary Transaction(OMT) program and Smoothy quantitative measures were key in stabilizing debt rates and easing market volatility.

The Covid-19 pandemic: During pandemic times, it levied stringent monetary policies aiming at supporting euro's economy through maintaining market liquidity, easy financial terms and

purchasing securities. Bank of Japan is continuously fighting prevalent deflation and slow development pace and these measures prove that BoJ is committed to maintain its country's economic stability and achieving inflation goals.

3. People's Bank of China

Golden financial crisis of 2008: During this period PBoC significantly increased public investment and followed monetary easing apart from lowering bank reserve requirements that resulted into higher lending. China was able to sustain robust economic development amid the global recession because to its proactive approach.

Recent Economic Slowdowns: The PBoC has used strategies including targeted reserve requirement ratio decreases and liquidity injections to promote economic activity in response to recent economic slowdowns and trade tensions. In order to increase the flexibility of monetary policy, the PBoC has also progressively moved toward permitting more market-oriented interest rate adjustments.

4. Reserve Bank of India (RBI)

The RBI adopted several unconventional measures aimed at increasing the availability of rupee and foreign currency liquidity. Measures aimed at expanding rupee liquidity included a special repo window under the liquidity adjustment facility for banks for lending to mutual funds, non-bank financial companies, and housing finance companies, and a special refinance facility that banks can access without any collateral. The RBI also set up a special purpose vehicle to provide liquidity support to non-banking financial companies (RBI 2009). However, the degree of unconventionality of these measures was modest.

The 2013 Taper Tantrum: When the U.S. Federal Reserve announced intentions to stop QE, the RBI saw large capital outflows and currency depreciation. In response, the RBI managed inflationary pressures and stabilized the rupee by increasing interest rates and interfering in currency markets.

During Covid-19, the central bank in India implemented several measures to support the economy including lowering of interest rates, enhancing liquidity and providing targeted support to the industries which were impacted. It also the Government Securities Acquisition Program (GSAP) with an aim to buy government bonds

MORE RECENT EXAMPLES:

1. Federal Reserve (US) Interest rate adjustments and inflation control in 2024: Despite earlier rate increases, the Federal Reserve was confronted with a difficult situation in early 2024 with sustained inflation. The Fed took a measured approach, slowly tinkering with interest rates to moderate inflation without taking an excessively dampening impact on economic growth. Fed Chairman Jerome Powell recently made comments that indicate a concern for finding balance between stimulating economic growth and managing inflation.

2. European Central Bank (ECB)

2024 Energy Crisis and Monetary Policy: ECB which tightened interest rates during 2022 to 2024 began interest rate cuts starting from June 2024 to till October to deal firmly with domestic persistent inflation and uncertainty owing to geopolitical risks resulting into firms' risk perceptions. Also reduced its investments in asset purchases to stabilize the economy and counter inflation.

3. Bank of Japan (BoJ):

In 2024, it increased its asset purchase and maintained negative interest rate through its nonaggressive monetary policy. Notwithstanding these efforts, Japan's inflation remained below target and economic growth has stayed sluggish. Though bank's policies reflect persistent problems faced while fostering growth in times of low price rise, but are intended to boost economic activity and achieve price stability.

4. People's Bank of China (PBoC)

in the year 2024 , through its monetary and fiscal policy it reduced reserve requirement ratio helping banks to lend more money to small and medium enterprises and could brought back economic stability and shortened debt among companies.

The above examples are the concrete evidence that central are framing and implementing suitable monetary and fiscal policies time and again to fight out inflation and maintain economic stability and prevent slowdowns in economy.

CHALLENGES AND CRITICISMS

Some of the significant challenges and criticisms, which central banks encounter, are outlined in the sections that follow:

1.Policy Limits: The limitations of monetary policy are often encountered by central banks when interest rates are at or lower bound is a situation that restricts the effectiveness of conventional monetary tools. Central banks may need to adapt credit and quantitative easing as tools where they can expand balance by purchasing assets. Quantitative Easing more focuses on increasing cash reserves with banks while Credit Easing(CE) revolves around buying private sector assets like mortgage-backed securities for stabilizing lending markets and boost credit conditions. But one should not forget these measures may not be successful overtime and turn into diminishing returns and can distort financial markets.

2. Asset Bubbles Potential: There is possibility of developing asset bubbles and in case their burst, particular investors incur substantial losses. Lower borrowing rates may induce investors to assume more risk and indulge in excessive buying of stocks, bonds or other assets paying higher price than their intrinsic values which was witnessed by the world in 2000s and 2008 financial crises.

3.Worldwide Impact: Policies of central banks will have impact worldwide leading to alterations in capital flows, currency fluctuations ultimately affecting developing economies. These policies can lead to exchange rate disputes between nations internationally too.

4.Independence or Accountability: There should not be any political pressures for central banks to implement monetary policies and they(central banks) also need to be more transparent in decision making process in gaining public confidence and making them understanding bank activity. Central banks should make sure their policies align with social and economic goals.

CONCLUSION

The examples quoted above reveal how central banks manage tough economic downturns. In the modern times integrated financial system is a solution for bringing back economic stability and sustainable development and promoting financial systems more robust and efficient. To

face future economic crises and strengthen economic stability or countries the central banks should strengthen their own financial resilience, follow more proactive regulatory approach, stimulate international cooperation and carry out efficient monetary policies. No doubt central banks remain crucial in balancing economic stability and building the world's financial system.

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