



## **The Role & Function of the Central Bank**

As part of our continuing support of Financial Literacy month our article this week will focus on the role and function of the Eastern Caribbean Central Bank. The first question one would ask is what is a central bank? To the layman a central bank is simply the issuer of currency. Well, a central bank is a monetary authority invested by government with the powers to control the financial system.

Our central bank, the Eastern Caribbean Central Bank or ECCB which was established in 1983 is a multi-national central bank. This means that the ECCB services as the central bank for the following territories:

- Antigua and Barbuda
- Commonwealth of Dominica
- St Kitts and Nevis
- St Vincent and the Grenadines
- Montserrat
- St. Lucia
- Anguilla
- Grenada

Although the headquarters of the ECCB is in St. Kitts, each territory has an agency office.

To achieve its objective of controlling the financial system, the central bank performs a number of functions. The functions performed by the central bank are critical to the financial survival of a country. It is therefore imperative that central banks put in place effective measures designed to ensure the survival and value of the currency under their supervision.

The following are the functions of central banks:

- To be the issuer of and manager of currency
- Act as a banker to governments
- Act as a banker to commercial banks
- Perform bank supervision
- Conduct monetary policy

### **To be the issuer of and manager of currency**

The central bank is the sole issuer of currency in the territory where it operates. This means that all currency issued by the central bank is legal tender and can be used for the settlement of all debts. It is also responsible for the production, distribution and redemption of notes and coins in accordance with the needs of the economy.

### **Act as a banker to governments**

The central bank may from time to time provide deposits and borrowing facilities to governments and give technical advice on matters of monetary and financial policy. Our ECCB also manages the levels of our foreign reserves by working with the respective Ministries of Finance to administer exchange control.

### **Act as a banker to commercial banks**

The central bank provides services in three areas when dealing with local banks:

- Commercial banks are required to maintain a certain balance with the central bank. This is called statutory reserves and is a legal requirement
- The central bank provides a Clearing House Facility where commercial banks meet daily for presentation of cheques and the settlement of inter bank balances
- The central bank would come to the aid of banks in financial difficulty. As the lender of resort if a bank faces a run by customers the central bank can provide emergency funding to prevent that bank from running out of cash

### **Perform bank supervision**

This function is critical to the survival of the banking system. The prime object of bank supervision is to foster and maintain sound banking conditions so as to ensure the continuation of essential banking services. The rationale for the bank supervision is double-pronged. Firstly, the promotion of the safety and soundness of financial institutions so that they do not become a source of systemic risk and pose threat to the payment system. And secondly, the promotion of an efficient and effective banking system that finances economic growth allocates credit and meets the needs of customers and communities.

It is important that deposit taking institutions are supervised because the funds they use to issue their loans are the savings and deposits of the public. These savings and deposits make up the wealth of the nation and must be secured. The supervision includes monitoring whether a financial institution has the appropriate levels of technical, financial and personnel resources to ensure its efficient, prudent, sound and profitable operation.

We recently received word from our central bank that the banks within our union were safe from the effect of collapses that was affecting the rest of the world because of the policies that are presently in place.

### **Conduct monetary policy**

Governments use two major tools to manage their financial position. These tools are fiscal and monetary policy. While the Ministry of Finance is responsible for fiscal policy, it is the responsibility of the central bank to manage the monetary policy. Monetary policy can be seen as actions taken by the central bank to influence the amount of money and credit in the economy. The central bank can therefore influence the rate at which domestic prices increases and the level of growth in the economy.

Next week we will touch on the tools that central banks use to affect their monetary policy.