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On the Issue of Coordinating the Objectives and Instruments of Financial and Monetary Policies

A.G. Siluanov
Financial University, Moscow, Russia

ABSTRACT

The relevance of the issue of mutual influence of the goals and instruments of financial and monetary policy increases during periods of economic instability. External and internal macroeconomic shocks can undermine the financial stability of the state and have a negative impact on both price and financial stability. In this regard, there is a need to adjust both financial and monetary policies based on harmonization of the instruments of financial and monetary regulation. The purpose of this study is to develop the theoretical, methodological and applied foundations for coordinating the goals and instruments of monetary and financial policies. The article concludes with the results obtained in the course of the research.

Keywords: financial policy; financial stability; money-credit policy; price stability; tools for financial and monetary regulation

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INTRODUCTION

The issues of efficiency and effectiveness of the state financial policy, optimisation of its goals, methods and tools are still relevant and are studied by scientists regardless of the phase of the economic cycle, but they become especially important in periods of economic crises and macroeconomic instability. External and internal macroeconomic shocks can undermine the financial stability of the state, have a negative impact on price and financial stability. Hence, there is a need to develop and implement sound financial policy in coordination with monetary policy implemented by the monetary regulator.

The state financial policy is traditionally understood as a joint activity of the authorities and financial regulator aimed at ensuring stability of the financial market and its individual sectors, maintaining stability of the entire financial system of the country. Monetary policy, in turn, in most countries of the world is aimed at price stability and is implemented by central banks, which, on the one hand, have the status of a certain independence from the state, but, on the other hand, carry out monetary regulation of economic processes in coordination with the legislative and executive authorities. The results of monetary policy implementation over the last ten years show that it is designed to ensure price stability in combination with the solution of problems of financial stability, employment, reliability of the payment system, and economic growth. Therefore, there are theoretical and practical issues of establishing the relationship between financial and price stability, the need for interaction between governments and central banks; the problems of "cross-sectional" influence of instruments and objectives of financial and monetary policy.

LITERATURE REVIEW

A significant number of scientific works by Russian and foreign authors are devoted to the problem of interrelation of financial and monetary policy. Conventionally, the list of works can be divided into three groups.

Scientists of the first group have conducted research on the influence of the state financial policy and financial stability on the conditions and results of the monetary policy implementation of the monetary regulator. For example, Yueli Xu et al. describe the impact of financial development as a result of financial policy on the effectiveness of monetary policy in developing countries [1]. Studies show that China's financial development enhances the transmission effect of monetary policy in general. Viral V. Acharya et al. come to similar conclusions and prove that the lack of financial stability reduces the effectiveness of transmission channels of monetary policy mechanism [2].

Tran Thi Kim Oanh et al. examine the impact of access to financial services on financial and price stability in countries with different levels of population wealth [3]. The authors argue that in countries with low levels of wealth, the availability of financial services increases financial stability and reduces inflation. And where the level of wealth is high, the availability of financial services increases financial instability, which leads to long-term inflation.

The study by Xiao-Lin Li et al. investigates the cyclical features and dynamic secondary effects of the relationship between monetary policy cycles and financial cycles in China during 1998–2018. [4]. The authors argue that the five cycles exhibit strong synchronisation in terms of response to shocks. The results of the study confirm the importance of analysing the financial cycle in monetary policy decisions.

Martin Tobal and Lorenzo Menna argue that financial instability leads to higher inflation and monetary policy faces the need to search for a trade-off in key rate decisions to ensure not only price stability but also financial stability in emerging market economies [5].

M.V. Ershov et al. describe the impact of public financial policy on the conditions of monetary policy implementation [6]. Using the example of developed and developing countries, the authors focus on the tacit role of the monetary regulator as a creditor of the government in the crisis period, which ambiguously affects the achievement of price stability by central banks.

M.A. Abramova et al. also study the impact of the state financial policy on the monetary policy of the monetary regulator [7]. Scientists note the positive impact of measures to ensure the stability of the financial system in the context of external shocks on price stability in the context of their restraining effect on devaluation of the exchange rate and volatility of stock market indices.

The authors of the second group conducted research on the impact of monetary policy on the financial stability of the state, which they consider as the main goal of financial policy. Hao Wang et al. on the example of data on China prove that monetary policy can contribute to financial stability in the post-crisis period, especially in the short term [8]. Researchers Aswati R. Nair and B. Anand also study the possibility of using monetary policy as a tool to achieve financial stability [9]. Their results show that asset price targeting as an alternative to the popular inflation targeting regime can be one of the effective ways to contain financial instability and subsequent economic downturns.

Researchers also write about the communication effects of the impact of monetary policy on the financial system. Conor Parle in his study assesses the direct impact of the ECB (European Central Bank) communication within the framework of press conferences on the financial market [10]. The author argues that market participants perceive information from press conferences as news about the future state of the economy and not only about changes in interest rates. Francisca Collingro and Michael Frenkel found that financial market participants react more strongly to monetary policy communication signals during the recovery period after the financial crisis [11].

Xiaoyun Wei and Liyan Han note that unconventional monetary policy instruments are much more effective in terms of influencing the stock and currency markets [12]. The authors conclude that if the monetary policy is aimed at stimulating financial markets, then to achieve the desired effect, it may require a tighter coordination with other macroeconomic policies, primarily with fiscal, tax and budgetary policies.

K.V. Krinichansky and N.E. Annenskaya study the impact of price stability as the main target of monetary policy on the financial development of the state [13]. The scientists prove that fluctuations in the price level in the economy affect the emergence of new financial market instruments, i.e., stimulate financial development.

The authors of the third group devote their research to the issues of neutrality of financial systems of developing countries in relation to the monetary and financial policies of the developed countries. Aimit Lakdawala assesses the impact of the US monetary policy on emerging markets on the example of India and argues about a fairly high degree of such an impact [14]. The researcher emphasises that monetary shocks of the US Federal Reserve System are transmitted through the uncertainty channel, affecting the market value of shares. At the same time, the higher sensitivity of the aggregate response is the same for the entire stock market and is not due to the increased dependence of any particular segment on the U.S. monetary policy.

Georgios Georgiadis and Martina Jančoková come to similar conclusions that monetary policy of the US Federal Reserve and the ECB affects financial conditions in small open economies through global and regional financial channels [15]. Continuing this theme, Georgios Georgiadis and Feng Zhu studied the problem of the relationship between monetary policy and financial system openness in the context of the impact of exchange rate shocks on financial markets and monetary decisions of regulators [16]. The authors talk about the importance of the floating exchange rate regime to ensure the independence of the financial system of the state from the monetary policy of other countries.

There is an interesting study by Dongwon Lee, who argues that emerging markets can maintain monetary autonomy in the face of global financial market volatility, while advanced economies have limited autonomy due to their close and tight financial integration in recent decades [17].

Thus, the literature review on the problem under study allows us to conclude the following:

- financial and price stability are interrelated: it is impossible to ensure financial stability without price stability, and vice versa;
- monetary policy forms conditions for achieving and maintaining financial stability;
- financial policy instruments influence price stability, primarily through their impact on non-monetary factors of inflation;
- financial and price stability in developing countries depends on the monetary and financial policies of the US and Eurozone countries;
- disintegration of the global financial system leads to a decrease in the dependence of financial and price stability in the countries of the world on the monetary and financial policies of the USA and Eurozone countries.

STUDY OF THE RELATIONSHIP BETWEEN PRICE AND FINANCIAL STABILITY IN RUSSIA IN THE CONTEXT OF ENSURING ECONOMIC GROWTH

Price stability from the position of the Bank of Russia means the situation when the annual growth rate of the consumer price index is close to the target value (target) of 4%.[1] Referring to this goal of the monetary regulator, researchers propose to assess the effectiveness of monetary policy based on the calculation of the percentage deviation of actual inflation from the target value [18]. On the one hand, this methodology has some disadvantages: it does not take into account the time lag between the regulator's decision on the key rate and the reaction of the real economy; it does not take into account other monetary objectives of the Bank of Russia. On the other hand, the quantitative parameter proposed by the authors can be used not only to measure price stability in the country (with low inflation), but also serve as an indicator to assess the degree of achievement of the monetary regulator's goal within the inflation targeting regime.

To investigate the relationship between price and financial stability we will use the index proposed by the scientists [18]:

$$I_{ps} = 1 - \sqrt[2]{\frac{i_{fact} - i_{target}}{\max\left(i_{target};\beta\right)}}, \quad (1)$$

where I_{ps} — is the price stability index; i_{fact} — actual value of annual inflation; i_{target} — target value of annual inflation; β — minimum value of target annual inflation determined by the accuracy of measurement.

Formula (1) takes into account the percentage of deviation of actual inflation from the target value. This deviation can be both positive and negative. Note that too low inflation rate and deflation are discouraging factors of economic development, therefore, negative deviations from the target can also be assessed as a decrease in price stability.

This approach, based on the calculation of deviation of actual values from target values, is also applicable to the calculation of the financial stability index. Moreover, if the calculations of price stability are based on the values of inflation calculated by the consumer price index, for the calculation of financial stability it is important to determine the indicator that would reflect the development of the entire financial system, including public finances, finances of organisations (financial and non-financial) and households. The ratio of annual growth of total financial assets of the economy to the population can be used as such an indicator [19]:

$$I_{fd} = \frac{FA_{gr}}{PN}, \quad (2)$$

where I_{fd} — is the index of financial development; FA_{gr} — annual growth of total financial assets of the economy; *PN* — number of populations.

[1] URL: https://cbr.ru/dkp/objective_and_principles/

This indicator not only measures the development of the financial system as a whole, aggregating the assets of all its elements, but also indirectly assesses the level of financialisation of the economy.

Based on the approach to calculation of the price stability index, it would be appropriate to assess the deviation of actual values of the financial development index from the target values, but the strategic financial documents do not define the target value of this indicator. In this regard, to determine financial stability, it seems reasonable to assess the deviation of the financial development index from the trend on the basis of regression analysis:

$$T_{fd} = a * t + b, \qquad (3)$$

where T_{fd} — is the trend value of the financial development index; *a, b* — model parameters; *t* — the number of the period under study.

Then the index of financial stability will take the form:

$$I_{fs} = 1 - \sqrt[2]{\frac{I_{fd} - T_{fd}}{\max\left(T_{fd};\gamma\right)}}, \qquad (4)$$

where I_{fs} — financial stability index; I_{fd} — actual value of the financial development index; T_{fd} — trend value of the financial development index; γ — minimum value of the financial development index trend determined by the accuracy of measurement.

As with the price stability index, higher values of the financial stability index mean a higher level of financial stability of the state. The results of the calculation of price and financial stability indices are shown in *Fig. 1*.

Figure 2 illustrates the relationship between price and financial stability in Russia during the crisis periods and clearly shows the relative autonomy/interaction of financial and price stability in different periods of economic development. Under conditions of positive economic dynamics, financial and price stability can be ensured under relative autonomy of financial and monetary policies, and the goals and instruments of their implementation do not necessarily have to coincide. However, in crisis periods, coordination of financial and monetary policy is the most important condition for overcoming them and minimising negative consequences for the economy.

Fig. 1. **Indices of price and financial stability in Russia**

Source: compiled by the author on the basis of data: [18]; URL: https://cbr.ru/dkp/objective_and_principles/; https://cbr.ru/statistics/macro_itm/fafbs/; https://rosstat.gov.ru/folder/12781; https://rosstat.gov.ru/statistics/price /

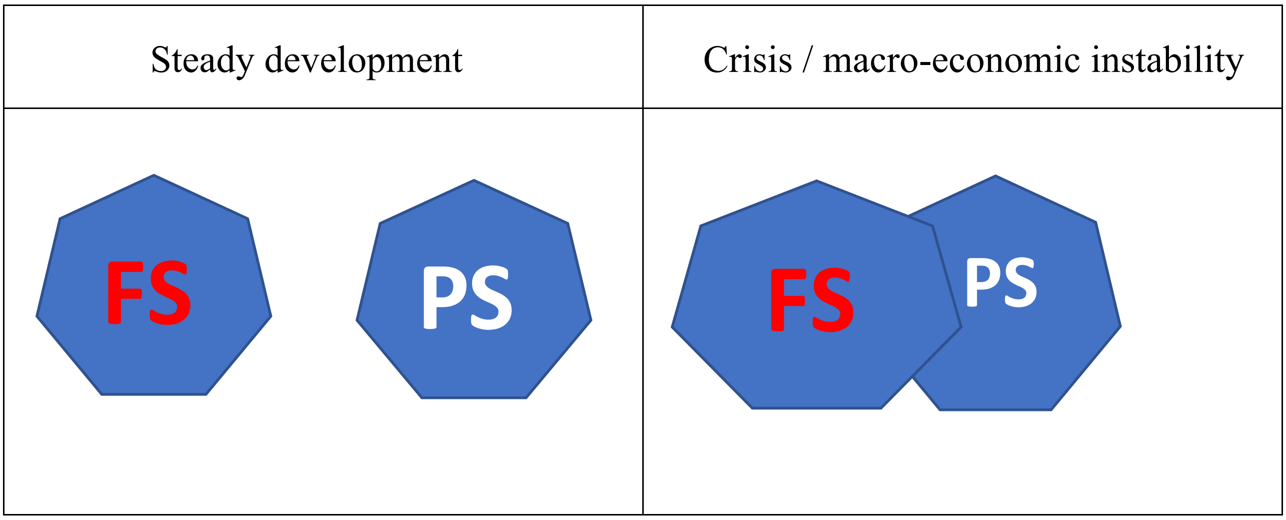

Fig. 2. **Interaction of financial and price stability in different periods of economic development**

Source: compiled by the author.

The analysis of data for 2014–2016 shows that the price stability index is more volatile than the financial stability index: the former is subject to a more severe recession during the crisis, but also recovers faster in response to the monetary anti-crisis measures of the Central Bank. On the one hand, this finding confirms that monetary policy is more flexible than government financial policy (provided that the financial market is well developed). On the other hand, it can be stated that financial stability in 2016–2017 was restored against the background of favourable conditions of price stability. Price growth reduces the predictability of economic development, reducing the volume of investment in the economy; negatively affects confidence in the national currency, weakening its exchange rate; reduces real incomes of households and businesses as consumers of financial services. Therefore, price stability has a significant impact on financial stability.

It is also interesting that financial stability in 2019 was declining, which is also demonstrated by *Fig. 1*. If we turn to the financial accounts of the NAS (national account system) of the Russian Federation[2] and the statistics of the Bank of Russia,[3] it becomes clear that the characteristic negative growth of total financial assets in Russia in 2019 is associated with a decline in demand for the services of non-credit financial institutions against the background of the key rate reduction and the corresponding growth in demand for the services of banks, as well as with the reduction in the volume of budgetary funds in the accounts of financial institutions. Hence, the conclusion about the dependence of financial stability on both the state financial policy and monetary regulation follows.

The volume and structure of assets and liabilities of economic entities are significantly influenced by monetary policy instruments. An increase in the key rate in order to reduce the overall level of consumer prices contributes to the growth of money and credit market rates, due to which the demand for loans from households and businesses decreases, but at the same time the demand for deposits increases, redistributing assets and liabilities in the economy. For example, a sharp increase in the key rate from 9.5 to 20% amid geopolitical instability in 2022, expansion of the volume of refinancing of credit institutions, as well as a significant reduction in the required reserves ratios and increase in the required reserves averaging ratios as monetary policy measures prevented the outflow of funds

[2] URL: https://cbr.ru/statistics/macro_itm/fafbs/

[3] URL: https://cbr.ru/statistics/bank_sector/sors/retro/archiv2/

from the banking sector — the core of the financial system, increasing its resilience to external and internal shocks.

Thus, the empirical study proves the existence of the relationship between price and financial stability in Russia, as well as confirms the impact of the monetary policy of the Bank of Russia on financial stability. Achievement of price and financial stability forms favourable conditions for maintaining *economic* stability as a factor of *economic* growth:

1. Low inflation rate creates an opportunity to improve the efficiency of the budget policy at different levels (municipal, regional, federal), forming predictability of future revenues and expenditures of budgets.

2. Price stability contributes to the welfare of the population by enabling effective financial planning.

3. Under conditions of low inflation, low rates on bank deposits are set, which motivates the population to choose alternative investment instruments with higher returns. In turn, the transformation of savings into investments is an important factor in the development of domestic production.

4. Stability of functioning of credit and payment systems ensures safety of non-cash funds of households and businesses in the conditions of external shocks, uninterrupted money turnover and payments, which creates favourable conditions for economic transactions and builds confidence of economic entities in the financial market regulators.

5. Stability of the investment system, the most important indicator of which is the low volatility of the stock market, ensures the inflow of external and internal investments into the Russian economy, creating opportunities for economic development.

6. Stability of the insurance system provides for the redistribution of risks in the economy,

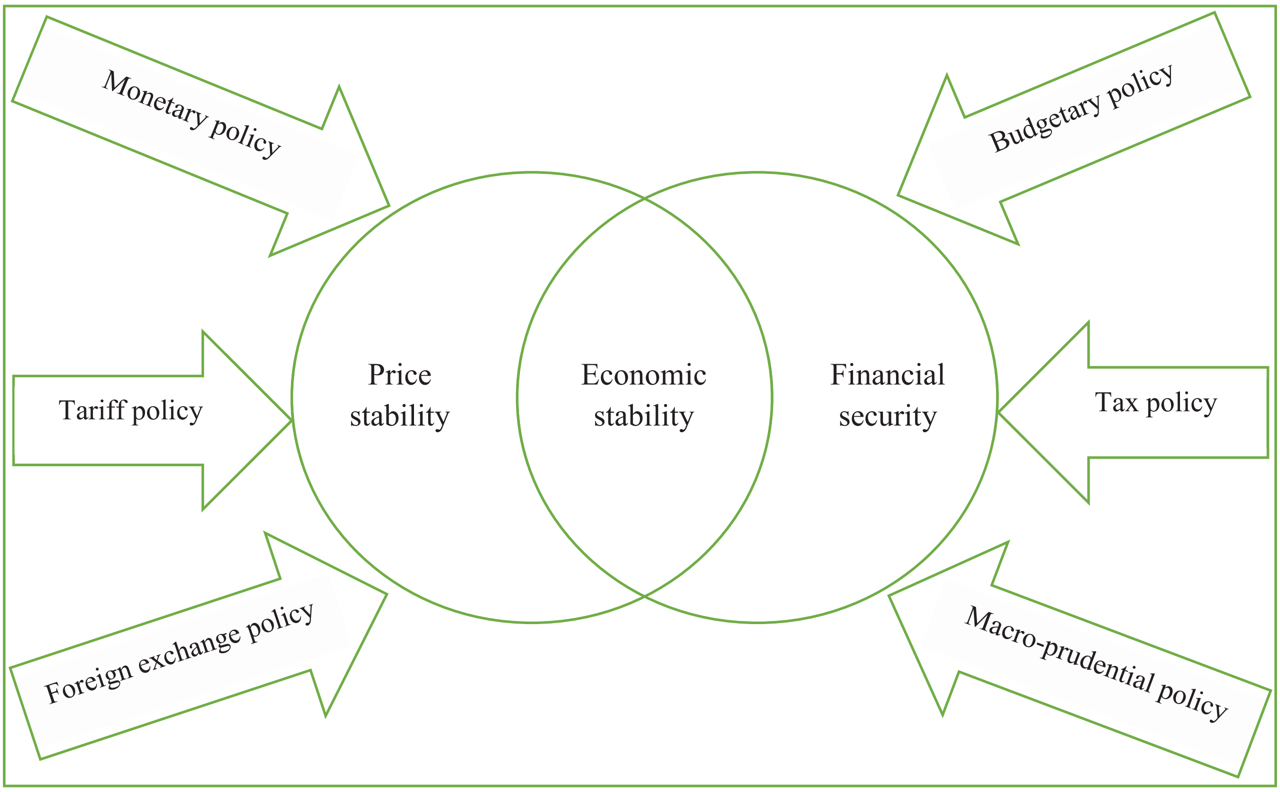

Fig. 3. **The relationship between price and financial stability**

Source: compiled by the author.

reducing the negative impact of external and internal shocks on the sectors of the Russian economy.

Thus, the coordination of monetary policy and various financial policies is necessary to ensure overall economic stability and sustainable economic growth in Russia (*Fig. 3*).

Figure 3 clearly illustrates the need for a comprehensive application of monetary policy instruments in combination with the levers of individual government financial policies to ensure price and financial stability in Russia.

Fiscal (tax and budgetary) policy is aimed at redistribution of funds for the implementation of strategic goals of economic development and improvement of citizens' welfare. At the same time, budget expenditures and taxes influence the money supply, determining the level of supply and demand in the commodity market and inflationary expectations of the population and businesses, which is a factor affecting the price level. Therefore, along with monetary instruments, fiscal levers also influence financial, price and economic stability.

In addition, customs tariff policy has a great potential to influence these parameters. Customs duties affect the prices of imported goods, which determines the general price level in Russia. Tariff quotas contribute to the regulation of export and import volumes, and the competitiveness of domestic producers and the investment potential of the Russian economy depend on it.

Currency (foreign exchange) policy also affects the balance of export-import relations, which determines the investment attractiveness of the domestic market. The stability of the national currency increases the confidence of foreign and domestic investors in the Russian market. Low volatility of the rouble exchange rate also has a positive effect on inflation dynamics due to the effect of transferring prices of imported goods to the prices of domestic goods.

Thus, economic stability is inextricably linked to price and financial stability, which is achieved through the coordination of monetary and financial policies of the government.

STUDY OF THE IMPACT OF GOVERNMENT FINANCIAL POLICY ON PRICE STABILITY

Financial policy, oriented at elaboration of development prospects and statutory and legal regulation of the operation of the financial market and financial institutions, is aimed at achieving financial stability and maintaining financial sustainability.[4] Moreover, while financial stability as a result of financial policy is manifested at any stage of the economic cycle, financial sustainability reveals itself only in crisis periods.

During the geopolitical crisis of 2022–2023, financial stability and financial sustainability in Russia were ensured through a combination of financial and monetary policy instruments.

Currency instruments of the Ministry of Finance of Russia and the Bank of Russia. They have shown high efficiency in terms of achieving financial stability and financial sustainability. In order to prevent the devaluation of the Russian rouble as a threat to financial stability and to increase the confidence of the Russian population in the national currency at the beginning of the geopolitical crisis, restrictions were adopted on foreign exchange operations of residents, on the import of foreign currency; obligations to sell part of foreign exchange earnings by exporters; a special procedure for settlements with foreign persons from unfriendly countries was introduced. These measures did contribute to the strengthening of the Russian rouble (*Fig. 4*), which formed conditions for further stable development of the financial system. In addition, these currency instruments had a significant positive impact on price dynamics in Russia. There was a high correlation between the exchange rate and inflation in the first three quarters of 2022: the correlation coefficient was 0.9524 (*Fig. 4*). Taking into account the fact that

[4] URL: https://minfin.gov.ru/ru/perfomance/finans/

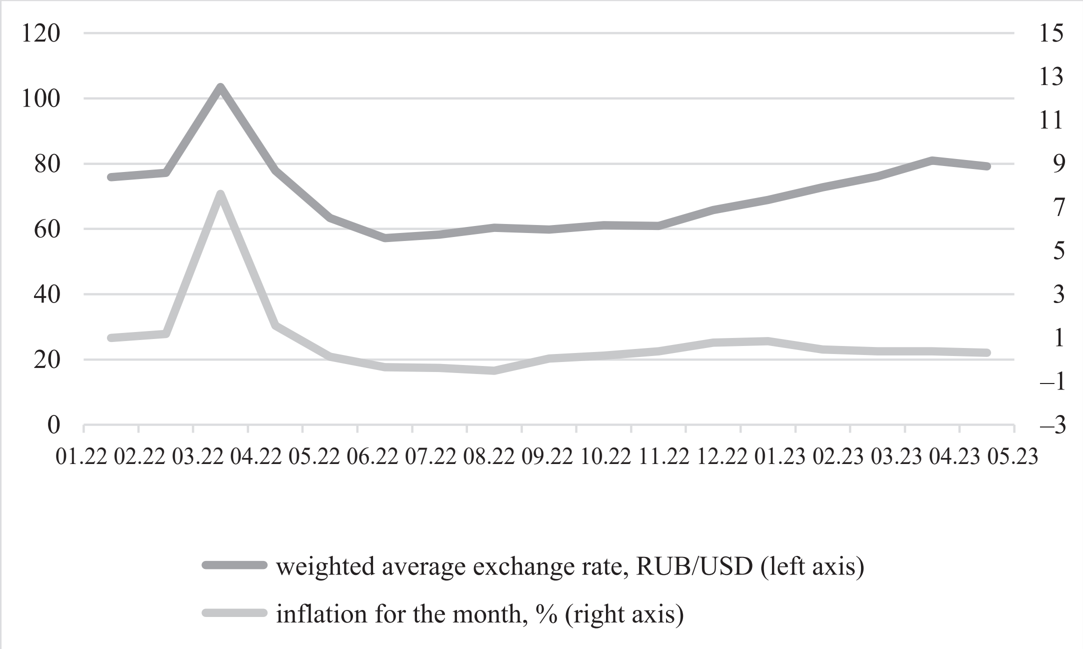

Fig. 4. **Exchange rate and inflation dynamics in Russia**

Source: compiled by the author according to the data of: URL: https://rosstat.gov.ru/statistics/price; https://www.moex.com/ru/markets/currency /

the adopted currency measures were aimed not only at maintaining a stable exchange rate, but also at reducing the dependence of the Russian economy on unfriendly countries, already from the fourth quarter of 2022 there was no correlation between these indicators: the correlation coefficient for September 2022 — May 2023 was 0.1629.

Thus, currency measures of financial policy can have a significant impact on price stability, although this is not the main objective of the state's financial policy.

Budgetary instruments of the Ministry of Finance of Russia. The most effective for achieving financial stability in Russia is the budget rule. From 2017 to 2022, its variant was applied, providing for the purchase (sale) of currency to (from) the National Welfare Fund (hereinafter — NWF) if the Urals oil price exceeds (does not exceed) the cut-off price. The main goal of the budget rule was to reduce the dependence of the rouble exchange rate on energy prices, and it was achieved. At the same time, the National Welfare Fund was replenished to a greater extent with the currency of unfriendly countries. In 2022, the accumulated reserves were frozen, and the budget rule was suspended.

Starting from 2023, a new budgetary rule is in effect, according to which the Bank of Russia buys currency from friendly countries for oil and gas revenues received in excess of the established value and sends it to the National Welfare Fund. In the opposite case, currency from the NWF is sold and its rouble equivalent is used to cover the federal budget deficit. This modification of the budget rule helps to reduce the dependence of the Russian economy on the economies of unfriendly countries, increasing the stability of the financial system. At the same time, the use of the NWF funds to cover the budget deficit means an increase in the money supply, which is a factor of inflation.

In addition to the budgetary rule, countercyclical instruments are also used to ensure financial stability: additional expenditures for the implementation of anti-crisis programmes, expenditures to support businesses and citizens. Additional budget expenditures also entail growth in consumer demand, which, in turn, provokes inflationary pressure. Therefore, the Bank of Russia conducts monetary policy by coordinating monetary decisions with budgetary decisions.

Macroprudential instruments of the Bank of Russia. In the context of the banking system's liquidity deficit, which developed against the backdrop of geopolitical instability, the Bank of Russia "dissolved" the capital buffer formed earlier by banks at the expense of premiums to risk ratios on unsecured consumer loans and mortgage loans. This measure had a positive effect on the stability of the financial system (financial security), but had no significant impact on price stability.

Thus, the study has demonstrated that financial policy instruments can have both restraining and stimulating effects on price stability. Therefore, to ensure financial and price stability in Russia it is important to coordinate monetary and financial policies with continuous interaction between the Ministry of Finance of Russia and the Bank of Russia. This interaction is currently underway. However, as noted above, in order to achieve the goals of financial and monetary regulation, an important condition is to strengthen the confidence of market participants in government structures — the conductors and implementers of the relevant policy. In the documents of the Bank of Russia and the Ministry of Finance of the Russian Federation concerning the development of the Russian financial market, a significant role is assigned to consumers of financial services. The objective of strengthening retail consumer and investor confidence in the financial market by strengthening its security and improving financial, investment, digital and cyber literacy is constantly being pursued. Special attention is paid to the *expansion of accessibility of financial services*, which generally has a positive impact on the level of financial development and economic growth rates [20].

In order to increase public and business confidence in financial and monetary policy, a high level of *openness* of interaction between the Ministry of Finance and the Bank of Russia should be ensured in the future.

CONCLUSIONS

The conducted research allows us to draw the following conclusions.

Financial stability (as a goal of financial policy) and price stability (as a goal of monetary policy) are most significantly correlated in crisis periods, which is confirmed by the calculations of price and financial stability indices. At the same time, the relationship between these indicators is two-way: a stable price level creates conditions for financial sustainability and financial stability, while financial stability increases confidence in financial institutions and the state, restraining the growth of consumer prices.

Monetary policy instruments can increase the resilience of the credit system to external and internal shocks, increasing the stability of the entire financial system and creating conditions for financial stability.

Financial policy instruments can both contain inflationary pressure (with smoothing exchange rate fluctuations and restraining fiscal policy) and stimulate it (with stimulating fiscal policy).

Reducing the dependence of the Russian economy on unfriendly states leads to positive effects of price and financial stability growth, which confirms the effectiveness of financial policy instruments.

In order to achieve price and financial stability, it is important to coordinate monetary and financial policies, as well as to increase openness in the process of interaction between the relevant government agencies in order to strengthen public and business confidence in them.

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ABOUT THE AUTHOR

Anton G. Siluanov **—** Doctor of Economics, Dean of the Department of Finance, Financial University, Moscow, Russia
https://orcid.org/0000-0001-6821-7888
AGSiluanov@fa.ru

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