

THE AMERICAN UNIVERSITY IN CAIRO
DEPARTMENT OF ECONOMICS
AND POLITICAL SCIENCE

Thesis for Master of Arts
In Economics

Title

THE CONTROLLING ROLE OF CENTRAL
BANK OF JORDAN
ON MONEY SUPPLY:
Analysis and Policy Implications

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CONCLUSION.

The purpose of this research has been to study and analyse the role of the Central Bank of Jordan in conducting the monetary policy, through controlling money supply. In order to achieve this objective a money supply model was estimated within the setting of the monetary system of the country.

Before specifying the estimated model, special attention was given in chapter one to components of the monetary and financial structure of the Kingdom. Emphasis was placed on monetary policy instruments that are actually entrusted to the CBJ to control the supply of money. It has been shown that the Bank has been able to use selectively instruments of monetary policy, relatively, more efficiently than the general instruments (open-market operations, the rediscount mechanism, and the reserve requirements).

With the establishment of the Amman Financial Market (AFM) in 1978 and the secondary market for bonds in 1988, one can say that the CBJ has started to pave the way for introducing a fully operationed capital market in the country. In addition, spreading of bank offices all over the Kingdom might be the main

reason for the increase in the Public's tendency to use the banking services. This was supported by the significant results obtained for the coefficient estimates of bank offices per capita in the model.

The monetary system in Jordan was assumed to consist of the public, commercial banks, the monetary authority and the rest of the world. The behaviour of each of these sectors was studied in order to analyse its effect on money supply in the country. Concerning the behaviour of the public two functions were specified for their cash holdings and their demand for time deposits. As for the commercial banks, their behaviour was studied by estimating a function for the reserves ratio. Finally, an import function was estimated to account for the behaviour of the rest of the world.

Estimates of the coefficients of the model, presented in chapter four, show that the price level and the bank offices per capita have significant influence on cash ratio. Introducing lags in the model, it was found that people's behaviour toward the demand for cash is influenced by the level of their holdings in the previous period.

The time deposits ratio, which is also expected to

explain the behaviour of the public, was best specified by the level of people's disposable income. It was found, however, that in order to have a speculative demand for money in the Kingdom, interest rate should be determined by the market forces. In other words, interest rates should be attractive enough to encourage people to use their excess income in the financial rather than the goods market.

The reserve ratio equation, which reflects the behaviour of commercial banks, was mainly found to be described by the amount of credit extended by commercial banks, the ratio of total reserves to total deposits, and bank offices per capita. It was also found that the level of the reserve ratio in the current period is affected significantly by its level in the previous period.

The real demand for imports, which is expected to explain the behaviour of the rest of the world, was best specified by two variables; namely: real income lagged one period and capacity to import.

The estimation of the money supply function showed that the supply of money in Jordan is mainly affected by: the monetary base, the level of inflation, and the local assests of the CBJ. Besides, the lagged value of

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money supply was found to be influential in determining the current level of the supply of money in Jordan.

Although some of the variables that determine the supply of money in Jordan are beyond the direct control of the CBJ, others are not. The Central Bank, for example, might not be able to affect directly the rate of inflation in the country, but it can, however, control both its local assets and commercial banks' reserves which constitute a relatively big portion of the monetary base. This means that the CBJ might offset increase in the inflation rate by changing the level of reserves, especially excess reserves, that might be extended as credits that create more money in the market causing a further increase in prices.

Concerning the open-market mechanism, the simulation technique showed that the monetary base plays a significant role in changing the level of money supply. The Central Bank, therefore, might issue bonds and securities in local and foreign currencies with attractive yields. Operations involving these securities should widen the monetary base. Besides, the foreign currency securities will provide the Bank with more hard

currencies which could help in stabilizing "convertibility" of the Jordan dinar.

The reserve ratio equation showed the relationship between total reserves and the level of credit extended by the commercial banks. The relatively small coefficient estimate of the credit variable might be attributed to the controlling role of CBJ- through credit ceiling policy- to limit the ability of banks to create money. CBJ, however, should be more effective at encouraging credit extended to development projects. This can be made through removing or at least easing the conditions that limit the commercial banks' ability to extend credit to these projects, especially those concerning credit ceilings. In this sense, also, it is advisable to induce commercial banks to increase their participation in syndicate loans that are channelled to industrial, agricultural, and other development projects.

The CBJ might, also, instruct banks to lower the cost of credit extended to the above mentioned projects. The Bank, in addition, is supposed to stand ready to provide credits that commercial banks and specialized credit institutions do not or can not provide to them.