OPTIMAL BANK'S LIQUIDITY SUPPLY BY THE CENTRAL BANK: A MICROECONOMIC APPROACH

Abstract:
Many observers focus on the Central Bank balance sheet in order to point out the excess of liquidity in the banking system as a failure to finance the economy, while banks may also decide to voluntarily hold liquidity above the level required in order to maximize their profit in an uncertain environment. In this paper, we tried to address excess reserves in the CEMAC banking system by looking from the point of view of commercial banks. By minimising the cost function of each commercial bank, we derived the optimal level of excess liquidity desired by it and consequently for the entire banking system. The result we obtained does not support the existence of excess liquidity in the banking system; furthermore, it approved the country approach implemented by the Central Bank concerning the required reserve coefficient. It is also helpful for the central bank in improving its liquidity supply to the banking system by anticipating the demands of liquidity by commercial banks during open market operations.