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The Effectiveness of Monetary Policy on the Financial Stability of the Commercial Banks in Somalia

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Abstract:- The purpose of this study is to look into the impact of Somalia's monetary policy on the financial stability of the country's commercial bank and to determine the impact of Open Market Operations on the financial stability of Somalia's commercial banks. This study's goal is to investigate the impact of Somalia's central bank interest rate on commercial bank stability, as well as to analyze the impact of reserve ratio requirements on Somali commercial banks' financial stability, and also the impact of internal and macroeconomic factors on Somali commercial banks' financial stability. The study concentrated on 18 well-known Somali banks. Data for the study is gathered from published financial statements of Somali commercial banks, monetary policy statements, relevant publications from the Central Bank of Somalia, and other sources. Commercial bank book values are obtained for the years between 2014 and 2020, interest revenue and expense for each year, the weighted average of the central bank's rate, the weighted average of its cash reserve ratio, and the weighted average of its 364 Treasury Bill rates are collected. SPSS and other descriptive statistical techniques aided the researcher in characterizing the data and determining how much of it is used. The T-Bill Rate is found to have a positive effect on the financial soundness of Somali commercial banks. As a result, the researchers concluded that T-Bill rates had a beneficial but limited impact on the financial health of Somalia's commercial banks.

Keywords:- *Cash Requirement Reserves, Gross Domestic Product, Return On Assets, Statutory Liquidity Requirement.*

I. INTRODUCTION

A commercial bank, according to the Central Bank of Somalia, is a financial entity that conducts or seeks to conduct banking operations in Somalia, which includes all commercial banks that operates in Somalia but with an exception to the Central Bank of Somalia (CBS) (Wang, Whited, Wu, & Xiao, 2020). The monetary authority that is standing in Somalia is the Central bank of Somalia. It's important to note that Somalia has struggled to reestablish a state that is functioning following the collapse of the authoritarian regime back in the year 1991. The state of Somali has since been recognized as a real example of the world's anarchist nations that has been considered as being stateless with really no existing formal system in place (Wang, Whited, Wu, & Xiao, 2020).

The space within which the commercial banks are operating has increasingly become very volatile since the world is continuously and constantly changing, this therefore has affected different factors that affects the performance and operation of these bank institutions. Since the start of the new millennium, the operation and the performance of the banks has since become very volatile and hostile because of the continuously changing business environment (Anwar, & Nguyen, 2018). The biggest challenge to the banking institutions has been to cope with the changing environmental factors. The competitive business environment has since pushed most of these commercial banks to deliberately rethink on their overall working strategies. The operations of these banks become fruitful especially when they can guarantee the good financial performance at all costs (Anwar, & Nguyen, 2018)

The newly revived Somali Central bank is really taking the center stage with regards to managing and influencing the monetary policy in Somalia, the central bank after being revived has now taken full hog the responsibility of managing and formulating the monetary policies in Somalia (Nor, Masron, & Alabdullah, 2020). However it must also be noted that the resumption in taking the full responsibilities of the Somalia monetary policies by the central bank of Somali has been crippled by a number of factors such as lack of adequate resource where both financial and non-financial resources are not adequately available to reinforce the implementation of the monetary policies in Somalia. Some of the challenges that are facing the Somali monetary policy implementation includes the fact that the Somali economy has heavily been dollarized therefore possing challenges to the weaker local currency that is available for utilization (Ibrahim, Omar, & Ali 2017).

To assess a company's financial stability, financial ratios generated from its financial statements, such as liquidity ratios, activity ratios, returns on profit, and financial liabilities, are used to gauge the company's capacity to meet its financial obligations. The ability of a commercial bank to make money is a reliable indicator of the health of that bank's finances. For commercial banks, profitability measurements such as net interest margin, return on assets, and return on equity are used to assess the financial health of the institution (ROE). It has been discovered by researchers (Aikman, Giese and Kapadia and McLeay, 2019) have found that (Aikman)

To put it another way, it's a comparison between the interest banks earn on their loans and the interest they pay to their lenders, including the amount of interest-earning assets the banks hold in their loan portfolios. A common way to define it is as the percentage of the financial institution's loan earnings and other assets less interest paid on borrowed loans divided by the average amount of assets from which banks derived their income during that period of time. Because the net profit is divided by the total revenue assets, a company's net margin is calculated. (Aikman, Giese, J., Kapadia, & McLeay, 2019).

A. Problem Statement

Since the Somali economy relies on financial stability, central governments employ monetary policy as one of their most important economic management tools. The concept of monetary policy is one of the quickest ways to resolve the largest financial shocks, measured against fiscal policy. Thus, monetary policies aims to manage many monetary targets, including price stability, growth promotion, the achievement of full employment, a more smooth business cycle, financial crisis prevention, long-term interest rates and the real exchange rate. Experience demonstrates that maintains price stability or low inflation rates are often given priority (Mohamed, & Nageye, 2018).

Somalia's Central Bank is in charge of recommending and implementing monetary policy instruments in Somalia. The CBS proposes the rate of bills for CRR, CBR and the Treasury. These instruments are applied by commercial banks and try to stabilize the economic price levels (Ali, Ibrahim, & Omar, 2017). The utilization of the cash reserve ratio influences the liquidity levels of business banks. In case of insufficient liquidity, commercial banks turn to other commercial banks for interbank borrowing (Aikman, Lehnert, Liang, & Modungno, 2020). Those monies are borrowed from the CBR and frequently quite large, which impacts the borrowing bank's interest expense and the retained earnings earned by the loan bank. The third technique of enhancing the bank's liquidity is through a borrowing tool. The debt instrument rate is also linked to the treasury bills or treasury bonds issued by the government via the central bank. These implications of monetary instruments are projected to influence commercial banks' financial performance in Somalia (Beileh, 2020).

Several research studies is carried out in connection with commercial banks: Gitonga (2010) examined the relation between the risk management of interest rates and the profitability of commercial banks; Kimoro (2010) examined risk management strategies of foreign exchange reserves espoused by the central banks; and Mbotu (2010) conducted a study of CBR's collision on commercial banking. Ongore and Kusa (2013) investigated the influence on the performance of commercial banks in Somalia from 2001 to 2010, based on bank variables and macroeconomic factors. Kiganda (2014) has carried out an impact analysis on the profitability of commercial banks with macroeconomic conditions.

This study has discovered a monetary policy gap and its impact on the financial performance of commercial banks in existing literature and research. The literature shows the government's great effort in influencing the money supply through the establishment of various policy instruments but an investigation of the consequences of such instruments in the commercial banks' financial performance, the most utilised channel for policy transfer, is equivocal (Aikman, Lehnert, Liang, & Modungno, 2020). This study aims aimed to cover the knowledge gap on the impact on financial stability of commercial banks in Somalia of the various monetary policy instruments with the corporate size as the control variable.

B. Slack resource Theory

First published by March and Simon was the theory of slack resources (1958). This idea is like an organism that tries to live in the turmoil of the environment in which it functions. Slack is an amalgamation of real or potential resources according to Boso, Danso, Leonidou, Uddin, Adeola and Hultman (2017), allowing an organization to successfully adapt itself to domestic pressure for adjustment or external pressure for policy change and to implement changes in strategy with regards to the external environment. Slack has four major tasks in an organization. Theory says.. Slack's first role is an incentive for members. (Zhao, Liu, & Sun, 2020).

C. Structural Contingency Theory

Pfeffer also gives the theory of structural contingency (1982). This hypothesis became known as the Organizational Structure Contingency Theory. The theory says that promoters like Smith (2019) contend that a fit organisation, which creates excess resources and leads to expansion, such as size growth, geographical extension, innovation, or diversity, has greater performance. The idea suggests that However, the amount of the contingency factors like size can be increased, resulting in an improper adaptation with the current structure. The inadequacy reduces performance, leading eventually to performance crises and structural adaptability. The move from fit to misplace hence is obviously dependent on the company's performance (Dikova, & Veselova, 2021).

D. The Agency Theory

The theory of agencies is becoming much more prominent in understanding companies' financial success. The idea attempts to explain the interaction between the management of an organization and its owners who normally persons are holding inventories. The assumption that there is a conflict between agencies (Panda, & Leepsa, 2017). The management of an organisation, as an agency employed by the holders to endeavour to increase the stockholder value through solid financial performance, is commonly regarded. Management should consequently work in the best interests of shareholders and improve the organization's financial performance (Vitolla, Raimo, & Rubino, 2020).

II. METHODOLOGY

A descriptive research strategy is employed to get to the bottom of the problem. A descriptive study, as defined by Cooper and Schindler, focuses on how, where, and what a phenomena is (2012). A descriptive research design is one that aims to describe specific behaviors in the context of the investigation (Greener, 2018). Financial stability in commercial banks in Somalia, including the impact of monetary policy tools such quantitative easing and quantitative easing, was the goal of the study. Commercial banks in Somalia should have been made aware of this study's findings. According to the researchers, the study's target population was the 18 commercial banks licensed and controlled by the Central Bank of Somalia as of December 31, 2020. This study drew on secondary data sources to compile its findings. This secondary data gives additional information to back up what is mentioned in documentary sources. Additionally, Somalia's Commercial Bank's financial statements and monetary policy statements, as well as other central bank publications, were made public. From the end of 2014 to 2020, data on the book values of commercial banks was collected, as well as revenue interest and interest charges per year, the central bank's weighted average rate, the cash reserve ratio, and the weighted average of 364 Treasury bill rates.

Using an excellent spreadsheet, the data collected for estimating the average values of research variables was organized in an efficient manner. Descriptive analytic methods were used to analyze the data, which were mostly quantitative in character. Descriptive statistical techniques like SPSS were used by the researchers in order to explain the data and identify the scope of the investigation. Tables and graphs, percentages, tabulations, resources, and other noteworthy patterns are used to present the findings. This research sought to discover the relationship between Somalia's commercial banks' monetary and financial stability instruments.

The model used in the study took the form below:

$Y = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + \mathcal{E}$

Where;

α = Constant Term;

$\beta 1$, $\beta 2$, $\beta 3$ and $\beta 4$ = Beta coefficients;

$\mathcal{E}$ = Error term

III. FINDINGS AND DISCUSSIONS

In this study, the impact of monetary policy instruments on Somalia's commercial banks was examined. As an indicator of open market activity, monetary instruments such as the 364-day Treasury Bill rate, Central Bank rate, and Cash Reserve ratio is utilized.

Table 1. Summary Descriptive Results

	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
NIM	126	.0332	.1797	.074985	.0025332	.0275688
TBILL	126	.0505	.1457	.110620	.0029298	.0407283
CBR	126	.0679	.1576	.086320	.0030101	.0415705
CRR	126	.0450	.0525	.040000	.0003029	.0021768
SIZE	126	16.3263	19.7477	17.40890	.1171721	1.2389111
Valid N (listwise)	126					

As Table 1 shows, a total of 126 observations required for analysis were gathered from 18 banks listed during the period of seven years. The NIM assessed average financial performance was 0.07499 with a standard 0.0276 deviance. The mean T-Bill rate was 0.1106, the standard 0.04072 was standard; the mean CBR was 0.0863 and the standard 0.04157 was standard; the CRR was 0.04, the standard 0.0217 was standard and the mean was 17.4089 and the standard deviation was 1.2389.

Table 2. Correlation Matrix

	NIM	TBILL	CBR	CRR	SIZE
NIM	1.000	.038	.021	.048	.415
TBILL	.058	1.000	.867	.852	.124
CBR	.022	.868	1.000	.564	.045
CRR	.058	.050	.565	1.000	.183
SIZE	.440	.125	.046	.185	1.000

Key: NIM = Net Interest Margin; TBILL = 364 T-Bill Rate; CBR = Central Bank Rate; CRR= Cash Reserve Ratio; SIZE = Size of the bank. Table.2 results showed that the rates and cash reserve ratio of central banks were closely associated to the T-Bill prices. This means that several of the independent variables showed multicolinearity, and suggested that input into the regression model would lead to faux findings as they were without a modification. These were converted with the first differences before the regression equation for analysis was entered.

Table 3. Regression Analysis

Model	Un standardizedCoefficients		StandardizedCoefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	-0.084	0.034		-2.463	0.015
DIFF(TBILL,1)	0.505	0.984	0.140	.514	.607
DIFF(CBR,1)	-0.231	0.547	-0.082	-.405	.677
DIFF(CRR,1)	-3.349	8.797	-0.087	-.494	.631
SIZE	0.008	0.002	0.416	4.640	.002

a. Dependent Variable: NIM

The T-Bill rate, indicated in Table 3, had a positive impact on Somalia's financial stability. At 5 percent level, β = 0.505, p =0.607 this effect was negligible. The data also reveal that the central bank rate has a negative impact on Somalia's financial stability. At 5% level, β =-0.231, p = 0.677, this impact was minor. The table also demonstrates a negative and minor impact on the commercial banks' financial stability on Cash Reserve Ratio, β=-3.349, p=0.631. In conclusion, the study showed that the Somali commercial banks financial stability has a positive and substantial effect on bank size β= 0.008, p<.05.

Table 4. ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.014	4	.003	5.681	.000[a]
	Residual	.063	104	.001		
	Total	.077	108			

a. Predictors: (Constant), SIZE, DIFF(CBR,1), DIFF(CRR,1), DIFF(TBILL,1)
b. Dependent Variable: NIM

The F-statistics were 5.681 and significantly importance at 5% p=0,000, which indicated that the model was suitable for explaining the connection of monetary policy instruments with financial stability of commercial banks in Somalia.

According to the study's findings, Treasury Bills are examined for their impact on Somalia's commercial banks' financial stability. For commercial banks in Somalia, the T-Bill rate of p=0.607 had no significant influence on financial soundness of financial institutions. The central bank's interest rate fluctuations and the financial soundness of Somalia's commercial banks are the subject of a second portion of the research. As a result of these data, it can be concluded that Somali commercial banks are not adversely affected by the Central Bank's interest rates (-0.231 and -0.677).

In this study, the impact of the Cash Reserve Ratio on Somali commercial banks' financial stability was examined in further detail. Findings suggest that Somali commercial banks' financial stability isn't affected by the Cash Reserve Ratio (-3.349, p 0.631). Adrian's findings from 2018 (Dell'Ariccia, Haksar, and Mancini-Griffoli) show that monetary policy tools have no substantial impact on the economic stability of commercial banks in Somalia.

In this study, the effect of bank size on Somalia's commercial banks was examined. For the study, the bank's size was a control variable. Somalia's financial stability is only little affected by the number of commercial banks in the country, according to the data (P value = 0.008, 0.05). Somalia's publicly traded commercial banks' financial health, evaluated in terms of their total assets, is determined by their size. This is in line with the study's findings (Aikman, Haldane, Hinterschweiger, & Kapadia, 2019).

IV. CONCLUSIONS

The effects of monetary policy instruments on the financial stability of commercial banks in Somalia were investigated in this study. According to the findings of the study, monetary policy instruments have no significant impact on Somalia's financial stability. As a result, the findings of the study indicate that monetary policy instruments have little impact on the financial soundness of Somali commercial banks.

The impact of the Treasury Bill Rate on the financial health of Somalia's commercial banks is investigated in this study, which was published in 2009. According to the findings, Somalia's financial stability was found to have improved as a result of the T-Bill rate. Thus, according to the findings of the study, T-Bill rates in Somalia have a minimal, but beneficial, impact on the financial stability of Somali commercial banks.

This study investigated the effect of the central bank rate on the financial stability of commercial banks in Somalia. According to the findings, the central bank rate has a negative impact on the financial stability of Somalia's economy. The analysis concluded that the central bank's rates had no significant impact on the financial stability of Somalia.

The study also analyzed the cash reserve ratio's impact on commercial banks' financial soundness in Somalia. The results showed that the financial soundness of listed banks in Somalia was negatively affected by the cash reserve ratio. The study therefore found that the cash reserve ratio has no impact on Somalia's financial stability.

The study studied the impact of bank size on Somalia's financial stability. The findings showed that the size of the banks was weakly favorable to commercial banks' financial soundness in Somalia. The survey therefore found that the size of the bank influences Somalia's listed companies' financial soundness.

RECOMMENDATION

The report suggests that registered commercial banks in Somalia concentrate more on internal financial stabilization aspects. These internal determinants, as mentioned in the literature review, include capital adequacy, asset quality, efficiency of management, profitability, and the management of liquidity. Management through risk management plans for Somalia's banks will also address the effect of monetary policy tools. The report further indicates that while the size of the bank is established to improve financial stability, banks must also be aware of the source of their money and the cost of such funds.

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