

## Review

# A COMPREHENSIVE PUBLICATION ON INTEREST RATES AND THEIR RISKS

**Meilė Jasienė. Palūkanų normos ir jų rizika.**

**Vilnius: Vilnius University, 2010. 304 p.**

In the course of the past decade, the modern crediting system has witnessed interest and interest rates becoming increasingly important in terms of their impact upon economic growth. In view of the expanding international and domestic economic sector integration, any changes in interest rates in individual countries and financial markets immediately and materially affect the situation in other countries. This has been specifically evident under recent conditions of prevailing financial volatility. Interest rates are one of the levers used in promoting the pace of economic growth, and lately this tool is being increasingly frequently used in developed economies. The regulatory powers of Central Banks create additional difficulties in analysing and forecasting interest rates and other factors affecting interest rate risks which in their turn lead to even more significant fluctuations of interest rates and enhanced interest rate risks.

Professor Dr. Meilė Jasienė, the author of the monograph “Interest Rates and Interest Rate Risks“, has presented a systemic overview of interest rates, theoretical and practical viewpoints of trends in interest rate development, interest rate risk and its management. The monograph also includes an overview of works of Lithuanian and foreign authors in the area. With a special focus on interest rate issues Prof. Dr. Meilė Jasienė analysed research papers of A.V. Rutkauskas, S. Uosis, V. Terleckas, J. Titarenko, T. Garbaravičius, S. Valentinavičius, G. Kancerevyčius, I. Fisher, R. Mundell, J. Tobin, T.W. Koch, F.J. Fabozzi, N. Douch and a number of other researchers. Based on a comprehensive theoretical study, the author of the monograph made her own weighty contribution into the area-related research. The author also conducted and presented in her monograph a survey of the trends in the development of interest rates in Lithuania in 1992–2010 and the relevant affecting factors; other issues surveyed by the author include interest rate risk, risk measurement issues and risk indicators, interest rate risk ratio to returns, in addition to the proposed interest rate risk analysis methods and their application; further, the monograph presents a summary of the interest rate management policy, experience in its organisation and the ways of further improvement.

The monograph consists of six sections. Section One, “Interest rates: theoretical background”, is dedicated to the issues related to the essence and economic significance of crediting, interest and interest rates. The section presents a classification of interest rates by different indicators, also a description and analysis of the functions of interest rates, as well as interest rate factors. The monograph presents a suggested breakdown of interest rates into constituents according to the effect of different factors, in addition addressing the issues related to interest rates forecast. Further, the monograph examines different factors affecting the supply and demand of funding, and the formation of market interest rates. The section is concluded with an overview of the principal interest rate theories.

Section Two of the monograph, “Interest rates in Lithuania”, presents a comprehensive survey of changes that took place in Lithuania in the course of the development and after the restoration of the national monetary system, and the effect of such changes upon interest rates in the transition period. The section summarises the analysis of average annual interest rates of deposits and loans in Lithuania, their trends and the principal affecting factors. In the opinion of the reviewer, the author of the monograph in this relation could have presented a more detailed analysis of trends in inter-bank interest rates identifying the principal factors that have caused the dramatic increase in the interest rates in the first years of the economic crisis. This, however, does not compromise the overall value of the monograph, and the reviewer suggests the author to continue the research work in the area.

Section Three, “Interest rate risk and its measures”, presents the concept of interest rate, a classification of principal risks related to banking operations identifying its principal factors, sources and constituents. The explanation of the principal interest rate risk indicators (duration and convexity) uses bond as an example in this connection, demonstrating the possibilities of the use of such indicators for an efficient management of interest rate risk.

Section Four of the monograph, “Interest rate risk evaluation by gap methods” contains an overview of gap analysis methods and models for analyzing the static and dynamic gaps in interest rate-sensitive assets and liabilities, including regular and cumulative gaps, gaps ratio, duration, their characteristics, possibilities of use in interest rate risk management, followed by a discussion of the off-balance sheet risk management instruments. It also includes an analysis of interest rate risk, referring to examples derived from Lithuanian banks.

Section Five, “Investment return and risk dilemma”, addresses the problem of the ratio between investment return and the related risk. The author proposes an investment return evaluation method taking into account the level of the risk assumed and using the Sharp indicator, and presents an analysis using this indicator.

Section Six, “Interest rate risk management”, examines the importance and organisation of the management of the a bank’s assets and liabilities, covering also the peculiarities of the interest rate risk management policy. Furthermore, the monograph describes

the principles underlying the interest rate risk management and supervision and the role of internal audit and control functions in managing the interest rate risk inherent to banking operations.

The monograph by Prof. Dr. Meilė Jasienė “Interest Rates and Interest Rate Risk” is a valuable publication and a source of knowledge for all researchers and practitioners, however, being of a special significance for doctoral and master degree students. This research presents the very first in Lithuania systemic analysis and coverage of theories and research methods pertaining to interest rates, also interest rate risks, their assessment models and management methods, including peculiarities pertaining to their organisation. This research work includes a systemic and generalised overview of Lithuania’s experience in developing its national monetary system, reflecting the changes in the monetary policy and the trends in interest rates starting from the post-hyperinflationary period up to the present. The analysis of the factors pertaining to interest rates is materially instrumental in learning and understanding mechanism and distinctive features of the formation of interest rates in Lithuania.

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