MONETARY POLICY UNDER THE IMPACT OF THE CURRENT GLOBAL CRISIS

Zina Marcu (Cioran)*

Abstract: *The issue of the financial crisis draws more and more the specialists' attention. The monetary policy has a decisive role in monitoring and reducing the inflationary phenomenon as much as possible, since it can become a real danger for an economy during a period of crisis. Inflation is a negative thing that affects the economy. It discourages the investments and the economic growth. The aim of this paper is to find the Central Bank's economic instruments and levers that can contribute to price stability in the economy. It was found that the elaboration of a measure of monetary policy with a restrictive feature can contribute to price stability on long term, but we should take into account the macroeconomic context in which it is applied.*

Keywords: central bank; inflation targeting; monetary policy; price stability
JEL Classification: E31; E52; E58; G01

INTRODUCTION

Twenty years after the Maastricht Treaty was signed, in which the European Council decided to found the Economic and Monetary Union, the monetary policy of the European Union continues to offer common viable solutions, as well as opposing reactions, since this policy has the biggest effects on economic performance and competitiveness between the member states, and also at the level of the entire European Union. The monetary policy measures have a direct impact on the evolution of national economies and the European economy, and an indirect impact on the institutional architecture.

At present, Europe is dealing with a series of economic and financial problems due to the significant crisis it is crossing, and these problems are reflected in the big macroeconomic unbalance of many countries, as well as through significant differences between the competitiveness levels of the member states. In this context, at the level of the European Union, the common plan offered by the monetary policy is more important than ever, hoping that it will control the downfalls and it will sustain the ensemble of member states in an economic balance.

Thus, the institutional actors and the factors of decision strive to make a constructive connection between the monetary policy achievements so far and the need to strengthen fiscal and budgetary discipline across the Union.

*PhD Student in Economics at the Faculty of Economics and Business Administration within Alexandru Ioan Cuza University of Iasi, Romania, e-mail: cioranzina@yahoo.com.

1. LITERATURE REVIEW

In the context of the current international turbulences, the reaction of the central banks as regards counteracting the effects of the economic-financial crisis has had an essential contribution in diminishing the tensions on the financial markets, in re-establishing the functioning of the monetary transmission mechanism and in resuming the economic growth.

Before the crisis, what dominated was the idea that the financial markets work correctly most of the times and "the monetary policy should respond to the evolution of assets' prices only as much as these affect the trajectories of the integrated request and of the prices." (Yellen, 2009)

In a recent work, Joseph Stiglitz made a remarkable synthesis of the evolution of the financial-banking system in the USA, which provoked the current crisis: "In October 2008, the American economy was in free fall ready to draw with it a big part of the world economy. We have had other stock market crashes, credit contractions, long downfalls on the dwelling markets and stock adjustments. But ever since the Great Depression, all these have never been in one place. And the black clouds over the Pacific and Atlantic Oceans had never gathered so fast… There is a common root: the recklessness of the financial sector when it came to giving loans, thus enhancing the real estate bubble that finally popped… This kind of bubbles and their repercussions are as old as capitalism and the banking activity itself." (Stiglitz, 2010)

In the research study made by Gherman and Adam (2010), the monetary policy focuses both on ensuring a bigger workforce employment and on price stability. This double purpose, known and analyzed in the specialized literature as a "dual mandate" of monetary policy can be seen in contrast with the alleged purpose of many central banks that deal especially, and sometimes exclusively, with price stability.

Both the theory and the empirical part indicate the fact that the monetary policy can influence for a significant period of time not just prices, but also the GDP, the employment and other important aspects of the activity of the nonfinancial economy. (Gherman and Adam, 2010)

Nowadays, few economists and business people, market investors, or even common people interested in the evolution of economy and, implicitly of business, still believe that the actions of the central banks do not have an impact on the evolution of the GDP and on the employment, or, more generally, on the real variables that have been in the public eye over the years. The fact that monetary policy cannot raise the natural rate of employment or cannot reach the GDP that corresponds to full employment cannot represent an excuse for the lack of efforts to bring these real variables as close as possible to the best levels, given the disturbances of business cycles. (Gherman and Adam, 2010)

The literature considers that central banks have a fundamental role in insuring the financial stability, even though there are no rules or patterns that can foresee the way to accomplish this process and, when analyzing it, the economic science must always be accompanied by intuition. (National Bank of Romania, 2012)

Numerous recent articles state that central banks have had an important role in the launch of the global crisis in 2007-2009 and, implicitly, of the real estate crises from numerous countries as a consequence of maintaining very low interests for a long period of time, of settlement and of inadequate supervision. Not the same thing can be said about the National Bank of Romania (NBR), which in January 2003 – September 2008 has maintained a high level of monetary policy interest in order to moderate the inflation pressures generated by the excessive internal consumerism. Thus, when global liquidities crisis began in September 2008, the monetary policy interest of NBR was 10.25% per year. (Dedu and Stoica, 2011)

Although several politicians and analysts alleged that the causes of the crisis were a fundamental defect of capitalism, the crisis was caused by the political people, because the laws they passed led to underperforming loans and by the monetary authorities, who created this abundant liquidity. Therefore, the causes of the crisis can be tied to the people who thought that they could break the basic rules of economy without any consequences. Through a profound crisis, these causes finally led to the sinking of the real economy.

Paun (2012) considers that central banks were not created in order to bring more order in the system by means of the policies they promote. He considers that ever since they were created, central banks have forgotten to think of the “national good.” By accepting blindly the ideas promoted by Keynes (who destroyed even the last shred of free market and capitalism that existed in people’s minds), the banks moved on to what they know best: printing money, helping the state and helping the “system” get out of the dead end that it is in. (Paun, 2010)

Central banks need to pay special attention to the evolutions of the financial markets, because a stable financial system is an essential precondition to ensure a monetary policy transmission that is efficient and lacking in tensions, contributing eventually to the achievement of the stable prices objective on the long term. Consequently, what is necessary is a systematic monitoring and an evaluation of the conditions of financial stability, with the purpose of identifying the sources of risk and vulnerabilities of the financial systems. But these risks and vulnerabilities are not connected only to the evolutions within the financial sector, but also to the changes registered by the macroeconomic environment. (National Bank of Romania, 2012)

According to John Nugée, CEO of State Street Global Advisors, "the central banks have already lost three characteristics that were some of the most important attributes they had: the clarity of their mission, the independence of action and the policy of neutrality." "Cleaning up" the consequences of the global financial crisis (mopping up) proves to be more costly than the authorities' intervention in order to limit or correct the lacks of balance in the beginning of their manifestation. (Stiglitz, 2010)

2. THE CENTRAL BANKS' REACTION TO THE ECONOMIC – FINANCIAL CRISIS

The crisis of "rotten" real estate assets that started in 2007 in the USA extended to Europe in 2008, strongly affecting the majority of the world economy areas in 2009, and with ample reverberations in 2010. It is not a coincidence that this crisis has been compared frequently with the "Great Depression" of the 1930s. The comparison is valid not only from an economic and financial viewpoint, but also from a social and political one.

The economic-financial crisis has changed and redefined the role of central banks. If price stability, financial stability, the interest rate and the inflation rate used to be the main objectives of the central banks, once the crisis began, their competence was extended and they had the capacity to re-establish economies and to achieve equilibrium through the measures of monetary policy that they adopted. Besides, one can notice a surpassing of the central banks' competences in connection to the other state institutions that can make decisions in financial, economic and fiscal policies, especially in the countries which are members of the EU.

When searching for the real causes of crises, it can be seen that at the base of the current crisis was the policy of cheap money promoted by the big central banks, having the silent approval of the International Monetary Fund. The central banks are being reproached the fact that they have limited themselves to measures of monetary policy that concern only price stability and have put in the background the objectives of stimulating the economic growth and creating employment for the workforce. Another criticism directed at central banks is that they have not taken enough measures so as not to increase the speculation bubble that caused the financial crisis.

The financial crisis started in 2007 brought to light a series of vulnerabilities in the financial sector and the fact that sovereign debts have high values that got government institutions and political people thinking. Thus, there have been successive changes on the political stage, such as the anticipated elections in Greece, Cyprus, Italy and Ireland. Therefore, the central banks and their governors have become more visible in the eyes of the citizens.

The growth of the banks' importance and visibility is due to the extended role that these have assumed, with or without permission, as main actors not only in establishing the monetary policy, but also in influencing the financial and sometimes even fiscal, policies. In order to extend their activities and competences, central banks will probably pay with the independence they have enjoyed so far, and the power growth, although it is not wanted in unanimity, is already raising some question marks concerning the transparency of banking activities and of the central banks' responsibilities regarding the government and the population.

The differences of monetary policy between the emerging countries and those from the developed countries are generated by the different economic contexts. In the developed economies, the rates of monetary policy interests have been reduced to almost zero ever since the crisis began, to avoid the risk of deflation. In the emerging economies, the offer shocks have hindered a more abrupt reduction of the rate of monetary policy interest.

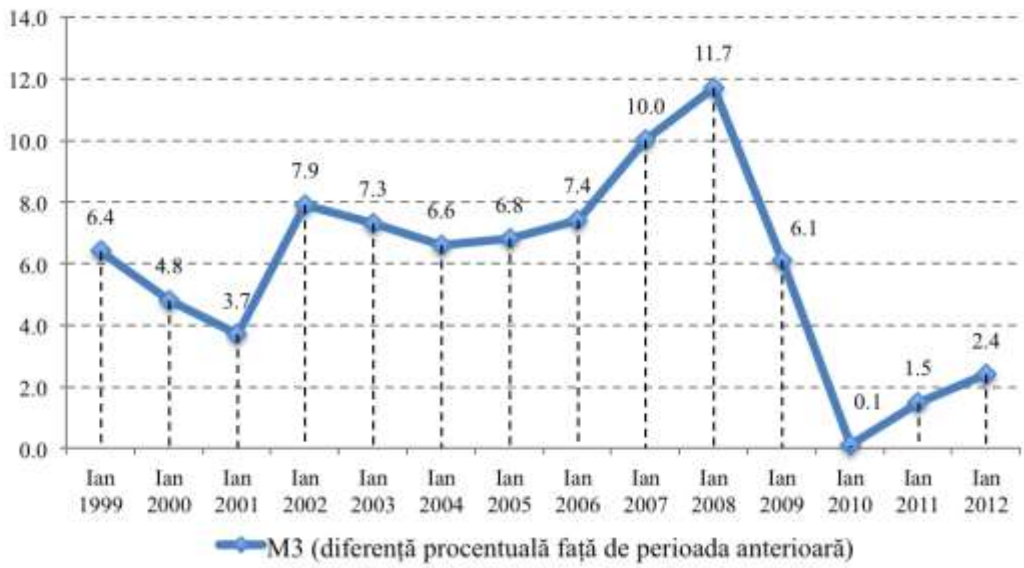
Another important phenomenon that has influenced and will continue to influence the results of monetary policy is the petrol price evolution. The growth of the petrol price affects especially the sectors that consume a lot of energy, for instance the chemical industry. The current world economy has been built based on cheap energetic resources and a rapid growth of the petroleum price has consequences in all the working sectors, thus causing inflation. If these growths are sudden and unanticipated, the effects on economy are ample and immediate, making the European Central Bank's mission a difficult one.

In the EU the evolution of the economy in the member states can be characterized by the liquidity degree of financial assets, reflected by the monetary aggregate M3. It has an important role in achieving the complementary purpose of the monetary policy: the stability of the unique currency. Although it is not an actual instrument for deciders to use in fulfill the ultimate goal, the monetary aggregate is a means of facilitating the ways in which the monetary policy takes shape and, finally, becomes real.

Figure 1 highlights the fact that the evolution of the monetary aggregate M3 does not suggest any risks for price stability on a medium term at the level of the EU, but one can also observe the substantial decrease of the liquidity level of the financial assets starting with 2010

– this tendency can be explained through the impact of the economic crisis at the level of the entire world. The estimations of the Europe Central Bank and Eurostat show a sustainable level of liquidity, based loosely on the incomes of households and financial intermediaries.

Figure 1 – The evolution of M3 aggregate in the countries from the European Union.



Source: Eurostat

3. THE FINANCIAL CRISIS AND THE MONETARY POLICY OF THE NATIONAL BANK OF ROMANIA

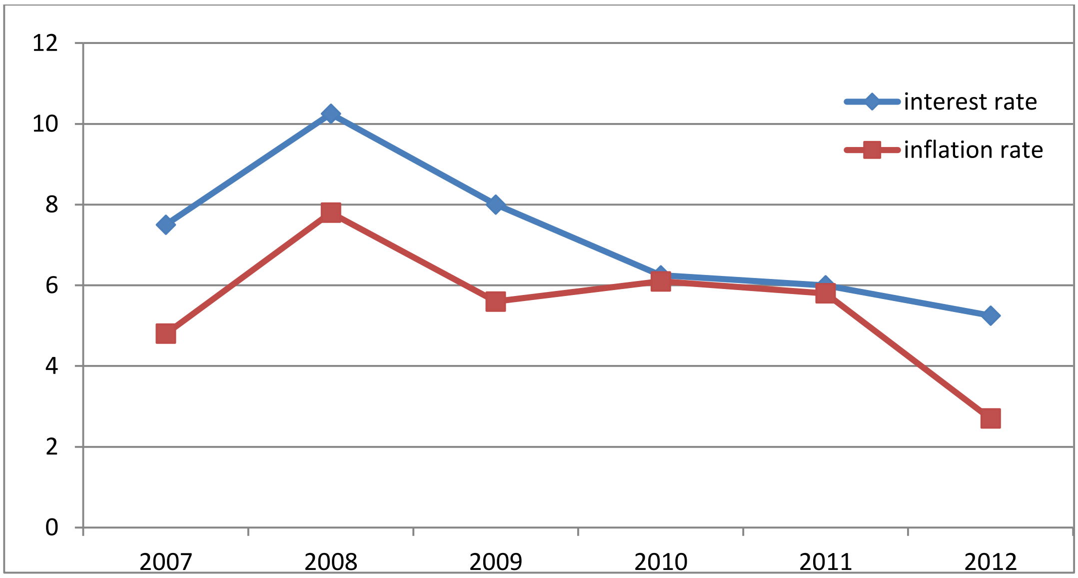
Law no. 312/2004 that refers to the Status of NBR claims that the fundamental objective of the central bank is to ensure and maintain the price stability and its main duty is to elaborate and apply the monetary policy. The essential goal of the monetary policy that central banks practice is to eradicate or, at least, limit the inflationary phenomenon.

In 2007, when Romania joined the European Union, inflation was over 6.5 per cent, because of the unfavorable internal and external shocks. After joining the European Union at the beginning of 2007, the economy of Romania took a dangerous road towards the achievement of real and nominal convergence within the European Union, and this process posed a lot of serious problems for the monetary policy.

When the international financial crisis broke out in July 2007, many analysts and politicians did not believe it could extend to our country too. It altered the order of priorities on the agenda of the economic politics deciders. First of all, one of the main causes of the financial crisis was the abundant liquidity. Second of all, the loans given by the banks to customers whom they knew had a small probability of reimbursing debts, proved to be damaging. Even though the NBR adopted a cautious monetary policy by maintaining a high monetary policy interest, there was a significant raise of crediting in economy due to the competition between banks and the abundance of resources in foreign countries drawn from the international financial markets for low prices. Step by step, without any big restrictions, these loans have been extended to a global level.

Anticipating the effects of the world crisis over economy, before they actually hit our economy, the Romanian authorities have signed agreements with the European Union, the IMF, the World Bank, and other financial institutions. These agreements have limited the impact of the international crisis over Romania. Thus, the fluctuations of the national currency have diminished their amplitude and the inflation has descended. Although it was significantly lessened, the severe recession in 2009 could not be completely avoided.

Figure 2 – Romania: the evolution of the interest rate and the inflation rate during the economic and financial crisis.



Source: own compilation using NBR data

Table 1 - Macroeconomic indicators: the interest rate and the inflation rate

	2007	2008	2009	2010	2011	2012
The monetary policy interest rate (%, end of period)	**7,5**	**10,25**	**8**	**6,25**	**6**	**5,25**
The inflation rate (annual average, % compared to the previous year)	**4,8**	**7,8**	**5,6**	**6,1**	**5,8**	**2,7**

Source: National Romanian Bank

Once the crisis started, the role of the central banks and their governors has known serious changes. The position of the governor has become stronger and more complex. For example, the results of the survey "The public opinion barometer – the truth about Romania," carried out by INSCOP Research in March 2013, showed that 47.2% of the population trusts the National Romanian Bank, this institution coming second, after the army (61.8%), and Mugur Isarescu, the governor of the NBR, comes third when it comes to the amount of trust that people have in public figures, with a score of 44%.

In this context, regarding the strategy of adopting the euro currency in the near future, the economists of the National Romanian Bank consider that it is not a good idea until the economic problems in the euro area are solved. They believe that once Romania enters the euro area, it must keep up with some competitors that have really high performances, and Romania still has the advantage that it controls its monetary policy. In this period of crisis, the Romanian economy has benefitted from several means to eliminate the shock provoked by the international crisis, by comparison with Greece or Ireland, who had only two such means: the workforce market, which generated a high unemployment rate, and the goods market, which led to a low inflation.

It is known that the monetary policy is strongly connected to the other macroeconomic policies, but especially to the budgetary-fiscal one, which synthesizes the state's incomes and expenses. When referring to Romania, it is believed that the budgetary-fiscal policy must be maintained within cautious limits, in order to reduce the external deficits and to ensure the necessary macro currency reform. In addition to this, the measures of monetary policy implemented by the National Romanian Bank focus on defending the national currency from downfalls or external undermining.

The NBR had introduced the inflation targeting regime in 2005. This monetary policy strategy brings a series of benefits for a central bank, including a clear focus on inflation. At the same time, the Romanian central bank needed to unburden its monetary policy in order to achieve further disinflation. But, three main contradictory pressures have been likely to arise: first, the requirements imposed by the need to achieve nominal and real convergence with a view of joining the European Union in 2007 and European Monetary Union at a later stage push the central bank toward a policy mix that is able to ensure growth and further disinflation. Second, under inflation targeting the divine coincidence of inflation stabilization and real stabilization objective can be achieved only in specific economic circumstances. Third, the operational requirements of a hard inflation targeting regime have been unlikely to exist under the current monetary transmission conditions.

The consolidation of disinflation by setting the annual inflation targets represented an essential challenge for the monetary policy promoted by National Romanian Bank, given the background of globalization and the present-day international crisis. The main difficulties encountered when implementing the monetary policy were the necessity to adjust the previous macroeconomic unbalances and the maintenance of financial stability.

Monetary policy has an important role within economy on the whole. Through monetary policy one tries to ensure a balanced economic growth, the stability of prices, the full employment of the workforce, ensuring a poised payment balance, as well as connecting the available means of payment with the economic needs through specific monetary instruments.

CONCLUSIONS

All in all, monetary policy has a very important role as an instrument of stability at the macroeconomic level. By implementing the central banks' different procedures, one tries to achieve the fundamental objective – price stability. Also, between monetary policy and other economic policies that have a major impact on the macroeconomic indexes there must be a correlation that should ensure a good economy management based on the financial monetary levers.

We consider that the reactions to global crises must be systematic, comprehensive, firm and coordinated. Many important problems encountered in this crisis required coordination on a global scale: re-funding the banks, isolating the financial engineering, facilitating the re-evaluation of their prices, guaranteeing the credits between banks, and reducing the central banks' reference interests. Only when all the important participants from the USA, Asia and the EU will have a systematic and coordinated reaction, there will be hope that will dissipate the fear of a probable crash of the entire economic-financial sector.

We would also like to point out that in periods marked by radical changes, although the process of making a decision should be guided by theory, an efficient policy means being firmly anchored in the economic reality. Therefore, even if the monetary policy is usually based on rules, it is necessary to maintain a certain degree of flexibility.

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