Social Economic Debates
Volume 6, Issue 1, 2017
ISSN 2360-1973; ISSN-L 2248-3837

# Premises for monetary policies redirecting towards objectives other than just supporting price stability

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**Abstract:** *The monetary policy is considered worldwide to be among the most balanced macroeconomic policies by the good management of the specific risks. The problems that arise, however, show that its role and objectives are not always in agreement with the contemporary economic evolutions, or with the future challenges that they will have to cope with. The article aims to debate the role of the monetary policies of the main central banks worldwide and the necessity of redirecting them towards some other objectives besides price stability, as well as the need for a better correlation of the role and objectives of the central banks with the instruments they use.*

**Keywords**: *financial stability, monetary policy,economic growth*

**JEL Classification:** *E52, E61, E65*

## Introduction

Both the academia and the world of practicians and specialists, as well as the media, often discuss about the role and the degree of central bank involvement in the economy. It is important to clarify the role of the central banks, particularly since the money circuit affects not just the businesses, but also the wealth and welfare of the people living within that particular economy. Several discussions also refer to the power and role of the major central banks, which govern a wide geographical area, or even several nations and human communities and which, by their decisions, advantage or disadvantage particular nations, business communities, categories of people, etc. Another important debate regards the extent to which ensuring price stability is or is not a real basis for economic growth.

The European Central Bank, the Bank of Japan, the Bank of England, etc. often invoke price stability as the basis for medium and long-term economic growth (idea also supported by Fischer, 1995). The US Federal

Reserves (Fed) also has price stability among it major objectives, but this objective is secondary to “full employment”. Fed also mentioned maintaining moderate long-term interest rates among its objectives. Taking into account the extremely loose policies of the past 8 years, except of the trend reversal in the end of 2015, the order mentioned by the Fed coincides very little with the measures it implemented, because the main accent was rather on increasing the employment rate and on a low long-term level of the interest rates (to stimulate the investing behaviour in the economy), and extremely little on regulating the evolution of prices. The targets mentioned by Fed, even though seem rather atypical, worldwide, respond perfectly to the need for social, economic and politic stability, which a country, the size of a continent, needs.

Before discussing whether the monetary policies are properly implemented, any central bank should ask the basic question whether its main objectives, followed by the secondary objectives, are properly chosen. The answer to this question must be conjugated with the answer to the question of how much and in what manner should a central bank get involved within the economy. Is price stability enough to ensure a stable future, a sustainable economic growth, and can it be used to ensure the financial stability?

**2. Literature review**

The literature often approaches the role of the monetary policies within the context of particular, more or less turbulent, episodes of the contemporary history. Next to related studies and reports, the statistics of the central banks often provide data and information that document the conjunctural and/or strategic reorientation of the monetary policy. Economic growth is often called forth, but the financial stability is actually targeted, other times stability is called forth, but the economic growth is actually the main target, stability being a precondition for medium and long-term economic growth.

Dănilă (2012), trying to explain the mechanisms that promoted the shift of central bank role from the provider of economic growth to the macroeconomic stability (n. analysing the evolution of the monetary policies, worldwide, from 1950 to 2012), said that the current global economic and financial crisis, which started in 2007, is not the first moment when the role of the central banks and of their monetary policy is reinterpreted. Authors such as Capie F, C Goodhart and N Schnadt (1994) and Goodfriend (2007), analysed the change of opinions, as well as the controversies on the role of the central banks (Fed, particularly), also approaching the problem of how adequate are the instruments used by the central banks to accomplish the undertaken objectives.

As it is know, and as it can be noticed, price stability and, rather recently, financial stability, are some of the most important end objectives of the monetary policies worldwide. However, as Dănilă (2012), noticed, the objectives proposed by the central banks, i.e. ensuring the purchasing power of the national currency and maintaining the financial stability, are rather means to accomplish a particular purpose, as he considers, that of "sustainable economic development".

**3. Methodology of research**

The paper presents elements of debate, of fundamental analysis of the role plaid by the central banks and shows some premises for monetary policies reorientation towards objectives other than the major objective of price stability. The comparative method is often used to depict the difference of vision between the role and objective of the main central banks worldwide. The paper uses data from the world banks across the world, reports and studies. It is a partial, and updated, deliverable within the 2016 theme "Post-crisis monetary policy – trends, instruments, objectives" (coordinated by Ailincă, A.G.) of the Centre for Financial and Monetary Research „Victor Slăvescu". The analysis aims to capture the recent developments regarding the role and objectives of the monetary policies, while also describing particular episodes from their history with the aim to show the consistency or inconsistency of these policies and to justify the need to reorient them.

**4. Results**

According to ECB, "financial stability is a situation in which the build-up of systemic risks is prevented", the systemic risk being described as the "risk of disturbance to the point that the economic growth and welfare can be significantly affected". According to ECB, the systemic risk bears upon the proper supply of financial products and services, and this is why ECB employs several macroprudential policies. These policies should depict the connection between price stability and the level of solvability and liquidity of the financial-banking sector. According to ECB, these policies have three dimensions: a temporal; dimension (such as preventing the build-up of excessive risks generated by external factors and market problems); a structural dimension (such as outlining the perspective of financial regulation) and a transversal dimension (by limiting the possible effects of contagion and by increasing the resistance of the financial sector to shocks).

Practically, under the conditions of a rather regional and global deflationist phenomenon, the central banks should encourage the real economy, which some central banks actually tried to do for the past decade or so, by monetary policy interest rates at the limit of zero and beyond it (ZLB), and by measures of quantitative and qualitative easing. However, according to the undertaken commitments and according to own definitions of the financial stability, the only real obligation of the central banks worldwide is not to allow the build-up of "systemic" risks, not to unlock the real economy. Getting deeply into the real sphere, the central banks will have to cooperate extremely close with the national governments, so that the goals of the two institutions harmonise and avoid generating new risks within the economy. Furthermore, they will have to cooperate closely or, at the best, coordinate their decisions at particular moments, so as not to yield adverse chain effects and create negative externalities on other monetary policies or even on other world economies. Risk detection should be primordial, and the stability reports of the main central banks might capture part of these risks. Nevertheless, the question is if, paradoxically, stimulating capital availability and decreasing the cost of financing in order to decrease the economic risks, might generate new risks, even more perfidious than those which should be controlled. The possibility of increasing the monetary policy interest rates is often invoked in the case of the spectacular increase of inflation, or of economic overheating, but there is no idea on what else could be done if inflation remains extremely low, and the "nonconventional" methods exhaust their efficiency. The answer will certainly be seen in a couple of years, when the market conditions will probably reverse.

Synthesizing, the problem of the central banks can be seen through the lack of synchronization between the extremely liquid and structurally massive financial system and the real economy. More precisely, there is an extremely low real capacity of the companies and households for growth, absorption and use of the financial instruments made available by the financial-banking system, but also an imbalanced distribution of the liquidities from the financial-banking area. A major disturbance can be noticed in the path of funds from the central banks to the commercial banks. Thus, the commercial banks, through the facilities provided by the central bank, mainly use their capitals also in relation with the central bank, and with other commercial banks, and less in relation with actors from the real economy. Despite the negative interest rates for the deposit facilities offered by some central banks worldwide, the commercial banks contribute extremely little to the economic revival. The monetary issuances, whether monetary basis or monetary aggregates, as well as other quantitative and qualitative forms of boosting the economy should be correlated, somehow automatically, with the economic result. For instance, the reversal or "normalization" of the US monetary policy in relation with the undertaken goal of maximal employment (or a particular unemployment rate) is rather natural.

Therefore, taking into account that there is some lag between the implementation of a monetary policy measure and its result in the economy, and that the effect is rather indirect – through the commercial banks, the main central banks worldwide should connect more closely and more directly their measures to the expected economic result, by a clear change of direction when the goals are no longer met, or when some objectives are fulfilled and the banks can pass to other objectives, while normalizing the instruments whose efficacy is to the lower limit of their effectiveness (for instance, Fed).

Before deciding on the manner of implementation, the central banks should ask themselves whether the objectives proposed by the monetary policy are the most adequate. For instance, price rising and reaching the positive area / end of the inflation, can be an extremely difficult, or even impossible task for the central banks, as long as inflation doesn't have just monetary causes. For instance, the increased work productivity, the new technologies which cut the processing and production costs, the commercial wars (artificial devaluation of the currency), the more judicious use of the raw materials, the decrease of raw materials costs, population ageing, consumer behaviour, manufacturer's behaviour, etc. are rather non-monetary causes, or monetary causes that escape the strict control of the central bank. Therefore, the central banks should ask themselves if and how much of the deflation has monetary causes and how much has other causes, and how much of the actions treating deflation can be under the influence of the central bank, thus reserving the right to treat just particular monetary causes of the deflation.

Furthermore, the exaggerate increase of the currency offer might trigger, in the near future, a higher inflation than before the crisis, and a modest economic growth, thus creating serious problems for the investors, companies and the population. At the same time, deflation is not such a big bad thing, as claimed; for instance, it restores the purchasing power of the consumers, but it can equally affect the economic growth and the unemployment rate, disturbing the demand for goods and services. If the restauration of the purchasing power through a moderate deflation is directed towards consumption, the economic growth will be restored rather through quantity than through price, and the number of jobs will not suffer too much. At the same time, the increase of consumption from imports has no benefits for the local jobs, and the economy grows rather from consumption, not from investments. Also, the debtors of the financial-banking system will be seriously affected by deflation, paying a high price for their debt, which is why the strongly indebted economies cannot enjoy the advantages of deflation.

Hence, another important question for the central banks: if a low, "dragging" inflation, up to 2%, is beneficial for the economy, can't the same be said about a deflation of the same type? Which level of deflation could be the accepted? Which level of deflation could become "dangerous" for the economy? How long must to be (months, quarters, years?!) before we may discuss with certitude about deflation, and how long to brand it as "negative inflation"? Is deflation such an unexpected and unwanted phenomenon – the experience of Japan proves that it is not, at least not always.

Certainly, after years of spectacular prices increases in the countries from the Central and Eastern Europe, and in the countries from the periphery of the Euro zone, deflation is the natural consequence of the low wages, increasing unemployment due to reorganization and privatization, (young) workforce immigration towards the more developed Western Europe, of the increasing indebtedness and of the intensifying competition on the regional and world markets of goods and services. Therefore, deflation can be the consequence of changing the economic structure at some time, not necessarily a strict monetary problem. Therefore, as long as the elements of financial instability and deflation often have non-monetary causes, the changes that have to operated must come from the side of the government, not from the area of monetary policies. The governments must make adjustments to decrease the social inequity, to increase the income from work, to enhance the quality and diversification of the public services, etc. Only when the social parameters reach a particular level (such as the average of the Euro zone, an additional margin to the world average, etc.), the elements pertaining to the monetary area, or to other areas, will be better identified and it will then be possible to "treat" them accordingly by the central banks and by the financial system.

At the same time, regarding strictly the policies of the central banks, taking into consideration that the nonconventional measures of monetary policy have been proposed as alternative to the "classical" instruments, when the latter became inoperable, isn't is only natural to return to the conventional methods, or to propose new, alternative, measures to them? Without taking into account the chosen monetary strategies, within the context of the need to reformulate the monetary policy objectives, I consider that it is necessary to restore the operationability of the classical instruments. They seem to be much more efficient and safe than the nonconventional instruments currently in use. The optimal dose of using conventional instruments (even nonconventional ones) should be more clearly connected to reaching a particular level in relation with the set objective. For instance, in the case of Fed, the monetary policy interest rates were reversed when the occupation target was considered accomplished.

Actually, the problem of monetary policy inefficiency can be seen in the two-fold increase of the nonconventional instruments, by the nonconventional utilization of the classical instruments, which transmitted a diluted signal, much too accommodative for a financial-banking market whose balance should self-restore through market mechanisms and through efficient regulations, not through "crutch" assistance. The role of the central banks is to convey a constructive message – restore the confidence in the financial banking system with productive, less speculative, role for the real economy. Therefore, the major contribution might be unlocking the relation between the commercial banks and the clients, less the use of direct interventions in the economy (purchases of public and private bonds, shares, etc.). However, if they decide to continue using this type of instruments, this might be done to ensure sustainability and a sustainable perspective for the economy by investing in those branches and areas, which to support the further development of the national economies they have to serve (such as energy, infrastructure, environment, education, innovation, technology etc.).

To that effect, in order to increase their external competitiveness, the central banks concerned by the acquisition of shares or private bonds might invest in companies belonging to the different branches of the national economy with the purpose of promoting the local products by exporting goods with a high level of innovation, incorporating advanced technology, or of high quality and in a large array of varieties; this will support and diversify the exports of a particular country or region which the specific central bank covers in monetary terms.

**6. Conclusions and recommendations**

The evolution of the monetary policies displays, depending on the economic cycle, periods of activation or deactivation of particular monetary objectives and instruments. This is done on the background of reinterpreting or recalibrating the role of the monetary policy function of the economic circumstances specific to a particular period of time. For instance, on the background of the effects of the global financial crisis, the financial tensions within the system led to changes in the objectives of the central banks or in the manner of using the monetary instruments, which includes the activation or design of nonconventional instruments. Beyond price stability and, implicitly, the reduction of the exchange rate volatility, the central banks had to support the financial stability as another major objective of the monetary policy. The worldwide financial tensions affected the monetary transmission, but the excessive easing of the monetary policy didn’t improve the financial stability and was not enough to boost the economic growth.

Synthesizing, part of the dilemmas, regarding the path which must be follow by monetary policies, have a connection with the reconsideration of the central banks’ role in the economy (idea also approached by Dănilă, 2012). On the one side, the opinion to continue the measures of monetary easing until inflation is reinstated (within the limit of 2%), considers that the central banks can contribute to job creation, to leaving behind the deflation trap and to boost the economic growth. On the other side, the perspective of a spectacular future inflation (idea supported by the Bank of International Settlements) on the background of the excessive measures of monetary easing is related to the incapacity/inability of the central banks to accomplish real economy objectives (economic growth and job creation) because they lack the proper instruments to do this.

The two perspectives are not entirely opposite, both having their validity: it is true that the monetary policy is limited in accomplishing real economy objectives, and the inflationist danger must not be overlooked, but it is no less dangerous not to do anything to stimulate the economic development. Cleaning the monetary transmission channel, stimulating the cooperation with the fiscal-budgetary organisms, clearing the balance sheets of the commercial banks and companies, fiscal-budgetary counselling by the central banks to achieve sustainable and balanced fiscal consolidation, maintaining the interest rates at moderate, yet medium and long-term sustainable, levels, are just a few elements supporting the reorientation and recalibration of the contemporary monetary policies.

The inefficacy of the contemporary monetary policy is often due to the nonconventional use of the classical instruments, thus transmitting a diluted signal to the markets, much too accommodative for a financial-banking market whose balance should self-restore through market mechanisms and through efficient regulations, not through "crutch" assistance. The role of the central banks is to convey a constructive message – restoration of the trust in the financial-banking system, with a productive, less speculative role for the real economy. Therefore, the contribution of the central banks should be unlocking the relation between the commercial banks and the clients, less the use of direct interventions in the economy through purchases of public and private bonds, shares. However, if the central banks decide to continue using this type of instruments, this might be done to ensure sustainability and a sustainable perspective for the economy by investing in those branches and areas, which to support the further development of the national economies they have to serve (such as energy, infrastructure, environment, education, innovation, technology etc.). This perspective should give the central banks the feeling of the social usefulness of their policies, more so as we speak of the European Union, where the sustainable development policies have been implemented much time ago, and need all the support they can get from other national and EU macroeconomic policies, including the support of the national monetary policies and of ECB policy.

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