NBR'S MONETARY POLICY AND ITS IMPLICATIONS ON ECONOMIC GROWTH

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Abstract

The study was developed to show the interaction between economic growth and monetary policy implemented by NBR to assess its impact on the main macroeconomic variables (GDP, exchange rate, inflation rate), through the influence of monetary authority decisions on economic and financial conjuncture.

Global economic climate facing at the moment with a process of which covers all areas, but especially the aspects that fall under the influence of central banks and monetary policy conducted by them. In this context, the present study aims to determine the optimal degree of monetary authorities to engage in the economy, focusing on this issue for a thorough study of the transmission mechanism of monetary policy and the complex processes of transit effects resulting from monetary policy decisions to macroeconomic variables involved.

Studying the optimal monetary policy of the NBR to achieve final objectives becomes even more important as its in-depth understanding can provide vital clues in responding, because, after all, matters primarily the effects of monetary policy decisions (or their absence), and the link between that decision and the final economic reality is given precisely the structure and functioning of the transmission mechanism.

Key words: *inflation, monetary policy, GDP, interest rate, minimum reserve requirement*

Jel Classification: *E52, E58*

1.The role of monetary policy to stimulate economic growth

In the market economy, economic growth can be determined using economic and social policies developed and implemented. To stimulate economic growth an extended period, monetary policy acts by liquidity management on the money market, by increasing / decreasing interest rate of monetary policy and minimum reserve ratio and also by targeting the exchange rate. Through the implementation of monetary policy, resource allocation is achieved efficiently, that allows:

- achieving long-term investment plans;
- proper functioning of market mechanisms;
- discouraging the speculative actions;
- removing economic imbalances (inflation);
- saving resources to invest in productive activities.

Next to monetary policy acts the fiscal policy using the system of taxes, public investment and social protection. A developed economy adopt structural policies, to ensure the functioning of market mechanisms by stimulating investment in certain sectors, but also by a restructuring of underperforming companies and reforming the labor market. So, the application of structural policies can reduce unemployment rate and increase workforce performance and quality of enterprises, helping the economy to function efffectively.

Regarding the economic growth on short and medium term as cyclical process, caused by periodic fluctuations, it`s clear that economic policies, especially monetary policy, act by adopting anti-cyclical behavior.Thus, in the expansion phase of economic cycle, characterized by the emergence of inflationary pressures, it's better to adopt a tight monetary policy, while in the recession phase of economic cycle, characterized by a lack of inflationary pressures generated by the existence of unused resources is beneficial stimulative monetary policy implementation. However, the decision to adopt a monetary policy becomes difficult given

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that supply shocks are dominant, particular in emerging economies. The situation is different in developed economies, because in order to reduce the risk of deflation, monetary policy interest rates have been brought close to zero.

Through monetary policy developed and applied by the central bank adopted an anti-cyclical behavior before and after the outbreak of global financial crisis which aimed to maintain financial stability and ensuring an optimal framework for restoring economic equilibrium. Thus, in the period of economic expansion, the central bank acted significant upside reserve ratios and interest rate monetary policy, tightening credit conditions, defined as restrictive conduct. Moreover, during economic recession, the central bank resorted to significant reduction of monetary policy rate and reserve ratios designed to stimulate aggregate demand.

A first step in the evolution of economic growth can be achieved by applying an economic policy mix, in various ranges, because no state are not used "pure" economic policy. Another way of intervention refers to stimulate aggregate demand in order to relaunch the economy.

Regarding the role of monetary policy, it is focused on maximizing well-being, contributing to sustainable economic growth through price stability and currency. Given the tools at its disposal, monetary policy can determine the inflation level in economy, but can not directly influence the level of GDP in long term. In order to determine inflation level in the Romanian economy NBR adopted an inflation targeting strategy, reducing its level comparative with the European one, despite some variations in trend.

2. NBR's role in the sustainability of economic growth in Romania

In general, the role of central banks is defined by the primary endpoint of monetary policy regarding currency stability and to maintaining financial stability. However, the fundamental objective pursued by central banks seems to be just a path that leads to a sustainable economic growth.

NBR`s objective to ensure price stability has been achieved, according to records from the period 2009-2015 (Chart 1). This statement is based on the fact that the objective of reducing the inflation rate was achieved gradually, the unemployment rate hovering at a lower level than the European critical level (10%).

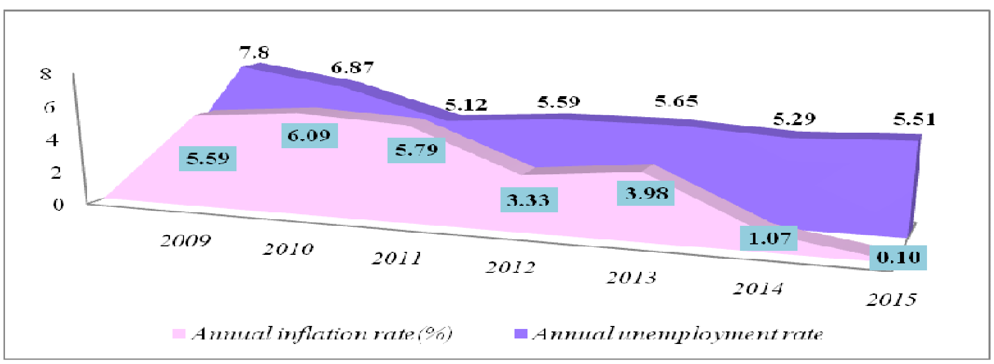

Chart 1 **The influence of inflation on unemployment rate evolution**

Source: National Agency for Employment, www.anofm.ro
National Statistics Institute, www.insse.ro

Thus, it can be considered that monetary policy implemented by the central bank was a flexible one, designed to preserve financial stability, and thus stopping the economic decline.

3. The effectiveness of NBR's monetary policy

In recent years, the central bank managed to reduce inflation rate by lowering the interest rate monetary policy, as can be seen in the following chart:

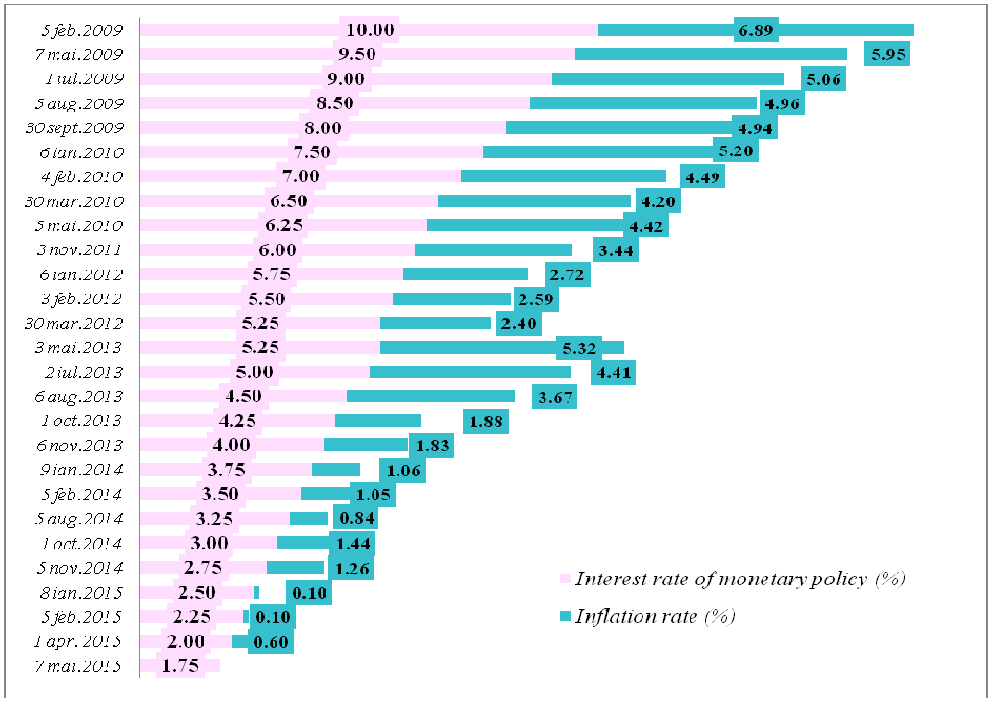

Chart 2 **Interest rate monetary policy influence on the evolution of the inflation**

Source: NBR monthly bulletins from the period 2009-2015, available on www.bnr.ro

Looking at the chart, we notice two important aspects:

- First, inflation shocks were anticipated, taking action in terms of monetary policy.
- Second, the interest rate of monetary policy respond to possible sources of inflation latent occurring and it manifests only in critical situations (stress) such as the inefficiency of public sector (generated by high costs and results of minimum resource allocation in public) and significant influence of the exchange rate on inflation expectations.

Regarding the transmission of monetary policy to the real economy, it is carried out effectively. Although the interest rate for interbank loans for three months has levels in the same range as that of interest rate of the monetary policy, as can be seen in Chart 3, the money market was not affected because of a optimal amount of liquidity in the banking system.

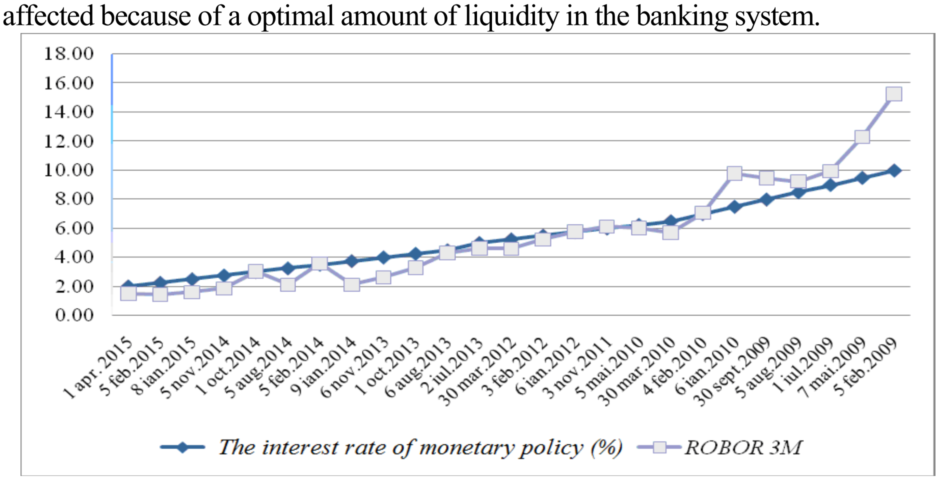

Chart 3 **The evolution of monetary policy interest rate level and the level ROBOR 3M**

Source: www.bnr.ro

4. Independence of NBR - an essential condition for the functioning of national monetary system

As regards NBR independence, it is essential for the functioning of the national monetary system. Therefore, the first research assumption concerns that greater independence of the central bank increases its degree of credibility and the emergence of more chances in optimal monetary policy management.

Central bank lacks independence for goal setting monetary policy, which is set by the government but independent in relation to:

- choice of instruments used to achieve this goal (independence in terms of the instruments);
- right to decide in any direction on monetary policy and price stability (functional independence);
- selection of the management based on high professional competence, without them being involved in politics or be subject to other pressures (personal independence);
- access to its financial resources to manage their own budget based on (financial independence).

5. NBR's monetary policy objectives

The importance of monetary policy resulting from its primary endpoint, price and currency stability, which is the primary objective of economic policy, along with sustainable economic growth, full employment of labor, balance of payments sustainability. Given that the primary objective is not under the direct control of monetary policy, there need to define intermediate targets which would ensure currency stability, namely:

- money growth to an optimal level;
- maintain interest rates at an appropriate level;
- practicing an optimum exchange rate;
- optimal allocation of financial resources (funds for lending) in the economy;
- limitation of inflation (control).

To achieve these objectives in each country are identified tools that lead to the best results, of which the most important are: fiscal policy, revenue policy, monetary policy, exchange rate policy and trade policy.

6. NBR's monetary policy strategies

Achieving monetary policy requires the adoption and implementation of strategies depending on the environment where the central bank acts (taking into account its independence), the ultimate objective of macroeconomic policy and the mode of action of the central bank. Thus, depending on the mode of action of the central bank stands two strategies:

- direct strategy;
- indirect monetary strategies.

Indirect monetary policy strategies

a) Strategy based on targeting the exchange rate

By strategy based on targeting the exchange rate, NBR tries to ensure exchange rate stability nominal through use their own tools aimed on the one hand changes in the interest rates applied, and on the other hand based on direct interventions in the forex market interventions designed to support the exchange rate. Adopting the strategy of targeting the exchange rate generates advantages and disadvantages. Advantages includes:

- stimulating the growth of comercial flows and investment generated by the stability and attractiveness of the domestic currency;
- promoting international cooperation and coordination.

As arguments directed against this strategy can be considered:

- need to maintain a low monthly inflation rates that do not affect the exchange rate and external competitiveness;
- high cost of foreign currency reserves;
- unable frequent adjustment of the exchange rate.

b) Strategy based on monetary aggregates targeting - involves the selection by the monetary authority of an optimal monetary aggregate that is relevant for the Romanian economy and achieve the ultimate objective of monetary policy.

c) Strategy based on interest rate targeting - is characterized by the fact that NBR has little possibility to influence the level of interest rates, central bank interventions on this indicator concerns only short-term transactions on the interbank market. As a result, the interest rates in the banking system can be quite hard influenced by the central bank, and if influence is exercised, the response is delayed compared to banks when applying monetary policy measure. The interest rate is preferred as intermediate target of monetary policy at the expense of money in the currency as demand recorded strong fluctuations.

d) Strategies based on an implicit nominal anchor

Regarding strategy based on an implicit nominal anchor a precondition for the successful operation of this regime is high credibility of the central bank's credibility based on long-term manifestation of monetary and price stability in the country analyzed.

Direct strategy of monetary policy

As a direct strategic monetary policy, the central bank was focused on inflation targeting, which involves setting a target for the inflation rate over a certain period of time, the target to be achieved through the application of monetary policy measures, so as to ensure stability prices.

7. Analysis of monetary policy instruments used by NBR

The application of monetary policy measures and strategies requires a set of tools through which NBR can exercise its influence on the economy.

As a result, the transmission channels of monetary policy and its effectiveness in achieving the fundamental objectives of macroeconomic policy, monetary policy depend on the way of implementation.

The set of tools and procedures by which the central bank implements monetary policy to achieve its primary objective forms the operational framework which belongs monetary policy. The main instruments of monetary policy that the central bank has at its disposal according to regulations are:

A.Open market operations

Purpose: Influence (guidance) interest rates, money market liquidity management and monetary policy achievement.

According to regulations, the main categories of open market operations available to NBR: repos operations, attracting deposits, issuing deposit certificates, reverse repos, granting loans collateralized with eligible collateral, sale / purchase of eligible assets, the swap rate. An analysis of the evolution of the monetary policy interest rate in the period 2009-2015 shows a decreasing trend, ranging from 10% (5 feb.2009) 2.25% (5 feb.2015) in order to stimulate aggregate demand (Chart 4).

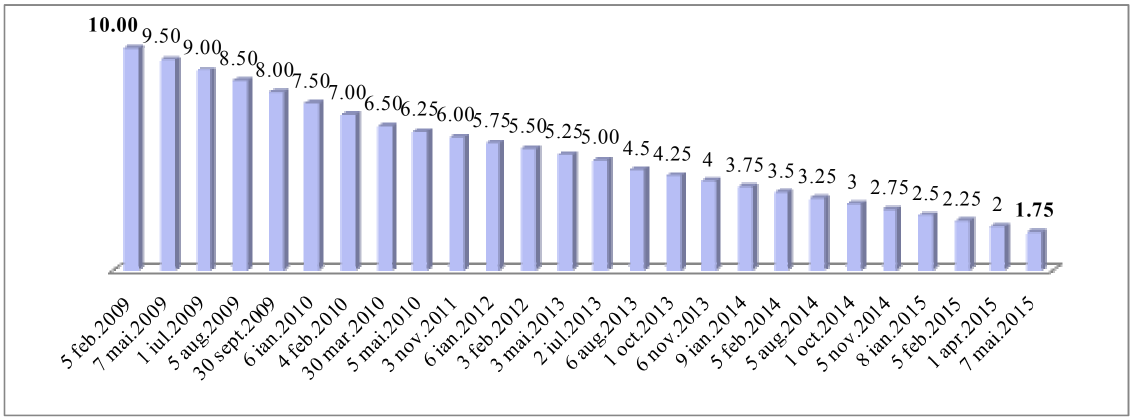

Chart 4 **Evolution level of interest rates (%) standing facilities (2009-2015)**

Source: National Bank monthly bulletins for the years 2015,2013,2011,2009.

By analyzing the evolution of interest rate level for the standing facilities there is a tendency to decrease the interest rate on the deposit facility and the interest rate on the lending facility. Thus, if the deposit facility rate (threshold) is in decline with 3.75% in February 2009 to May 2010, remaining at 2.25% until 6 January 2012 when another place down 0.25%. The same downward trend is reached in August 2014 that the interest rate on the deposit facility to 0.25% and maintained until February 2015.

Superior to the deposit facility rate is the interest rate on the lending facility (ceiling), whose percentage changes recorded in the same direction as the interest rate on the deposit facility, changing it from 14% (5 feb.2009) to 4.25% of February 5, 2015 (Chart 5).

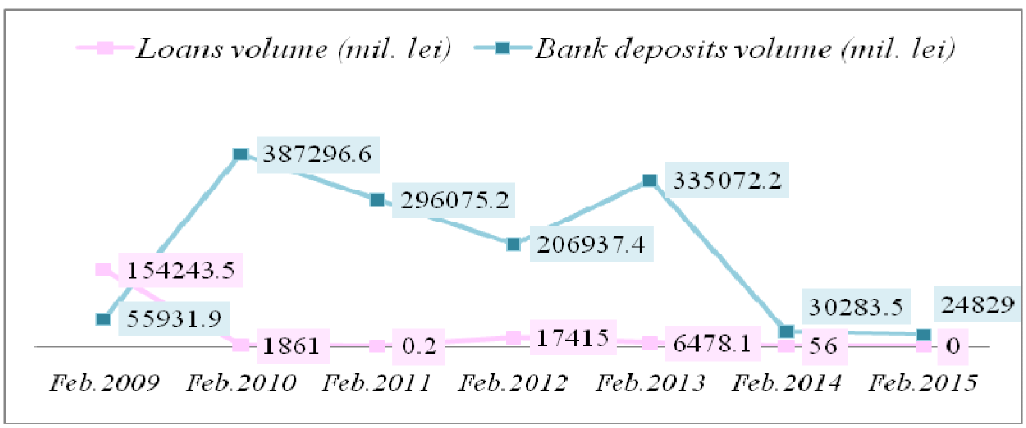

Chart 5 **Standing facilities granted to credit institutions by the NBR (2009-2015)**

Source: National Bank monthly bulletins for the years 2015,2013,2011,2009

In terms of deposits and credit volume as standing facilities offered by the central bank, in February, in the period 2009-2015, they has experienced the following developments:

In case of deposits, the maximum volume was recorded in February 2015 (142 748 mil. Lei), while the lowest volume was recorded in February 2009 (2 006 mil. Lei).

For overnight loans, the maximum amount was reached in February 2009 (38 625.2 mil. Lei) in 2010, 2012 and 2015 - in February the loans was nil (Chart 5).

B. The minimum reserve

Purpose: balancing interest rates, contributing to monetary expansion and ensuring structural liquidity.

The analysis of the interest rate on the deposits of credit institutions showing the change in the same direction, downwards, to the national currency, and at $ or € (Chart 6).

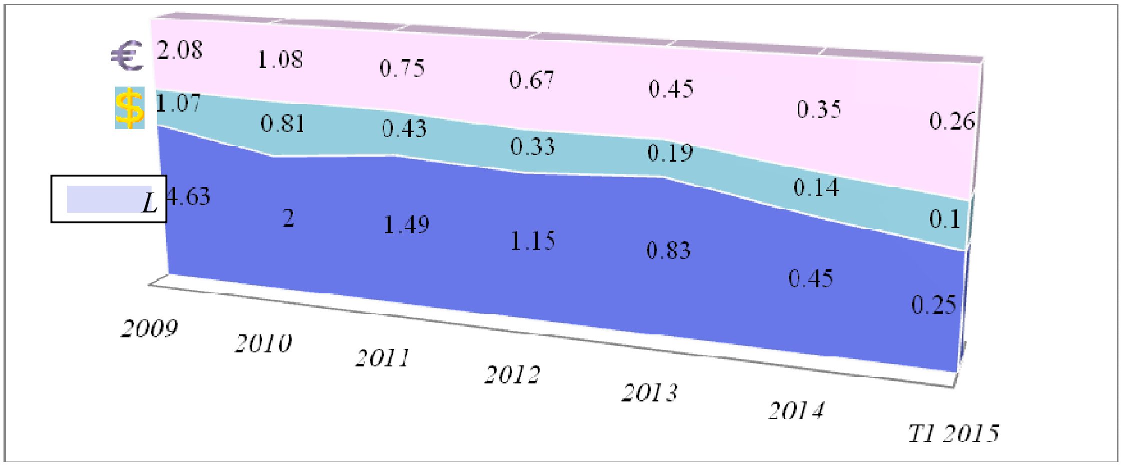

Chart 6 **Interest on deposits of credit institutions**

Source: National Bank monthly bulletins for the years 2015,2013,2011,2009

Regarding the reserve ratio for the period 2009-2015 (Chart 6):

- RMO rates in national currency (LEI) decrease by 8%, reaching 18% in 2009 to 10% in 2015 to stimulate aggregate demand.
- RMO currency rates changes by 26%, from 40% in 2009 to 14% in 2015.

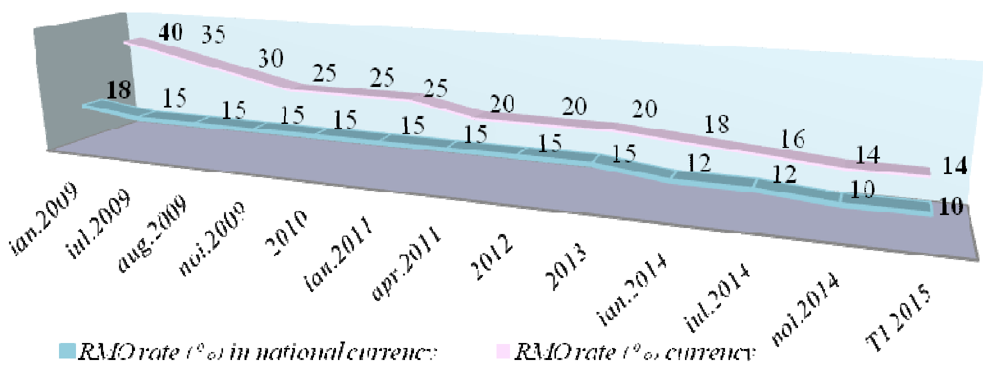

Chart 7 **The reserve ratios 2009-2015**

Source: National Bank monthly bulletins for the years 2015,2013,2011,2009

In the long term, economic policies can not directly create, economic growth, however, pursuing price stability, monetary policy contributes indirectly to sustainable growth, because no country has achieved economic growth relatively high for long periods under high inflation persistent (Chart 7).

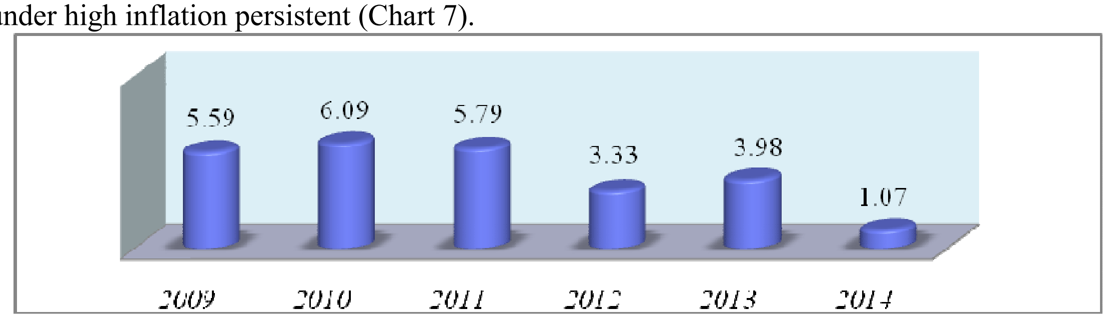

Chart 8 **Inflation rate (%) 2009-2014**

Source: National Institute of Statistics

Thus, we can say that through control of the monetary policy interest rate, the reserve ratio, the exchange rate and by a liquidity management in the money market, monetary policy may result in economic development. This development can be seen by analyzing the evolution of the GDP in the period 2009-2014 (Chart 9, 10).

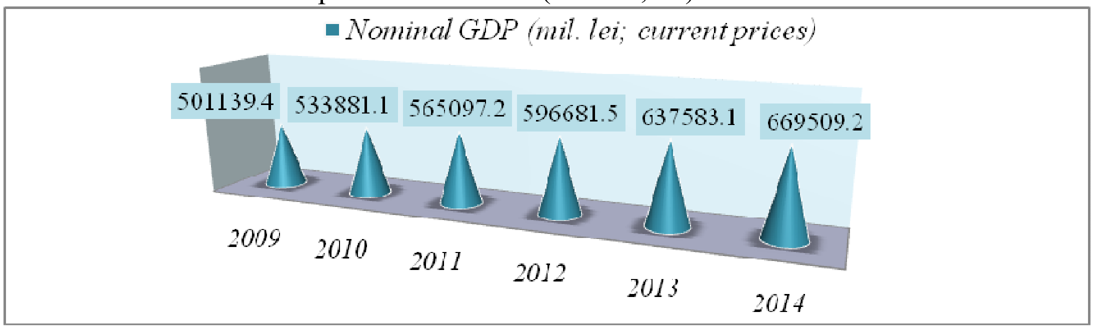

Chart 9 **Evolution of nominal GDP**

Source: National Bank monthly bulletins for the years 2015,2013,2011,2009

In terms of nominal GDP evolution, he knows an increasing trend in the period, rising from 501 139, 4 mil. lei in 2009 to and 669 509,2 mil. lei in 2014.

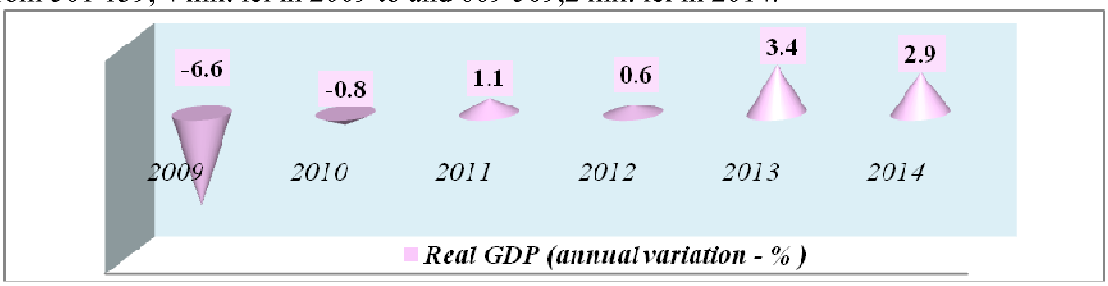

Chart 10 **Real GDP**

Source: National Bank monthly bulletins for the years 2015,2013,2011,2009

Real GDP registered a positive growth in 2013 (3.4%), the performance is superior to previous years, continuing in the same vein in 2014 (2.9%).

8.Conclusion

Looking at the monetary policy transmission mechanism as a whole and studying each channel association, we find little evidence to advocate a strategy, in terms of principle, the activity of the central bank monetary less. On the contrary, the increased complexity of how the economy works makes the process of auto-balancing of them become impossible. All this indicates the need for a more active attitude of the central bank, which must use a more generous arsenal of monetary policy instruments in order to comply and maintain the economy on a positive vector.

Given that nowhere in the world are no longer used economic policies "pure", but the authorities' actions takes the form of a "policy mix" in the game more varied and composite, it can be said that price stability, increased employment, sustainable growth, financial system stability, stability of interest rates and exchange rates define an optimal monetary policy, characterized in that it is coordinated with fiscal policy and other elements of economic policy.

As regards central bank's monetary policy is acting to maximize welfare, pursuing price stability, thus contributing to sustainable economic growth. Thus, in the period of economic expansion, the central bank adopted a conduct restrictive characterized by considerable increase in required reserve ratios, interest rate increases monetary policy tightening lending standards, and in the period of economic recession, NBR worked to stimulate aggregate demand through interest rate cuts and reductions in monetary policy rates ample reserves.

In conclusion, I believe that a greater role for money would allow to emphasize more strongly the importance of a clear institutional framework, with strong operational independence and a degree of responsibility appropriately. Also, it puts a new light on the need to ensure price stability in the medium term.

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