THE MONETARY POLICY OF THE CENTRAL EUROPEAN BANK

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Abstract: In this work there are analysed the strategies of the Central European Bank, a presentation of the monetary policy of the Central European Bank as well as the instruments, the procedures of monetary policy that determine the operational frame of the policy after which the Central European Bank conducts itself. The above mentioned instruments are accordingly to the exigibly counterparties of the monetary market, the exigibly actives and the systems of payment that refers as well to the payment operations and to the value bonds. The conclusions of the work concentrate the main ideas and make a syntesis of the most important opinions commected to the most relevant aspects of the monetary policy of the Central European Bank.

JEL classification: G15, G18, G21.

Key words: monetary policy, the strategies of the Central European Bank, instruments of monetary policy

1. INTRODUCTION

By the common monetary policy of the European Union may influence the economic activity, using available tools of the central bank: money supply, interest rates and exchange rates. Often, this policy may be in disagreement with fiscal policy, which is associated with changes in government spending, respectively, of government taxes. A good monetary policy is one that provides a stable value of currency to economy and that avoids disruption of payments in the banking system.

The European Central Bank was founded in 1999 in order to implement and coordinate monetary policy within the European Monetary Union. At that time the European Central Bank took over the former role of central banks of EU Member States. European Central Bank has wide autonomy, by its constitutive document they can not monetize budget deficits of the governments of member states and its independence is due to the fact that governors have relatively little influence on central bank policy.

2. OBJECTIVES

The main objective of the European Central Bank is to *maintain price stability in the Euro area.* [1] Price stability must be maintained over the medium term, thus it is not expected from the European Central Bank to deal with price fluctuations caused by commercial terms or other shocks. As pointed out by Mishkin (2000), an institutional

[1] See Article 105 of the consolidated version of the Treaty on European Union.

commitment to price stability as such is not enough to bring much-needed credibility of central banks. In 1998, the European Monetary Institute has defined price stability as "the annual increase in the Harmonised Index of Consumer Prices"[2] for the euro area below 2%.[3] In May 2003, the European Central Bank Executive Board reaffirmed the definition of price stability adding a shade: the Council agreed that to achieve this goal "is needed to keep inflation close to 2% over the medium term.

In the European Union Treaty specifies that without prejudice the aim of price stability, the European Central Bank should support the general economic policies of the European Community in order to achieve Community objectives.[4]

I must specify that the instruments of the European Central Bank monetary policy are: minimum mandatory reserves, open market operations on - open market[5] and permanent facilities[6]. European Central Bank may intervene directly in the market and foreign exchange operations. Unlike last time when there is a significant monetary demand, reserves help to induce a structural lack of liquidity in the Eurosystem. In order to improve liquidity, banks borrow from the European Central Bank on the short term or long term.

In terms of inflation targeting, central bank handles monetary policy instruments in order to limit direct medium-term inflation. Like other banks that have adopted inflation targeting policy, European Central Bank has an explicit inflation target and need to keep inflation closer to target (an increase of 2% in the overall harmonised consumer prices[7]) on the medium term. Note that the European Central Bank gives a moderate attention to transparency. It is unclear how the Board shall decide the reference interest rate considering that the internal discussions are not publicly known. European Central Bank does not publish a forecast official inflation. This is not surprising given the technical difficulties that should be overcome to obtain adequate predictions. Thus, from this point of view, the monetary regime adopted by the European Central Bank appears to be similar to the Federal Reserve against inflation targeting regimes in Britain and Sweden.

European Central Bank does not truly target inflation even if it borrowed important elements from this strategy. As Federal Reserve, European Central Bank's monetary policy aims at an element of flexibility so they can effectively address a different threat to price stability, including in exceptional circumstances (deflation, war, terrorist attacks, commodity prices shocks import, the collapse of major capital markets). Achieving the primary objective, price stability, i.e. the European Central Bank's initial strategy focused on two "pillars": the first and most important, control of

2 Harmonised index of prices is a weighted average of consumer price indices, collected in a uniform manner in the Euro zone states.

3 European Central Bank Press in 2001

4 Defined in Article 2: "The Union must promote social and economic progress and a high level of employment and to achieve a balanced and long-term development."

5 At the initiative of the European Central Bank

6 At the initiative of credit institutions

7 Brochure - "The European Central Bank. The Eurosystem. The European System of Central Banks", Mai 2006, pag 20, http://www.ecb.int/pub/pdf/infobr/ecbbr2006en.pdf

money supply by setting the reference value for M3 growth (4.5%), and the second analysis outlook for price developments in the euro area through a set of indicators.[8]

Please note that the confidence of the European Central Bank monetary strategy based on two pillars, did not lead to transparency and public understanding of monetary policy decisions taken by it. In fact, the first pillar (the reference value of M3) was a landmark insufficient monetary strategy, which reflects, among other things, the demand for currency instability. In fact, the first pillar was apparently more of a barrier to communication with the public, and created confusion on the role of tracking changes in managing monetary policy.

ECB Governing Council in May 2003 has redefined strategy, officially recognizing the economic analysis given more weight than money, that what was at first pillar, has now become secondary component of the monetary strategy.

The EU wants to increase its competitive strength in global context, using a single currency contributed to the widening trade not only within the area, but also in relations with the world, the increasing volume of financial transactions. The single currency, the monetary policy is transferred to Community competence becoming the European Central Bank, absolute independence.

3. EUROPEAN CENTRAL BANK'S MONETARY POLICY

EU common monetary policy has been created by the European Monetary Institute (EMI), which established the European Central Bank's strategies, the role of supporting the economic policies of the European Community actions in the following areas: monetary policy of the Community, own and operate official reserves of the Member States, promoting an efficient payment system, contributing to the prudential supervision of credit institutions in member countries, authorizes the issuance of banknotes in the European Union, so only banknotes issued by the ECB and the NCBs have official character.

3.1. European Central Bank Strategies

A monetary policy strategy is a set of procedures that found coherent decisions taken by the central bank to achieve its final objective. The main objective of the ESCB is to maintain price stability and supporting economic policies in the Community

a) The affirmation of monetary nature of inflation

Inflation, without the monetary presence and the general price level could not exist, and therefore it is the main cause of uncontrolled growth of money in circulation accordingly. Benefits of price stability is based on four arguments.

• elimination of distortions in relative price adjustment mechanism

• Current price decrease nominal interest

• economy in terms of real resources to be mobilized to reduce effects of uncertainty on future prices

• disappearance of inflationary effects on the distribution of real and financial heritage and the distribution of income between creditors and debtors.

No central bank has no money politca tools that will allow direct control over the price level.

[8] It is non-monetary indicators (economic growth, wage developments, fiscal variables, prices of raw materials, the price of imports) and monetary indicators (monetary aggregates, exchange rate euro, interest rates on financial markets).

b) Search for an operational credibility

A monetary policy using certain tools to achieve their ultimate objectives. Sometimes to reach the final target is to control and easier to use an intermediate target, so we can talk about the final targets and intermediate targets.

TOOLS →INTERMEDIATE TARGET → FINAL TARGET

For an intermediate target to be competent to be taken into account:
• to be a reliable indicator evolutionary endpoint, meaning that there is a strong relationship between these two
• must be watched and controlled by monetary authorities
• must have the confidential nature
- Monetary aggregates
- Interest tax
- Exchange fee

c) The adopted strategic line

European Monetary Institute (EMI) noted two possible strategies for the European Central Bank: a target intermediate monetary target, a direct target on inflation

The objective of monetary intermediate target set is based on comparing developments and findings targeting monetary aggregates. If registered growth of a monetary aggregate growth is faster than my anticipated, monetary policy must become more restrictive

Inflation target is based on direct comparison between the realized inflation and provided. On October 13, 1998 the ECB did not want to take any of the strategies proposed by EMI and decided to impose my own monetary policy directed on an endpoint represented by price and an interim target a monetary aggregate.

To implement these two strategies helped the ECB to the four recommendations of the EMI: setting a quantified target for inflation, set a quantified target for money supply, using a wide range of indicators, to be prospective.

3.2. ECB's monetary policy panel

Accurate and detailed presentation of the content of monetary policy:

a. **a strictly quantified inflation objective**

A level of inflation <2% over the medium term. He points out that the ECB fixeasza precise limits the maximum inflation consistent with price stability. Recourse to IPCA index (Harmonized price index of consumption). This index was designed to evaluate the size of the national inflation rate of the second phase of the Economic Monetary Union, and is calculated monthly for each Eurostat.

b. a monetary target

Monetary aggregate price level. The ECB's inflation outlook is ultimately a monetary phenomenon and so you have to control the money supply trend of evolution hence a so-called monetary aggregate.

The choice of M3 aggregate. A monetary aggregate is defined as the sum of currency in circulation and attract certain maturities of financial institutions. This chargeability must have a strong character in terms of cash businesses, and so we headed for liquidity.

The narrower and immediate money is a fiduciary currency (banknotes and coins) and all demand deposits held by the public.

M1(40%) = cash changeover (7%)
(small aggregate) (+)Sight deposits (33%)
M2 (88%) = M1 (40%)
(intermediate aggregate) (+) Depozits on term <2 years(20%)
(+)Deposits redeemable at notice
≤3 months (28%)
M3 (100%) = M2 (88%)
(+)Pensions (4%)
(+)Securities and instruments of monetary money market (6%)
(+)Debt securities with a duration
≤2 years (2%)

An annual growth of M3 reference. Governing Council announced on December 1, 1998 a reference value for M3 cesterea quantified for 1999. This will be 4.5%.

c. inflationary trends

Non-monetary causes of the general movement of prices include exogenous factors (VAT increase) endogenous factors and the use of a wide range of indicators that: - Indicators of demand: the evolution of wages, the evolution of private financial heritage; - Supply indicators: unemployment rate, percentage of production capacity utilization, the evolution of labor costs, cost of raw materials, the evolution of share exchange, subsidies on production, the evolution of industrial prices, the distance between potential and actual production.

3.3. Monetary policy instruments and procedures

Monetary policy instruments and procedures sets the operational policy carried by the ECB. This is in relation to three instruments:

- Open market operations which include: temporary assignment operations, farm operations (sale and purchase of assets by the ESCB), issuance of debt certificates by the ECB currency exchange operations of the ESCB's, cash in white (time deposits paid, incurred by banks in the ESCB).
- Permanent facilities enable the provision or withdrawal of liquidity such as the marginal lending facility, deposit facility.
- Reservations required

The three tools (operations) are in agreement with:

- Due to money market counterparties which is a pre-contract in a financial transaction and must respond to specific chargeability criteria;
- Chargeable assets where all ESCB credit operations must be performed on a safety basis (Article 18 of the Protocol regarding the ESCB and the ECB);
- Payment systems that address both payment transactions and the securities.

ESCB puts into operation two types of payment mechanisms: The TARGET (Trans-European Automated acronym of Real - time Gross settlement Express Transfer) system for interbank payments and securities pay.

4. CONCLUSIONS

The analysis of the European Central Bank monetary policy and its impact on international transactions resulting conclusion that the involvement of the international financial institution in the transformation and restructuring of the European financir system is extensive, the areas affected by projects financed by the contribution of the very diverse and of particular importance. Desire of the European financial system subjected to uniform and transparent rules, meant to increase the allocation of capital resources, support begins to shape the institutions created for this purpose.

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