ALEXANDRU IOAN CUZA UNIVERSITY of IAŞI

FACULTY OF ECONOMICS AND BUSINESS ADMINISTRATION

With the support of the Erasmus+ Programme of the European Union

EU CONOMICS

TOWARDS NEW PARADIGMS OF EU ECONOMICS: FINANCIAL AND MONETARY MILESTONES

Jean Monnet Module, projet no. 620297-EPP-1-2020-1-RO-EPPJMO-MODULE

Module 3: Monetary Policy in the European Union

(*Modulul 3: Politica Monetară în Uniunea Europeană*)

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Module 3: Monetary Policy in the European Union

(Modulul 3: Politica Monetară în Uniunea Europeană)

Administrative issues:

Course curicula

Meeting schedule

Evaluation requirements

Course curricula

1. REGULATORY FRAMEWORK, MONETARY POLICY CONTENT AND ITS EFFECTS ON THE REAL ECONOMY/ CADRUL JURIDIC, CONȚINUTUL POLITICII MONETARE ȘI EFECTELE SALE ASUPRA ECONOMIEI REALE

2. INSTITUTIONAL FRAMEWORK OF THE SINGLE MONETARY POLICY/ CADRUL INSTITUȚIONAL AL POLITICII MONETARE UNICE

3. LEGAL AND OPERATIONAL FRAMEWORK OF THE SINGLE MONETARY POLICY/ CADRUL JURIDIC ȘI OPERAȚIONAL AL POLITICII MONETARE UNICE

4. UNCONVENTIONAL MONETARY POLICY INSTRUMENTS OF THE ECB/ INSTRUMENTELE NECONVENȚIONALE DE POLITICĂ MONETARĂ ALE BCE

5. OPERATIONAL FRAMEWORK FOR MONETARY POLICY IN THE NON-MEMBER STATES OF THE EURO AREA/ CADRUL OPERAȚIONAL AL POLITICII MONETARE ÎN STATELE NEMEMBRE ALE ZONEI EURO

6. COORDINATION OF MONETARY POLICY WITH FISCAL POLICY IN EU MEMBER STATES / COORDONAREA POLITICII MONETARE CU POLITICA FISCALĂ ÎN STATELE MEMBRE ALE UE

7. CURRENT CHALLENGES FOR MONETARY POLICY IN EU/ PROVOCĂRI ACTUALE PENTRU POLITICA MONETARĂ ÎN UE

1. REGULATORY FRAMEWORK, MONETARY POLICY CONTENT AND ITS EFFECTS ON THE REAL ECONOMY

1.1. Monetary policy - the main component of economic policy

- the concept of monetary policy and the rationale for its fundamental objective
- Monetary policy strategies to ensure price stability
- direct strategies (direct inflation targeting)

1.2. Monetary policy strategies to ensure price stability

- indirect strategies (exchange rate targeting, monetary aggregates targeting, default nominal anchor)
- direct strategies (direct inflation targeting)

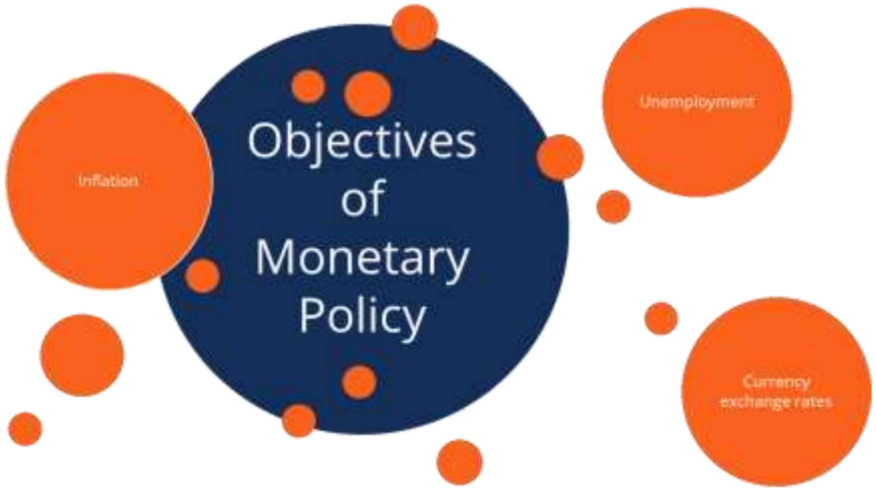
1.3. Independence of central banks and its role in increasing the efficiency of monetary policy

- principal components of central bank independence
- measures of central bank independence
- effects of central bank independence

1.4. European regulations on accountability, transparency and communication in monetary policy

1.5. The impact of monetary policy decisions on the real economy

What is Monetary Policy?



- an economic policy that manages the size and growth rate of the money supply in an economy.
- a powerful tool to regulate macroeconomic variables such as [inflation](#) and unemployment, implemented through different tools
  - the adjustment of the interest rates,
  - purchase or sale of government securities,
  - changing the amount of cash circulating in the economy.
- The central bank or a similar regulatory organization is responsible for formulating these policies.
- The primary objective of monetary policy = to reach and maintain a low and stable inflation rate, and to achieve a long-term GDP growth trend. This is the only way to achieve sustained growth rates that will generate employment and improve the population's quality of life.

Monetary policy strategies to ensure price stability

- Price stability is the best contribution that monetary policy can make to economic growth
- KEY TAKEAWAYS
    - Inflation targeting is a central bank strategy of specifying an inflation rate as a goal and adjusting monetary policy to achieve that rate.
    - Inflation targeting primarily focuses on maintaining price stability, but is also believed by its proponents to support economic growth and stability.
    - Inflation targeting can be contrasted to other possible policy goals of central banking, including the targeting of exchange rates, unemployment, or national income
- Direct strategies/direct inflation targeting
- Inflation targeting can be contrasted to strategies of central banks aimed at other measures of economic performance as their primary goals, such as:
    - targeting currency exchange rates,
    - the unemployment rate, or
    - the rate of nominal Gross Domestic Product (GDP) growth.

Independence of central banks and its role in increasing the efficiency of monetary policy

- **What exactly is central bank independence (sometimes referred to as autonomy) and why is it important?**

Independence means independence from the government authority and the freedom to conduct monetary policy as central bankers (and not politicians) decide is appropriate.

- **Why does it matter whether a central bank is independent or not?**

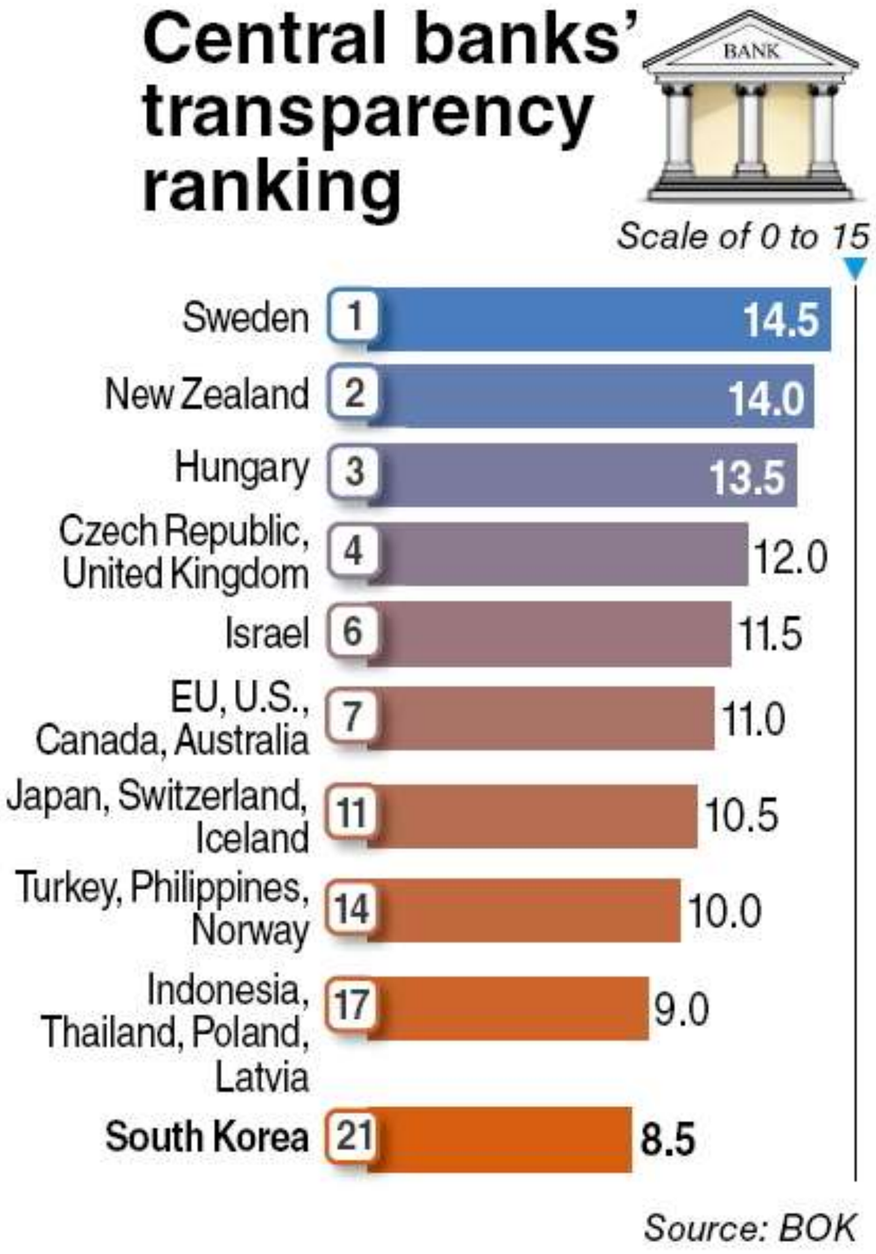
When a country's central bank becomes more independent, its average inflation rate drops.

To determine the independence of the central bank in nations with rule of law, it's best to follow the purse/ follow the money

- The central bank is independent if it controls its own budget, as the Fed and ECB (and the Bundesbank of Germany did).
- The Fed is slightly less independent than the ECB, because its existence is not constitutionally guaranteed. The United States Congress could change or abolish the Fed simply by passing a law and getting the president to sign it.
- The ECB was formed by an international treaty, changes to which are very dificult to achieve (it must be ratified by all the signatories).

Central banks led by people who are appointed are more independent than those led by popularly elected officials. Long, nonrenewable terms are better for independence than short, renewable ones, which tend to induce bankers to curry the favor of whoever decides their fate when their term expires.

Country	Independence	Average Inflation, 1973–1988
New Zealand	1	12.2
Spain	1.5	12.4
Italy	1.75	12.5
Australia	2	9.5
Belgium	2	6.0
France	2	8.2
Norway	2	8.2
Sweden	2	8.3
United Kingdom	2	6.7
Canada	2.5	7.2
Denmark	2.5	8.6
Japan	2.5	4.5
Netherlands	2.5	4.3
United States	3.5	6.4
Germany	4	3.4
Switzerland	4	3.1






Independence of central banks and its role in increasing the efficiency of monetary policy

measures of central bank independence

- In the relevant literature three **indicators** of actual **independence** are developed:
  - the rate of turnover of **central bank** governors
  - an index based on a questionnaire answered by specialists in 23 countries,
  - an aggregation of the legal index and the rate of turnover. explaining cross-country variations in the rate of inflation.

central bank independence index – World bank

however, determining a central bank's independence is not easy, particularly when de jure and de facto realities differ

effects of central bank independence

- An independent Central Bank may have more credibility. If people have more confidence in the Central Bank, this helps to reduce inflationary expectations. In turn, this makes inflation easier to keep low.

Central banks in most developed nations are institutionally **independent** from political interference. Still, limited control by the executive and legislative bodies exists.

European regulations on accountability, transparency and communication in monetary policy

1. The independence of the central bank and its accountability

The legal mandate of the ECB as stipulated in the Maastricht Treaty is very clear and simple: the core assignment that has been entrusted to the ECB is to maintain price stability in the euro area.

The Treaty grants the ECB and its Governing Council full independence, so that it can efficiently fulfil this narrow mandate.

Internally, the Euro-system is also organised in such a way as to minimise the risk of influence from the outside. The three key features are

the collegial decision-making procedure,

the majority principle and

the one person, one vote principle.

2. The transparency and predictability of monetary policy

The central banks need to communicate in a consistent manner with at least four constituencies with somewhat different needs: the markets, the media, the politicians and the general public. The borderlines between these different constituencies and the different ways in which they should be addressed are naturally obscure.

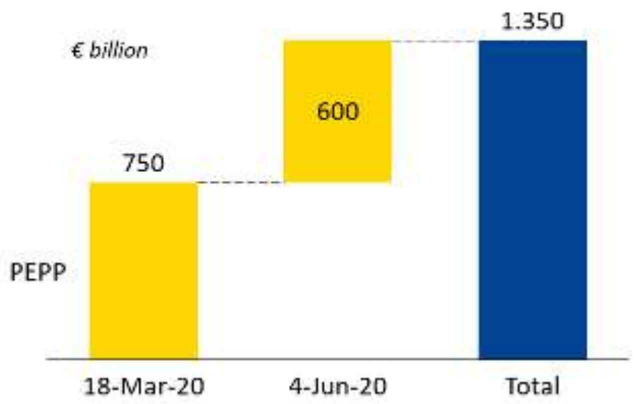
The key words in relation to the collaboration with the markets and the media are "credibility" and "predictability”.

The impact of monetary policy decisions on the real economy

EUROPE'S RAPID MONETARY AND FISCAL COVID-19 RESPONSE

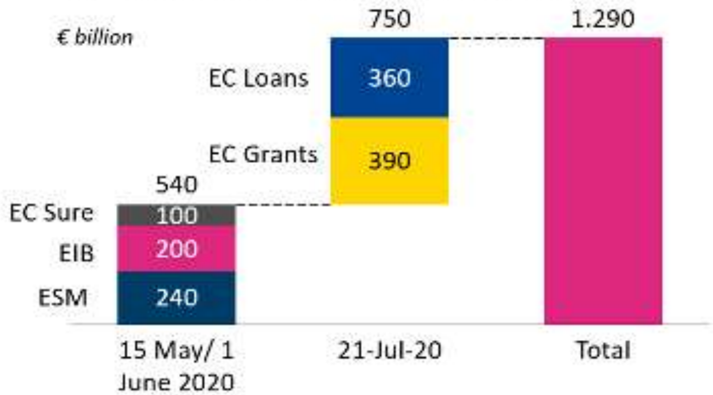
Monetary response

- European Central Bank's Pandemic Emergency Purchase Programme (PEPP)
- €750 billion was announced 18 March and increased to €1.3 trillion in June 2020
- This comes on top of the existing monetary policy



Fiscal response

- A rapid COVID19 response was put in place in 2 months' time: ESM €240bn for medical costs, EIB €200bn guarantees for companies (SMEs) and European Commission €100bn for unemployment support
- In July, an additional €750bn was approved of which €390bn are grants and €360bn loans
- This comes on top of all national fiscal response



Source: ECB, EIB, EC and ESM

ECB - Helping the economy absorb the shock of the current crisis

The €1,850 billion pandemic emergency purchase programme (PEPP) aims to lower borrowing costs and increase lending in the euro area. This in turn should help citizens, firms and governments get access to funds they may need to weather the crisis.

This programme complements the asset purchase programmes ECB has had in place since 2014.

ECB buys several different kinds of assets in this programme. For example, when ECB buys bonds directly from banks, ECB makes more funds available to be lend to households or businesses.

ECB can also buy companies' bonds, giving them an additional source of credit. Both kinds of purchases help boost spending and investment, with the aim of supporting economic growth.

Keeping borrowing affordable

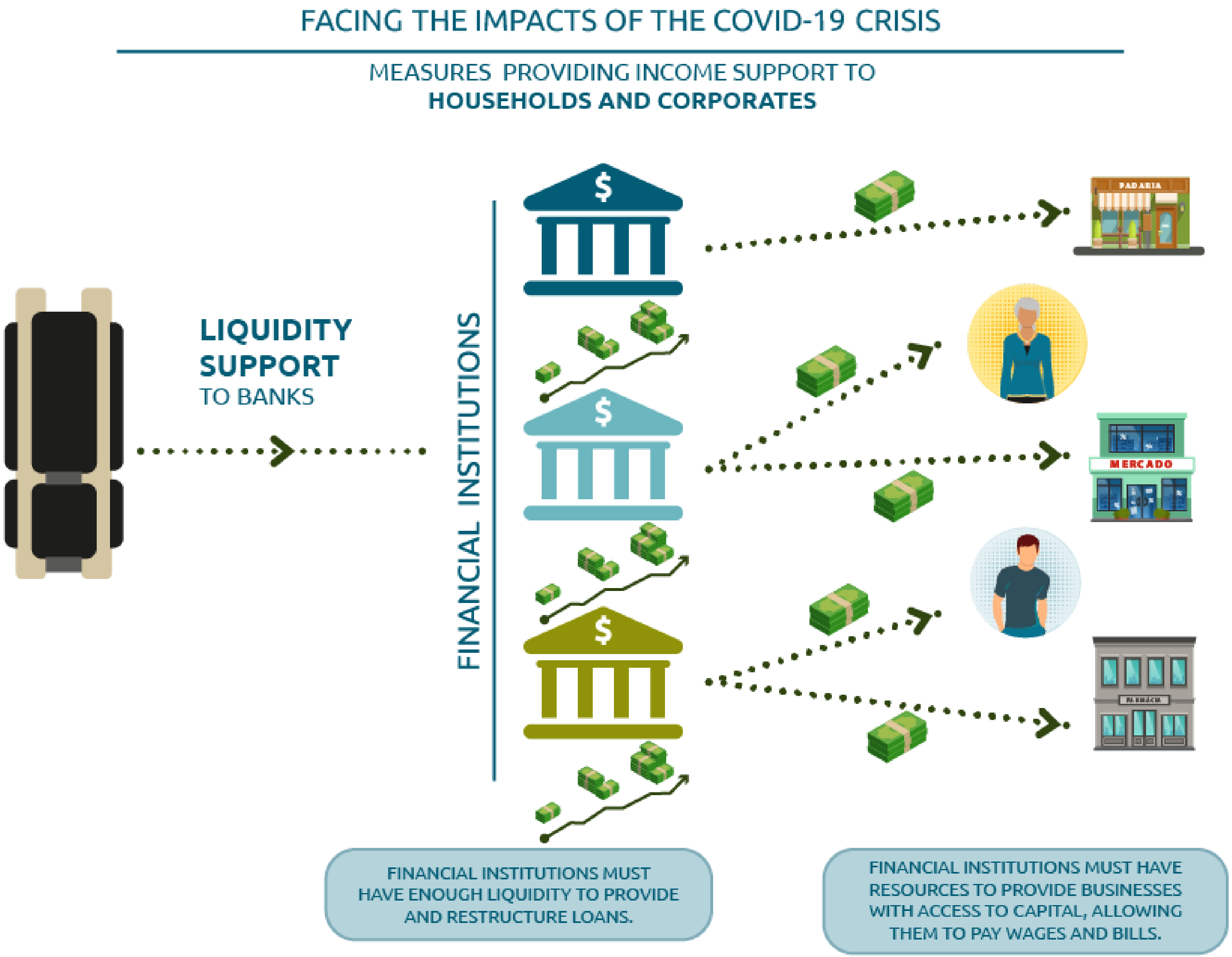
- ECB has kept the key interest rates at historically low levels so borrowing costs remain low.
- ECB rates impact how much it costs to take out a loan. Low rates make it easier for people and companies to borrow funds, and should support spending and investment.

Supporting access to credit for firms and households

- ECB has increased the amount of money that banks can borrow and made it easier to borrow specifically to make loans to those hardest-hit by the spread of the virus, including small and medium-sized firms.

- One of the ways ECB has made borrowing easier is by easing the standards for the collateral that banks give a form of insurance we lend to them. ECB is temporarily expanding the list of assets that banks can use as collateral.

- ECB is also being less strict with the measure to determine these assets' value (known as a "haircut").


FACING THE IMPACTS OF THE COVID-19 CRISIS
MEASURES PROVIDING INCOME SUPPORT TO
HOUSEHOLDS AND CORPORATES
LIQUIDITY SUPPORT
TO BANKS
FINANCIAL INSTITUTIONS
PADARIA
MERCADO
FINANCIAL INSTITUTIONS MUST HAVE ENOUGH LIQUIDITY TO PROVIDE AND RESTRUCTURE LOANS.
FINANCIAL INSTITUTIONS MUST HAVE RESOURCES TO PROVIDE BUSINESSES WITH ACCESS TO CAPITAL, ALLOWING THEM TO PAY WAGES AND BILLS.

ECB action ensuring short-term concerns do not prevent lending

ECB aims to help smooth over any temporary funding issues for solvent banks by offering immediate borrowing options at favourable rates. This support helps banks continue granting loans to citizens and firms in need.

ECB announces measures to support bank liquidity conditions and money market activity

ECB action for Increasing banks' lending capacity

In times of great uncertainty, banks may find it harder to secure funds for short-term needs.

ECB is temporarily less strict about the amount of funds, or "capital", that banks are required to hold as a buffer for difficult times.

ECB is also giving banks more flexibility on supervisory timelines, deadlines and procedures.

All of these measures help euro area banks focus on playing their vital role as lenders during this extraordinary period. Banks are expected to use any freed-up funds to absorb losses and support the economy, and not to pay out dividends.

Preserving financial stability through international cooperation

- Central banks around the world hold reserves of currencies that are not their own. This is because their domestic banks also do business in these currencies, and thus sometimes require foreign-currency loans in the course of daily business.

- In times of great uncertainty, customers' demand for foreign currency assets can increase. If banks do not have enough foreign currency reserves on hand to meet increased demand, markets can become unstable. So central banks have established so-called currency swap lines. These swap lines let central banks of one country exchange their national currency reserves for those of the central bank of another country – thus ensuring that central banks can meet increased demand.

- ECB has recently reactivated swap lines and enhanced existing swap lines with central banks across the globe in response to the current difficult situation.

2. INSTITUTIONAL FRAMEWORK OF THE SINGLE MONETARY POLICY

2.1. The legal normative basis regarding the functioning of the institutions with a role in the realization of the single monetary policy

2.2. Organization and functioning of the ECB

2.3. The objectives and tasks of the Eurosystem

2.4. The Single Supervisory Mechanism and the role of the ECB

2.5. The Court of Justice of the European Union and its role in monetary policy

CVRIA

2.1. The legal normative basis regarding the functioning of the institutions with a role in the realization of the single monetary policy

- **Hard law**
  - **European Union primary law:**

    Treaty on the European Union, Maastricht 1992

    TITLE VI ECONOMIC AND MONETARY POLICY, Chapter 2

    Monetary policy, Chapter 3 Institutional provisions

    Treaty on the Functioning of the European Union, Lisbon 2009

    PART THREE - UNION POLICIES AND INTERNAL ACTIONS, TITLE VIII

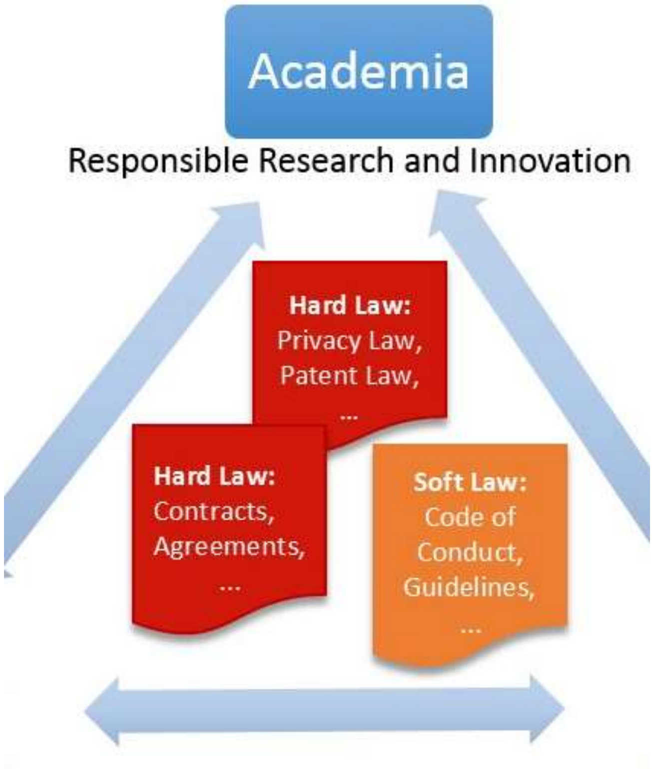
    ECONOMIC AND MONETARY POLICY, CHAPTER 2 MONETARY POLICY, CHAPTER 3 INSTITUTIONAL PROVISIONS, CHAPTER 4 PROVISIONS SPECIFIC TO MEMBER STATES WHOSE CURRENCY IS THE EURO
  - **European Union secondary law**

    Protocol no. 4 on the Statute of the European System of Central Banks and the European Central Bank from 1998/updated version 2018

    ESCB and ECB normative acts (decisions)

2.1. The legal normative basis regarding the functioning of the institutions with a role in the realization of the single monetary policy

- **CJEU jurisprudence**
- **Soft law**
  - recommendation of the European Commission



2.2. Organization and functioning of the ECB

The European Central Bank (ECB) is one of the seven institutions of the EU and the central bank for the entire Eurozone.

It is one of the most critically important central banks in the world, supervising over 120 central and commercial banks in the member states.

The ECB works with the central banks in each EU state to formulate monetary policy to help maintain stable prices and strengthen the Euro.

President of the ECB

+ 4 decision-making bodies of the ECB

- Executive Board
- Governing Council
- General Council
- Supervisory Board

The Executive Board of ECB

- President, Vice-President, and 4 other executive members appointed by the European Council.
- eight-year non-renewable term.
- The role of the Executive Board:
  - To implement the monetary policy as defined by the Governing Council
  - To manage the day-to-day operations of the ECB, alongside the Chief Services Officer.
  - To prepare the Governing Council meetings and exercises power delegated to it by the Governing Council.
- meetings every Tuesday.

The Governing Council

= six members of the Executive Board
+ governors of the national central banks of the Euro area.

The Council members meet twice a month at the ECB offices and their meetings minutes are published prior to the next meeting.

Functions of this body in Euro area

- the formulation of monetary policy
- make decisions on monetary objectives, interest rates, and the supply of reserves
- decisions that ensure the performance of the functions of ECB

Every six weeks, the President and Vice-President of the ECB must chair a press conference to explain in detail their monetary policy decisions.

The General Council

- a transitional body that carries out responsibilities of the European Monetary Institute (EMI).
- President, Vice-President + Governors of the national central banks of the EU member states.
- It will exist until all EU member states have adopted the Euro.
- Functions:
  - fixing the exchange rates of currencies for countries taking up the Euro.
  - preparing the ECB annual report
  - setting conditions of employment for the European Central Bank members of staff
  - collecting data.

The Supervisory Board

- chair, vice-chair, 4 ECB representatives +representatives of national supervisors.
  - It plans and executes the supervisory function of the ECB.
  - It proposes draft decisions for the Governing Council
- The Steering Committee (the Chair, Vice-Chair of the Supervisory Board, one ECB representative + 5 representatives of national supervisors) supports the board's activities (including organizing the meetings)

2.3. The objectives and tasks of the Eurosystem

The Eurosystem is responsible for:

defining and implementing monetary policy

conducting foreign exchange operations

holding and managing the euro area's foreign currency reserves

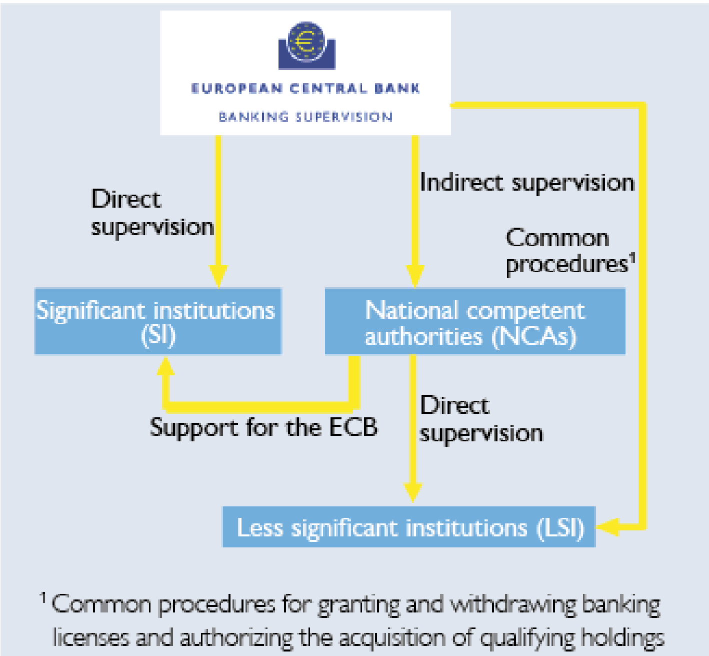
promoting the smooth operation of payment systems

The ECB carries out specific tasks in the areas:

- banking supervision
- banknotes
- statistics
- macroprudential policy
- financial stability
- international and European cooperation.

2.4. The Single Supervisory Mechanism and the role of the ECB

Roles and responsibilities within the SSM



Source: OeNB.

The Single Supervisory Mechanism (SSM) refers to the system of banking supervision in Europe. It comprises the ECB and the national supervisory authorities of the participating countries.

The main aims of European banking supervision are to:

- ensure the safety and soundness of the European banking system
- increase financial integration and stability
- ensure consistent supervision

European banking supervision is one of the two pillars of the EU banking union, along with the Single Resolution Mechanism.

Why do we need European banking supervision?

- The recent financial crisis has shown how quickly and forcefully problems in the financial sector can spread, especially in a monetary union so the purpose of European banking supervision
    - to help rebuild trust in the European banking sector
    - to increase the resilience of banks.

Who is supervised?

- **Directly supervised banks**
    - 115 significant banks (82% of banking assets in the participating countries).
    - Each significant bank has a dedicated Joint Supervisory Teams JST, comprising staff of the ECB and the national supervisors.
- **Indirectly supervised banks**
    - "less significant" institutions continue to be supervised by their national supervisors, in close cooperation with the ECB.
    - At any time the ECB can decide to directly supervise any one of these banks to ensure that high supervisory standards are applied consistently.

As an independent EU institution, the ECB oversees banking supervision from a European perspective by:

- establishing a common approach to day-to-day supervision
- taking harmonised supervisory actions and corrective measures
- ensuring the consistent application of regulations and supervisory policies

The ECB, in cooperation with the national supervisors, is responsible for ensuring European banking supervision is effective and consistent.

What does banking supervision entail?

The ECB has the authority to:

- conduct supervisory reviews, on-site inspections and investigations
- grant or withdraw banking licences
- assess banks' acquisition and disposal of goods
- ensure compliance with EU prudential rules
- set higher capital requirements ("buffers") in order to counter any financial risks

Which countries participate?

- All euro area countries participate automatically in European banking supervision.
- Other EU countries that do not yet have the euro as their currency can choose to participate. To do so, their national supervisors enter into "close cooperation" with the ECB. Bulgaria and Croatia joined European banking supervision through close cooperation in October 2020.

Cooperation with non-participating countries

- memorandum of understanding

2.5. The Court of Justice of the European Union and its role in monetary policy

- The Court of Justice of the European Union (CJEU) interprets EU law to make sure it is applied in the same way in all EU countries, and settles legal disputes between national governments and EU institutions.
- "In order to ensure that EU law is applied uniformly, the Court of Justice alone – which was created for that purpose by the member states – has jurisdiction to rule that an act of an EU institution is contrary to EU law," the court said in a statement.
- The Court of Justice of the European Union (CJEU) gave the green light in 2018 to the ECB scheme, which kept the euro zone in one piece after its debt crisis but which critics argue has flooded markets with cheap money and encouraged over-spending by some governments.
- The German court's challenge to the CJEU could set a precedent for its peers in other EU countries, said Miguel Poiares Maduro, a professor at the European University Institute in Florence, and a former CJEU adviser.

Jurisdiction of the Court of Justice of the European Union on implementing monetary policy.

Case Dietrich, CC-422/19 + case Häring (C-423/19), both ruled in January 2021, refer to

- Weis case (11 dec. 2018)
- case Gauweiler (C-62/14)

The CJEU extensive analysis of the proportionality of the measures implementing monetary policy

- Article 119 (2) and Article 127 (1) TFEU, in conjunction with Article 5 (4) TEU show a monetary policy bond purchase program may be validly adopted and implemented only in so far as the measures which it entails are proportionate to the objectives of that policy,
- the acts of the institutions of the EU are such as to ensure that the **legitimate objectives pursued by the rules in question are attained and do not go beyond what is necessary to attain those objectives.**
- With regard to the judicial review of compliance with these conditions, the CJEU recognizes a wide discretion of the ESCB, because when designing and implementing a money market operations program, the ESCB makes choices that are technique and complex
- in order to have inflation rates below 2%, but close to that percentage, monetary and financial conditions will be relaxed, including those of non-financial corporations, and of households, to suppaggregate consumption and investment spending in the euro area and to ultimately contribute to a medium-term return of inflation rates to those values.
- In order to establish the proportionality of the measures taken, the CJEU notes that
    1. the measures were adopted in a context described by the ECB as marked, by a low level of long-term inflation, which could generate the risk of triggering a cycle of deflation ,

    i.e. the measure is **JUSTIFIED IN THE CONTEXT OF ITS ADOPTION**

    2. the inability to counteract this risk by using other instruments available to the ESCB to ensure an increase in inflation rates.

i.e. the measures **DO NOT CLEARLY GO BEYOND WHAT IS NECESSARY TO ACHIEVE THAT OBJECTIVE.**

JUSTIFICATION OF THE NATIONAL MONETARY POLICY MEASURE

- Article 119 (2) TFEU that the action of the Member States and the Union consists of three elements
  - a single currency, the euro
  - defining and organizing a single monetary policy
  - defining and organizing a single exchange policy.
- the notion of 'monetary policy’
  - not limited to its operational implementation, which is, under Article 127 (2) TFEU, one of the fundamental tasks of the ESCB,
  - also implies a regulatory dimension that seeks to the status of the euro as the single currency.
- this interpretation of the concept of 'monetary policy' is supported by the main objective of that policy, as set out in Article 127 (1) and Article 282 (2) TFEU, namely to maintain price stability.
- If the status of the euro as a single currency could be understood differently and governed by different rules in Member States whose currency is the euro, the uniqueness of the single currency would be called into question and thereby seriously undermine the objective of maintaining the price stability.

3. LEGAL AND OPERATIONAL FRAMEWORK OF THE SINGLE MONETARY POLICY

3.1. Price stability - fundamental objective of the single monetary policy

- Monetary policy is a basic component of economic policy, along with other components (mainly budgetary and fiscal policy)
- main objectives:
  - ensuring balanced economic growth,
  - full employment
  - price stability
  - ensuring the balance of external payments.

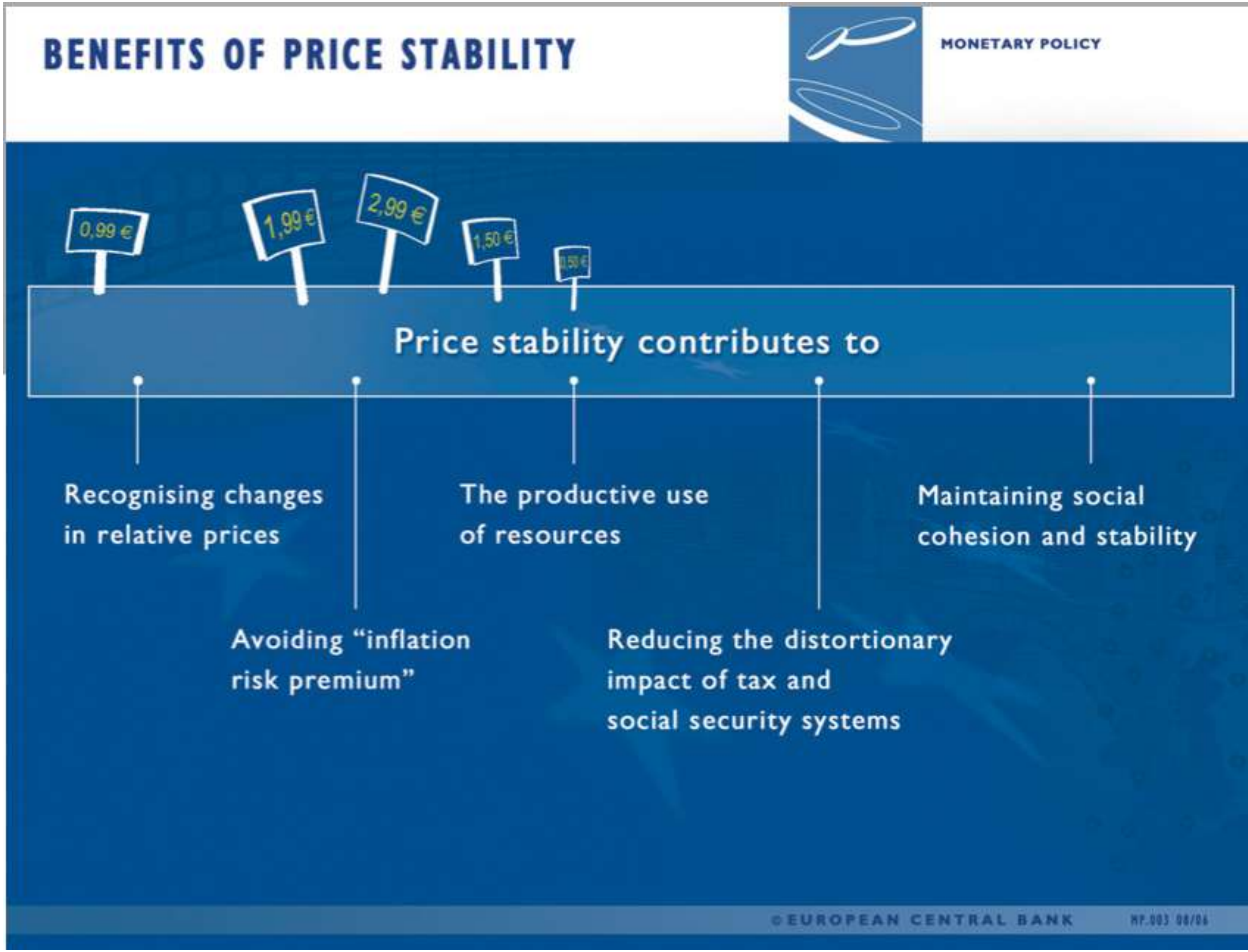
Monetary policy reflects actions taken by the central bank or monetary authority of a country (or monetary areas) regarding the liquidity of the economy in order to achieve the objectives of economic policy.

the mission of monetary policy is to regulate the liquidity of the economy so that it has a sufficient volume of liquidity in order to ensure its normal functioning and balanced development.

Based on the above, it is found that the final objectives of monetary policy are, in principle, the same as those of economic policy.

Simultaneous achievement of the objectives of growth and full employment requires a context of price stability and balance of external payments, which in turn can be ensured by controlling liquidity in the economy.

Moreover, the normal functioning of an economy presupposes that transactions and payment operations take place in good conditions and in a climate of trust.


BENEFITS OF PRICE STABILITY
MONETARY POLICY
0,99 €
1,99 €
2,99 €
1,50 €
Price stability contributes to
Recognising changes in relative prices
Avoiding “inflation risk premium”
The productive use of resources
Reducing the distortionary impact of tax and social security systems
Maintaining social cohesion and stability
©EUROPEAN CENTRAL BANK

The advantages of price stability

improves the transparency of relative prices, which allows more efficient allocation of resources and, therefore, increase production and welfare of the population. In a market economy, individuals and firms use the prices of goods and services as clues in making the decision to consume or invest. If prices fluctuate significantly, it is difficult to make appropriate decisions about consumption or investment, and this can hinder the efficient allocation of resources in the economy.

in conditions of price stability, the risk premium included in the interest rates is reduced, which stimulates investments and, consequently, economic growth;

in conditions of price stability, the diversion of resources from the productive sphere to unnecessary hedging operations against inflation is avoided;

prevents the arbitrary redistribution of income and wealth, a phenomenon encountered in both inflationary and deflationary environments. If high rates of inflation or deflation can create political and social instability, an economic environment characterized by stable prices contributes to maintaining stability and social cohesion;

contributes to financial stability, which would ensure the normal functioning of the financial intermediation process. This, in turn, allows the efficient allocation of financial resources from depositors to investors and, implicitly, the amplification of economic growth.

3.2. The European Central Bank's monetary policy strategy and current challenges

Article 127 of TFEU/ex Article 105 of the TCE - the main objective of the European Central Bank (ECB) is

1. to "maintain price stability"

2. to supports the general economic policies of the EU in order to contribute to the achievement of its objectives.

The Treaty therefore sets out a **clear hierarchy of the objectives** pursued by the ECB, attaching particular importance to price stability, and the other objectives are subordinate to and conditioned by it.

ECB report for 2020 – next slide

Eurosystem modelling

Assesses knowledge gaps in the main models used for monetary policy decision-making.

Fiscal and monetary policy in a monetary union

Takes stock of the fiscal policy landscape in the euro area and assesses implications for monetary policy.

Globalisation

Assesses the impact of globalisation on the transmission of monetary policy decisions to the economy and to inflation.

Inflation expectations

Analyses how inflation expectations are formed and deepens the understanding of their main drivers.

Inflation measurement

Analyses the most accurate method of measuring inflation, and assesses potential measurement issues.

Macroprudential policy, monetary policy and financial stability

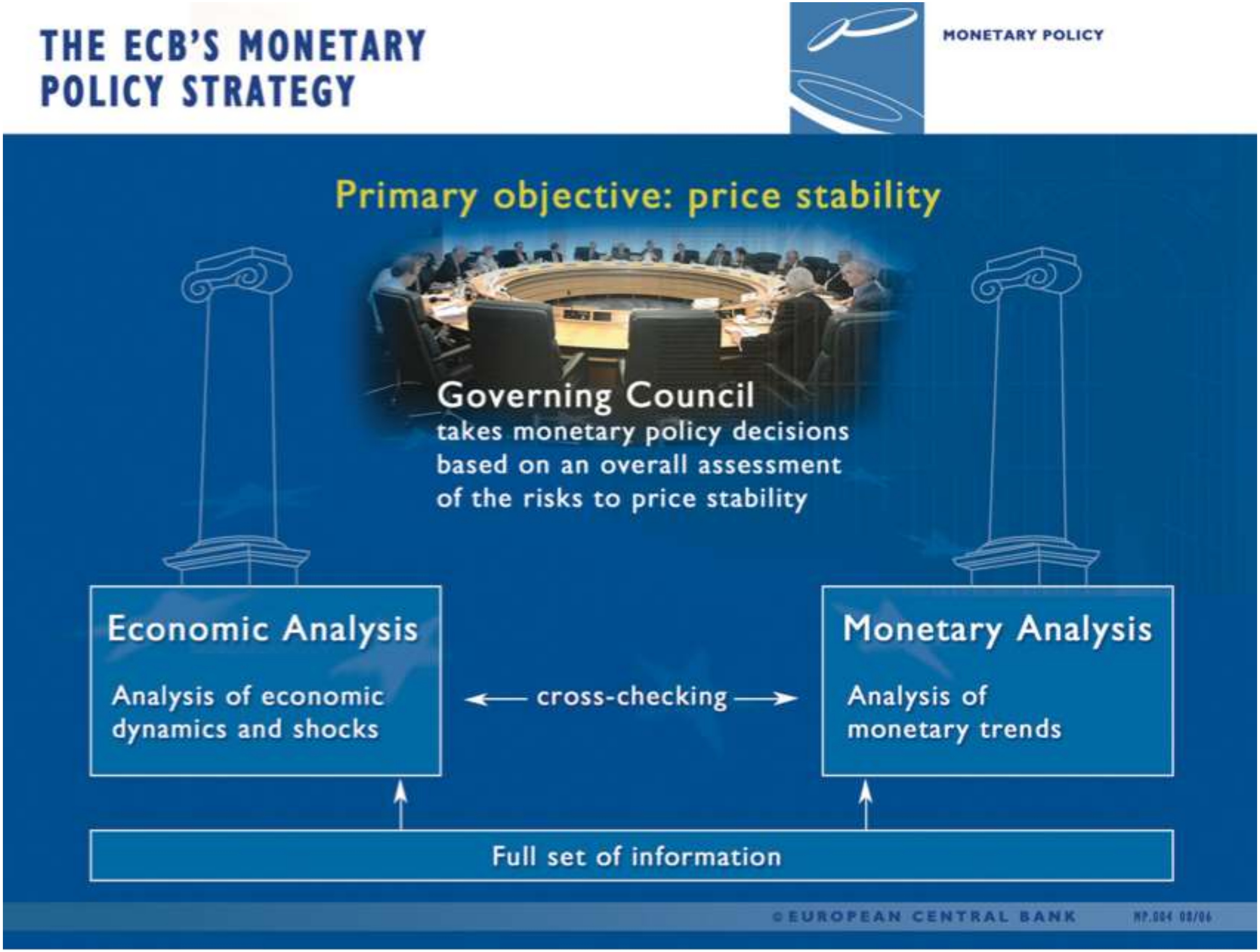
Contributes to the assessment of the interaction between macroprudential policies, financial stability and monetary policy.

Monetary policy communication

Non-bank financial intermediation

Examines how the changing

Price stability objective


THE ECB'S MONETARY POLICY STRATEGY
MONETARY POLICY
Primary objective: price stability
Governing Council
takes monetary policy decisions based on an overall assessment of the risks to price stability
Economic Analysis
Analysis of economic dynamics and shocks
cross-checking
Monetary Analysis
Analysis of monetary trends
Full set of information
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MP.004 08/06

Direct inflation targeting involves at least five components:

1) stating the assurance of price stability as a single or priority objective of the monetary policy, either by constitutional means or by the public commitment of the monetary authority. Ensuring price stability means achieving a low and stable level of inflation.

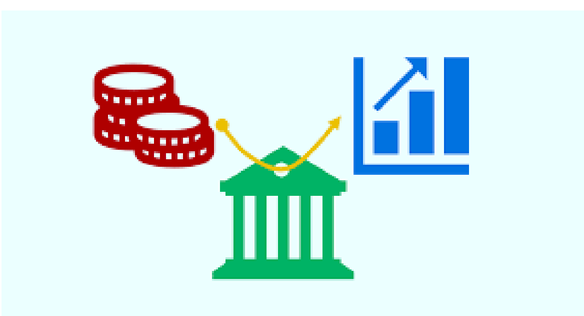
2) quantifying the objective of monetary policy as an inflation rate to be achieved within a time frame (most often annually, but it is also possible to define multi-annual or medium-term objectives). The inflation target may be set by the government and delegated to the central bank, set jointly or specified independently by the monetary authority;

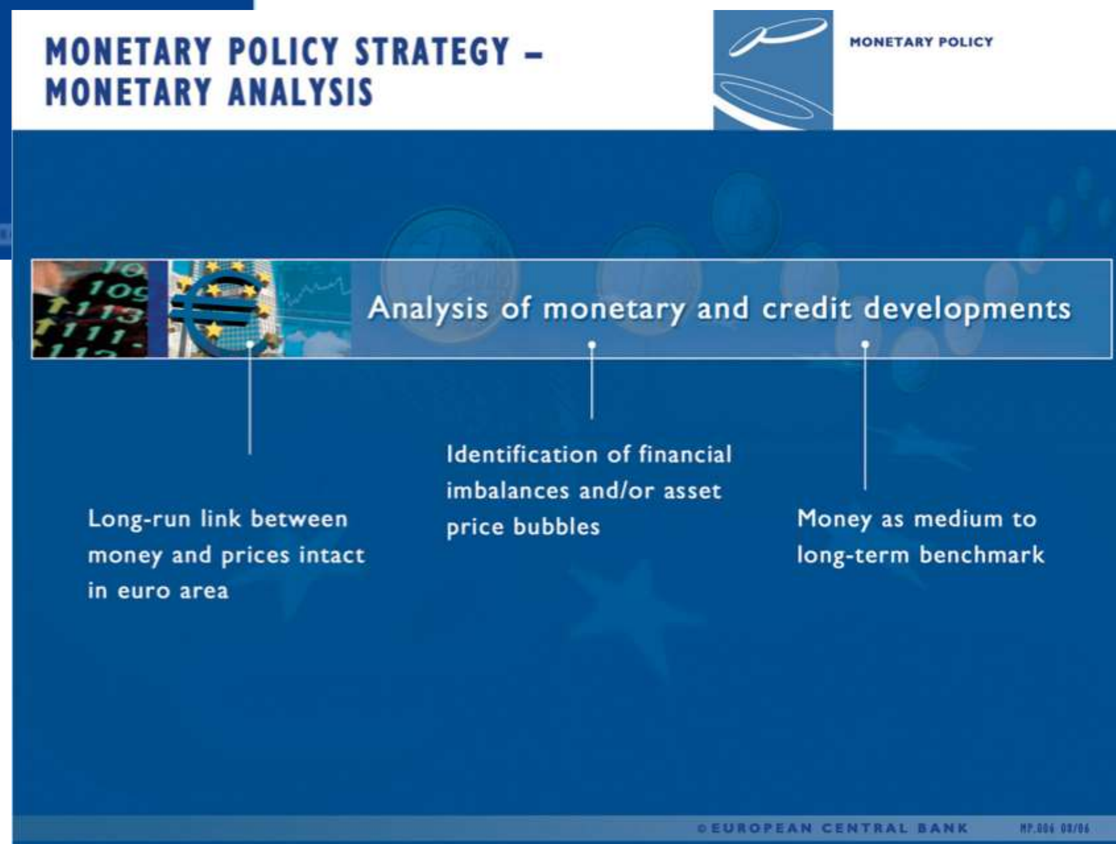
3) the independence of the central bank in the use of monetary policy instruments to achieve the target inflation rate. Such independence of the central bank would be manifested, in particular, by reducing the role of intermediate targets.

4) elaboration and application of the monetary policy in conditions of full transparency, through the regular publication by the monetary authority of some reports on inflation;

5) the existence of the responsibility of the central bank for the failures in reaching the set inflation targets. Central bank penalties for failing to meet the proposed target can take various forms, from explicit ones (dismissal of the governor or reduction of the bank's budget) to implicit reputational costs.


MONETARY POLICY STRATEGY –
ECONOMIC ANALYSIS
MONETARY POLICY
Analysis of a broad range of economic/financial developments with a view to
Supply
Demand
Goods, services, factor markets
to assess
Economic shocks
Dynamics
Perspectives
Resulting risks to price stability over short and to medium term




MONETARY POLICY STRATEGY –
MONETARY ANALYSIS
MONETARY POLICY
Analysis of monetary and credit developments
Long-run link between money and prices intact in euro area
Identification of financial imbalances and/or asset price bubbles
Money as medium to long-term benchmark
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Indirect monetary policy strategies

In order to achieve the ultimate goal of monetary policy, monetary authorities have certain tools at their disposal, which, however, influence the ultimate goal indirectly and over a period of time. For this reason, central banks need to set certain intermediate targets, which ensure the link between monetary policy instruments and its ultimate objectives.

According to economic practice, the following indirect monetary policy strategies have emerged:

1. exchange rate targeting;

2. targeting monetary aggregates (money targeting);

3. default nominal anchor.

1. The exchange rate targeting strategy – advantages

- allows to reduce inflation by reducing the volatility of import goods prices. Such an advantage appears especially in the case of small countries, with a high degree of openness, in which import goods have a significant share in international trade;
- inflation expectations are anchored at the inflation rate in the country whose currency is used as the anchor currency;
- is a clear and simple strategy, which is easily understood by the public. Thus, the use of the exchange anchor would ensure a rapid reaction from the public;
- provides an automatic rule for conducting monetary policy, which avoids the temporal inconsistency of monetary policy (see box below).

2. The strategy of targeting monetary aggregates

- involves the explicit use by the monetary authority of a monetary aggregate as a nominal anchor (intermediate objective) in order to achieve the objective of ensuring price stability.
- The targeting of monetary aggregates is based on the quantitative theory of currency, according to which, in the long run, the increase of the price level is determined by the increase of the money supply. In this sense, the use of monetary aggregates as an intermediate target (objective) of monetary policy implies the establishment of a certain level of growth of the money supply (which differs from one country to another, depending on the chosen monetary aggregate) compatible with price stability and control. in order to eliminate excess liquidity from the economy.
- Within the strategy of targeting monetary aggregates, the monetary policy promoted by the central bank aims, as a priority, to control the volume of means of payment in the economy in order to avoid monetary imbalances.

3. Strategy based on the default nominal anchor

- Such a strategy does not explicitly establish a nominal anchor. The central bank monitors various indicators, depending on which monetary policy it conducts.
- The successful implementation of the strategy based on the default nominal anchor presupposes that the monetary authority has a high degree of credibility, acquired as a result of the long-term manifestation of monetary stability and prices in the respective country.
- The strategy based on the default nominal anchor is applied, for example, in the USA where the Federal Reserve System chooses a default nominal anchor, which will ensure long-term price stability. The Federal Reserve System strategy (also called "just do it") is based on economic forecasts and aims to adjust interest rates so as to maximize the likelihood of achieving the objectives pursued.
- The discretionary policy promoted in the USA has achieved positive results in terms of inflation and employment, but it is not transparent and is vulnerable to problems related to inconsistency over time. The success of the monetary policy promoted in the USA would be due to the public trust in the officials of the Federal Reserve System.

3.3. The transmission mechanism of single monetary policy

To achieve its primary objective of maintaining price stability, the Eurosystem has at its disposal a set of monetary policy instruments.

OPEN MARKET OPERATIONS

STANDING FACILITIES

MINIMUM RESERVES


THE MONETARY POLICY INSTRUMENTS
MONETARY POLICY
Standing facilities
Open market operations
Reserve requirements
Deposit facility
Marginal lending facility
(Rates generally lower than market rates)
(Rates generally higher than market rates)
Main refinancing operations
(Maturity: one week)
Longer-term refinancing operations
(Maturity: three months)
Fine-tuning operations
Structural operations
RESERVE BASE
Deposits, debt securities and money market paper
RESERVE RATIO
2% for the majority of the items to which the reserve base applies
REMUNERATION
Reserve holdings will be remunerated at the Eurosystem's rate on its main refinancing operations
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Open market operations

1 Main refinancing operations are regular liquidity-providing reverse transactions conducted by the Eurosystem with a frequency and maturity of normally one week. They are executed in a decentralised manner by the national central banks on the basis of standard tenders and according to an indicative calendar published on the ECB's website. The main refinancing operations play a pivotal role in fulfilling the aims of the Eurosystem's open market operations and normally provide the bulk of refinancing to the financial sector.

2. Longer-term refinancing operations are liquidity-providing reverse transactions with a longer maturity than the main refinancing operations. Regular longer-term refinancing operations have a maturity of three months and are conducted each month by the Eurosystem on the basis of standard tenders in accordance with the indicative calendar on the ECB's website. The Eurosystem may also conduct non-regular longer-term operations, with a maturity of more than three months. Such operations, with maturities of up to 48 months (the longest being the targeted longer-term refinancing operations, or TLTROs), are not included in the indicative calendar. Longer-term refinancing operations are aimed at providing counterparties with additional longer-term refinancing and can also serve other monetary policy objectives.

3. Fine-tuning operations can be executed on an ad hoc basis to manage the liquidity situation in the market and to steer interest rates. In particular, they are aimed at smoothing the effects on interest rates caused by unexpected liquidity fluctuations. Fine-tuning operations are primarily executed as reverse transactions, but may also take the form of foreign exchange swaps or the collection of fixed-term deposits. The instruments and procedures applied in the conduct of fine-tuning operations are adapted to the types of transaction and the specific objectives pursued in performing the operations. Fine-tuning operations are normally executed by the Eurosystem through quick tenders or bilateral procedures. The Eurosystem may select a limited number of counterparties to participate in fine-tuning operations.

4. Structural operations can be carried out by the Eurosystem through reverse transactions, outright transactions,and the issuance of debt certificates. These operations are executed whenever the ECB wishes to adjust the structural position of the Eurosystem vis-à-vis the financial sector (on a regular or non-regular basis). Structural operations in the form of reverse transactions and the issuance of debt instruments are carried out by the Eurosystem through standard tenders. Structural operations in the form of outright transactions are normally executed through bilateral procedures.

3.4. Conventional monetary policy instruments of the ECB

Standing facilities

Standing facilities aim to provide and absorb overnight liquidity, signal the general monetary policy stance and bound overnight market interest rates. Two standing facilities, which are administered in a decentralised manner by the NCBs, are available to eligible counterparties on their own initiative.

Marginal lending facility

Counterparties can use the marginal lending facility to obtain overnight liquidity from the NCBs against eligible assets. The interest rate on the marginal lending facility normally provides a ceiling for the overnight market interest rate.

Deposit facility

Counterparties can use the deposit facility to make overnight deposits with the NCBs. The interest rate on the deposit facility normally provides a floor for the overnight market interest rate.

Minimum reserves are an integral part of the operational framework for the monetary policy in the euro area.

The intent of the minimum reserve system is to pursue the aims of stabilising money market interest rates and creating (or enlarging) a structural liquidity shortage.

The reserve requirement of each institution is determined in relation to elements of its balance sheet. In order to pursue the aim of stabilising interest rates, the Eurosystem's minimum reserve system enables institutions to make use of averaging provisions. This implies that compliance with the reserve requirement is determined on the basis of the institutions' average daily reserve holdings over a maintenance period of about one month. The reserve maintenance periods start on the settlement day of the main refinancing operation (MRO) following the Governing Council meeting at which the monthly assessment of the monetary policy stance is pre-scheduled. The required reserve holdings are remunerated at a level corresponding to the average interest rate over the maintenance period of the main refinancing operations of the Eurosystem.

4. UNCONVENTIONAL MONETARY POLICY INSTRUMENTS OF THE ECB IN THE CONTEXT OF THE LATEST GLOBAL CRISIS

4.1. Typology of the ECB's unconventional monetary policy instruments and their implementation

4.2. Unconventional monetary policy measures adopted by the European Central Bank in the context of the COVID-19 pandemic

4.3. Macroeconomic effects of the ECB's unconventional monetary policy

5. THE OPERATIONAL FRAMEWORK OF THE MONETARY POLICIES OF THE EU MEMBER STATES WHICH HAVE NOT ADOPTED THE EURO

5.1. Characteristics of monetary policy instruments in non-euro area EU Member States

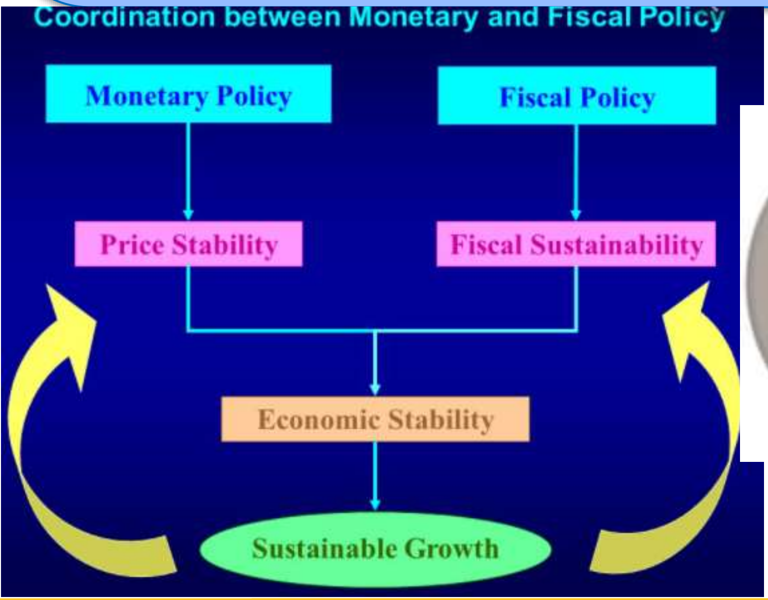
5.2. Impact of monetary policy instruments on the banking sector and the real economy in EU non-euro area Member States

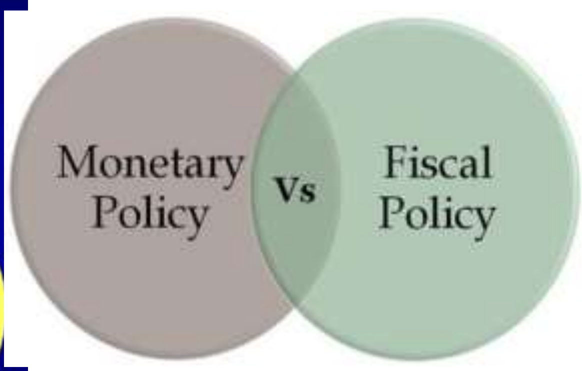
6. COORDINATION OF MONETARY POLICY WITH FISCAL POLICY IN EU MEMBER STATES

6.1. The need to coordinate the monetary policy with the fiscal policy in EU Member States

6.2. The mechanisms of coordination between the two policies in the EU Member States and possibilities of improvement

6.3.The role played by the monetary and the fiscal policies in the macroeconomic stabilisation of the EU countries





7. CURRENT CHALLENGES FOR MONETARY POLICY IN EU

7.1. Implications of financial and technological innovations on monetary policy

7.2. Digital currencies of central banks and monetary policy implications

7.3. Monetary policy and climate change

7.4. Implications of Brexit for the ECB's monetary policy

Questions?