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Monetary policy – instrument for macroeconomic stabilization

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Abstract

The purpose of this article is to determine the transmission mechanism and importance of monetary policy for macroeconomic stabilization. For this purpose it was analyzed: the monetary policy decisions since 2012; the transmission mechanism of the monetary policy (real monetary conditions index); the effects of monetary policy decisions to rates on loans and deposits, and how to evaluate the credibility of monetary policy.

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Keywords: monetary policy; target inflation; real interest rate; effective exchange rate; monetary conditions index.

1. INTRODUCTION

The monetary policy rate (or the base rate as for the Republic of Moldova) is one of the instruments of monetary policy through which the monetary authority of a country influences the direction of the national economy in line with the set objectives. The monetary policy rate is used to influence the demand for money. When the monetary authority lowers the monetary policy rate, it stimulates interest for refinancing banks as they require more loans, which are used for lending to the economy. Otherwise, increasing the base rate makes the central bank credit "more expensive", discouraging the practice of refinancing and reducing banks' potential to lend to the economy.

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If the primary objective of monetary authorities is price stability, the monetary policy rate is an indirect instrument of influence for the medium and long term inflation. For example, the increase in the policy rate, causes financial institutions to operate with increased interest rates, which inhibits investment and consumption in favor of saving. This lowers aggregate demand and aggregate supply given stiffness to monetary policy in the short term, creating "excess supply", causing a decrease in prices and a lower level of inflation. Otherwise, a decrease in the rate is an alternative to boost economic activities in the periods when aggregate demand is below potential, and also to fight disinflationary pressure.

2. GENERALCONCEPTS

Long-term price stability became a fundamental objective for central banks. This objective is achieved through different monetary policy regimes. Monetary policy regime implemented in 2010, in the Republic of Moldova, according to the monetary policy strategy in the medium term is inflation targeting. Among the CIS countries inflation targeting regime, explicitly or implicitly, have passed in recent years Armenia (2006), Georgia (2009). Other CIS countries, including the Russian Federation, Ukraine, Kazakhstan, and Belarus are in the process of transition to inflation targeting regime. Target price is also promoted by the monetary authorities of the Czech Republic (1997), Poland (1999), Hungary (2001), Turkey (2002), Romania (2005), etc.

In some countries, monetary policy is oriented towards exchange rate stability. Changing the policy rate, if that is used to avoid destabilizing the exchange rate at the target level as a result of pressures that arise through uncovered interest parity. Typically, monetary policy decisions are strongly correlated with monetary policy decisions of the economy whose currency serves reference currency. Therefore, this implies a reduced monetary independence. This type of arrangement is found mainly in Asian countries (Hong Kong, Singapore, Sri Lanka, etc..) - Which is explained by their orientation towards exports, but such policies are still present in some CIS countries, Bulgaria etc.

However, the monetary policy rate of the most important global economic players is an indicator that reflects the trend of the global economy. Monetary policy decisions on the base rate of the U.S. Federal Reserve System, the European Central Bank, the People's Bank of China, and The Central Bank of England are important for financial markets, causing changes in global financial environment. For example, in early July the policy rate was reduced by the European Central Bank and by the People's Bank of China, causing an imminent decline of the global economy, followed by a significant drop in oil prices and prices other raw materials.

In 2012, as the Eurozone crisis and disruption of world trade and mitigating pro-inflationary tensions, several countries decided to lower the policy rate, in order to support the work of national economies and to prevent a possible recession. However, considering the time the impulse propagates to lower policy rate, forecasting and decision making preventive deflationary phenomenon led to achieving successful outcomes for some monetary authorities. Since January 2012, up to now, the National Bank lowered the policy rate by 1.0, 2.0, 2.0 and 1.0 percentage points respectively to the level of 3.5 percent. In Table 1 are described some of the monetary policy decisions of neighbors and economies of scale:

Table 1. Monetary policy decisions in 2012 in neighboring economies and economies of scale

			Inflation in the previous month to the monetary policy decision			Base rate (interest rate)	
Country	Monetary policy	Target inflation in 2012	annual	monthly	Date of the modification of the base rate	Unmodified	Modified
Armenia	Target inflation	4% ± 1.5 p.p.	Starting with the 6th of September 2011 - 8.0%				
Georgia	Target inflation	0.06	2.0	0.6	18th of January 2012	6.75	6.5
			-2.2	-0.2	25th of April 2012	6.5	6.25
			-2.1	0.0	23rd of May 2012	6.25	6.0
			-3.3	-0.9	20th of June 2012	6.0	5.75
			0.1	0.0	21st of November 2012	5.75	5.5
			-0.5	0.1	19th of December 2012	5.5	5.25
			-1.6	0.2	13th of February 2013	5.25	4.75

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