

THE MONETARY POLICY AND THE FINANCIAL STABILITY IN THE CONTEXT OF GLOBALIZATION

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Abstract

It is unanimously acknowledged at an international level that, for the long term, the stability of prices is the fundamental objective of the monetary policy of central banks. The international financial crises that have occurred in the context of financial globalization have determined central banks from various countries to give special attention to the promotion of financial stability. This attitude is due to the fact that a stable and solid financial system provides the prerequisites for the implementation of an efficient monetary policy, which contributes to the achievement of the fundamental objective, that of ensuring the stability of the prices.

This paper aims at emphasizing the relationship between the stability of the prices and financial stability in the context of financial globalization, and the extent to which central banks can, via the monetary policy they promote, can contribute to the achievement of these objectives.

Key words: monetary policy, financial stability, central banks, financial globalization, financial crises

JEL classification: E52, E58, E61, G01

1. Introduction

In the context of the financial globalization process that began in the '80-s, the financial systems of most states of the world registered significant transformations. They were determined, mainly, by the reforms undertaken by the authorities in order to liberalize and modernize financial systems, as well as by the multiplication of financial innovations. The mutations registered allowed an efficiency growth in resource allocation, but also the pronounced growth of financial instability that lead to the numerous financial crises of the last years.

The significant growth of the financial markets under the impact of capital movement liberalizations, financial innovations, technical progress, their greater role in the financing of national economies, as well as the easy multiplication and spread of risks, due to market interdependence, determined central banks to show great concern to ensure financial stability.

Ensuring financial stability represents a natural concern of central banks, result of some of its specific functions: lender of last resort, regulation and supervision of the banking

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sector, regulation and monitoring of the economy payment systems and the function of foreign currency center. In the last years, ensuring financial stability became a major concern of central banks, due to the fast propagation of financial crises, their negative effects on financial markets and the macroeconomic perspectives, but also due to the economic and social costs that they imply.

From the standpoint of monetary policy, central banks are interested to ensure financial stability because monetary policy is implemented through operations on the financial markets, while the efficient transmission of monetary policy measures onto the real economy depends, mainly, on the good operation of financial institutions and markets. As a matter of fact, there is a close link between financial stability and monetary policy. Thus, on the one hand a stable and solid financial system allows the efficient transmission of monetary policy, and on the other hand, financial disruptions may be prevented and eliminated through the operational framework of monetary policy.

Our work is structured in the following way: section two shows the relation between price stability and financial stability from the standpoint of the two approaches sketched in specialized literature: the conventional approach and the "new environment" approach. Section three presents, from the perspective of monetary policy, the actions undertaken by central banks, particularly with references to the Federal Reserve System and the European Central Bank, in order to restore the normal work order of financial institutions and markets in the context of the present international crisis. The study ends with some conclusions.

2. Price Stability as a Fundamental Aim of Monetary Policy and its Relation to Financial Stability

At international level, as a result of numerous studies and further to practical experience, that stressed the significant costs of both inflation and deflation, there is a consensus regarding price stability as a fundamental objective of monetary policy.

In present conditions, the statutes of most central banks define the ensuring and maintaining of price stability as a fundamental aim of monetary policy.

For example, according to article 105 of the European Community Treaty, *the main objective of the European Central Bank (ECB) is "to maintain price stability"*, but also, without affecting the fulfillment of this goal, *"a lasting and non-inflationist economic growth, a high level of employment and social protection"*. Therefore, the Treaty establishes a clear hierarchy of the objectives pursued by the ECB, giving special attention to price stability and subordinating the other objectives to this main goal.

In the U.S.A., the Federal Reserve System (FED) has the following objectives, defined by its statute: *"a maximal degree of employment, price stability and moderate long term interest rates"* [The Federal Reserve Board, 2000].

That is, unlike the ECB, *FED has a multi-objective mandate*. In the case of the Federal Reserve System and according to its statute, price stability is not defined as the priority objective of monetary policy. However, FED officials have repeatedly stated that by *"a maximal degree of employment"* they understand a *"maximal degree of sustainable employment"*, that is a non-inflationist one, in such a way that the main objectives, equally important, would be a complete labor force employment and price stability, while maintaining long term interest rates at a moderate level would be a secondary objective.

In Romania, under Article 2 of the Law on the Status of the National Bank of Romania *"the fundamental objective of the National Bank of Romania is to ensure and maintain price*

stability", and without affecting the fulfillment of this fundamental objective, the National Bank of Romania "supports the general economic policy of the State".

By defining price stability as the main objective of monetary policy, monetary policy is considered to make the most important contribution to lasting economic growth, a better labor force employment and social welfare enhancement. The contribution of price stability is stressed by its advantages, among which [European Central Bank, 2004, 41-43]: *the improvement of relative price transparency*, which allows a more efficient allotting of resources and, therefore, the growth of production and population welfare; *its contribution to the diminishing of nominal and real interest rates*, which stimulates economic growth and the raise of employment; *the protection of the real value of incomes and wealth*, which allows maintaining social stability and cohesion; in conditions of price stability the diversion of resources from the production sector to useless anti-inflation covering operations is prevented.

In specialized literature we may find numerous definitions of price stability, which have, however, the following common elements [Isărescu, 2006]: price stability refers to the aggregate level of prices, measured through indexes; price stability is attained when money keep their value in time or the erosion speed of their purchasing power is very slow; the concept of monetary stability laps over the concept of price stability.

Practice shows that central banks, which have as their fundamental objective to ensure price stability, use explicit (quantitative) definitions of this objective. For example, in the case of the European Central Bank, price stability is understood as the situation in which the inflation rate, calculated on the bases of the harmonized index of the Euro-Zone consumption prices, is under (but near) 2%. In the case of central banks that apply the strategy of direct inflation targeting, price stability is defined by the comparison to the numeric target to be attained, which can be a fluctuation band or a certain percentage with or without fluctuation interval.

In comparison to price stability, considered easy to define and quantify, financial stability is a complex concept (due to the complexity and dynamics of the financial system) and up today there is no generally-accepted definition or a synthetic indicator for its quantification. For example, ECB defines financial stability as the situation in which „*the financial system – comprising of financial intermediaries, markets and market infrastructures – is capable of withstanding shocks, thereby reducing the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities*” [European Central Bank, 2009a, 9].

According to the National Bank of Romania, financial stability represents "that characteristic of the financial system of facing systemic shocks on long-lasting bases and without major disturbances, of efficiently allocating financial resources in the economy and of identifying and administrating risks efficiently [National Bank of Romania, 2006, 7].

The concept of financial stability is usually defined in financial stability reports published by central banks. However, we should point out that a wider definition reflects a deeper concern to ensure financial stability and that reports are more consistent in information and analyses.

Table no.1 presents various definitions of the financial stability concept, derived from the stability reports of some central banks.

From the perspective of the role of monetary policy in ensuring financial stability, Mugur Isărescu, Governor of the National Bank of Romania, offers a wide and unrestricted

interpretation of financial stability [Isărescu, 2006]. The wide definition of financial stability gives a high importance to the functioning of the financial system as a whole and represents the situation in which the financial system ensures the efficient allocation of money resources and resists to shocks without significant disruptions. This definition suggests that monetary policy is very important from the standpoint of the efficient allocation of resources in the measure that it contributes to price stability.

The definition of financial stability in a narrow sense stresses crises prevention and represents the situation in which there are no banking crises and the asset prices and, specially, interest rates show a high level of stability. From this point of view, monetary policy presents a high importance in ensuring financial stability, but the possibility to use its main instrument (monetary policy interest rate) can be limited to prevent a conflict between price stability and financial stability.

In the last two decades, financial crises produced in the process of financial globalization determined the intensification of debates between authorities, but also in specialized literature, regarding the relation between price stability and financial stability.

In specialized literature two approaches regarding the relation between price stability and financial stability have been sketched: the conventional approach and the "new environment" hypothesis.

Table no. 1 – Defining the concept of financial stability under the financial stability reports of central banks

Country	Definition	Location
Czech Republic	financial stability as a situation where the financial system operates with no serious failures or undesirable impacts on the present and future development of the economy as a whole, while showing a high degree of resilience to shocks	Foreword at Financial Stability Report, 2007
Germany	financial stability as the financial system's ability to perform its key macroeconomic functions well, including in stress situations and during periods of structural adjustment.	Foreword at Financial Stability Review, november, 2005
Hungary	Financial stability is a state in which the financial system, including key financial markets and financial institutions, is capable of withstanding economic shocks and can fulfil its key functions smoothly, i.e. intermediating financial resources, managing financial risks and processing payment transactions.	Foreword at Financial Stability Report, april, 2005
Poland	Financial system stability is a situation when the system performs all its functions in a continuous and effective way, even when unexpected and adverse disturbances occur on a significant scale	Foreword at Financial Stability Report, june, 2009
Slovenia	Financial stability is defined as a situation in which the components of the financial system (financial markets, financial institutions and financial infrastructure) function without disruption and in which each component of the financial system provides the greatest possible degree of flexibility in responding to any shocks that occur.	Introduction at Financial Stability Report, 2003
Slovak Republic	Financial stability is defined as the situation when financial system and its varied elements– such as financial markets, financial institutions, systems for transfers of payments and securities, and settlement systems – function fluently and are prepared to settle potential difficulties	Foreword at Financial Stability Report, 2003

Source: [National central banks]

The conventional approach of the relation between price stability and financial stability was stressed by the American monetarist Anna Schwartz, who sustained that a monetary policy oriented towards ensuring price stability contributes to reducing the frequency and negative consequences of financial crises. Such an approach, known in specialized literature as "the Schwartz hypothesis" sustains that price stability is a condition necessary and sufficient to maintain financial stability [Mésonnier, 2004, 70].

The conventional vision is analyzed on the basis of statistical data, mostly in the works of Bordo, Dueker and Wheelock (1998, 2001) that stressed that the most serious banking crises appeared in periods characterized by the significant instability of prices. The studies made by Bordo and others (2001) show, on the basis of statistical data from the U.S.A. and Great Britain, the existence of a positive relation between inflation and financial instability in the periods 1790-1933 and 1972-1999. The conclusion that we may draw from the authors mentioned above is that price stability and financial stability are complementary and coherent.

International financial imbalances that have occurred since 1997, including the present financial crisis were generated in the context of a financial environment characterized by stable prices, which invalidates the conventional approach according to which price stability represents a sufficient condition to ensure financial stability.

The study made by Goodfriend (2001) stresses for the first time the role of a credible monetary policy (which acts against inflation) in the manifestation of financial imbalances. This vision was also sustained in Borio and Lowe's (2002) and Borio and others' studies (2003), which reveal the fact that financial imbalances can appear and even multiply in an economic environment characterized by stable prices. The aforesaid authors have stressed the central role of a credible monetary policy in the aggravation of financial imbalances, stating in an explicit way the "credibility paradox" hypothesis of monetary policy.

The "credibility paradox" of monetary policy was formulated in specialized literature also under the name of "new environment" hypothesis, according to which, together with the stabilization of inflation at reduced levels, a new economic environment is created, in which financial stability is not guaranteed [Isărescu, 2006]. Therefore, price stability represents a necessary condition, but not sufficient to ensure financial stability.

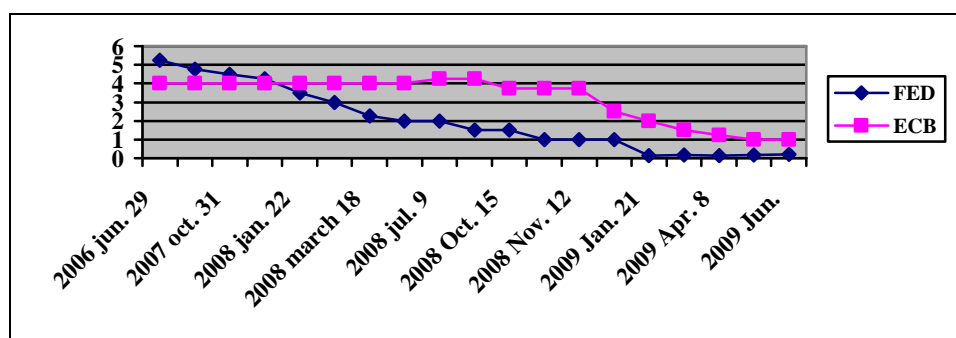
The "credibility paradox" of monetary policy or the "new environment" hypothesis stresses the fact that in an economic environment characterized by a low and stable inflation there might be created a climate of excessive confidence that will encourage the assumption of considerable risks. In this context, there was an excessive increase of financial assets price, which led to the instability of the financial system. Even though the "credibility paradox" hypothesis of monetary policy could not be empirically verified up to-day [Mésonnier, 2004, 79] the relation between price stability and financial stability continues to be in the center of attention of central banks.

The present international financial crisis that began in August 2007 in the mortgage credit market of the U.S.A. stresses the fact that there may be situations in which ensuring financial stability is more important than the objective of maintaining price stability. In this case, a monetary policy oriented to ensuring price stability can accept, at least at short term, adopting priority measures to ensure financial stability. If there is no financial stability the increase of monetary policy efficiency cannot be ensured and, therefore, long term price stability cannot be ensured either.

3. The Role of Monetary Policy in Ensuring the Stability of Prices and of the Financial System in the Context of the Present International Crisis

The sub-prime mortgage credits crisis in the U.S.A. that began in August 2007 spread fast to other markets and other states, which imposed the necessity of a fast intervention of central banks in order to reestablish the health of the financial system.

From the standpoint of monetary policy, the reactions of central banks to financial turbulences were different, depending on the nature of the shocks that affected the economies, on the particularities of economic and financial structures and on the transmission mode of monetary policies onto the real economy [Noyer, 2008]. For example, in the U.S.A. the real estate crisis, which broke out in a context characterized by the over-indebtedness of the population, slow down of economic growth and fear of economic recession, determined the monetary authority to modify the orientation of monetary policy by relaxing it. Thus, on September 18, 2007 the Federal Reserve System reduced the federal funds rate by 50 basic points, i.e. from 5.25% to 4.75%. Such a situation reflects the deep concern of the Federal Reserve System for the impact that the restriction of activities in the field of real estate and the hardening of crediting conditions could have on economic growth perspectives. In the opinion of Governor Frederic S. Mishkin, the decision to reduce the federal funds rate was a most prudent action from the macroeconomic point of view, which created no conflict with the price stability objective, as data regarding the inflation were favorable [Mishkin, 2007]. From the beginning of the crisis up to-day, the Federal Reserve System reduces the federal funds rate several times in order to reestablish the normal work order of the financial system (see figure no. 1). On December 18, 2008, in order to anchor anticipations regarding the federal funds rate, the Federal Reserve System communicated to the public its engagement to keep this instrument within the fluctuation range of 0 - 0.25% [The Federal Reserve Board, 2008].



Source: <http://www.federalreserve.gov/fomc/fundsrate.htm>,
<http://www.ecb.int/stats/monetary/rates/html/index.en.html>

Figure no. 1. The evolution of the monetary policy interest rate (in percent per year) of the FED and the ECB, June 2006 - June 2009

In comparison with the U.S.A., the economic context in the Euro Zone, characterized by economic growth, but also by inflationist tensions, determined the European Central Bank not to change the orientation of monetary policy, in such a way that the interest rate of the monetary policy was maintained at the level that existed before the crisis, i.e 4%. There-

fore, the orientation of the monetary policy of the European Central Bank remained focused on the fundamental macroeconomic objective of maintaining price stability at middle term.

The actions undertaken by the European Central Bank in the period August 2007 – October 2008 in order to correct financial instability and reestablish the normal work order of the financial system were guided by the principle of separating the monetary policy, which is defined by directing interest rates and aims to attain the fundamental objective of maintaining price stability at middle term, from asset administration, which aims to ensure the normal work order of the interbank monetary market, as well as from the efficient transmission of monetary policy impulses onto the real economy [Papademos, 2009]. In the period mentioned above, due to the high inflation rate, the actions of the European Central Bank were not aimed to change the orientation of the monetary policy, but to adapt the monetary policy operational framework in such a way that liquidity on the interbank monetary market might be ensured.

The aggravation of the international financial crisis from September 2008, the confirmation that the economies of important states entered recession, as well as the reduction of the risk of inflation increase due to the fall of prices of oil and raw material, determined the European Central Bank to announce the first reduction of the monetary policy interest rate (from 4.25% in July 2008 to 3.75% in October 2008) by participating in the coordinated action to reduce the monetary policy interest rate (by 50 basic points), in which participated at the same time the Federal Reserve System, the Bank of Canada, the Bank of Sweden and the National Bank of Switzerland.

In the next months, due to the deterioration of macroeconomic indexes and the fall of the inflation rate (as a result of the fall of oil and raw material prices), the European Central Bank promoted a relaxed monetary policy, characterized by the repeated reduction of the monetary policy interest rate, which currently amounts to the level of 1% (see figure no. 1). Thus, in the period October 2008 – May 2009, the monetary policy interest rate diminished by 325 basic points, which is considered as the most important reduction ever achieved in Europe in such a short period of time.

When central banks establish the monetary policy interest rate, they intend that its level be compatible with the fundamental objective of the monetary policy, i.e. they give a significant importance to the evaluation of the risks that might affect it. For example, the European Central Bank evaluates the risks that might jeopardize price stability on the basis of the information supplied by the two pillars of its monetary policy strategy: the economic analysis and the monetary analysis. The first pillar, the economic analysis, is common to most central banks and represents the analysis of global supply and demand within the economy. It intends to evaluate the risks to price stability. The second pillar, the monetary analysis, has a more important role at European Central Bank level than for other central banks, as the European Central Bank sustains that there is a close middle and long term relation between the increase of the monetary mass and inflation. Within this analysis, credit and asset price evolution, as well as their implications are given a special importance.

When central banks draft the actions to undertake in order to reestablish the health of the financial system, they take into consideration the anticipations regarding inflation and intend, at the same time, to keep it firmly anchored to the monetary policy objective of ensuring price stability. Such a behavior of central banks highlights the fact that it is necessary to ensure price stability during financial instability periods, too.

In order to ensure financial stability central banks, and especially the Federal Reserve System and the European Central Bank, have undertaken, besides the reduction of monetary

policy interest rate, other actions as well, such as: the operational adaptation of the monetary policy, in such a way that it might ensure the necessary liquidity to keep a normal work order of the interbank monetary market, as well as the adoption of extraordinary non-standard measures. Such measures are called in this way because they differ from the classic measures adopted in normal conditions, when there are no financial disruptions. Presented in a synthetic way, those actions of the Federal Reserve System and the European Central Bank, were concretized in:

- the extension of the due date for refinancing operations of commercial banks. For example, in the Euro Zone the due date for longer term refinancing operations is currently of 12 months;
- the enlarging of the range of assets accepted as guarantee instrument in the refinancing operations carried out by central banks. For example, in the case of the Federal Reserve System, the list of assets accepts for refinancing include Treasury bonds, but also private and mortgage-backed securities;
- the increase of the number of counterparts eligible for refinancing operations carried out by central banks. For example, in the U.S.A., thanks to the creation of the Term Auction Credit Facility, all insolvable commercial banks and deposit institutions are accepted for refinancing. In the case of the European Central Bank, it is foreseen that the European Investment Bank will become an eligible Eurosystem counterpart within monetary policy operations;
- the supply of the Eurosystem of unlimited refinancing in exchange of a very wide range of eligible assets;
- the purchase of bonds rendered and issued in Euro by the Eurosystem, in order to sustain the private market of real estate securities, which was powerfully affected by the financial crisis;
- the direct crediting of the real economy, a measure considered as exceptional measure, because the normal practice of central banks is to supply liquidities through the bank sector.

The actions undertaken by different central banks in the context of the international financial crisis are presented in table no. 2.

*Table no. 2. Monetary policy measures adopted by various central banks in the period August 2007 - June 2009**

Objective	Measures adopted	FED	ECB	BoE	BoJ	BoC	RBA	SNB
Influence wholesale interbank market conditions	Modification of discount window facility	x ¹		x				
	Exceptional long-term operations	x	x ²	x	x	x	x	x
	Broadening of eligible collateral	x	x	x	x	x	x	x
	Broadening of counterparties	x		x	x	x	x	
	Inter-central bank FX swap lines	x	x	x	x	x	x	x
	Introducing or easing conditions for securities lending	x		x	x	x		
Influence credit	CP funding/purchase/collateral	x ³		x ⁴	x ⁵	x ⁶	x ⁷	

market and broader financial conditions	eligibility							
	ABS funding/purchase/collateral eligibility	x ⁸	x ⁹	x ⁴			x ⁷	
	Corporate bond funding/purchase/ collateral eligibility			x ⁴	x ¹⁰	x ⁶		x
	Purchase of public sector securities	x ¹¹		x ⁴	x ¹²			
	Purchase of other non-public sector securities				x ¹³			x ¹⁴

* BoE - Bank of England; BoJ - Bank of Japan; BoC - Bank of Canada; RBA - Bank of Sweden; SNB- Bank of Swiss

Source: [Bank For International Settlements, 2009, 7]

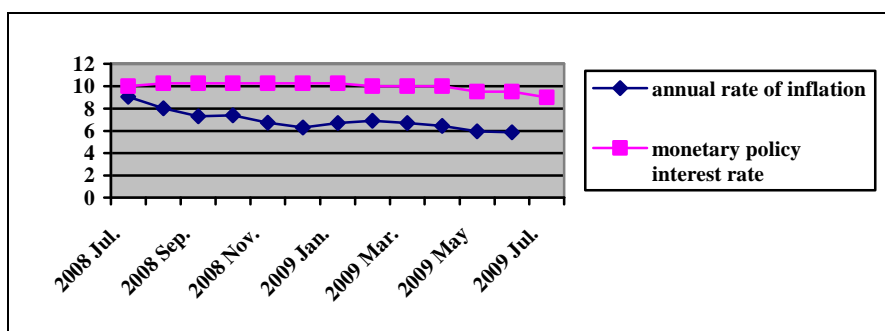
The different measures adopted by central banks in order to reestablish the normal work order of the financial system are justified by the particularities of the financial system of each country. For example, in the Euro Zone, indirect financing through the banking sector is prevailing, while in the U.S.A. direct financing through the market is. In order to illustrate this aspect, we should mention that at the end of 2007, the contribution to the Gross National Product of bank credits given to the private sector was 145%, as compared to the U.S.A., where the contribution was just of 63% [Trichet, 2009]. In this context, the measures adopted by the European Central Bank in the context of financial instability, including those taken in the present, are based mainly on the bank sector and intended to ensure its normal work order and to sustain the bank crediting activity for economic entities and households.

The exceptional monetary policy measures adopted by central banks in the context of financial instability are conceived so that they will be used only in crisis conditions, when classical measures are inefficient or present a low efficiency. Therefore, once confidence in the financial markets is reestablished and macroeconomic conditions are improved, central banks must be ready to abandon these measures. Otherwise, middle and long term price stability could be jeopardized. In this context, the drafting and implementation of an adequate strategy of exceptional measure resigning will constitute a new challenge for central banks.

As for the monetary policy measures promoted by the National Bank of Romania on the background of the current world economic and financial crises, similarly to those promoted by other central banks, they took into account, on one hand, the risks against its fundamental objective – ensuring the medium-term stability of prices and, on the other hand, the necessity to ensure the normal operation of the banking sector and implicitly of the financial system. In Romania, similarly to other countries of the European Union, including the Euro area, the financial system focuses on the banking system, yet it was not affected directly by the world crises because it has not been exposed to the toxic assets and because of the prudent administrative actions of the National Bank of Romania taken in good time [Isărescu, 2009].

Starting with October 2008, the effects of the international crisis were felt indirectly by the Romanian banking sector in the reduction of the external financing volume, determined by the decrease of the credit supply and demand, respectively the restriction of the banking crediting. As for the credit supply, its decrease was determined, besides the increase of the cost of external financing resources and the decrease of the liquidity surplus of banks, by the

increase of banks' aversion to risk and the negative perspectives regarding economic growth and unemployment. Regarding the credit demand, its decrease was determined mainly by the increase of expenses with interests and by the instability of the economic and financial situation of the potential credit applicants. Against this background and, moreover, taking into account the risks on price stability, the National Bank of Romania decided, on the one hand, to maintain unchanged the monetary policy interest rate at 10.25% during the last quarter of the year 2008 and in January 2009. Nevertheless, further to the restriction of the liquidity surplus of the banking sector and as banks passed to a liquidity deficit, starting with October 2008, the NBR decided to reduce the minimal compulsory reserve rate for the liabilities in lei of the credit institutions from 20% to 18% in order to ensure the normal operation of the banking sector.



Source: [<http://www.bnro.ro/Statistica-87.aspx>, <http://www.insse.ro/cms/rw/pages/index.en.do>]

Figure no. 2: The evolution of the annual rate of inflation and monetary policy interest rate in Romania, July 2008 – July 2009

Starting with February 4, 2009 up to the present, the NBR promoted a relaxed monetary policy (concretized by the decrease of the interest rate and of the minimal compulsory reserve rate), in keeping with the domestic economic context, characterized by the improvement of the anticipations regarding inflation and by the significant reduction of the economic growth and of the bank crediting (see figure no. 2 and table no. 3).

Table no. 3 - Monetary policy measures adopted by the National Bank of Romania, in October 2008 - June 2009

Period	Monetary policy measures
2008 Oct. 30	- Maintains the monetary policy interest rate at 10.25% per year
	- Reduces the minimal compulsory reserve rate for the lei liabilities of banks from 20% to 18%
	- Maintains the level of the minimal compulsory reserve rate for the foreign currency liabilities of banks (40%)
2009 Jan. 6	- Maintains the monetary policy interest rate at 10.25 % per year
	- Maintains the level of the minimal compulsory reserve rates for the liabilities of banks (18%, respectively 40%)
2009 Feb. 4	- Reduces the monetary policy rate by 0.25%, from 10.25% to 10% per year
	- Maintains the level of the minimal compulsory reserve rates for the liabilities of banks (18%, respectively 40%)
2009 Mar. 31	- Maintains the monetary policy interest rate at 10% per year

	<ul style="list-style-type: none"> - Reduces to zero the minimal compulsory reserve rate for the foreign currency liabilities that are residually overdue in over two years, from 40% - Maintains the level of the minimal compulsory reserve rates for the liabilities of banks (18%, respectively 40%)
2009 May 6	<ul style="list-style-type: none"> - Reduces the monetary policy rate from 10% per year to 9.5% per year - Maintains the level of the minimal compulsory reserve rates for the liabilities of banks (18%, respectively 40%)
2009 Jun. 30	<ul style="list-style-type: none"> - Reduces the monetary policy rate from 9.5% per year to 9 % per year - Reduces the minimal compulsory reserve rate for the lei liabilities of banks from 18 % to 15% - Reduces the minimal compulsory reserve rate for the foreign currency liabilities from 40% to 35%

Source: [<http://www.bnr.ro/Press-releases-1104.aspx>]

Compared to other central banks, the NBR did not have to call up to date exceptional monetary policy measures (unconventional ones) thanks to the particularities of the Romanian banking sector and to the slight effects of the current crises on this sector.

The monetary policy measures adopted by the NBR against the background of the current world financial and economic crises took into account the fundamental objective, that of ensuring the price stability and the necessity to correct the macroeconomic unbalances and to ensure the normal operation of the financial system.

4. Conclusions

Ensuring financial stability is a natural concern of central banks that arises from their specific attributions regarding the drafting and implementation of monetary policies and their role of "bank of banks" that regulates and monitors the payments within the economy.

The significant development of financial markets in the context of the globalization process, the increase of risks to financial stability and the serious consequences of financial instability for the good work order of financial institutions and markets, as well as for the economic growth and price stability, determined central banks to give priority in the last years to ensuring financial stability.

From the standpoint of monetary policy, the special interest on central bank to ensure financial stability is justified by the fact that a solid and stable financial system contributes to the increase of monetary policy efficiency and implicitly to the achievement of its fundamental objective of ensuring price stability.

The significant concern of central banks to achieve financial stability does not mean that they give less importance to price stability. On the contrary, the actions of central banks intended to ensure a normal work order of the financial systems must take into account the need to ensure price stability at middle and long term. This is due to the fact that a stable and solid financial system allows the increase of monetary policy efficiency, i.e. the achievement of the main objective of ensuring price stability. However, ensuring price stability over the medium and long term can correct financial imbalances.

The international financial crises that took place in the last years determined the necessity to reconsider the relation between price stability and financial stability. Thus, unlike the conventional approach, that sustains that price stability is a condition necessary and sufficient to ensure financial stability, the "new environment" hypothesis, sketched in the context

of the international financial disruptions of the last years, shows that a low and stable inflation is not a condition necessary and sufficient to ensure financial stability.

From the standpoint of monetary policy, the reaction of central banks to the financial imbalances that broke out from August 2007 was different, depending on the particularities of the economic and financial structure of each state. However, the objective was the same and namely, to restore the health of the financial system, in such a way that economic growth and price stability at middle and long term will not be jeopardized.

The exceptional monetary policy measures adopted by central banks, especially by the Federal Reserve System and the European Central Bank, in the context of the present financial disruptions, were conceived so that they will be used only in crisis conditions. Therefore, we may assert that eventually, after confidence in the financial markets will be reestablished and macroeconomic conditions will be improved, the drafting and implementation of an adequate strategy of withdrawal from the exceptional measures will represent a new challenge for central banks.

From the point of view of monetary policy measures, the present international crisis stresses how important is cooperation between central banks in order to manage instability and prevent significant imbalances in the future. At the same time, the present financial disruptions highlight the necessity that central banks give more importance to the price of assets, as they represent the main channels, through which monetary policy measures are transmitted onto the real economy. Asset price evolution may offer to central banks meaningful information for evaluation of risks that might affect the financial stability, as well as for the adoption of measures necessary to ensure the normal work order of financial systems.

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Note

1. Reduce rate and expand term on discount facility; allow participation of primary dealers (Primary Dealer Credit Facility);
2. Including fixed rate full allotment operations;
3. Finance purchase of short-term certificates of deposit, commercial paper (CP) and assetbacked CP (ABCP) (Money Market Investor Funding Facility, Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility and Commercial Paper Funding Facility);
4. Asset Purchase Facility;
5. Increase frequency and size of CP repo operations and introduce outright CP purchases;
6. Term Purchase and Resale Agreement Facility for Private Sector Instruments;
7. Acceptance of residential mortgage-backed securities (MBS) and ABCP as collateral in repo operations;
8. Finance purchase of asset-backed securities (ABS) collateralised by student, auto, credit card and other guaranteed loans (Term Asset-Backed Securities Loan Facility);

9. Purchase of covered bonds;
10. Expand range of corporate debt as eligible collateral and introduce loan facility against corporate debt collateral;
11. Purchase Treasury debt as well as direct obligations of and MBS backed by housingrelated government-sponsored enterprises;
12. Purchase of Japanese government bonds to facilitate smooth money market operations; not intended to influence bond prices;
13. Purchase equity held by financial institutions;
14. Purchase foreign currency.