Monetary Policy Strategy in Romania

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Abstract

Choosing this research theme was made because some European countries went through a period of post-communist transition, moving from a planned economy to a type of market economy, which has been the emergence of new events in monetary policy. Thus, each country had to designate a monetary authority to manage and control the monetary policy developments by using monetary policy strategy. Also, the fight against inflation is a prerequisite for stimulating sustainable national economic growth.

Key words: strategy, monetary policy, inflation, price stability
JEL Classification: E31; E58.

1. Introduction

"Economic policy is a deliberate state intervention in the economy in order to realize certain goals (structural or conjectural)" (Basno *et al*, 1999). In other words, the primary objective of ideal monetary policy is macro-stabilization. Macro-stabilization requires sustainable economic growth (Vasile *et al*, 2013), a balanced state budget, a zero level of unemployment and a balanced trade balance based on price stability. In reality all these requirements listed above cannot be met simultaneously.

It notes the existence of two monetary policy strategies with which banks may be related to the purposes of consistency and precisely transitional strategy based on the objectives and direct targeting of inflation (Costică, 2005). Noting that the transitional objectives are no longer operative in the past two decades, central banks in developed countries have successfully introduced the direct inflation targeting as a monetary policy strategy.

Specialists in monetary policy emphasizes that maintaining price stability remains the ultimate goal. Inflation is stable, positive and low. This view is different from one central bank to another, holding monopoly in compliance with and essential objectives of monetary policy (Balaban *et al*, 2012). Monetary policy is the main pillar of macroeconomic macro stability program in a national economy and is one of economic policy instruments with which trigger demand and supply of money in the economy.

2. Sustainability monetary policy

Price stability is the ultimate objective of monetary policy; the central bank can act on it through an indirect control. Also, this goal remains favorable due to the complexity of the transmission mechanism of monetary policy, involving effects on specific decisions. Practice argues that achieve the objectives of this policy can be achieved by using monetary policy strategy. The macroeconomic analysis requires economic, in any event, if the national economy is in recession (Aceleanu, 2009) or expansion, the total production of goods and services on the market, which manifests a certain level of inflation.

The Central Bank is the monetary authority with responsibility for ensuring the purchasing power of the domestic currency market and the role of maintaining financial stability.

Monetary policy in a national economy can be expansionary or recessionary by increasing and decreasing the money supply, money demand, interest rates and reserve requirements in the economy. In the short term, monetary policy (Ball *et al*, 2003) expansionary lead to a reduction in unemployment and economic growth and long-term price increases and wage determined by the private sector are offset by a lax monetary policy. So in the long run will increase inflation and economic situation is altered by its negative effects reflected on the inflation rate, when they are independent of short-term temporary special central banks being able to avoid meeting them.

The essential objective of monetary policy is the sustainable price stability. Price stability is configured as the most important key objective of monetary policy (Costică, 2002). More attention is given to definitive surveillance relative price stability, but not the absolute. This does not require that all prices be fixed or stable. A low unemployment rate consistent with a higher rate of inflation leads to some higher costs. Increased demand salaries remain the same regardless of business sector productivity. A high rate of inflation causes a random distribution of income, providing that those records revenue opportunity to take advantage of variable salary increases made in a short time than those who have a fixed income. Price stability is achieved when operators no longer take into account their business decisions to expected price increases.

Since the transmission mechanism of monetary policy is multilateral requiring long and variable delays in realizing the consequences of decisions, price stability is a goal of monetary policy over which the central bank can exercise only indirect control. Practice has shown that achieving this ultimate objective can be achieved using various monetary policy strategies.

Definition of price stability differs from one central bank to another, designed to be the primary objective of a national economy. Internationally it is considered that the trend of transition from the fixed exchange rate regime more flexible exchange rate provides capital account liberalization and a better appreciation of the national currency against other currencies. Fundamental objective of price stability is based showed that some monetary policy strategy, which is geared towards setting intermediate targets: targeting monetary aggregates (monetary base M0, M1, M2 and M3); direct inflation targeting and exchange rate targeting. Monetary policy strategies, interbank interest rate (d') amends the consumer price index (I.P.C) in the population of a given country (Dumitru, 2009).

Inflation targeting can be an effective strategy only to the extent that inflation follows a downward trend, which may give greater credibility and macroeconomic stability.

The decision to move to inflation targeting strategy was accepted after preconditions characteristic of this change were made. Preconditions for transition to inflation targeting strategy according to NBR (www.bnro.ro):

- lowering the annual inflation rate below 10%;
- accumulating a gain credibility by the central bank;
- strengthening the independence de jure and de facto for central bank;
- progress in fiscal consolidation and improving coordination between monetary and fiscal policy, lower fiscal dominance;
- flexible exchange rate and reducing the vulnerability of the economy to fluctuations of this variable (Isărescu, 2003);
- recovery and strengthening the banking system and higher bank intermediation;
- increase transparency of the central bank and the central bank scope and intensity of communication with the public and financial markets, including matters related to the new monetary policy strategy preparation and adoption;
- clearer picture of the macroeconomic behaviors and mechanisms of functioning of the economy to identify and enhance the effectiveness of monetary policy transmission channels (http://www.bnr.ro/Tintirea-directa-a-inflatiei-711.aspx).

At the end of 2004, inflation reached for the first time in 14 years, on the level of a figure, registering a value of 9.3 percent. At times when other countries (Svensson, 2003) agreed strategy of inflation targeting, similar values were specified.

The absence of fiscal dominance in the years prior to acceptance regime of inflation targeting, fiscal dominance has decreased, largely due to fiscal consolidation and more coherent macroeconomic policy mix. As a result, both consolidated budget and public debt have had more satisfactory values (Isărescu, 2005).

The exchange rate has become more flexible in October 2004, NBR decided to significantly reduce foreign exchange intervention, moving from a fixed exchange rate regime to a flexible exchange rate. In 2004, the euro became the sole currency of reference of the exchange rate.

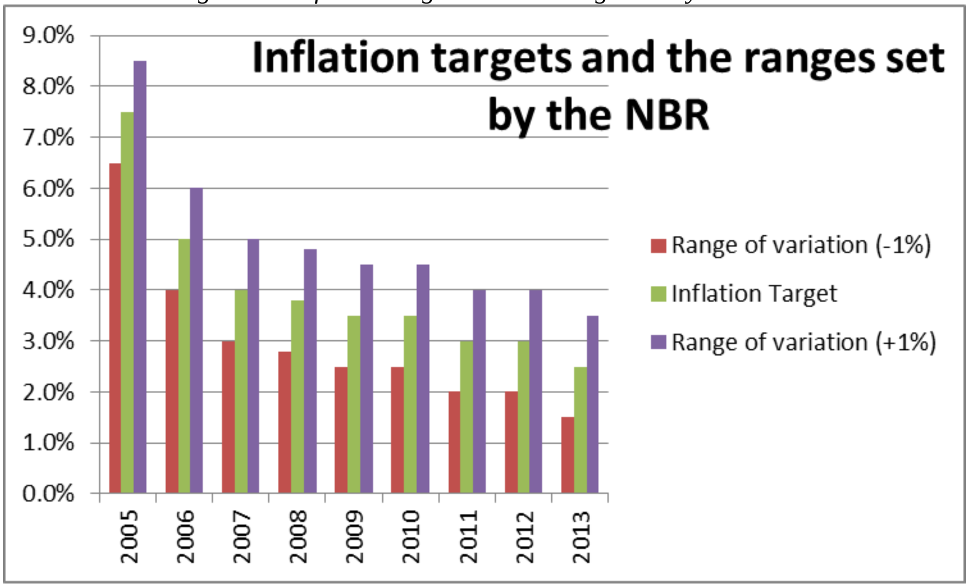
Increased performance was due to the banking system prudential regulations imposed by NBR, surveillance activities, as well as restructuring and privatization; the banking system in Romania marked a significant consolidation.

Inflation forecasting capacity, the NBR put particular emphasis on this issue. In this case, set up under its domestic in April 2004, Department of Macroeconomic Modelling and Forecasting.

Given that Romania's national economy is in a deflationary process, a sustainable inflation rate is consistent with the quantitative definition of price stability. Inflation targets are annual and are set for a period of two years (Popa, 2009).

Inflation targets and acceptable NBR range of variation for inflation during the years 2005-2013, are as follows (see fig. No. 1):

Fig. no. 1. Inflation targets and the ranges set by the NBR



Source: http://www.bnro.ro

National Bank of Romania chose a gradual decrease in inflation targets, setting targets credible but realistic thereby strengthens the central bank's credibility. The inflation target for 2010 was specified by the central bank at an amount identical to that of the previous year. This was due mainly inflationary shocks multiple and successive inflation target of failure, both in 2007 and 2008 (www.insse.ro). However the decision to maintain the inflation target in 2010 equal to that of the previous year was implemented because of the need to achieve the inflation target, an essential goal to maintain the central bank's credibility.

The price of food products and oil prices is characterized by a high degree of unpredictability and through a direct major impact exerted on the consumer price index evolution. Inflationary effect of these factors was confirmed to be unexpectedly large and durable, involving multiple successive revisions of quarterly and adverse macroeconomic projections in the medium term.

Other inflationary factors which recorded unfavorable development of NBR initial expectations, helping to overcome inflation targets were administered price adjustments and indirect tax. Direct attempt to counter the effects of these shocks on the supply side would have required a stronger tightening of monetary policy designed to force rapprochement with faster inflation as the target. Such a reaction can lead to major fluctuations in economic activity and social conditions. In this context, the National Bank of Romania preferred to tolerate a temporary deviation of inflation from the target, directing its efforts towards avoiding the risk of side effects of these shocks in order to prevent their translation on inflation expectations and on pricing behavior and wages. Another major difficulty for achieving the inflation targets was a shock on the demand generated by the easing of fiscal policy, especially for incomes, but also by rapid credit expansion amid higher capital inflows. In this perspective, the monetary policy over quasi-integral (burden) bringing excess demand at levels consistent with achieving the inflation target. From the perspective of domestic absorption of excessive dynamic extension and the widening current account deficit has been complicated ensuring sustainable disinflation, maintaining associated with high growth rate of external debt (Mărcuţă *et al*, 2013). This action causes a rapid depreciation of the RON against the major currencies. In this context, the central bank responded with a restrictive monetary policy, using all the tools they had available. The monetary authority announced public about deviations from the inflation target and the causes thereof, and the measures taken with regard to sustainable decline in inflation rate path implied by medium-term targets. Apart from the rise in the restrictiveness of monetary policy, NBR repeated growth consistent mix of economic policies in order to support the strengthening of the fiscal policy, a more prudent (Vasilescu, 2011) income policy and stepping up structural reforms for labor market. Such an approach was considered essential to avoiding the minimum financial and economic costs of significant de-anchor inflation expectations; they may allow return of inflation to the target trajectory consistent with achieving the medium-term.

3. Conclusions

What we have discussed in this article show that crossing toward a new monetary policy strategy was not easy, and success in achieving the goals set was based on several factors, both economic and political.

Considering the rather slow disinflation in Romania, the inflation rate falling below double figures only after 14 years of transition, and episodes that disinflation was interrupted, consider that a new strategy to strengthen the disinflation process by steady-state prices, helping to anchor inflation expectations of the public by its transparency, was more appropriate. However, the use by August 2005 the monetary policy of monetary targeting has been shown to be a good support for lower inflation in 2004 reaching a single digit inflation rate.

In the future, the real challenge for Romania is to ensure sustainable growth of economic activity. It must be guaranteed by a sound monetary policy, but, importantly, related to fiscal policy likewise. Otherwise, the repercussions will soon appear, as happened in the years following the outbreak of the economic crisis, when pro-cyclical fiscal policy (and a number of other exogenous factors) has blurred many positive effects due to monetary policy.

The main conclusion we can draw from that article is that switching to direct targeting of inflation was a new concept which has enhanced public accountability of the central bank and compelled the collaboration between agencies influencing economic processes.

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