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THE MONETARY POLICY INSTRUMENTS USED BY THE NATIONAL BANK OF ROMANIA AND THEIR EVOLUTION

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Abstract

This paper attempts to create an overview image on main monetary policy instruments used by the National Bank of Romania, starting from 2000 until present, as well as on the evolution and the changes that these instruments have undergone in terms of value. The first part of this paper tries to present the main monetary policy instruments used by the central bank, while the second part analyzes the evolutions which these instruments have encountered during the considered period. According to the National Bank of Romania, currently, in Romania three main monetary policy instruments are used, namely, open market operations, permanent facilities and minimum reserves required. Following the analysis we have made, we can say that, overall, the evolution of these three monetary policy instrument can be characterized as a descending one and the effects that the changes made in terms of their values had on the economy were, most of the time, the ones that the central bank has anticipated.

Keywords: monetary policy instruments, central bank, monetary policy, price stability
JEL Classification: E52, E58

I. INTRODUCTION

In order to achieve their objectives, central banks are using a series of operational tools and procedures. „There is a wide variety in the choice of instruments, operating procedures and strategies of monetary policy by central banks" [1]. This statement raises the question of whether there is a relationship between these aspects of monetary policy and whether the specific choice of instruments and procedures affects the ability of central bank to achieve its operational objective.
Prudential instruments are essential in terms of the instruments used in order to create the monetary policies which aim to ensure economic stability. „Micro prudential policies aim to minimize the risk of failure of individual financial institutions, while macro prudential policies aim to limit the risks and cost of systemic crises by addressing interconnectedness among financial institutions" [2].

The main monetary policy instruments used by a central bank in order to achieve its objectives can be grouped into two broad categories, as it follows:

- Indirect monetary policy instruments (with action on the market) – „used by the central bank in its relations with non-financial agents and other market-oriented banks"[4]. These instruments make possible the control over the cost and quantity of currency;
- Direct monetary policy instruments (as a result of the measures taken by the monetary authorities) – „used in order to influence financial agents (the users and owners of money): credit rating, administrative interest rates fixing, control of exchange rate" [3].

The requirements that the monetary policy instruments must meet are the following:

- To ensure the existence of coordination between the exchange rate policy and the interest rates applied internally by the central bank. This is necessary in order to neutralize the effects that the evolution of the exchange rate has on the quantity of money existing in the economy;
- To ensure the possibility of central banks to permanently feed the economy with primary currency, in order to satisfy the need for currency that the clients may have;
- To create a state of dependence for commercial banks against the central bank, reason which underly the minimum reserve required as a result of technological development.

Regarding the main types of monetary policy instruments used by central banks, we can identify five such instruments:

- Repurchase agreement (repo) open market operations;
- Reverse repurchase agreement (reverse repo) open market operations;
- Permanent facilities granted to credit institutions;
- Requested minimum reserve ratio;
- The permanent absorption mechanism.

The main monetary policy instrument used by the National Bank of Romania (NBR) will be presented in the followings, together with the evolutions that these instruments have recorded in time.

II. CONSIDERATIONS ON THE MAIN MONETARY POLICY INSTRUMENTS USED IN ROMANIA

According to the National Bank of Romania[10], its fundamental objective is to ensure and maintain price stability and, starting with August 2005, the monetary policy is implemented in the context of the indirect inflation targeting strategy.
In order to ensure the transmission of monetary policy, NBR uses a series of instruments which are meant to influence the dynamics of aggregate demand and the price level.As for the main monetary instruments which are currently used by the National Bank of Romania, they are three, as it follows:

- Open market operation (money market operations) – it is the most flexible and frequent monetary policy instrument used by central banks for monetary policy strategy

implementation and control. The main open market operations used by NBR are repo operations, reverse repo operations, deposit certificates issue, attracting deposits, granting collateralized loans, purchase/sale of eligible assets for trading and currency swap;

- Permanent facilities – through which the central bank ensures the absorption of liquidities in the very short term in order to fulfill the monetary policy strategies. The main facilities granted by the National Bank of Romania are the lending facility and the deposit facility;
- Required minimum reserve ratio – represents one of the traditional tools used and it aims to ensure the achievement of the monetary policy objectives by ensuring structural liquidity, stabilizing interest rates and ensuring a certain degree of control over the monetary expansion.

Next, will be presented the main developments that these monetary policy instruments have recorded in time.

The evolution of the average repo interest rate has registered a significant decrease. As we can see (Figure 1), the highest level registered by this rate was recorded in January 2002, 40.62%, while its lowest level was recorded between May 2015 and December 2017, when the National Bank decided to inject currency into the economy, in several tranches, at an interest rate of 1.75%. Regarding the volume of the money injected by the bank through repo operations, we can observe (Figure 1) that during the analyzed period there were four periods in which the NBR decided to inject a significant amount of currency into the economy, as it follows:

- Between April 2009 and February 2010, the National Bank of Romania, in the position of lender for the banking system, has injected 162,579.1 mil. RON into the economy by using repo operations. This liquidity injection intended to accommodate the liquidity deficit which existed during that time in the interbank money market;
- Between December 2011 and March 2013has took place the largest liquidity injection, the NBR introducing into the economy 890,035.1 mil. RON. The highest liquidity injection took place on February 4th, 2013, when 38,496.7 mil. RON were injected into economy at an interest rate of 5.25%. As in the previous case, these measures were taken as a result of the National Bank's attempt to accommodate the reserve demand of the credit institutions;
- Between October 2017 and December 2017, through repo operations, an amount of 43,700.1 mil. RON was injected into the Romanian economy, at an interest rate of 1.75%;
- Between August 2018 and November 2018, the National Bank of Romania proceeded to carry out repo operations for a total amount of 98,003 mil. RON, at an interest rate of 2.50%.

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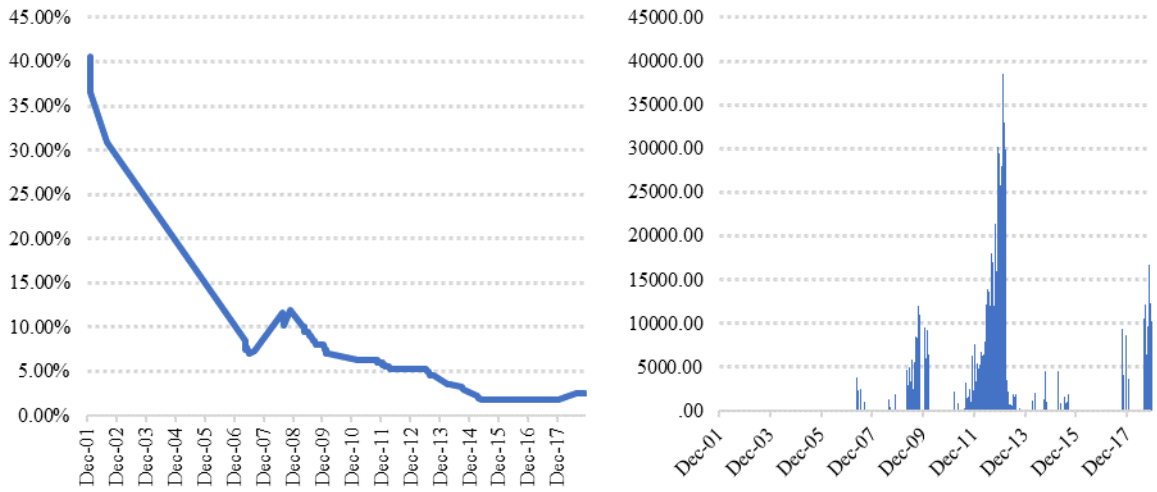

Figure 1: The evolution of the average repo interest rate and the amount of money offered by the NBR (January 2000 – December 2019)

Source: Own computations based on https://www.bnr.ro/Seturi-de-date-628.aspx

Reverse repo operations are similar to repo operations, with the mention that reverse repo operations are intended for the absorption of currency. The liquidity absorption is done by selling securities eligible for trading, made by central bank, with the commitment to redeem them at a later date, at a price established when the transaction is made.

During the analyzed period (2000 – 2019), and as it can be seen (Figure 2), the National Bank of Romania has used this instrument over four years:

- Between October 2000 and December 2000, the NBR offered securities worth 1,138.6 mil. RON, at an interest rate ranging from 42% to 50%;
- Between January 2001 and December 2001, the value of the securities offered by the National Bank accumulated 7,659.6 mil. RON, while the accepted interest rate ranged between 33.21% and 50%;
- The securities offered by NBR between January 2002 and November 2002 amounted 5,153.8 mil. RON, the interest rate has varied between 20.99% and 34%;
- Between March 2009 and September 2009, 8.909.6 mil. RON were absorbed, at an interest rate which ranged between 8.50% to 10%.

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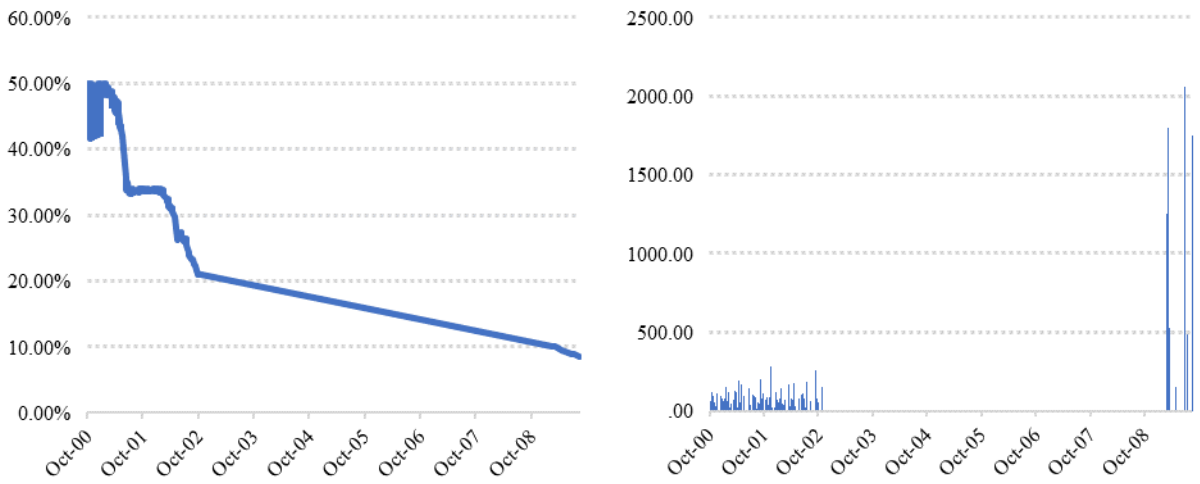

Figure 2: The evolution of the average reverse repo interest rate and the amount of money offered by the NBR (January 2000 – December 2019)

Source: Own computations based on https://www.bnr.ro/Seturi-de-date-628.aspx

In Romania, in order for a credit institution to benefit from the lending facilities provided by the National Bank, it has to be registered as participants in the SaFIR settlement and deposit system. According to art. 29 paragraph 2, letter b of Law no. 312/2014[5], „the National Bank of Romania operates the financial instruments depository and settlement system SaFIR, acting as Central Securities Depository for the government securities issued on the interbank market, the certificates of deposit issued by the National Bank of Romania and other fixed income financial instruments set by National Bank of Romania's Board".

As we mentioned above, the permanent facilities ensure the absorption of liquidity in the very short term in order to fulfill the monetary policy strategies, as well as the limitation of the interest rates in the very short term.

As we can see (Figure 3), both the interest rates for the lending facility and for the deposit facility had a downward trend, except in the period immediately following the global financial crisis, when both rates experienced an appreciation. According to NBR [7], „their evolution was marked by the fluctuations of the autonomous liquidity factors, whose impact was amplified in the context of the gradual reduction of the liquidity surplus". The lowest level of the deposit facility rate was recorded during August 2014 and May 2015 (0.25%) because the annual rate of inflation was below the forecast level, due to the aggregate demand deficit, as well as against the persistence of low inflation in the euro area. The lowest level of the lending facility rate was recorded in November 2017, when its level reached 2.75%. According to NBR [9], „given the features of the updated path in the projected annual inflation rate and its determinants, as well as the risks thereto, stemming mainly from the fiscal and income policy conduct and the uncertainties associated with economic growth in the euro area and worldwide, the Board of the National Bank of Romania decided to continue the adjustment of the monetary policy stance by narrowing the symmetrical corridor of interest rates on the NBR's standing facilities around the policy rate to ±1.00 percentage points from ±1.25 percentage points and by ensuring firm

liquidity management in the banking system". As a result of this decision, together with the National Bank's decision to keep the monetary policy interest rate at 1.75% , the credit facility interest rate decreased at 2.75%, and the deposit facility interest rate increased at 0.75%.

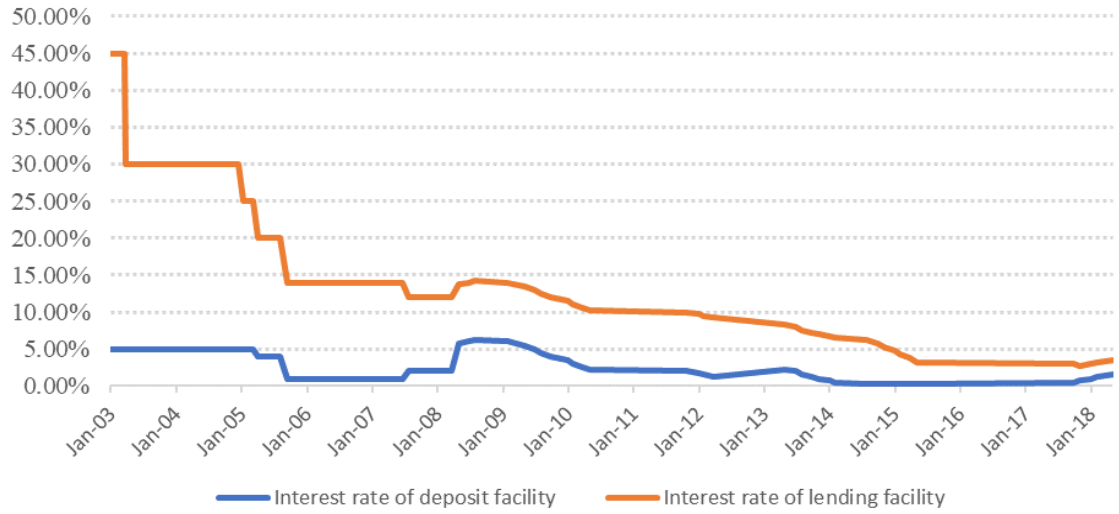

Figure 3: The evolution of the permanent facility interest rates in Romania (January 2003 – December 2019)

Source: Own computations based onthe data provided by the National Bank of Romania

On March 23rd, 2020, the National Bank of Romania decided to reduce its monetary policy rate by 0.5%, reaching 2%. With this measure, the central bank also decided to decrease by one percentage point the lending facility interest rate (Lombard), which fell to 2.5%. These measures have been taken as a result of the decision to ensure a greater exchange rate stability and an interest rate stability, in order to prevent an economic crisis which could arise as a result of the protection measures taken by the governments worldwide to diminish the spread of the COVID-19 virus.

Introduced in 1992, the required minimum reserve ratio is one of the traditional monetary policy instruments and it aims to ensure structural liquidity, stabilizing interest rates and ensuring some degree of control over monetary expansion. Even though the importance of this instrument has diminished considerably in the recent years, it remains one of the basic monetary policy instruments.

In Romania, the evolution of required minimum reserve ratio, both for the liabilities expressed in RON and for the liabilities expressed in foreign currencies, cannot be considered a linear one. During the analyzed period, the rates experienced a series of ups and downs. At the beginning of the period, more precisely, in August 1998, both of these rates were at the same level, namely 15%. Subsequently, they increased in July 1999, when they reached the level of 20%.

As we can see (Figure 4), in the first part of the analyzed period, the required minimum reserve ratio for the RON liabilities was at a higher level than the one for the liabilities expressed in foreign currencies. However, starting with November 2002, the required reserve ratio for the

liabilities expressed in RON has undergone a significant decrease, as a result of the National Bank of Romania`s decision to increase the transparency of monetary policy, in order to align it with the practices of the European Central Bank, by decreasing the importance of the administrative instruments and move it over the market instruments. Likewise, according to NBR[6], „what the central bank envisaged by the aforesaid move was to bolster restoration of credit and interest rate channels and to make foreign exchange borrowings less attractive, by influencing their relative costs." This trend ended in July 2006, when it was decided to increase the required reserve ratio for RON to 20%, as a result of the tightening of the monetary policy promoted by the National Bank. According to the central bank, due to the excess of liquidity existing at that moment in the banking system, it was assumed that the change of this ratio could act as an stimulus for compensatory movements to the interest rates related to deposits and loans, given the possibility of perceiving it as an increase in intermediation costs.

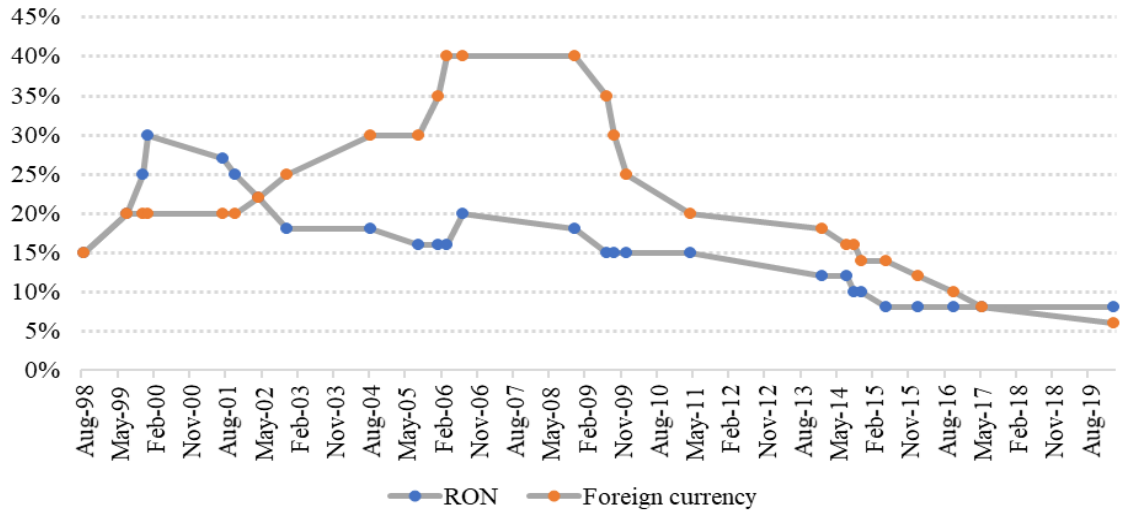

Figure 4: The evolution of the minimum reserve ratios applied by the NBR (August 1998 – February 2020)

Source: processed according to the inflation reports published periodically by the NBR

The same situation was encountered for the required reserve ratio for the liabilities expressed in foreign currency, which between March 2006 and November 2008 remained at 40%. Starting with the middle of 2009, both these ratios have experienced a significant decrease, reaching, by the middle of 2017, 8%. According to NBR[8], these changes „aimed at further adjusting the monetary policy strategy from the perspective of ensuring that medium-term inflationary expectations are anchored in line with the stationary target, at the same time as the sustainable revival of the lending process, as well as improving the functioning of the monetary transmission mechanism." As a result of the evolution offoreign currency lending, as well as following the National Bank of Romania's attempt to continue the process of harmonizing the minimum reserves with the European Central Bank' practices and standards, in February 2020, the central

bank decided to reduce it required reserve ratio for the liabilities expressed in foreign currencies up to 6%.

III. CONCLUSIONS

As mentioned above, central banks are using a series of monetary policy instruments in order to achieve their objectives. The actions of these instruments can be indirect (market-oriented), by controlling the amount of money, or direct, used to influence economic agents (control over the exchange rate, changes made in terms of interest rates, etc.). The National Bank of Romania uses three such monetary instruments, namely, open market operations, permanent facilities and required reserves ratio.

In this paper we tried to analyze the evolution of these instruments in time, more precisely, over the last twenty years, starting with the year of 2000 and up to present. Following the analyzes made, we can see that all the identified rates (repo interest rate, reverse repo interest rate, permanent facilities interest rates and the required minimum reserve ratio) had a downward trajectory. The only period of time when these rates have experienced an appreciation was the immediateperiod after the global financial crisis, but this appreciation did not last very long. The paper also tried to highlight the reasons behind these decisions, as well as the extent to which the change in terms of these rates had the expected effects on the economy.

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