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Summary  
PhD Thesis

**The effectiveness of the monetary policy transmission  
mechanism in the context of globalization**

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## **Summary**

In the present research we have proposed as a general objective to highlight the economic and financial impact of globalization on the effectiveness of the transmission mechanism of monetary policy signals, particularly from a qualitative perspective, taking into consideration the complexity and topical of the phenomenon studied.

### **CHAPTER 1 Mutations in the content and objectives of monetary policy in the context of globalization**

In the first chapter of the research we have reviewed considerations regarding the evolution and developments that revolve around monetary policy under the imprint of globalization, both in terms of the factors that enhance the effectiveness of the activity of central banks, and those acting for the purpose of reducing it.

With increasing independence, central banks have obtained a greater freedom in the choice and implementation of their strategies, which is why over time, monetary policy strategies were under the sign of dynamism.

Despite the advantages of other monetary policy strategies, we believe that inflation targeting strategy (with a certain level of flexibility required by the economic and financial environment in countries that practice this regime) is the most appropriate to use, of evidence being also the evolution in the macroeconomic performances to which it has been referred to in the present study.

With the onset of the current international crisis, the role of monetary policy has gained a new dimension by assigning to central banks (explicitly or not) the mission of ensuring financial stability. It should be noted, however, that expanding the powers of the central bank in this sphere should not be seen only through the prism of trust granted to monetary authorities, but especially in the light of the tasks received, which is likely to potent the diminishing independence in relation to the political factor.

In the same vein, circumstances of crisis (as components of globalization) can determine changes in the hierarchy of objectives of the central banks and decrease monetary policy performances, without the effectiveness of the monetary policy transmission mechanism to be directly responsible.

Once the fundamental objective changes, transformations occur also at the level of monetary instruments. In this regard, the central bank's arsenal has recently been completed with "unconventional" monetary policy tools, for a period of time not clearly delimited, that managed to improve the functionality of the monetary mechanism. Moreover, in the context of maintained anemic economic growth worldwide and the uncertainty associated with the sovereign debt crisis, we believe that there are sufficient grounds for which the new frame of thinking in monetary policy matters to include part of the so-called "unorthodox" measures.

## **CHAPTER 2 Monetary policy influences over the real economy**

In the second part of our research we approached the transmission mechanism of monetary impulses from a general perspective, in the light of specialized literature, following, in particular, three areas: the relationship between the real and monetary economy, characteristics of monetary transmission channels and factors of influence on their functionality.

In addition to structural transformations in the economy, other important determinants of the transmission process of monetary impulses are the following closely related to the speeding up of economic and financial globalization: amplification of financial innovation, increasing connections between financial systems, raising interdependencies in financial markets, increasing degree of economic openness, economic and financial turbulences, evolution in the level of public debt and not only.

In the same vein, in the context of accelerating globalization, monetary transmission channels have undergone numerous mutations, in terms of importance. Thus, in terms of the development of financial markets, has taken up the interest rate channel (and complementary, the credit channel with banking systems development subsequently), and in

recent years, it has been put more and more emphasis on the inflation expectations channel.

Also, in the context of the current international financial crisis was shaped a new channel of monetary transmission, namely the risk taking channel and it is put under question the increasing importance of asset prices channel.

As monetary policy decisions are aware of the wide-scale impact of globalization on the economic and financial sphere, at least in theory, recent studies have questioned the possibility of a global framework development for the transmission of monetary policy signals. Despite the fact that the benefits of formulating a monetary global framework are evident, we believe that the specifics of economies constitute an essential barrier to the design of a global framework for the transmission of monetary impulses, as well as the nature of the fundamental objectives.

From the perspective of the degree of economic development, unlike developed countries, emerging states are experiencing considerable difficulties in the process of influencing the real economy, amid greater volatility of real and financial variables.

Last but not least, because of the weight of influencing factors and beyond, central banks face limits in the design and implementation of monetary policy. It is important however that the impact of these limits to be as low: thus, if globalization influences the national monetary policy framework, it is urgently required for the incorporation of a global vision in the monetary arsenal; although there are objectives which can be conflicting at times, central banks need to prioritize them appropriately.

### **CHAPTER 3 The role of transparency and communication of the actions of central banks in enhancing the efficiency of the monetary transmission**

In the third chapter we focused on the role of transparency and communication in the enhancement of effectiveness of the transmission mechanism of monetary signals both in the real and financial plan. This chapter begins with an overview of the two dominant forms of communication in monetary policy which have been the subject of many controversies, namely the „action” and „word”.

One of the most important advantages of an increased transparency is the raise in monetary policy predictability, which is why we considered useful to highlight it using the ARIMA model. The results of our research on the predictability of monetary policy are in line with those in the literature, according to which, there are periods during crises when monetary policy needs a certain degree of predictability, for instance, meant to calm tensions in the market or to counter any actions inconsistent with economic and financial fundamentals.

In addition to the importance of monetary policy predictability, it is to be noted the clarity of the messages of central banks in relation to the general public, which is very little treated in specialized studies, although it is one of the most complex issues in the communication policy of monetary authorities.

In order not to remain strictly in the area of qualitative analysis of clarity of communication on the part of central banks, within the framework of our research have been used readability statistics and content analysis on the example of the following central banks of world importance - the Federal Reserve System, the Bank of Japan, European Central Bank and the National Bank of Romania, taking into account the upcoming adoption of euro of the latter.

In spite of the high similarity with respect to the degree of development of economies surveyed, we found significant differences in the level of clarity of communication policies of central banks, for instance, caused by the lack of uniformity in the objectives pursued, but also by differences in the degree of financial education.

On the same registry ideas on enhancing transparency of central banks, a recent implication induced by the current global crisis highlights monetary policy transparency in connection with financial stability. For the purpose of capturing the link between monetary policy transparency and the transparency related to financial stability, it has been applied the analysis of major components (ACP) on the example of the following states, grouped according to their economic and financial specific: the Czech Republic, Hungary, Poland, Romania, Slovakia, Bulgaria, on the one hand, and the United States of America, Japan, United Kingdom and Germany, on the other hand.

In the case of the majority of states surveyed, the connection between the transparency of the communication policy of the banks regarding the financial stability is positively correlated with government debt; however, in the medium term, increasing the correlation between the two variables it is most likely to generate pressures for central banks, particularly in the context of the alarming growth in public debt.

Following changes in the communication policy of central banks, from a qualitative perspective, we believe that one of the most important mutations in the transparency of central banks is the commitment concerning the monetary policy stance, and in quantitative terms, it is most likely that we attend to a scale amplification of fiscal information.

#### **CHAPTER 4 The impact of economic and financial globalization on monetary policy performances**

The fourth part of our research is an analysis on the effectiveness of the monetary transmission mechanism under the impact of globalization. Thus, are taken into account the particularities of the monetary transmission mechanism in developed and emerging countries and last but not least, the implications of economic and financial crises on the process of transmission of monetary policy decisions on the financial and real sector, in close relation with innovative tools used by central banks.

Some of the most debated implications of globalization on monetary policy performances relate to the effects on inflation formation process and monetary policy transmission mechanism. According to statistical data, together with the amplification of the phenomenon of globalization, the inflation rate went on a downward trajectory, leading to the so-called "Great Moderation".

On this plan, prospects to take into account are numerous:

- integration in the labour market of economies such as China or India favoured reductions in wages, but also boosted economic growth rates which exert substantial pressure in the sense of rising prices;
- from the perspective of central banks, increasing the effectiveness of monetary policy (as evidenced by decreasing lag of monetary policy transmission and increasing pass-through of interest rates) supports the reducing inflation;

- studies attest the fact that globalization has been accompanied by a reduction in the volatility of gross domestic product, coming out in support of monetary policy and the list goes on. However, it cannot be revealed with certainty the role of globalization in reducing the level of inflation worldwide.

Another mutation in the monetary policy is manifested in the light of the fact that, in determining inflation nationally, global factors play a significant role, **if not majority**, thus affecting the efficiency of the monetary transmission, for example through the reduction of interest rate pass-through.

From a different angle of approach, an unfavourable implication on monetary policy performances is generated by globalization through economic and financial turbulences. With regard to unconventional measures adopted by central banks in order to counter the effects of the global crisis, we believe that bringing into attention the risks and costs associated with non-standard instruments is more than indicated, taking into account their magnitude and unprecedented nature.

Considering that the implementation of extraordinary monetary policy measures succeeded to avoid entering into a financial meltdown and a greater sacrifice of the real economy, we support the imminent need of introducing them, especially in developed countries, from where the turbulences erupted. However, unknowns regarding the persistence of the impact of non-standard measures, lack of precedent and the uncertainty revolving around their implementation in the light of the risks (of which detaches the reputational risk) and costs, requires a careful design of conceiving exit strategies.

Therefore, globalization can influence the monetary policy performances both favourably and unfavourably, but it is important that decision authorities to capitalize to a greater extent the benefits of accelerating interdependencies globally and to eliminate as far as possible, adverse effects.

## **CHAPTER 5 Analysis on the functionality of the monetary policy transmission mechanism in Romania**

Part five of our work is devoted to the analysis of the functionality of the transmission mechanism of monetary signals in Romania. From an overall perspective, the evolution in the central bank's strategy plan was in tune with the global changes in the sense of adopting the flexible inflation targeting regime.

As of the 2000s, the Romanian banking system has experienced significant mutations with positive implications reflected in a faster and more symmetrical transmission of monetary impulses to the economic activity. So, amid the strengthening of financial intermediation, are reactivated the credit and interest rate channels wiped out earlier by control mechanisms established by the state.

Also, in terms of capital controlled by the state, nor the exchange rate was functional. Currently, however, in the conditions of a high degree of currency substitution, exchange rate channel proves very active, including by stimulating exports or for bringing the exchange rate in line with economic fundamentals, which is why Romania should still avail of this leverage, and moreover, not to speed up the process of adopting the single currency if the real economy does not give the expected signal.

Since 2005, when it was adopted the inflation targeting regime, another channel has acquired a crucial importance in achieving the basic objective, namely the inflation expectations channel, which has determined the reconfiguration of the monetary policy transmission mechanism of the National Bank.

As regards the objective of the National Bank of Romania in the context of the recent crisis, as was natural, the central bank gave priority to the goal of ensuring financial stability, without however neglecting the maintenance of price stability, the latter coming on a strong downward trend, though not because of NBR's actions (as resulted also from the application of a VAR model) but because of external factors such as deficiency of demand, resumption of downward trend of oil quotations or good agricultural harvests.

Whereas Romania has an open economy and is under the impact of globalization, one of the paper's sections aimed specifically at the impact of the global crisis on the monetary transmission, which is in an early stage of development.



If in the financial markets were episodes with major fluctuations were managed with prudence, quickness and efficiency by the National Bank, the impact on the real economy is a more delicate matter. Visible efforts of the central bank to boost economic activity, have not found a correspondent in the reactions of commercial banks amid strong growth of risk aversion, drastic reduction in the external financing and demand and growth of the share of non-performing loans in the portfolios, which surely contributed to hindering the transmission mechanism of monetary impulses. Thus, in the case of the NBR, despite the fact that the economic fundamentals of functioning of monetary transmission channels required a more expansive monetary policy, the need to ensure financial stability has hampered the exact implementation of the reaction functions suggested by monetary models.

From the extensive range of challenges to the National Bank of Romania, probably the most difficult to manage are those relating to the central bank's entrance on the „unorhodox ” tier measures, given the lack of precedent and implications on the communication policy with the financial markets and general public, plus the downward trend of inflation, which is not in line with the central bank's target.

In the medium term, the main challenge for the National Bank of Romania is lining up to the standards of the ECB for the purpose of joining the euro area, at present the target being January 1, 2019, but the one that should give the verdict in this sense shall be the real convergence.

Based on those shown in the framework of our research, it can be affirmed that the mutations induced by the phenomenon of globalization on monetary policy, are more than evident. In these circumstances, it is difficult to assert whether globalization has facilitated the task of the central bank, or the contrary, that it made it more difficult. One thing is certain however: currently, central banks do not conceive the development and implementation of the transmission mechanism of monetary policy impulses without incorporating a global vision.

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