SOME THOUGHTS ON THE DIVERGENT CONDUCT IN CENTRAL BANKING

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Abstract*:*

In the recent post-crisis years, the monetary policy, especially of central banks in the advanced economies, is marked by the limited space for handling the conventional instruments. This feature is a defining one to reflect the new challenges faced the monetary authority, because it has complex repercussions at the global level of the economy. There is a vast literature dealing with the new challenges for central banks, but in this paper we will focus on presenting the reactions of central banks to the new post-crisis conditions, in order to highlight the differences or similarities of their policy conduits. In our view, the post-crisis age for central banking is related not only to the time for adapting the monetary policy framework at the challenge of the narrow room for policy manoeuvre, but also to the time of potential divergent paths for conducting the monetary policy, in the global perspective.

Key words: post-crisis time, monetary policy challenges, advanced and emerging economies

JEL classification codes: E52, E58, F62

1. Introduction

The monetary policy in major advanced economies is marked by a limited space for handling the conventional instruments, especially in the recent post-crisis period. This feature is a defining one to reflect the new challenges faced by the monetary authority, because it has complex repercussions at the global level of the economy. On the one side, the central banks experiencing "zero lower bound" condition are those that dominate the global economy and also are constrained to use unconventional monetary policy instruments, in order to achieve the assumed objective. On the other side, these measures influence the monetary policy of other central banks, particularly of those form the emerging economies.

The challenges for conducting the monetary policy are not only large, but also complex ones, varying from those regarding the relation between the monetary policy objective (the price stability) and the financial stability policy, or those related to the proportion of used conventional and unconventional monetary policy instruments (Criste, 2014; Criste and Lupu, 2014; Criste and Lupu, 2015), to the problem of assessing the impact of unconventional measures implemented by central banks (Altavilla and Giannone, 2015). In the present paper we will focus on describing the reactions of central banks to the new post-crisis conditions, in order to disclose how divergent are their monetary policy.

2. Debates on the central bank policy in the post-crisis era

There is a deep concern on the way of adapting the monetary policy strategy in the post-crisis time characterized by a narrow space for policy manoeuvre (BIS, 2016). In this context, there are new challenges regarding the influences of the external monetary policies, i.e. those that dominate the global economy, on the domestic ones, especially for monetary policy of the emerging economies.

The unconventional monetary instruments applied especially in developed countries had produced adverse effects in the financial markets from emerging economies through the channel of capital flows, of assets' prices and of the exchange rate, the monetary policy being in the difficult position to counter the global capital movements. Therefore, the relaxed monetary conditions from developed countries make difficult handling the monetary policy instruments: a restrictive conduct of the monetary policy to counteract the external shock increases the capital inflows, which

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stimulate the local lending cycle and the increase of the asset prices. Capital inflows require interventions on the forex market for the exchange rate adjustment.

The effects of US monetary policy greatly affect the world economy as a result of the US dollar domination in the global financial markets and international trade (Bruno and Shin, 2015). Cetorelli and Goldberg (2012) and Rey (2013) show that, in fact, the US is the engine of the global financial cycle, and from this perspective, the change of the Fed monetary policy conduct affects the financial conditions of other economies.

A number of empirical studies (Bauer and Neely, 2013; Fic, 2013; IMF, 2013) addressed the issue of the effects entailed by the application of unconventional measures and largely conclude that emerging countries with sound economic fundamentals and more developed financial markets were relatively more resilient to adverse shocks related to global central banks' decisions. In contrast, other studies argue that emerging economies with larger and better developed capital markets have been subject of these pressures more from outside (Eichengreen and Gupta, 2014; Aizenman et al., 2014) or that sound macroeconomic fundamentals (lower levels of public debt, higher foreign exchange reserves) have not protected them against the effects entailed by the Fed unconventional measures (Eichengreen and Gupta, 2014).

Although the results of these studies are not converging, overall, it seems that most national currencies have depreciated in the post-crisis phase, and the countries with weaker economic fundamentals were strongly affected by the "foreign" monetary policy. Turkey's central bank largely used foreign exchange reserves to ease the pressure on the currency, and the central bank of South Africa has used the exchange rate as the main tool to absorb the shock. Many emerging countries have been forced to increase the interest rates to reduce the capital outflows and the pressure on the exchange rate (Turkey, Mexico, South Africa, Brazil).

There are also concerns considering the effects generated by the interdependences between the emerging and developed economies.

Emerging economies play an increasingly important role in the world economy (mainly, through the commercial and financial channels) and growth prospects in these countries are more and more reflected in the global economy - a slowdown of the economic growth in these countries affects a potential economic recovery overall.

For the emerging economies, the liberalization of capital accounts and the increasing role of external financing, especially through the lending channel are factors that determine the dependence on the external financial environment. McCauley et al. (2015) points out that this dependence is especially on the US financial conditions, as most of these loans are in US dollars. The increase of external crediting denominated in US dollars, especially from 2008, is determined not only by the rapid and high growth rates in emerging countries, but also by more favourable interest rates for dollar and by expectations regarding the evolution of the exchange rate of local currencies (Bruno and Shin, 2014).

A study of the BIS (2016) shows that the dependence of the emerging economies on foreign loans and the accumulation of a large stock of debt denominated in foreign currency increased the potential for generating bottlenecks in the developed countries. Lower interest rates in the US and a weaker dollar had stimulated for a period the lending activity, increased the asset prices, and encouraged the economic growth in emerging economies, but the modification of the financial conditions in US could generate adverse effects in advanced economies.

3. Methodology and data

Based on these debates and discussions, the present study focuses on identifying some important characteristics of central banks' monetary policy, in the recent post-crisis phase. In this sense, considering a number of twenty-three central banks, some of global importance, others of local importance (see Table 1), we aim at highlighting the way in which the monetary policy relates to the current challenges. For this purpose, we look both at the dominant type of measures applied (conventional or unconventional) and at their direction of use, reflected by the type of monetary policy conduct (tighten or easing). Generally, the monetary policy stance is defined by the central bank's responses to the challenges facing it. This behaviour is founded on the relation between the main objective of monetary policy and the economic conditions, both domestic and external.

Table 1

Classification of central banks according to the type of the economy and the degree of global influence

Central banks with global influence from:		Central banks with local influence from:	
advanced economy	**emerging or developing economy**	**advanced economy**	**emerging or developing economy**
- European Central Bank (ECB) - Federal Reserve (Fed)	- People's Bank of China (PBC)	- Bank of Canada (BoC) - Bank of England (BoE) - Bank of Japan (BoJ) - Czech National Bank (CNB) - Danmarks Nationalbank (DNB) - Norges Bank (NB) - Reserve Bank of Australia (RBA) - Reserve Bank of New Zealand (RBNZ) - Swiss National Bank (SNB) - Sveriges Riksbank (SRB)	- National Bank of Romania (NBR) - Magyar Nemzeti Bank (MNB) - National Bank of Poland (NBP) - Bank of Mexico (BoM) - Central Bank of Brazil (CBB) - The Central Bank of the Russian Federation (CBRF) - Central Bank of the Republic of Turkey (CBRT) - Reserve Bank of India (RBI) - South African Reserve Bank (SARB)

Source: authors' representation

Our analysis refers to the third stage of the post-crisis era, considering that the post-crisis time could be divided into three stages, according to the three major unfavourable events produced after the global financial crisis outbreak: the early stage, after the Lehman Brothers shock (between the end of 2008 and 2010); the middle stage – the Eurozone crisis (2011-2012); and the recent post-crisis stage, after the declining of oil and other commodities prices (since the middle of 2014).

The data and information used in this paper are taken from central banks' annual reports and from the central banks' websites.

4. Results

Overall, the results of our analysis, summarized in Table 2, show different patterns of monetary policy stance across the selected central banks, depending on the specific "source", as the main element that influences the monetary policy decisions (managing the domestic economy, the dominance of the external monetary policy or the global market conditions).

Table 2

The diversity in conducting the monetary policy across central banks during the recent post-crisis stage (after 2014)

CRITERIA	**The main source of influences for monetary policy conduct**					
	Managing the domestic economy		The dominance of the external monetary policy		The global market conditions	
	The monetary policy stance					
	tightening, towards normalization	easing	tightening	easing	tightening	easing
Standard measures	CBB	PBC, NBR, NBP, MNB	BoM, SARB, CBRT			BoC, RBA, RBNZ, NB, CBRF, RBI
Non-standard measures	Fed, BoE	BoJ, ECB, CNB		DNB, SNB, SRB		

Source: authors' representation based on central banks' Annual Reports 2014, 2015, and data from central banks' official communications (for 2016).

In the developed countries, regardless of the dominant element of influences (either the domestic economy, the monetary policy dominance or the global market conditions), the monetary policy was mostly an easing one, though the Fed has kept policy interest rates (Federal fund rate) unchanged since the end of 2015, and the Bank of England has never operated further policy interest rate cuts (i.e. Bank rate). These central banks are pursuing forward an adjustment of the monetary policy conduct, from an easing monetary policy, to a more restrictive one, mainly based on maintaining the using of non-standard monetary instruments, not by increases in interest rates as a priority for monetary policy. Other central banks (Bank of Japan and ECB) adopted a more aggressive easing for monetary policy conduct, by focusing on avoiding the potential deflation episode and also on detracting from the potential risks of a ”de-anchoring” of inflation expectations over the medium-term, as a result of a persistent undershooting of the inflation objective.

Instead, in the emerging countries, the monetary policy conducting is more heterogeneous, depending on the dominant element (”source”) of influence. Some central banks have adopted a relaxed conduct of monetary policy, while others - a restrictive one. For instance, the Central Bank of the Russian Federation and Bank of India have adopted an easing monetary policy, in order to reduce the adverse effects of the commodity prices falling, given that those countries’ profile is developed based on natural resources, with economies dependent on the terms-of-trade. On the other hand, the Bank of Mexico, and central banks from Turkey and from South Africa have adopted a restrictive monetary policy, being forced to increase their interest rates as a response to the Fed's monetary policy stance. They are further constrained by this dependence, either in order to maintain the monetary anchor (currency peg), or to avoid a more severe vulnerability concerning the foreign exchange market and the capital movements.

Another category includes those central banks whose policy is oriented primarily to the domestic economy. People's Bank of China adopted a loose stance by introducing new monetary stimulus in order to support economic restructuring. Likewise, central banks of Poland, Romania and Hungary are in the same category with an easing monetary policy and applying conventional measures to respond to internal problems in the economy. Instead, the Central Bank of Brazil has a tightening monetary policy conduct, in response to the deep economic recession and to the higher inflation.

Based on the measures implemented by central banks and also on the stance adopted during 2015 and 2016 years, Hochstein (2016) qualifies five categories of central banks: ”*Unconventional normalizers*” (Bank of England and Federal Reserve); ”*Disinflation fighters*” (European Central Bank and Bank of Japan); ”*Forced followers*” (Bank of Mexico, South African Reserve Bank, Swiss National Bank, Danmarks Nationalbank and Sveriges Riksbank); ”*Terms-of-trade victims*” (Central banks of Canada, Australia, New Zealand, Norway and Russian Federation) and ”*Idiosyncratics*” (People’s Bank of China, Central Bank of Brazil).

4. Final remarks

In the post-crisis time, a general feature of central banks, mainly from the advanced economies, is the running short of standard policy options.

The analysis made for the twenty-three central banks shows a diversity of “models” for monetary policy stance, according to some factors: the dominant “source” of influence, the space for using conventional instruments, and the temporary factors.

Sánchez (2016) underlines that the main concern in this post-crisis time is not the monetary policy differences across countries, which has happened many times before, but the using more or less intensively, the unconventional monetary policy measures, with their consequence derived from the difficult problem of a timely withdrawal of monetary stimulus. However, we consider that the differences matters, at least because they produce divergences regarding central banking conduct across countries, so that they could further amplify the macroeconomic uncertainty engendering an increasing volatility in the financial markets.

Moreover, a persistent divergence of monetary policy across countries, for an extended period, affects the international channels of monetary policy transmission. In this regard, the potential effects driven by measures applied by central banks with global influences on the other economies, refers especially to the capital flows, to the bond markets, and to the foreign exchange markets.

In the near future, as Mishra and Rajan (2016) underline, a major challenge remains to identify, at the global level, some simple rules for monetary policy, in order to avoid or at least to minimize the potential negative effects generated in the domestic economy by the external monetary policy of major central banks. This condition implies assuming an international responsibility in conducting the monetary policy.

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