

# THEORETICAL AND PRACTICAL ASPECTS REGARDING THE TENSIONS ON THE MONETARY MARKET FROM ROMANIA – BRIEF ANALYSIS OF THE EXCHANGE RATE

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## Abstract

Many publications and reports on the financial stability and the global risks highlight several threats to the regional or world economic financial stability. However, these menaces have been enumerated and evaluated to the extent they could have been identified, since there are many other negative aspects that are difficult to track and classify as risks, vulnerabilities, incertitude, etc. While the vulnerabilities and risks are approached a lot in the relevant literature, it cannot be said the same about the concept of tensions. Thus, this article tries<sup>1</sup> to clarify the concept of tension, while presenting various typologies of the tension, which may facilitate the identification of several tensions specific to the monetary market. The paper also analyses how much the evolution of the exchange rate from January 2005 to January 2015 can show important tensions for the monetary market from Romania.

**Keywords:** monetary market, tensions, risks, exchange rate

**JEL Classification:** F36, E58, F31, E65

## 1. Introduction

The economic growth is yet to come worldwide, and the significant gaps between the nominal and real economy continue to deepen, being accompanied by much more rigid financial-banking conditions than those from the period before the onset of the global economic and financial crisis. The architecture of the world financial-banking system changes rapidly, and we still don't know clearly how it will look in the next period, because there still are fundamental and formal problems to be solved, which have implications on the regions and countries of the world. Within a strongly globalized environment,

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the problem of communication and coordination of the public and private policies and strategies is vital. Otherwise, there will be conditions favourable for the development of potential tensions, vulnerabilities and risks to the international, regional and national financial stability. This too, is the situation with the monetary policy and monetary market in Romania, which receives the international changes in the public and private policies with a specific lag, the effect being sometimes even brutal.

The internal structural problems of the Romanian financial-banking system add to some phenomena such as financial de-intermediation and fragmentation and decisional isolation, which currently affect all or almost all regions of the world and which develop faster in Europe. Thus, the identification of the possible vulnerabilities, tensions and risks on the monetary market from Romania is not only useful, but also necessary for the proper management of the reality.

This article aims to clarify the concept of tension on the monetary market, while describing several typologies of tensions, which will help us identify the tensions specific to the monetary market from Romania. At the same time, the paper will make a case study of the exchange rate of the national currencies into the main hard currencies from January 2005 to January 2015, which affects the credits on the Romanian monetary market. The analysis of the exchange rate aims to identify its relation with the tensions on the monetary market from Romania.

## **2. Description of the problem and methodology**

This article aims to make a theoretical study of the tensions from the monetary market in Romania, applying it to the evolution of the exchange rate of the Romanian RON in relation with the Swiss francs, with the Euro and with the USD. The objectives of the paper include the clarification of the concept of tension on the monetary market and the identification and analysis of the tensions which generate instability on the monetary market from Romania, with particular reference to the exchange rate from January 2005 to January 2015. The methodology presumes the use of logic, statistic, comparative and descriptive analyses, the interpretation of the reality and a literature review.

## **3. Literature review**

Extensively treated by the literature, the concepts of hazard, vulnerability, risk, threat and challenge, dominated the final decades of the past century and the beginning of this century. Thus, Buzan (1983, p. 75-83), distinguished, within the broad category of threats, the economic threats (incapacity to pay the debt, currency control,

practices regarding the export and limitations of the import, elements pertaining to the internal stability, etc.), highlighting the necessity to understand the vulnerabilities and the causes of the threats, which can be controlled (reduced or even eliminated) through political actions.

The concept of threat has often been substituted, even mistaken for the concept of challenge, while the term of vulnerability has been better analysed and defined in dictionaries and encyclopaedia, being generated, according to Barnett (2001, p. 132-133) by the social, economic and political processes. Vulnerability has also been defined by O’Riordan (2002, p. 369) as „the incapacity to avoid danger, or to be uninformed of impending threat, or to be so politically powerless and poor as to be forced to live in conditions of danger”, while Oliver-Smith (2004, p. 10) said that “vulnerability can become a key concept in translating that multidisciplinary into the concrete circumstances of life that account for a disaster”, the disasters being perceived by society as risks which affect the political, social and economic institutions and actions. At the same time, Nathan (2007) sees in vulnerabilities a complex process with multiple interconnected dimensions and sets two distinct traits of them: exposure and insufficient capacities. The general direction in terms of concept has recently turned global. Thus, Cardona (2004, p. 37-51), suggested rethinking the vulnerabilities and risks from a holistic perspective, in his vision, the physical destruction being often caused in the developing countries by social economic, cultural and educational aspects, vulnerability being related to the lack of resilience. According to Brauch (2005, p.41), vulnerability is „always socially constructed. In the end, therefore, ‘vulnerability’ is how the analyst or policy-maker has defined it and which of the many definitions have become accepted by a consensus within the respective research community”. Peduzzi (2000, p.2) defined vulnerabilities as “expected percentage of population loss due to socio-politico-economical context”, and the risks according to Tobin and Montz (1997) are „a measure of the expected losses due to hazard event of a particular magnitude occurring in a given area over a specific time period”.

The concept of risk has evolved even from the 15<sup>th</sup> century, being defined and analysed in various forms, going as far as extremely individualized areas such as the “theory of risk”, the “risk premium”, the “risk analysis” and “risk management” (Grüske and Schneider 2003, p. 456). Thus, risk is often defined within the context of a present incertitude, Jaeger, Renn, Rosa and Webler (2001, p. 17) speaking about risk as “a situation or event in which something of

human value (including humans themselves) has been put at stake and where the outcome is uncertain”.

Although the concepts presented above abound in clarifications, several aspects still are extremely confuse, while the term of tensions is often neglected, and when it is used it gets unclear. Thus, tensions are described either in a manner which is external to the economic environment (geopolitical, social, cultural, military tensions) or in a rather obscure manner, such as “monetary market tensions”, rather describing a permutation of the adverse effects at the level of the same domain, but with no clear identification of the tensions. Hence, this article is a novelty because it attempts to clarify, at least partially, this concept and to show a practical application of it, the case of the exchange rate.

#### **4. Thorough presentation, particularisation and conceptual delimitation of the term of “tension” in relation with similar, complementary or opposed concepts and presentation of several typologies of tensions**

Starting from the definitions given by different dictionaries of the Romanian language, the concept of tension denotes: the state of strain, stretch, “anxiety”, “nervousness”, interior force that appears within a body or system due to external forces, “the difference of potential”, the pressure (generally treated as a limit or normal value), “agitation”, “feverishness”, joint effort, accumulation of energies or forces which, being in a closed environment, tend to get away. Therefore, the tension is a trait, a feature of something which needs three elements for an adequate description: the environment of action, the factor of phenomenon exposed to tension and the force or group of forces which determine a particular form of manifestation of the factor within that environment.

In medicine, for instance, the pressure (blood pressure, for instance), describes the pulsatile pressure which results from the regular contraction of an organ (the heart, for instance), which creates a system of forces which propel a particular substance (blood, for instance) through all the “arteries” of the body. From this definition we may draw the conclusion that the pressure is a natural, physiological state of a living organism or system; only if it exceeds the “normal” limits it may signal problems with the state of “health” of the particular system.

If, generically speaking, we consider that the macroeconomic system is a logically vivid system<sup>2</sup>, then the financial-monetary

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<sup>2</sup> Also see Dinga, E. (2009). *On the Logically Vivid System. Theoretical and Applied Economics.- General Association of the Economists from Romania - AGER. - Vol. 05(534).2009, 05(534), p. 45-62.*

market, which has a strong human component, may also be regarded as having the characteristics of the logically vivid systems. Therefore, if we consider that the financial stability is the state of “health” of the financial and monetary systems and markets, and the financial instability describes the state of “disease” or “severe disturbance”, then the tensions observed on these markets can be seen as a state of “pre-disease” or “feverishness”, which signal the imminent break of the “disease” (either an uncontrollable high volatility or, even worse, collapse or isolated bankruptcy of an element, or the generalized bankruptcy of an important part of the financial system, or even of the entire financial system of a country, which starts financial crises). Within this context, the tension can be seen as a signal for the change of the normal physiological state of that particular financial-monetary system, being a relevant indicator of the imbalance of “disease” to be soon noticed.

Thus, we can make a first typological classification of the tensions as:

- Independent tensions, physiologically normal, of tonus, stagnant, stable, adaptive, inherent;
- Acute tensions, which signal a „disease”, anomaly or imbalance, which accumulates and can get worse in time;
- Chronic, transformative tensions, which will invariably change, sooner or later, turning into risks.

We must also notice the distinction which involves the occurrence, with high probability, of an adverse, often irreversible, phenomenon. The tensions can be considered as irreversible in many situations, momentary and even positive sometimes, describing the normal state of the “tonus” of the financial-monetary market (Pop, 2008), under the conditions of a low or moderate volatility. In this direction, tension can be described as a characteristic of the automatic stabilizers. The tensions can be also generated by a latent, often hardly identifiable and altered state of manifestation of the risks, being influenced by specific factors or forces, shifting, under specific environmental conditions, to the state of threat or risk.

As mentioned in previous papers<sup>3</sup>, an important source of macroeconomic imbalances, thus a factor which fuels tensions, uncertainty, vulnerabilities and risks on the international markets (the financial-monetary markets included), is the disconnection of the price from the intrinsic value of the goods and services. In this direction, a

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<sup>3</sup> See Ailincă, A.G., Iordache, F. and Milea C. (2013). *Theoretical Fundamentals Concerning the Transmission Channels from the Perspective of the External Equilibrium*, *Annals. Economic Sciences series*, vol. XIX/2013 Faculty of Economic Sciences, “Tibiscus” University, Timișoara.

natural measure to reduce the tensions, vulnerabilities and risks is to correct or normalize, in a rational manner, the price in the proximity of the costs and tougher measures taken by the market surveillance and control organisms.

If we consider the occurrence of the imbalance or the manifestation of the “disease” of the financial system (crisis, for instance), the state of recovery can be a state of tension too, because it will be difficult to say whether that adverse phenomenon will pass rapidly or will persist and if it will generate new side effects which are sometimes hard to predict. The recovery, reconstruction, return to a previous state cannot be immediate and demands time, being thus a period of “convalescence”; from this angle, the crisis can be beneficial, a state of re-seeking and repositioning towards a new state of balance. The institutional (central banks, governments, international bodies, etc.) “medication” or “cure” and the “dose” to be used when the “disease” or crisis breaks out on the monetary market are extremely important, since they can hurry the “healing” or, on the contrary, can prolong indefinitely the return to a state of balance, and may even trigger again even more serious imbalances on the financial-monetary markets.

When the tensions, vulnerabilities and risks occur gradually, it is easier to identify the disturbing factor which caused the imbalance, therefore the “treatment” comes faster, it is easier to give and to bear. A sudden burst, often with no previous “symptoms”, of an adverse phenomenon can make it difficult to identify correctly the cause and the proper “treatment”. Therefore, in this situation, there are no warning tensions, or they cannot be identified, only the risks being visible. So, according to their manner of manifestation, the tensions can be slow, diluted, insignificant in time or fast.

The tensions describe a specific level of integration of the unwanted events. Thus, within the general macroeconomic framework, some aspects become relevant and can be included in the concept of “tension”, and as the adverse phenomenon “worsens” it may transform into vulnerability and then in risk. Therefore, according to this perspective, the tensions belong to the sphere of risks, being a structural element of those.

The factor or system on which the tensions act is extremely important particularly in terms of its size, of its importance for the economy, country or region of the world where it acts, in terms of the size of the cross-border activities and of its interconnection with the system in which it acts or with the financial system which it influences. The more these elements are towards maximal levels, the more the tensions that act on the phenomenon which has these

significant characteristics can turn into elements generating vulnerability and even risks.

Another vision is that the tensions are distinct, even opposed sometimes to the problems of risks, being considered momentary anomalies of the general environment of action.

The tensions can also be classified as: exogenous or endogenous to the analysed system, the monetary market in our case. According to this approach, the tensions are considered rather exogenous, which don't belong to the studied phenomenon and framework. For instance, the risks can be readily identifiable and ascribed to the internal abnormalities of the monetary market, while the tensions can be of a different nature: social, political, cultural, psychological, environmental, etc. so they can be out of the strict control of the monetary or even governmental authorities from a particular country, groups of countries, or region of the world. According to this classification, the tensions cannot be mistaken for the risks, being rather changes of the general economic environment which describe a state of structural external relocation, cyclical or conjunctural in relation with the analysed system. This vision is closer to what the literature analyses often, being a problem external to the framework of analysis, often difficult to control (see the stability reports of ECB, IMF, BNR, etc.). Considering the above classification, and also counting the phenomenon of aggregation within the framework of activity, the *tensions can be seen as horizontal or vertical*, since they can occur in a horizontal plane, at the level of the same domain (for instance, generating the transmission of the effects between the monetary markets from different countries or regions of the world), or they may gather effects coming from different environments or domains (for instance, tensions of the monetary market manifesting simultaneously with social and/or geopolitical tensions).

The tensions can be positive or negative. For instance, the injections or withdrawal of currency by the national banks, in "homeopathic" doses can be an example of positive tensions, which ensure the proper operation of the internal financial-monetary market, the tensions being in this case a normal state of pre-regulation of the balance on this market.

Speaking of their effects, the tensions can be dissipative or accumulative. The dissipative tensions are those tensions which dissipate, dilute, diffuse, regulate or accommodate the state of the adverse phenomena. Such example could be the measures taken by the central banks which, anticipating a wrong direction towards which the commercial banks are heading, issues regulations which dissipate, "dilute" the risks that might occur on the financial-monetary

market. The accumulative tensions are those which gather, store a negative phenomenon, or several adverse phenomena, behaving like a true centralizer of macroeconomic problems and disturbances, acting directly or indirectly on the monetary market.

To the extent in which they can be circumscribed to the functioning of the economic cycle, the tensions can be cyclic or anticyclic. They can also be periodical, succeeding regularly or sporadically, accidentally, appearing only under particular circumstance (for instance, the tensions appear due to regional and political events).

When the tensions appear due to the change of the monetary market structure or if they belong to the general macroeconomic conjuncture, they can be classified as structural or conjunctural tensions.

Because the multitude of typologies doesn't allow an exhaustive approach of each type, this article will only approach the endogenous-exogenous nature of them. Given the difficulty of analysing the exogenous tensions (social, political, religious, cultural, environmental, etc.) on the monetary market, the paper will focus on the endogenous approach. The analysis will concentrate on the tensions that may occur due to the higher volatility of the exchange rate, with reference to the period between January 2005 – January 2015, analysing particularly the extent to which the evolution of the exchange rate of the national currency, RON, in relation with the main hard currencies, fits to the concept of tensions and its typologies.

##### **5. Case study on the exchange rate of the Romanian RON in relation with the Swiss franc, Euro and the USD, in the period January 2005-January 2015**

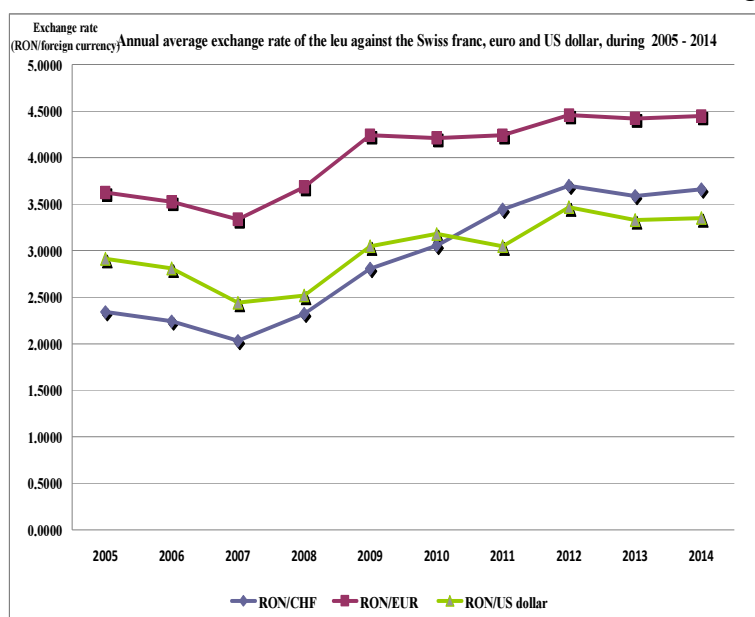
Although the analysis focused on the exogenous approach, if we look the extremely fluctuating episode of the exchange rate RON/Swiss franc, in early 2015, we may say that the effects which occurred on the Romanian monetary market had an external cause, the changed strategy of the National Swiss Bank (BNS). Thus, BNS wanted to unlock the exchange rate between the Swiss franc and the euro, on the grounds that the forced administration of a rigid exchange rate is too costly, and they warned that there will also be further episodes of "liberalization" of the exchange rate. However, the manner in which BNS implemented this strategy raised fear and panic on the international markets and affected the financial-banking sector by material and credibility losses. The price of the shares of Swiss companies and of the Swiss financial-banking system decreased on the capital markets. The banks from Central and East European countries which provided products and services in Swiss francs were



confronted with a strong fluctuation of the exchange rate. This phenomenon might increase the number of nonperforming credits, in these countries, depending on the proportion of credits in Swiss francs out of the total volume of credits. While Hungary, Croatia and Poland already took measures to protect the debtors and to find solutions for the conversion of the Swiss francs credits into national currency or in Euro, Romania, and BNR, particularly, considered that no such measures are needed, proposing individual solutions between the debtors and their banks.

Irrespective of the measures taken by the central banks from the region, the shock of a strong variation of the exchange rate can affect the entire financial-banking system from a particular country or region and it may even disturb the balance of that economy or area. Such shock can also come from the variation of the exchange rate of a nonconventional or “exotic” currency, which has been used actively, from various reasons, for the promotion of the offer of credits.

Chart 1



Source: BNR data processed by the author

Chart 1 shows that the evolution of the exchange rate of the Romanian RON in relation with the Euro, USD and Swiss franc, displayed an increasing trend over the period 2005-2014. While the USD largely followed the trend of the European currency in its relation with the Romanian RON, the Swiss FRANC appreciated constantly, the RON/FRANC exchange rate increasing almost constantly over the period 2007-2012.

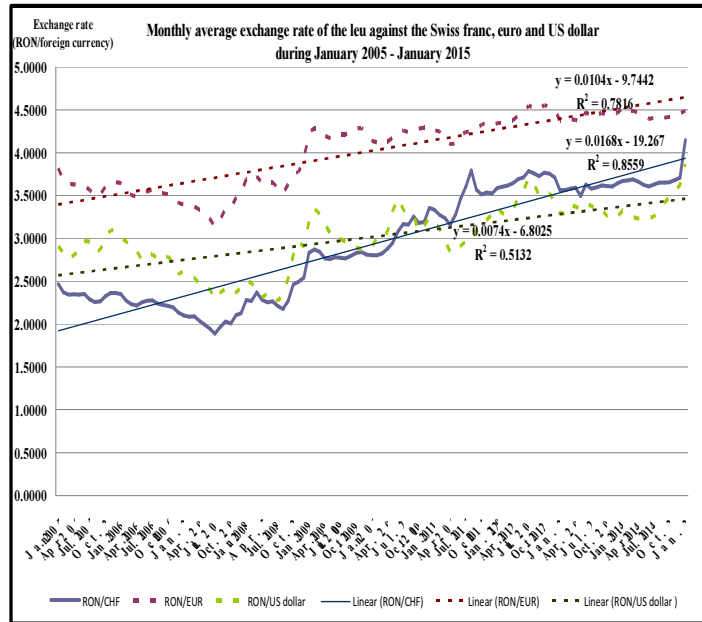
Returning to the definition of the tensions and to their classification, we may say that the evolution of the exchange rate RON/EURO and RON/USD, was according to the typology of the adaptive, slow, physiologically normal, inherent tensions, while RON/FRANC exchange rate displayed an accumulation or worsening in time, belonging rather to the acute type of tensions.

The evolution of the exchange rate of the national currency in relation with some hard currencies may produce tensions in economy, particularly if the products and services expressed in that particular currency hold an important share or they are influenced by the variation of that currency, the level of interconnection of the system (for instance, the financial-banking system) with the rest of the economy or with the regional economies also being extremely important.

If we analyse strictly the evolution of the RON/Swiss franc exchange rate in January 2015, we may see that it is related to an exogenous tension, because it doesn't belong strictly to the national monetary market, being "imported" through the channel of the RON/Swiss franc exchange rate. We may also see that it is a horizontal type of tension, its effects being transmitted between the monetary markets from different countries, BNS decision being a spot decision, not anticipated by the central banks from Europe or worldwide, or by the markets, which shows that the evolution of the RON/Swiss franc exchange rate is sporadic, or accidental.

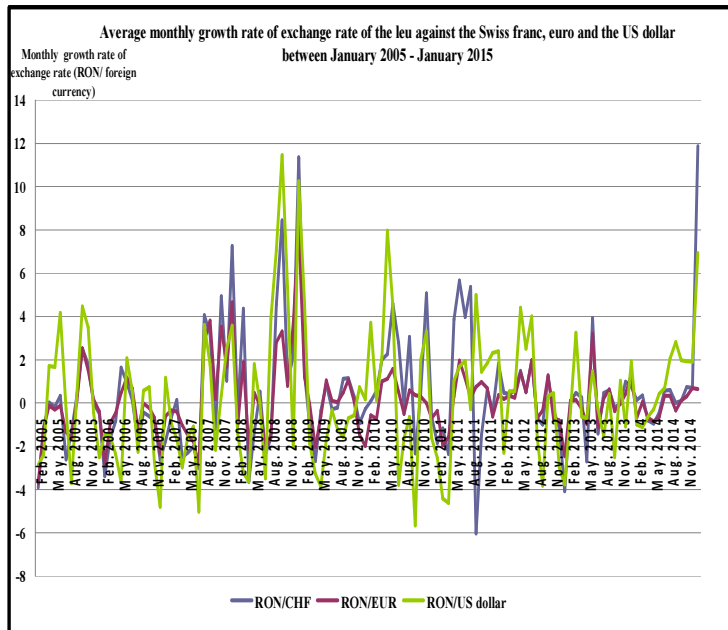
However, if we analyse the monthly evolution of the exchange rate of the Romanian RON in relation with these three hard currencies (Chart 2), we may notice that the evolution of RON/euro and particularly RON/Swiss franc exchange rates, is not that accidental, or unpredictable, as it may look at first sight.

Chart 2



Source: BNR data processed by the author

Chart 3



Source: BNR data processed by the author

The rate of increase of the RON/USD exchange rate cannot be considered too stable either, the monthly data showing strong variations in late 2008 and early 2009, May 2010, October 2010 and September 2011, slowing down somehow until late 2014 and early 2015, when it reached again high levels.

Thus, taking into account the above, we may say that the evolution of the exchange rate may generate significant tensions on the monetary market from Romania, not so much regarding the conventional currencies (although they are not spared either of important hazards!), but more regarding those currencies which escaped the vigilance of the financial and banking surveillance institutions, and which accumulated adverse effects which turned into vulnerabilities an even risks to the financial stability.

## **6. Conclusions**

Although the problem of tensions often eludes a rigorous analysis of the weaknesses of an economy and even of the whole financial-banking system, the analyses focusing on the identification of the conditions of incertitude, vulnerabilities and risks, the fundamental and methodological clarification of the tensions (implicitly regarding those affecting the monetary market) may provide important theoretical bearings and may fundament the possible decisions for a better management of these tensions.

The article includes two levels of analysis: on the one hand, a theoretical and methodological study regarding the tensions, and on the other hand, an exemplification of the extent to which an important element of the monetary market – the exchange rate – fits the theoretical facts about the tensions, with punctual reference to the period January 2014 – January 2015.

Monitoring the annual (2005-2014) and monthly evolutions of the exchange rate of the Romanian RON against the Euro, the Swiss franc and the USD, we may notice an obvious increasing trend, which allows us saying that:

- Largely, the tensions generated by the evolution of the exchange rate, except for the period when the international crisis broke out, may be included in the category of the normal tensions, of state, adaptive, particularly regarding the exchange rate against the Euro; at the same time, the evolution of RON/Euro and RON/franc is confirmed significantly by trends;

- The monthly data from January 2005 to January 2015 regarding the rate of increase of the exchange rate show some tensed moments (“saw teeth”) particularly for the RON/USD and RON/Swiss franc exchange rates, which calls utmost prudence on the side of the authorities;

- Although in January 2015, the decision of the Swiss National Bank to loosen the exchange rate of the Swiss franc against the Euro was unexpected, based on the obvious increasing trend of the RON/franc exchange rate in 2007-2012, it could have been somehow anticipated; would it have been announced earlier, its effects might have been less “painful” for the debtors in Swiss francs, both in Romania and abroad;

- Although the financial-banking legislation is extremely rigorous, the actors of the financial and monetary market (the commercial banks especially) can find ways to avoid or slacken the effects of the legislation, particularly of the prudential one, hoping for higher profits (such as services and products presented in an attractive manner without highlighting the potential losses and the risks assumed by the debtors, the currency risk in this case), creating serious problems for the financial stability.

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