RETHINKING A GLOBAL SUSTAINABLE MONETARY POLICY IN A POST-CRISIS ERA

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Abstract

The central banks are some of the key institutions which act and intervene through specific operations to influence the overall economic activity. The global financial crisis and its driven effects maintained over time the focus on the way in which the central banks reacted to regulate the engine of the economy. During the post-crisis period, difficult for the global economy, the monetary authority tried to address the challenges through measures aiming to support the financial stability, which is essential for the sustainable economic growth. Within this framework, the central banks which dominate the global economy have implemented several non-conventional measures in order to accomplish their objectives, which cause adverse effects for other economies, particularly the emerging ones. Starting from the characteristics of the post-crisis environment, observed at the global level, the paper identifies some challenges to the central banks, which require rethinking a global sustainable monetary policy.

Keywords: central bank, secular stagnation, disinflation, globalization

JEL Classification: E52, E58, F65

1. Incursion in the post-crisis reality

Most analyses and research papers in the macroeconomic field start from the state of the world economy. Without going into technical details, rather giving a general image of the post-crisis period, Table 1 shows some traits of the global economy as resulting from recent reports of IMF (2016; 2017) and OECD (2016).

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Table 1

State of the world economy, 2015-2017

	Traits regarding the macroeconomic indicators
1.	Lower rate of potential GDP growth in the developed and emergent countries
2.	Low rates of increase of the total productivity of the factors and of the stock of capital
3.	Lower total volume of the trade with goods
4.	Low levels of the *core* and *headline* inflation
5.	Maintenance of the near-term and longer-term inflation expectations (particularly in the developed countries)
6.	Persistent low levels of the short-term and long term interest rates
7.	Higher quantitative easing applied by the central banks from the developed countries
8.	Persistence of high levels for the private sector debt

Source: processing of OECD, 2016; IMF, 2016 and 2017 information

Although there are recently some signs of improvement of trade and manufacturing growth rate, there is a slow economic activity, the global economy being entrapped in a "trap of slow growth" (OECD, 2016). The characteristics that describe the world economy in the post-crisis stage tend to be of long-term, the diversity and complexity of the interactions between them making hard the process of self-correction, as the world economy would recover. Wheeler (2016), noticed, within this difficult context of recovery, that the low inflation rate from some countries is related to the demographic changes, particularly in the countries with decreasing workforce and in the countries with ageing population. The low inflation is also determined by the technological changes regarding the flow of information and energy production and, worldwide, by the excess offer of processed goods and raw materials. The decrease of the natural interest rate can be due to the lower increase of productivity, while the increase of the global saving can be due to the process of post-crisis disintermediation and population ageing.

Generally, it is considered that the decrease of the real interest rates on the medium and long-term, another trait of the post-crisis stage, is determined by the reduction of the natural interest rate following the changes in the basics of saving and investment (Bean et al, 2015). Summers (2014) says that this trend is due to the low demand for capital, to the higher inclination towards saving and to the sluggish economic growth, which actually are traits of the secular stagnation. On the other hand, Broadbent (2014) considers that the reduction of the natural interest rates is caused by the higher inclination of the emergent economies to save, conjugated with the increasing preference of the investors for safer assets.

Juselius et al. (2016) highlights that the general trend of reducing the real medium and long-term interest rates is rather persistent and significant to be explained merely by the general decline of the natural interest rate. Borio and Zabai (2016) link the interest rate level to the financial conditions, giving importance to the periods of financial boom and boost.

The empiric study of Juselius et al. (2016), on the basis of USA economy data, shows that, considering the influence of the financial cycle, the estimated interest rate usually is higher and less dynamic, while the monetary policy interest rate is below the estimated one. The results of the study reflect the interaction between the monetary policy and the financial cycle as explanation of the decline noticed on the interest rates market. Within this context, the authors consider that the policy acted aggressively and persistently towards the financial decline, but it didn’t manage to act swift enough and deliberately in order to control the episodes of financial effervescence, and such asymmetry could be the cause for the trend of decreasing real interest rates.

There are two hypotheses that explain the situation of the world economy (Cunliffe, 2016). On the one hand, this situation would be caused by the low process of economic revival which interacts with the unfavourable events that occurred during the post-crisis period: the Great Recession (2008-2009), the Euro Area crisis (2011-2012) and the deflationist shock manifested by the crash of the oil price (as of late 2014). On the other hand, this situation would be the result of the action of deep structural and secular forces which started to manifest before the onset of the global financial crisis, but whose effects were shaded by the incentives offered by the financial effervescence. In this situation, there is recovery after the financial crisis, but in the economies with lower potential of growth and with higher vulnerability to shocks.

Mishra and Rajan (2016) highlighted that the risk of an economic slowdown both in the developed and in the emergent countries is linked to the higher internal political tensions. One of the political concerns is the identification of those measures and instruments capable to restore the economic growth at the level before the onset of the global financial crisis, but some showed that such objective would be anachronic, given the action of breaking factors. Thus, the financial boom before the great recession left the developed countries with high levels of debt, which hampers the economic recovery. Although the debt could be depreciated as a means of supporting the demand, it is not certain whether this measure would be sustainable. Before the Great Recession, the based-debt demand, which had now become aggressive, concealed a structural slowdown of the global growth potential due to the ageing population in the developed countries and also to the slowing the growth of productivity.

2. Post-crisis challenges for the central banks

2.1. From disinflation and deflation to the risk of de-anchoring the inflationist expectations

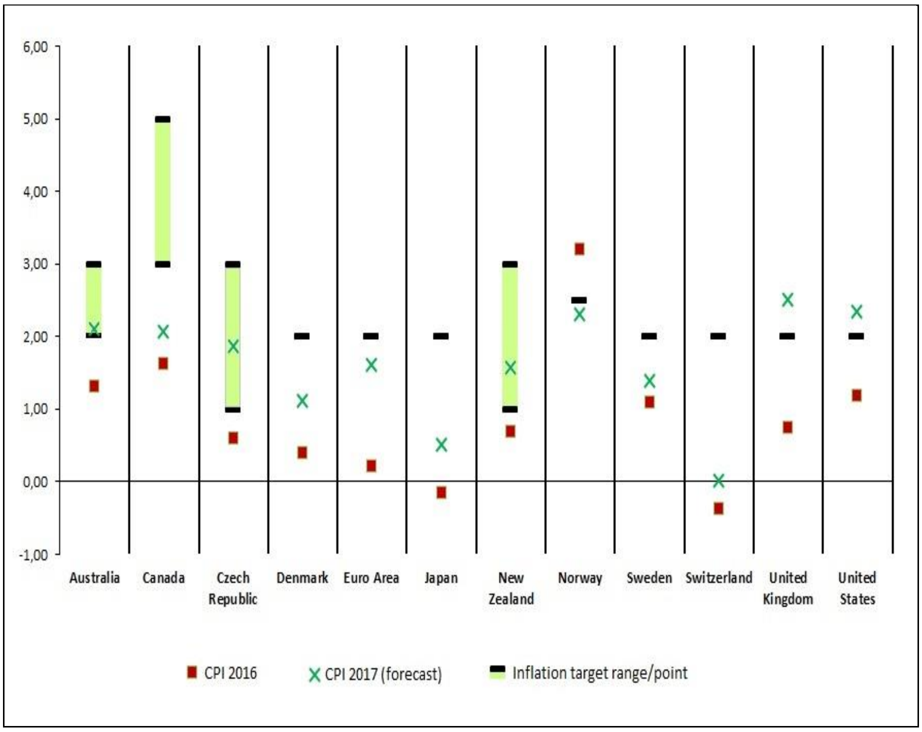
One of the features of the post-crisis period, particularly after 2013, is the persistent decrease of inflation, globally, below the medium-term expectations. According to IMF data (2016), in 2015, out of 120 countries, 85% reported deflationist trends and 20% even displayed signs of deflation.

The conventional explanation of this phenomenon is the low demand and slowed economic growth, both in the developed countries and in the emergent ones, as the post-crisis period is marked by the build-up of the debt (public and private), but also by the decreasing prices for raw materials, oil included, which “self-maintained” the trend of price decreasing by keeping the wages low.

The import prices also contributed to deflation, due to the sharp decline of oil prices in 2014. However, the core inflation (which excludes this very category of prices, as well as the price for food), also decreased below the inflation target set by the central banks in most developed countries (see Graph 1).

Graph 1

Inflation and gap of inflation from its target, in developed economies, in 2016 and 2017

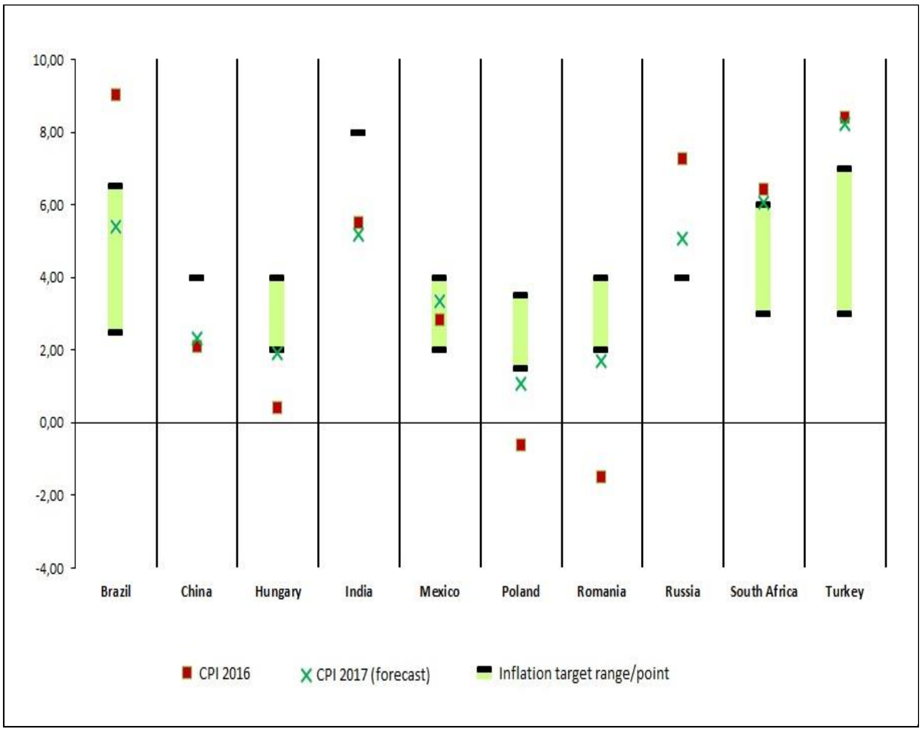


Note: CPI inflation, annual average, percent changes; for 2017, estimated data. Although for Denmark there is no inflation target, we presumed it to be 2% (as for Euro Area).
Source: representation based on IMF data, October 2016; European Commission data for the Euro Area.

For the emergent economies, however, although the image is much more diverse, inflation (IPC) exceeded sometimes the target (see Graph 2).

Graph 2

Inflation and gap of inflation from its target, in emergent economies, in 2015 and 2016



Note: CPI inflation, annual average, percent changes; for 2017, estimated data.
Source: representation based on IMF data, October 2016.

The explanation of the decreased import prices also lies in the large decline of the industrial activity in the emergent economies, particularly in the Asian countries, where there is an excess of capacity in the tradable goods sector. This surplus is the result of the accelerated increase of investments in this sector, before the global financial crisis, due to the favourable forecasts for the global and local demands. Another factor which feeds the general disinflation is the change in the power of price negotiation on the labour market, due not just to the slowing economic activity per se, but also due to the structural changes induced by the market globalization and by the technological progress. The increased competition in the open markets and the technological development put pressure on reducing the power for prices negotiation, both for the companies and for the workforce. The structural changes within the economy have developed and maintained a feeling of incertitude regarding the employment, inducing a cautious behaviour of the workforce.

Ehrmann (2015), who conducted a study in several countries, suggested that the central banks may have larger difficulties in accomplishing the new inflation targets under the present conditions, when the actual inflation is many times below the target (compared to the situation when the actual inflation exceeded the target). On the other hand, a low, stable and predictable inflation helps maintaining the trust in the value of the currency and contributes to a sustainable economic growth and to improve the standards of living (Bank of Canada, 2016). A clear and transparent communication is essential, also including here the risks that might bear on the published forecasts for the economic indicators.

Not disinflation per se is worrying, rather its persistence, under the conditions in which it leads gradually to a down-adjustment of the expectations regarding the evolution of prices, which might produce costly deflationist cycles, with increased debt burden and long-term hampering of the economic growth and occupation.

According to IMF study (2016), there is a higher risk of prolonged low inflation period, particularly in the countries whose monetary policy is constrained by keeping the interest rates close to zero, the central banks being perceived as not having enough area of manoeuvre to stimulate the economic activity and avoid disinflation. Actually, the results of the study show that the sensitiveness of these expectations tp the unexpected changes in inflation (which should be zero, if the inflationist expectations are perfectly anchored) increased, which might show a phenomenon of de-anchoring the inflationist expectations from the target objective of the monetary policy in those countries. Hence, the role of the inflationist expectations and the path of prices become essential, and the ability of central banks to anchor these expectations on the medium-term inflation objective can help avoiding the related risks.

2.2 Limiting the space of manoeuvre of the monetary policy

From the perspective of the monetary policy, the post-crisis period is marked by the limitation of the manoeuvre space of the interest rate, particularly in the developed countries. This element is defining in reflecting the challenges confronting the monetary authority, in general, because, on the one hand, the central banks with zero lower bound usually are those which dominate the global economy and are forced to apply non-conventional measures in order to accomplish their objectives and, on the other hand, these measures influence the monetary policy of other economies (particularly the emergent ones).

2.2.1. Influences of the monetary policies dominant at the global level

The effects of the monetary policy of the USA largely influence the world economy due to the domination of the US dollar on the global financial markets and in the world trade (Bruno and Shin, 2015). This domination is reflected in the evolution of prices for assets, of the risk premium and of the lending activity, at the global level. There are studies showing that the USA are the drive behind the world financial cycle (Cetorelli and Goldberg, 2012; Rey, 2013), and from this perspective, the change of Fed's monetary policy conduit influences the financial conditions of other economies.

There are empirical studies (Bauer and Neely, 2013; Fic, 2013; IMF, 2013) which approach the problem regarding the effects of non-conventional measures. Their conclusions show that the emergent countries with solid economic fundamentals and with more developed financial markets were rather resistant to the adverse shocks caused by the decisions of the global central banks. Some studies noticed that for such countries, the results were better in terms of the exchange rate, bond price and stock yield (Ahmed et al., 2015), Mishra et al., 2014). On the other hand, other studies claim that the emergent economies with larger and more developed financial markets were affected more by these external pressures (Eichengreen and Gupta, 2014; Aizenman et al., 2014), or that the solid macroeconomic bases (lower levels of the public debt, higher currency reserves) didn't protect them from the effects of Fed's non-conventional measures (Eichengreen and Gupta, 2014).

Although the results of these studies are not converging, overall it seems that most national currencies depreciated in the post-crisis, and the countries with weaker economic bases were strongly affected by the "external" monetary policy. The Central Bank of Turkey used much of its currency reserves to alleviate the pressure on the national currency, and the Central Bank of South Africa used the exchange rate as the main instrument to absorb the shock. Many emergent countries had to increase the interest rate in order to decrease the outflow of capital and the pressure on the exchange rate (Turkey, Mexico, South Africa and Brasilia).

Some studies (Buitron and Vesperoni, 2015; BIS, 2015) try to suggest that the effects induced in the Euro Area countries might become important, particularly those generated by the non-conventional measures, and which act through the financial channels.

2.2.2. Influences of the emergent economies

The relations between the emergent economies and the advanced ones continue to represent a challenge during the post-crisis period, not just because there are concerns regarding the impact of the monetary policy decisions from the advanced countries, but also because the emergent economies play an increasingly important role in the trade and financial world circuit, and the growth perspectives of the emergent countries are reflecting in the world economy – the slowing economic growth from these countries affect a potential recovery of the world economy.

One of the channels of influence of the global economy is the commercial one, by more intense relations with the developed countries, and from this perspective, the role of the Chinese economy is dominant due to its increasing share to the world GDP and to its level of trade openness to the exterior. Hence, the decisions of internal economic policy have increasing repercussions at the global level. Thus, China influences the world economy following both its consolidated relation with the US economy and its trade relations with the euro zone countries, by the high level of imports of European intermediate goods which the Chinese industry uses to manufacture goods exported to the rest of the world. A decline of the internal demand in China means lowering the raw materials prices at the global level, being an incentive for the importers of such products (from Euro Area countries).

The influences of the emergent economies on the developed economies are also determined by the intensifying process of their financial integration within the world economy, but the emergent economies tend to be rather receptors than sources of financial influences (BIS, 2016). The process of capital accounts liberalization and the increased importance of the external financing, particularly via the lending channel, are factors which determine the dependence on the external financial environment, particularly on the USA financial conditions, as most of such loans are in US Dollars (McCauley et al., 2015). The increasing level of the loans denominated in US Dollars, particularly as of 2008, is determined not just by the fast and high rates of economic growth in the emergent economies, but also by the more favourable interest rates for US Dollars loans, and by the expectations regarding the exchange rate developments of the local currencies (Bruno and Shin, 2014).

For the emergent economies, the dependence on the external lending and the accumulation of a high stock of debt denominated in foreign currency have increased the potential for blockages in the developed countries. The low interest rates in USA and the US Dollar depreciation stimulated for a while the crediting activity, increased the price of the assets and stimulated the economic growth in the emergent economies, but the change of the financial conditions in the USA might generate adverse effects in the advanced economies as well. Constâncio (2015) highlights the fact that European Central Bank analyses carefully the events from the emergent economies because their effects on the rest of the world, including on the developed economies, might become more important if the reciprocally potentiating side effects materialise.

In terms of the monetary policy, the post-crisis stage is characterized by the limited area of manoeuvre of the conventional instruments and measures specific to this policy, under the conditions in which the world economy is within a process of secular stagnation, and the disinflation forces persist.

The effects of the monetary policy decisions, irrespective of being conventional or unconventional, are mostly analysed at the domestic economy level, ignoring the influences of the external environment, although, as the post-crisis reality shows, the adverse effects are not insignificant. The challenge for the future is to identify simple and globally applicable rules aimed at minimising these adverse effects.

3. Final remarks

The post-crisis challenges for the central banks are the effect of deeper imbalances reflected not just by the harshness of the recession induced by the global financial crisis and by the persistently weak subsequent recovery, but also by the imbalanced mix of the post-crisis policies, which left monetary policy with the task of managing this burden.

This analysis shows that during the post-crisis period, the central banks have changes their position from an offensive one, given by the assumed posture of important actor in managing the adverse effects of the global financial crisis, to a defensive posture, as an accommodating reaction to the conjuncture created by the complexity of the post-crisis challenges. Such a defensive position of the monetary policy is dominating during this period, both in the context of a narrowed area of manoeuvre of the monetary policy instruments, and with the global economy being in a secular stagnation, or at least in a long process of slowing economic growth.

The narrowed area of manoeuvre of the interest rates reflects the challenges to the monetary authority because, on the one hand, the central banks in this situation usually are those dominating the world economy and they are compelled to apply unconventional measures to meet their objectives, and, on the other hand, these measures influence the monetary policy of other economies, particularly the emergent ones.

These conditions show the necessity of rethinking a monetary policy from the global perspective, the sustainable monetary policy considering all the relations between central banks. The elements which define a sustainable monetary policy refer, among other, to:

- Defining and applying measures with positive effects for the national and world economy;
- Avoiding unconventional measures, whose effects cannot be clearly assessed;
- Limiting the risks of the low interest rates on the financial stability;
- Additional measures to stimulate the economic activity of the large economies able to produce important growth effects, such as to compensate the potentially adverse influence (currency depreciation, capital outflows, and speculative bubbles).

A sustainable monetary policy at the global level is that one which takes into account the international dimension of its assumed responsibility. The basis of its implementation refers to establishing and keeping those rules that maximise the ratio between the favourable effects at the national level and the adverse effects at the global level.

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