

Financial Institutions and Services

Central Banking: Between Policy Monetary and Global Crisis

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Abstract: Central Banks have been at the heart of the recent Global Financial Crisis and in the face of unprecedented challenges: to ensure monetary stability in a period of deep financial turmoil. Which seems to require rethinking the theoretical precepts and practice of international monetary this study is to survey the evolution of the central bank in terms of functions performed throughout its history in the context of the dominant paradigm of each stage of evolution of society. The empirical research work carried out year impact of monetary policy on the evolution of inflation targeting price stability over the last fifty years. The Great Inflation to the current global crisis. Paradigm dedicated to monetary policy focused on price stability as an independent and objective, seems to resist the crisis. Although there is agreement on maintaining price stability as a priority objective of the central bank, most researchers and practitioners believe that financial stability is as important for monetary authorities.

Keywords: central banking; monetary policy; global financial crisis; price stability

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1. Introduction

The current global financial crisis has shown, if needed, that the monetary savings are not science laboratories equipped with the ability to conduct controlled experiments and that no central bank, ore monetary policies cannot ensure a financial stability atolls.

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Starting in August 2007, the world was hit by a “once-in-a-century credit tsunami” (Alan Greenspan). The financial crisis pushed Central Banks in front line (Caruana, 2011) and it highlighted a new set of challenges for central banking. The financial crisis caused the most severe contraction since the world-wide great depression and is associated with often subliminal changes in the mandates and functions of both central banks, but it seemed to sweep away also the confidence in the ability of central bankers to successfully manage the economy. (Mishkin, 2011) Central bankers responsible for inaction were worsening the broadly held during the great economic downturn inflation of the 1970's. Milton Friedman was attributed responsibly for the great inflation economic and political leaders. He argues that the great inflation occurred because of the political and economic officials in charge who were at the time. And the great inflation of the people ended because ware in charge at that time. (Taylor, 2002) The failure of weak monetary regimes to reign in high inflation led to the establishment, in the early 1980's, monetary policy of price stability frameworks solidly anchored by mandates, and safeguarded by independent and Central Autonomous

The 'great moderation' of the 1990's appeared to have inflation under control permanently and conveyed the impression that the monetary policy battles of yesteryears had been won, but the current financial crisis has brought new challenges and requires new approaches monetary theory and practice.

The crisis has reaffirmed the Importance of a clearly defined having objective for price stability and central bank of independence, which, under the specific mandates together with transparent communication continue to policies will be instrumental in the pursuit of price stability by monetary authorities, but incorporating monetary phenomena in the policy framework established can help the economy in the medium term. That coupled with the inescapable fact inflation is a monetary phenomenon in the long term, this is a reason to redress powerful under-appreciation of the monetary and credit variables in policy frameworks characteristic of the policy paradigm in the run-up to the crisis.

2. Central Banking - Between Science And Art In Monetary Policy

2.1. Highlights of the evolution of central banking

From the viewpoint of history, the central bank is a relatively new “invention”, the last of the three great inventions since the beginning of time, revealed by Will Rogers, (Samuelson & Nordhaus, 2000) located at the “crossroads” and involving in practice a considerable amount of learning and adaptation to a changing environment. (Silk, 2002)

When the descent set in history in the second half of the eighteenth century, central banks (table no. 1) did not meet until the early twentieth century, a major role in the economy, their appearance is caused by reasons related to:

- Public debt management and operation as clearing house for commerce, similar to Swedish Riksbank, the first central bank recognized as an institution;
- Financing the costs of war, the typical example being the Bank of England, structured as a finality of a long evolutionary process of the commercial bank status;
- Stabilize the currency after the hyperinflation of paper money during the French Revolution and to aid in government finance, such as Bank of France;
- Creation of new institutions, invested with a clearly defined mandate and specific tasks, a situation found, in Bank of Japan or the National Bank of Romania.

An American President, Andrew Jackson (1829 - 1837) even dispensed with his country's central bank in the nineteenth century. Because he did not think that it was very important, attitude confirmed by the reality: in 1900 only nineteen countries have central banks of which two were placed outside the European area - Bank Indonesia (1828) and Bank of Japan (1882).

Implemented under the rule of dominant theoretical precepts of that time, the current political pressures and the dictum "think before taking decisions," said central banks were on the stage of economic life after 1900, at developments at all surprising, almost tripling the number by the end of the twentieth century, reaching 1990-161 central banks, compared with 59 central banks in 1950 were one (Capi Forrest, 2004), because at the beginning of the millennium, in 2011, to operate in the world's 173 central banks. An important place it occupies in the hierarchy of their latest creation in the European Central Bank, holding a new central bank, conceived as a supranational body, immune to the interests and influences national governments of the Member States.

Strong economic international environment and institutional marking The Great Depression years 1929-1933, World War, United inflation and the rising of unemployment in most developed countries as a result of the collapse Bretton Woods arrangements, but the oil shocks of the 1970s, re-imposed conventional thinking and Central Banks have turned into "the force that drives the whole banking system." (Kirişescu, 1994), with responsibilities in ensuring the health of the banking system and currency stability. Since 1936, in her book *The Rationale of Central Banking*, Vera Smith Lutz explained that the twin mandates of Central Banks stable money and sound banking was. In fact, the main objective of the Bundesbank, established in 1957 in the country suffered from hyperinflation. That during the inter-war, was price stability.

2.2. Defining features of modern central banking

In a world where “the monetary savings are not science laboratories equipped with the ability to conduct controlled experiments” (Friedman, 2000) central banks, combining scientific rigor with professional makers, fulfilling different functions, the appropriate concept of management economic and financial development of each stage of economic and financial.

In the report of Central Bank Governance Group (BIS, 2009). David Archer analyzed a sample of 41 statutes including central banks and emerging economies belonging to the diversity of functions, customary designed “for the Economic Interests of the nation, consistently with government economic policy” and found, in part or in whole, in the laws governing the activity of each central bank. In the modern central banking the list of central bank functions is open-ended and dynamic, and the relative importance of the functions of the central bank have changed over time and across countries. (Lastra, 2009)

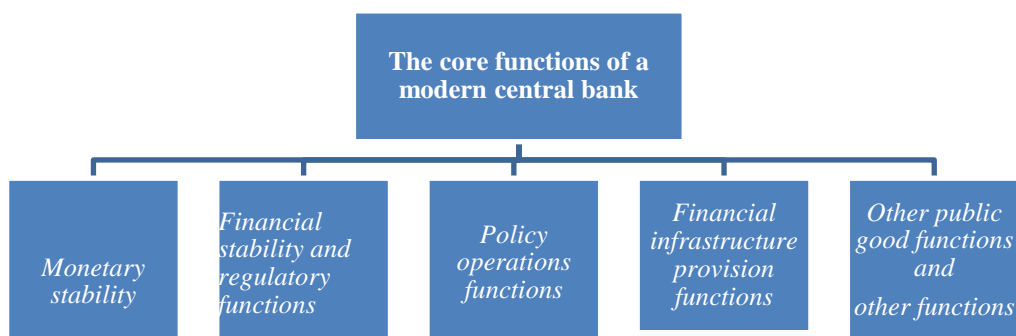


Figure 1. Central Bank Functions

That breakthrough industrialized economy to have narrowed Central Banks awnings their range of functions over time, Archer identifies two main reasons for the Emerging Market Economies in Central Banks to be allocated awnings wide range of functions of Central Banks in industrialized economies:

- in this countries, Central Banks is a source of expertise often that can be used in wide range of applications;
- responsible for Central Banks is often guiding the development of immature Financial Systems.

International experience shows that, at the end of a century of expansion, mystic and mystery that characterized the activity of central banks, has become, especially in the last two decades in power, independence, accountability and transparency in history unrivaled experience, professionalism, intuition, ability and competence of decision makers are essential criteria which gives credibility to central banking. Although it cannot be legislated, credibility in monetary terms is a concept of insurance policies attached to currency stability and community. (Fraser, 1994)

In the established sense, central bank independence as legal status is defined by freedom conferred on it by using tools available in the manner it deems appropriate to ensure price stability. In this context, Rosa Lastra argues that Central Bank independence is conceived as a means to achieve the goal of price stability. (2009) In stand's view, Central Bank independence means that, except in exceptional circumstances, nobody can interfere in the decisions made by the central bank in the exercise of its functions or, reverse the course of its decisions. (2003)

An extensive literature reveals agreement on central bank independence, designed to protect the many temptations of political power in a world of democracy in which politicians "are shortsighted because they are driven by the need to win the next election, with the first objective, they focus on long-term goals such as promoting price stability." (Mishkin, 1995)

In a recent approach, nuanced under the impact of the current international financial circumstances, the central bank Adam Posen independence is defines as "the ability to say no when demands for bond purchases they have economically unjustified, no more, no less." (2010)

Central bank independence has allowed the affirmation of a new behavioral dimension: transparency of its operations. With different connotations, central bank transparency is defined in the literature as "the public can monitor and infer central bank intentions, in particular, the current intentions." (Hans Dillen, 1998)

The new paradigm "independence and transparency" is a topic of the debate academic. At the official level of monetary policy transparency is considered "extremely useful in a firm anti-inflationary orientation banks," (NBR, 2002) suggesting the public the seriousness and responsibility of monetary policy targets announced and generating reputational gains. Public credibility of central bank policy remains a useful tool for policy makers working in monetary central bank responsibility for decisions regarding the independence and transparency associated concepts.

3. Pre-crisis Monetary Policy Paradigm

3.1. Price stability - one of the twin foundations of the dominant paradigm monetary policy

Main concern, with fiscal policy, which “influence governments, usually in a market economy, speed and direction of all economic activities, including not only the aggregate production and employment, and the general index increase or decrease in prices.” (Friedman, 2000) monetary policy decision-making and implementation is the defining characteristics of the central bank.

The Great Inflation of 1965 to the mid-1980's the central monetary event of the latter half of the 20th century. It destroyed the Bretons Woods system of fixed rates exchanges, bankrupted much of the thrift industry, and heavily taxed the U.S. capital stock, and redistributed income and wealth arbitrarily. It was an event policy also, having all major policy issues. (Meltzer, 2005)

In this context, monetary policy responds to the challenges of structural changes affecting the global economic architecture in an attempt to model the real economy side, incited to further explore the nature of practical action opens up new horizons. The monetary history of United States during the post-World War II period consists of the Great Inflation flanked by two periods of relative price stability: from price stability in the mid 1950s through the 1960s, late 1960s to inflation from the 1980s to the early, disinflation in the early 1980's, to price stability in much of the period since then. Milton Friedman attributed responsibility for the Great Inflation economic and political leaders. He argues the Great Inflation occurred because of the political and economic officials in charge who were at the time that started. And the Great Inflation of the people who ended because were incCharge at the time that ended. (Taylor, 2002)

Table1. Inflation developments in United States and United Kingdom, 1969 – 1983

EAR	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
U.S.A.	5.4	5.9	4.2	3.3	6.3	11.0	9.1	5.8	6.5	7.6	11.3	13.5	10.4	6.2	3.2
U.K.	5.5	6.4	9.5	7.1	9.2	16.1	24.7	16.3	15.8	8.6	12.6	16.9	12.2	8.5	5.2

Source: Nelson Edward The Great Inflation of the Seventies: What Really Happened?, Working Paper January 2004. Federal Reserve Bank of St. Louis

The consensus model of monetary policy aims in the sense of good friend, the priority for price stability, the targeting of core inflation rather than headline, the importance of credibility for low inflation and preemptive interest transparent policy rates supported by objectives and procedures. (2007)

Learning lessons of practical experiment, price stability, namely “the ability to achieve a stable currency based on trust in society and in the future” (Otmar Issing, 2000) became, after the 80’s, a fundamental objective of most central banks. Price stability is defined as a member in the general price level which is literally the inflation rate is stable or sufficiently low and stable. (Papademos, 2006)

The monetary low level, and relatively stable levels of inflation of the “Great Moderation”, showing strong anti-inflationary commitment of government policies involving more credibility and monetary authorities have transformed the disinflation process in a “global phenomenon” (Borio, 2003) with a significant impact on economic performance.

The lower and more stable inflation performance of recent years reflects, in part, a sea change in thinking at Central Banks. The high inflation of the 1970s led to Central Banks to focus policy on a much Greater degree inflation performance over the medium term.

In this context, it should be noted that at the beginning of the millennium, inflation seemed bet was finally won: in international and emerging economies, inflation rates over 10 percent annually constitute rare exceptions.

Table 2. Inflation rate between 1980-2001

	1980/1984	1985/1989	1990/1994	1995/1999	2000/2001
Major industrialized countries*	6.9	1.4	1.5	0.9	2.2
Other industrialized countries**	8.4	4.6	2.0	0.9	3.5
East Asia***	12.1	4.3	4.1	13.9	6.5
Latin America****	106.0	306.9	1202.9	32.5	10.5

Source: Claudio Borio, William English, Andrew Filardo: “A Tale of Two Perspectives: Old and New Challenges for Monetary Policy?”, Bank of International Settlements, Working Papers no. 127/februarie 2003

(*USA, Euro Area, Japan, Britain, Canada, **Australia, Sweden, Norway, Switzerland, ***Thailand, Malaysia, Indonesia, Korea, ****Brazil, Mexico)

The fear of inflationary pressures in maintaining consensus reflected in the governmental authorities to assume the priority of price stability objective of monetary policy inflation target by directly targeting strategies.

Academic level, the final nomination of monetary policy pursued by objectives the central bank is widely debated topic, divergent approaches focus on either “steady increase domestic production and maintain low unemployment” (Samuelson & Nordhaus, 2000), “Nominal income targeting” (R. E-Hall, NG, 1994), price stability and real GDP (Feldstein & Stock, 1994) or employment and price stability added growth (Fry, 2000) or price stability.

According to a survey undertaken in July 2007 (Cocris, Capraru, 2008) on the Statutory Objectives of Central Banks, comprising a sample Statutes 128 Central Bank, monetary stability is the ultimate goal for 57 central banks (44.5 percent), price stability the central bank only 38 (29.6 percent), price stability and one or / and others objectives for 22 central banks (17.2 percent) and economic growth or “for the purpose of economic growth” for 38 central banks (29.6 percent).

3.2. Challenges of Grand Moderation and the “New Economy” Pre-Crisis

Multiplying the intellectual capacity in the same way as the industrial revolution has increased the physical capacity, information and communications technology, with a major impact on the financial services industry, has generated various financial innovations and allowed quick and easy access to information flows linking all spheres of human activity, bringing academic debates of the 90’s year’s, a new concept of a “new economy”.

“The new economy,” whose essence lies “in a permanent increase in potential output growth, with productivity gains due to technological innovation as the main force behind this development” (Duisenberg, 2003), held in it new challenges:

- various information technology innovations resulting from advances in the form of new products and financial instruments such as internet banking, electronic money, Broking services on-line or electronic system for conducting financial transactions, have dissipated within the boundaries between different financial instruments;
- causing expansion of capital markets, IT infrastructure has had a rapid impact technology on financial markets, incorporating new developments in investment decisions, opened a new era of business opportunities, exceeding all previous records in the field. For example, the amount of new investments in stock markets in the euro area increased from 130 billion in 1998 to 320 billion euros in 2000,

while average monthly price-earnings ratio of shares held in the fields of technology, media and telecommunications overcome, in March 2000, over five times the average of the last 25 years.

- explosive growth of stock prices, creating the illusion that “the sky may become limited” (Duisenberg, 2003) in early 2000, accompanied by excessive volatility, stock prices led the decline and expanding financial imbalances. In the euro area, stock prices, measured by Dow Jones Euro Stocks Index, represented the end of April 2003, only about 43% from the level recorded in March 2000. Issuance of new shares was in 2002, only about 45 % of the annual average for the period 1999-2002. International Monetary Fund estimated in 2003 that 10% supported reducing the share price could affect economic growth with a lag of two years of decline in market capitalization, especially in countries with traditional markets, channel and consumer spending investment.

Table 3. The evolution of inflation and real GDP, 2003 -2007

	2003		2004		2005		2006		2007	
	Inflation	Real GDP	Inflation	Real GDP	Inflation	Real GDP	Inflation	Real GDP	Inflation	Real GDP
The World	3.6		4.9		4.6		5.3		5.4	
Advanced economies	1.9	1.9	3.1	2.0	2.7	2.3	3.1	2.4	2.8	2.2
U.S.	2.5	2.3	3.5	2.7	3.1	3.4	2.7	3.2	1.9	2.9
E.U. area	0.7	2.1	2.2	2.2	1.7	2.2	3.2	2.2	3.0	2.1
Emerging and Developot Economies	6.2	6.6	7.5	5.9	7.3	5.8	8.2	5.6	8.9	6.5
Central and Eastern Europe	4.8	10.9	7.3	6.6	5.8	5.9	6.4	5.9	5.5	6.0
Independent States	4.8	12.3	7.3	10.4	5.8	12.1	6.4	9.4	5.5	9.7
Developed Asia	8.1	2.6	8.5	4.1	9.5	3.7	10.3	4.2	11.5	5.4

Source: IMF, Global Outlook Report, September 2011

This extraordinary dynamism printed on all levels of economic life revealed reverse: although episodes of boom and bust (boom and busts) have existed since the early 80's. Global emphasize integration of financial markets and increasing capital flows and investment portfolio, experiences of the new millennium were sometimes even surprise the authorities.

The global economy has produced since the fall of 2001, new surprises. The U.S., on the first line of home business reduced engine power, in an amazing synchronization across the planet, (table) with a possible combined effect of the end of a boom in investment activity (investment boom) with strong fluctuations in stock prices.

Unforeseen events which succeed each other rapidly, more and more virulent financial crises and the overall evolution of the global economy are real challenges for central banks. Statutory requirement to maintain price stability over the medium time horizons, and should focus efforts towards maintaining financial stability through information analysis, current and future, financial markets and their incorporation in the content of strategic decisions at the central bank sent the real economy through financial markets

Signaling capacity of the monetary authority, essentially the ability to communicate in a credible and convincing, his intentions on changing conditions in the money markets and long-term objectives may influence the behavior of integrated financial markets. Credibility and good communication with the markets are allowed to transform the financial system in an efficient mechanism for allocating resources in society, able to avoid failures.

4. Paradigm of Monetary Policy during the Global Crisis - Lessons of the Crisis

Although the evidence is the dimension of the recent global turmoil Financial, Almost four years after the onset of the crisis, There is still no full agreement among policymakers and Researchers on what caused an the build-up of Financial imbalances Globally. Jean-Claude Trichet believes that the main causes of the crisis HAS Been the negligence of Financial Risk. (2011), Blundell-Wagnall while Adrian Paul Atkinson and the Current Financial Crisis Explained as being at two levels caused an: Policies affecting liquidity by global macro by the very poor and Regulatory Framework (2008).

In fact, the global crisis was an outcome of the interplay between both macroeconomic and microeconomic factors. From a macroeconomic perspective, the crisis has been attributed to the persistence of global imbalances, excessively accommodative monetary policy pursued in major advanced economies and lack of recognition of asset prices in policy formulation. From a microeconomic

perspective, the crisis has been attributed to the rapid financial innovations without adequate regulation, credit boom and the lowering of credit standards, inadequate corporate governance and inappropriate incentive system in the financial sector and overall lax oversight of the financial system. (Mohanty, 2009)

The crisis has brought the global economy in a dangerous new phase. Global activity weakened and become more uneven, confidence recently fallen sharply, and downside risks is growing. Besides, the euro area encountered major financial turbulence, global markets suffered a major sell-off of risky assets, and there are growing signs of spillovers to the real economy. The structural problems facing the crisis-hit advanced economies have proven even more than expected intractable, and the processes of devising and reform implementation are even more complicated.

World Economic Outlook (WEO) projections indicated that the global growth moderated to about 4 % through 2012, from over 5 % in 2010. Real GDP in the advanced economies is projected to expand at year anemic pace of about 1 ½ and 2 % in 2011 respectively 2012 (table)

Table 4. Real GDP and inflation estimates, 2011 - 2016

	2011		2012		2016	
	Real GDP	Inflation	Real GDP	Inflation	Real GDP	Inflation
World	4,0		4,0		4,9	
Advances economies	1,6	2,6	1,9	1,4	2,7	1,8
United States	1,5	3,0	1,8	1,2	3,4	1,7
Euro Area	1,6	2,5	1,1	1,5	1,7	1,9
Emerging and Development Economies	6,4	7,5	6,1	5,9	6,7	4,3
Central and Eastern Europe	4,3	5,2	2,7	4,5	3,9	3,6
Commonwealth of Independent States	4,6	10,3	4,4	8,7	4,2	6,4
Developing Asia	8,2	7,0	8,0	5,1	8,6	3,5

Source: IMF, *Global Outlook Report*, September 2011

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