OPEN MARKETING - A SPECIFIC FORM OF MONETARY POLICY IN ORDER TO MONETARY VOLUME ADJUSTMENT

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Abstract: *Applying a uniform monetary policy by all European Union member states also require harmonization of monetary policy instruments and national interbank market integration also. Monetary policy instruments used by NBR (National Bank of Romania) have evolved over time as a result of alignment with the instruments used by the European Central Bank. Money market operations in Romania have appeared for the first time in 1997. Starting from the wishing of Central Bank to reduce excess liquidity in 2001 they became the most important monetary policy tool used by the National Bank of Rumania. Open market operations are the instrument of monetary policy, central banking in Eastern Europe to work towards monetary contraction or expansion. Open-market operations in recent years have become the most important monetary policy instrument they play an essential role in promoting monetary policy by the central bank. Through open marketing operations the monetary authorities aim to alter bank reserves and thereby influence the amount of currency in circulation. In Romania, the open marketing operations are initiated by the National Bank of Romania, which determines what type of tools will be used while setting terms and conditions of the implementation. Through the use and control of monetary policy instruments, the central bank as the state bank seeks managing liquidity in the economy.*

Key words: monetary policy, open marketing, repo operations, reverse repo operations, ratio of monetary policy
JEL Classification: E52, E58

1. Introduction. The necessity to use the monetary policy instruments

In the frame of emerging economy conditions, specific Romanian credit institutions are encouraged by monetary policy in order to provide loans for sustainable growth of the economy. Lending activity of commercial banks increase money supply which in order to not contribute to rising inflation is continuously monitored by the central bank. As its quality of national bank, it is set to lead the monetary and credit policy of the state. Monetary policy represents a set of actions through monetary authorities supervise and regulate the amount of currency in circulation [4]. Level of interest rates, exchange rates and other economic indicators are the main instruments of monetary National Central Bank for achieving economic and monetary overall policy objectives (Figure 1)

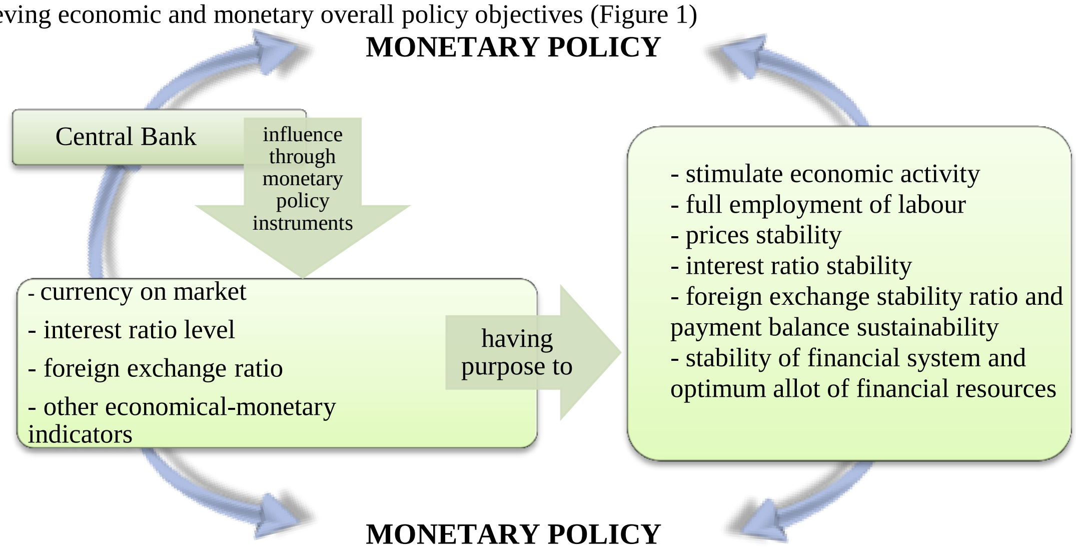

Figure no.1 Monetary policy

Monetary policy measures through the central bank exercised its influence to the nationwide level is achieved by using a set of tools. Instruments of monetary policy used by central banks, on the one hand can be generated by their actions and, on the other hand generate influences to the monetary plan because to the monetary credit institution actions made inside the system.

Through the use and control of monetary policy instruments, the central bank as the state bank seeks managing liquidity in the economy. Efficiency of these instruments use is determined by the credit multiplier. Depending the impact it exerts on monetary variables, monetary policy instruments can be divided into direct instrument tools and indirect instruments tools (Figure 1).

Because indirect instruments guarantee an effective interface with the market and create prerequisites for a rational allocation of resources, globally they are preferred to direct ones instruments.

In Romania as a result of the changeover from the single banking system to its pyramidal organization, the National Bank has exercised a direct control over the volume and cost of credit through direct instruments of monetary policy. Their abandonment of it, behalf of indirect debuted in 1991, but were gradually because the transmission of monetary impulses was influenced by poor financial discipline, lack of competition in the real sector and financial, as well as quite slow pace of macroeconomic reorganization.

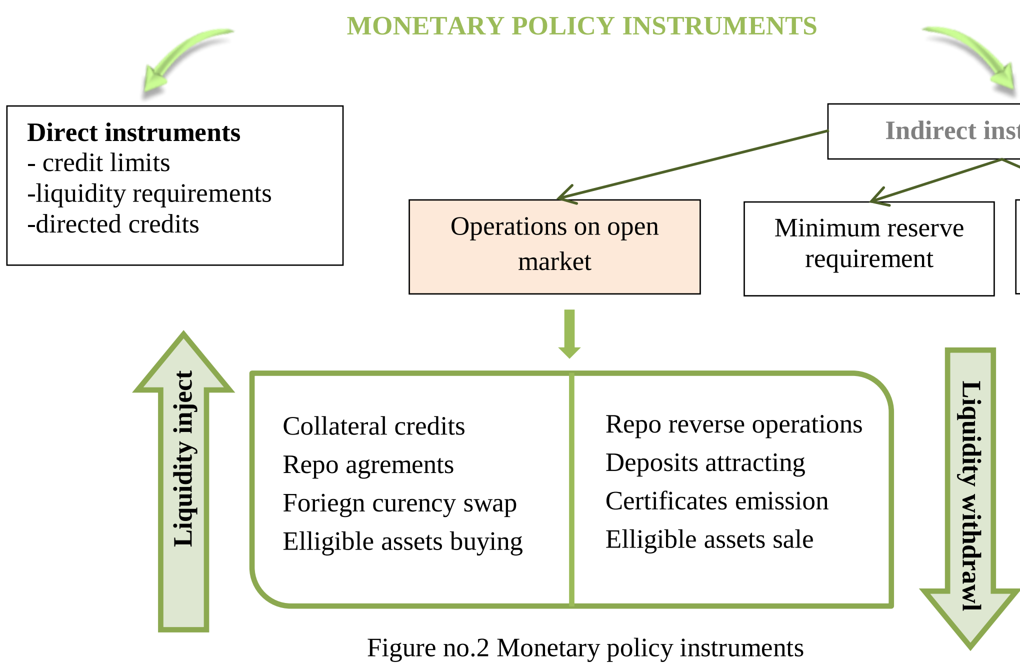

Figure no.2 Monetary policy instruments

Indirect instruments of monetary policy are classified (Figure 2) thus:

- Operations on open market (open marketing),
- Minimum reserve requirement – through these, the central bank controls the money offer in the form of commercial banks availabilities kept to National Bank.An increase in minimum reserves caused a reduction in the possibility of lending by credit institutions, thus reducing the money supply and the purpose of lowering reserve lending is amplified, resulting in increased money supply.
- Permanent facilities - by these operations the Central Bank design to inject and withdraw liquidity from the short-term market (overnight)

2. Study on open marketing operations initiated by the National Bank of Romania

Open-market operations in recent years have become the most important instrument of monetary policy playing a key role in promoting monetary policy by the central bank in order to handle this using the interest rates, managing the liquidity in the market and also as a status indicator in monetary policy decisions.

In our country, open marketing operations are initiated by the National Bank of Romania, which determines what type of tools will be used while setting terms and conditions of the implementation. These operations are performed either by standard auctions (in which case the period between the date of the tender announcement and confirmation of the amounts allocated shall not exceed 24 hours), quick tender (to be completed in less than an hour) and bilateral procedures (carried out through stock exchanges and market agents).

Through open marketing operations the monetary authorities aim to alter bank reserves and thereby influence the amount of currency in circulation. When the central bank sells securities, there is a cash withdrawal from credit institutions thus reducing the money supply in circulation. In case of purchase of securities, the central bank "injects" liquidity inflating thus the money supply.

The main category of open market [8]-[9] operations specific to NBR (National Bank of Romania) are :

- *Repo operations* are reverse transactions, with the goal to inject liquidity. They occur when the central bank buys from credit institutions eligible assets, with their commitment to repurchase these assets at a later date at a price set on trade date.
- *Deposits increasing* represent pre–maturity transactions, aimed at liquidity transactions, in which the central bank takes deposits from credit institutions.
- *The certificates of deposit emission* appears as liquidity-absorbing transactions in which the National Bank sells certificates of deposit to credit institutions.
- *Reverse repo operations* are reverse transactions, with the objective to liquidity absorption, where the central bank sells to credit institutions eligible assets, pledging to redeem those assets at a later date at a price set on trade date.
- *Grant the loans collateralized with the eligible assets* represents reverse transactions for injection of liquidity, in the frame of them NBR provides loans to credit institutions, these retaining ownership of eligible assets pledged as collateral.
- *Sale / purchase of eligible assets for transactions* appear as transactions for absorption / injection of liquidity, which the central bank sell / purchase eligible assets and transfer their ownership from seller to buyer is on a "delivery versus payment" mechanism.
- *Foreign currency swap* consists of two simultaneous transactions concluded with the same counterparty. During them, first Central Bank injected liquidity by buying spot convertible currency against lei and selling at a later date the same amount in convertible currency against lei, on the other hand absorbs liquidity by selling convertible currency against lei spot and buying later the same amount in convertible currency against lei

Eligible assets used by National Bank of Romania for trading and warranty in open market operations are:

- government bonds denominated in domestic or foreign currency, issued by the Ministry of Finance on internal market;
- bonds issued by Ministry of Finance to foreign markets;
- denominated bonds in lei currency, issued by international financial institutions;
- certificates of deposit issued by the central bank;
- other categories of assets established by decision of the Board of NBR

They are assessed daily by the National Bank at the adjusted price determined by deducting some margin, expressed as a percentage of the price set by the NBR for all categories of eligible assets.

Open market operations play one of the most important roles in guiding interest rates, managing the liquidity conditions in the money market and signaling the monetary policy stance.

Monetary policy rate is the interest rate used for the main open market operations conducted by the National Bank of Romania. Currently, these are the repos operations to term a week, conducted by tender to fixed interest rate.

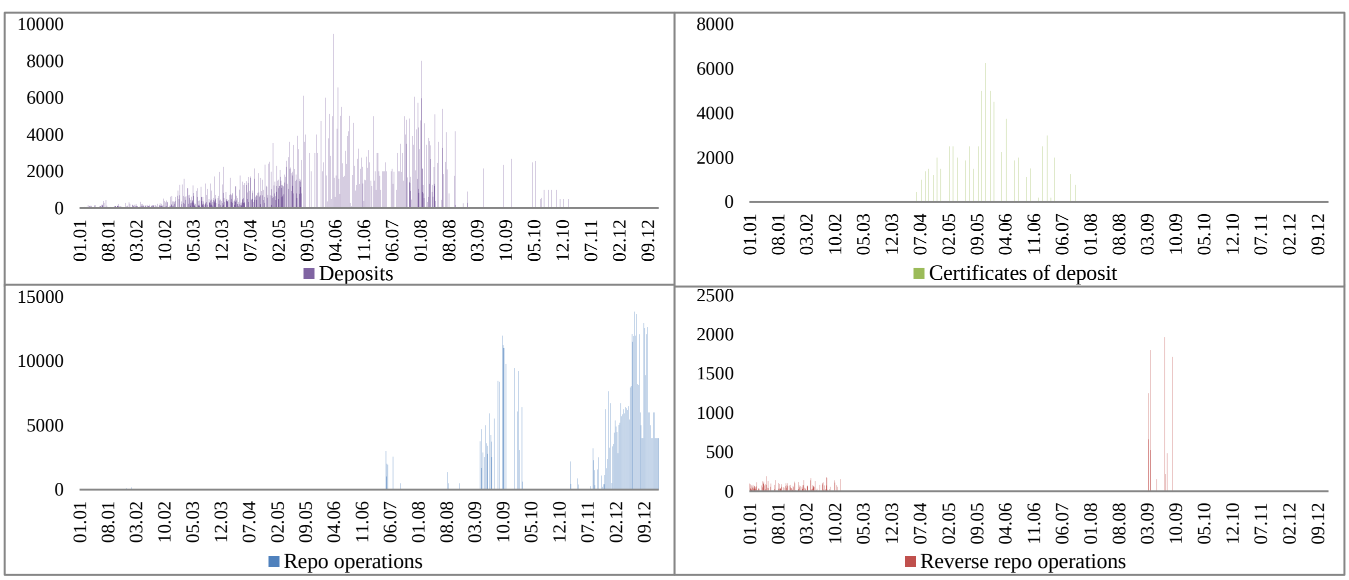

Figure no.3 Evolution of open market operations in Romania until to 31.12.2012

Source: National Bank of Romania

During 2001-2012, open marketing operations initiated by National Bank of Romania were represented by the formation of deposits (Figure 3). Through this operation National Bank of Romania wanted the withdrawal of liquidity from the money market. In 2001, the interest rate for these deposits was 40% -50% it decreased gradually to 6,25% reached in 2011. The biggest amount of liquidity sterilized by the central bank by building deposits through the auction was registered between2005-2008, the period which saw economically growth. The main objective of the National Bank of Romania, by initiating these operations was to reduce inflation. It decreased from 8,6 to 6,57, stood at 3,77 in April 2007.

It can be seen (Figure 3) that in 2005-2008 in addition to amounts of deposit operations, the National Bank of Romania withdrew liquidity from the market by auction certificates of deposit operations. They were purchased by credit institutions for a period of 91 days and redeemed at maturity at NBR to a greater value. Although after sterilization operations to provide liquidity to the market, the National Bank of Romania shall bear liability attached to these operations, it made its primary objective of inflation targeting.

As a result of the global crisis that inevitably affected our country, the National Bank policy strategy has changed, so we tried on the one hand supporting economic activity at the national level (through lending operation), providing a stable national currency linked to addition to its primary objective, the inflation targeting.

Thus, since 2009 a priority for operations of the National Bank became operations from which it inject liquidity, repo operations, so took the creditor position of the banking sector.

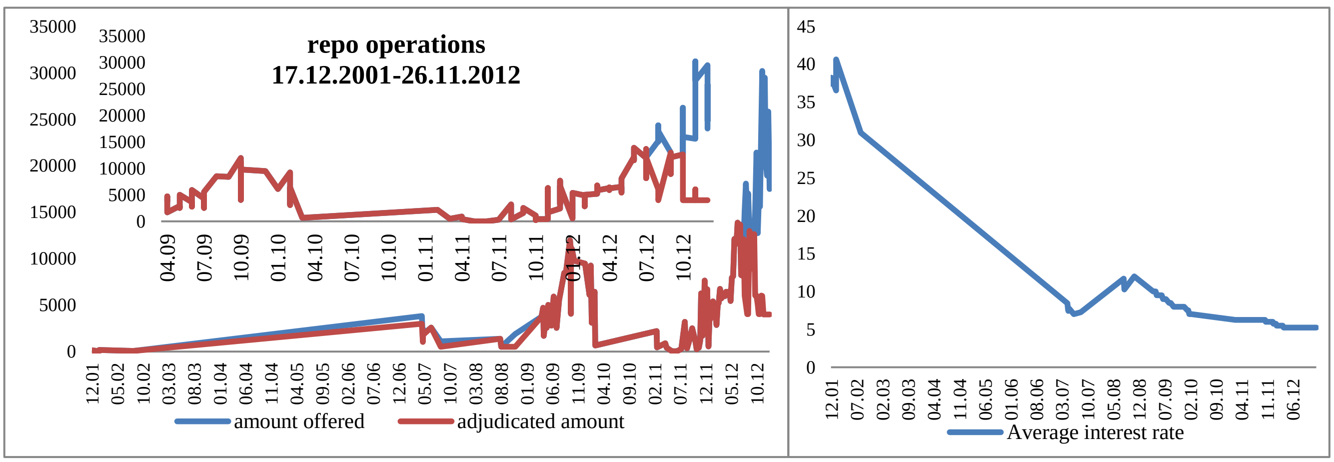

Figure no.4 Repo operations made by NBR

Source: National Bank of Romania

From previous figure (Figure 4) we see the repo operations evolution made by NBR. By supporting these operations and gradually reducing the monetary policy rate from 10% in early January to 5,25% in late 2012. There is a reduction in repo operations in 2010, 2011. If we check also the inflation in these years there is an increase in inflation outside the range set by the NBR.

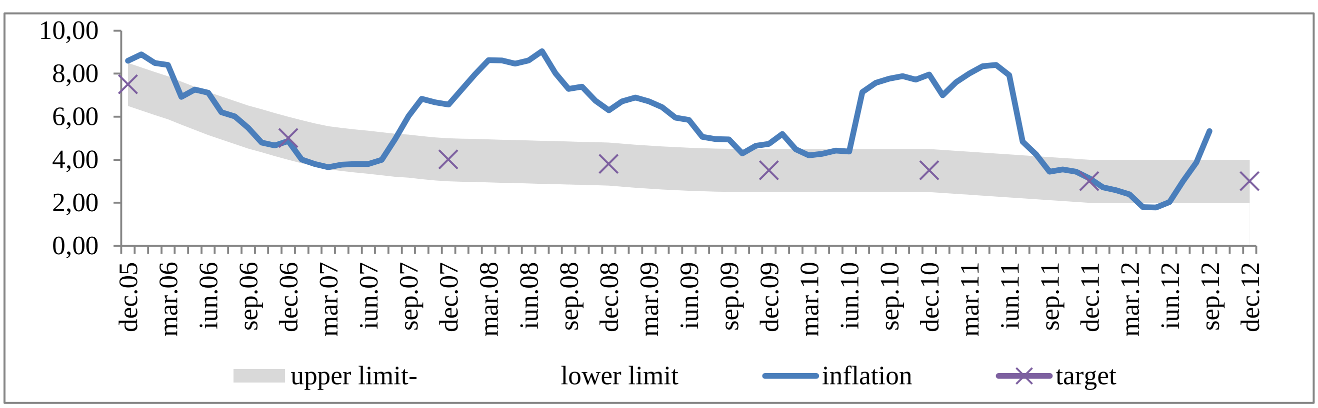

Figure no.5 Evolution of inflation ratio

Source: National Bank of Romania

By reducing these operations there have not been placed liquidity on the market, thereby aiming to reduce inflation (Figure 5), which happened in late 2011.

Due to lower inflation and maintain within repo operation frames were resumed by the NBR with the gradual reduction in the rate of monetary policy. The reduction in monetary policy pursued by the central bank to lower rates on loans in lei offered by non-bank credit institutions sector. Thus by supporting lending in domestic currency aimed to strengthen national currency which lately lost ground to the euro.

During 2009 - October 2012, the amount offered by credit institutions by the central bank sold securities was equal to that awarded, but towards the end of 2012 the central bank repos limited, amid a rise in inflation. It came towards the end of 2012 to 5,3 in September, 2,3 points higher than the initial target of NBR.

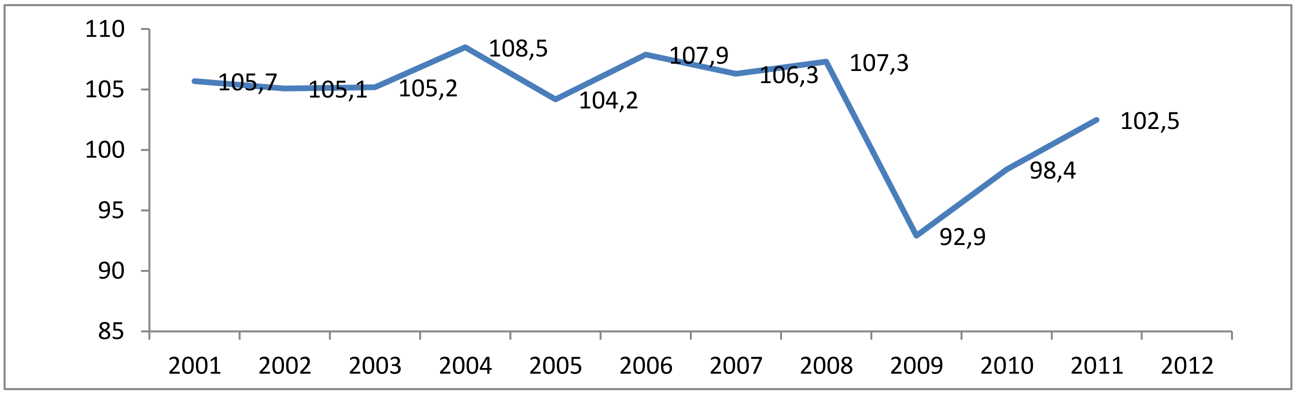

Figure no.6 GDP index
Source: Romanian Statistical Yearbook

However NBR not restricted totally repo operations, because it must support the economy, which increased slightly from the previous period (Figure 6), but still lower than in 2008. Support lending by reducing the impact of monetary policy has increased consumption (which provides short-term economic growth to a country level) and investments (the main factor that ensures long-term economic growth - leading to economic stability)

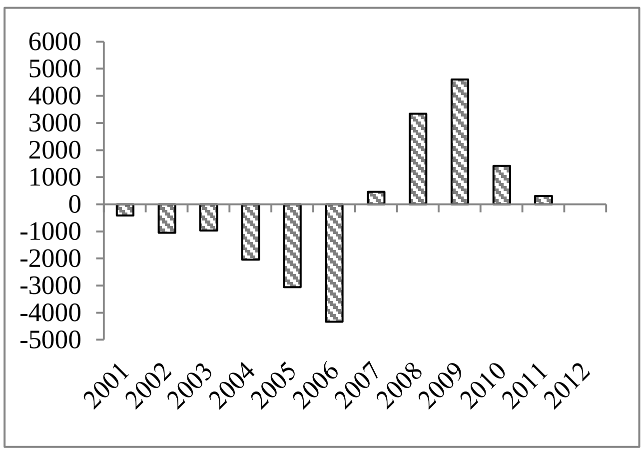

Figure no.7 Result of financial exercise to NBR

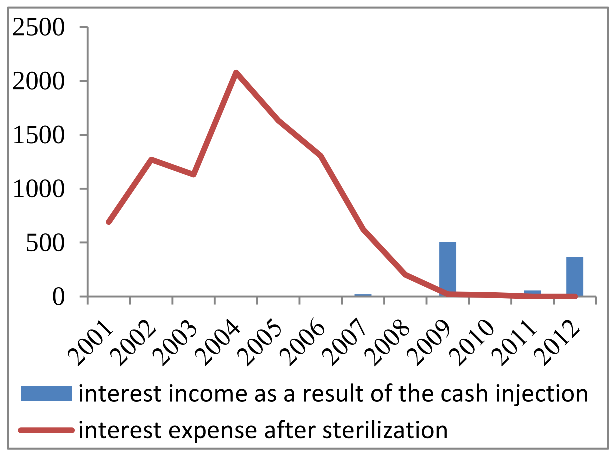

Figure no.8 Incomes/expenses evolution due to monetary policy operations

Source: National Bank of Romania

If by 2009 NBR focus on a monetary policy aimed at sterilizing the money supply volume, resulting in higher spending and hence reduce profit can be observed (Figure 7 and Figure 8) that since 2007, when he began bashful to liquidity injection operations at the expense of the central bank recorded profit absorption. The highest profit value was recorded in 2009 when its value reached to 4.607.683 thousand lei, and income from repurchase agreements arrived at a value of 505,07 million lei. In 2010 and 2011 the National Bank profit dropped, the same trend can be observed on income repos. Looking at 2012, against a backdrop of monetary policy based on liquidity injection operations (repo) interest income accruing to the National Bank amounted to 349,58 million lei.

When decisions are made by injection of liquidity, the central bank must take account of its main objective - inflation targeting. Thus, while approved repo operations, monetary volume/ supply (M3) will increase, and with this growth it increases the risk of inflation.

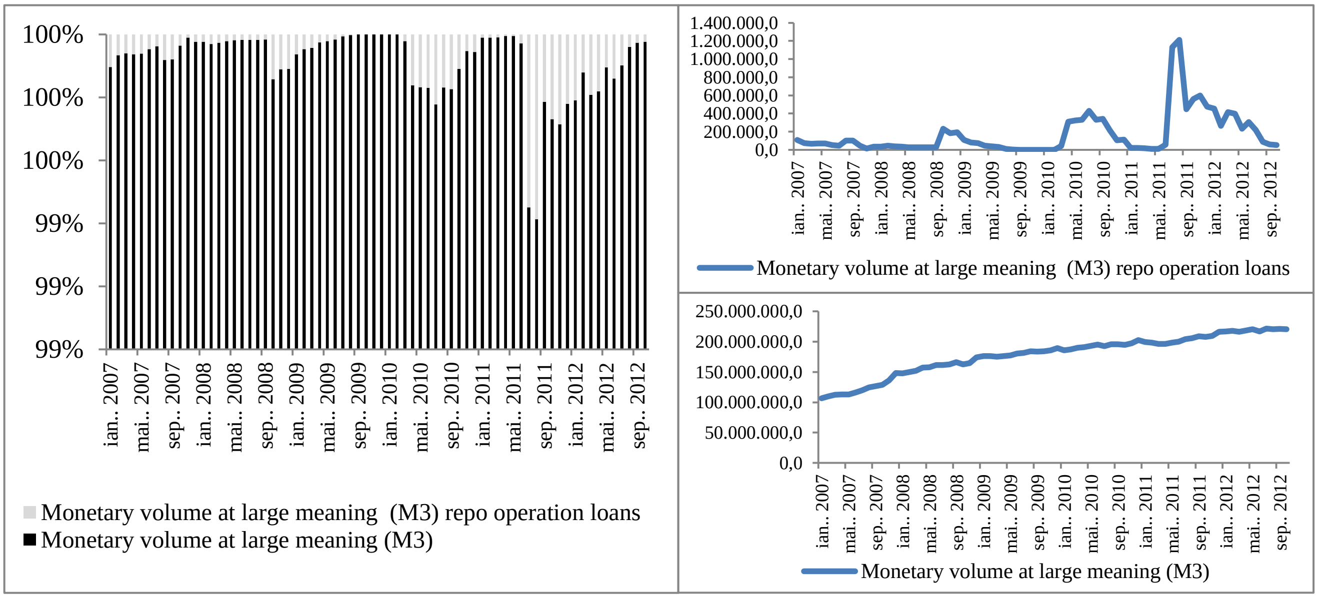

Figure no. 9Monetary volume evolution

Source: National Bank of Romania

Is shown (figure 9) the proportion of money supply representing repo operation loans in total money supply. It appears that these banking operations have annual percentage below 50%, except July (59%) and August (55%) 2011

Conclusions

Open market operations are the instrument of monetary policy, for central banks in Eastern Europe to work towards monetary contraction or expansion. These operations change the structure of the circulation of money against or for liquidity. These monetary policy tools allow central bank's directly control the monetary base and reserves of commercial banks. By the specific tools the Romania state bank also seeks targeting interest rates and monetary policy shift requirements. Through supervision and control of the money supply, central banks constantly act on inflation for financial stability.

Due to increased flexibility offered, the open-market operations have become the main instrument of monetary control both in developed countries and in emerging economies.

Acting continuously on commercial banks' lending policy, open market policy always affect bank over - liquidity, giving the central bank the possibility to influence these cash surpluses destination.

Open market operations are performed on the money market. By restricting the money market liquidity resulting increase the interest on market, making credit institutions to be, on the one hand, less inclined to sell securities in order to secure and profitable net cash surpluses. But the central bank can not only adapt to the monetary market situation, but can change it in the sense of its objectives.

Central bank has the role of collecting and disseminating accurate information on securities, volume transactions, financing on institutions types.

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