CONSIDERATIONS ON THE UNCONVENTIONAL MONETARY POLICY IN CENTRAL AND EAST EUROPEAN COUNTRIES

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Abstract
Over more than a decade after the outbreak of the recent financial crisis, we can say that its effects are still visible in the economic world. In order to overcome this crisis, central banks had to rethink the interaction between the financial economy and the real economy and they started to use a series of monetary policies that were considered unconventional. This paper aims to identify the most important unconventional monetary strategies used by a series of central banks from Central and East Europe. The first part of this paper focuses on identifying the unconventional monetary strategies used word-wide, while the second part tries to identify if the Central and East European central banks have used unconventional monetary policies and if they did, to point out which were the main unconventional monetary policy tools they have used. Another purpose of this paper is to identify the effects that the introduction of this kind of unconventional monetary policies had on the economy. It can be concluded that, even though most of the countries have overcome the shocks caused by the outbreak of the recent financial crisis, their current state does not rise to the financial robustness they had back in 2007.
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Clasificare JEL : *E42, E52, E58*

1. Introduction

Before the outbreak of the recent crisis, the world economy could be characterized as a calm economy, with a steady and robust economic growth. The monetary policy used by central banks, and especially by central banks from advanced economies, was predictable, and the monetary policy transmission mechanism was clear and easy to understand. However, with the onset of the global financial crisis, central banks were forced to rethink the interaction between the financial economy and the real economy and they began to use a series of monetary policies that were considered unconventional. These unconventional monetary policies had two objectives. The first objective was restoring the functioning of financial markets, while the second objective was aimed to ensure a monetary policy accommodation at a zero-lower bound (ZLB).

2. Considerations regarding the unconventional monetary policy

The unconventional monetary policy helps central banks in times of major crisis, when the monetary policy instruments normally used by central banks have no longer the same effects that they have during the periods of economic stability, and the final goal of these type of policies is to ensure macroeconomic stability.

A definition given by the National Bank of Czech Republic is that unconventional monetary policy „involves steering long-term real interest rates. This can be done by (i) affecting interest rate and inflation expectations as important indirect determinants of the long-term real interest rate; (ii) affecting financial asset markets with the aim of directly reducing the long-term nominal interest rate (e.g. by purchasing government bonds) or reducing the risk premium in the yields on certain financial assets. By purchasing government bonds with newly issued money, central banks increase the bank reserves (quantitative effect) and foster lower interest rates (price effect) in order to achieve the desired easing of the financial conditions. With such measures, the central bank simultaneously sends a signal to the economy that it will achieve price growth by issuing money (expectations effect)." [12]

According to A. Beyer et. al., „bold and unprecedented action by public authorities, accompanied by progress in the institutional and regulatory financial architecture, have, however, helped to reduce economic slack, to bring down record unemployment and to put the world economy and the euro area, at last, back on a path of solid economic expansion". [3]

Currently, the most popular unconventional monetary policies are quantitative easing, forward guidance and negative interest rates.

By adopting a negative interest rate, central banks charge commercial banks for the reserves that are held by central banks. They use this method to reduce the amount of money that central banks hold in reserves and it aims to increase the lending or the investment in financial markets.

Forward guidance refers to the action of providing a series of information regarding the future intentions of monetary policy makers to market participants. According to International Monetary Fund, „one version, the central bank aims to clarify how monetary policy will evolve in the future depending on its own expectations for economic activity or inflation. In the alternative and potentially more powerful version, the central bank commits to keeping interest rates low even if economic conditions improve in the future and warrant a monetary tightening". [5]

Quantitative easing mainly refers to large-scale securities purchases made by central banks. Usually, this is implemented by announcing a specific timetable, as well as the amount of securities that will be purchased.

Ben Bernanke has appreciated that „quantitative easing works in practice, but it doesn't work in theory" [2]. He referred to the fact that government bond purchases made by central banks should have no effect on bond yields under a purely theoretical model where there are no fractions of the financial market and no free movement of investors, regardless of the asset categories. However, in practice, the situation is quite different, through the acquisition of bonds, the central banks are leading to a reduction of yields and, therefore to a decrease in their price.

Worldwide, with the outbreak of the recent global financial crisis, given that the monetary policy strategies used by the central banks have not been able to cope with the obstacles encountered, central banks started to use unconventional monetary policies.

In this regard, among the most important unconventional monetary policies used by the Federal Reserve Bank were quantitative easing and forward guidance. The quantitative easing model used in the United States of America consisted of four purchasing programs: „the three Large-Scale Asset Purchases (LSAPs), commonly known as QE1, QE2, and QE3; and the Maturity Extension Programme (MEP), also known as the second "Operation"1 Twist." [9].

As a result of this purchasing programme, in the United States of America, the total assets held by Federal Reserve have increased, from one trillion dollars in 2007 to 4 trillion dollars by the time that this programme had finished.

As for the forward guidance, through it, the Federal Reserve has increased the transparency of actions, in order to stimulate the economy.

Regarding the actions taken by the European Central Bank, given the fact that, at the beginning, the bank has paid greater attention to liquidity injection, the use of unconventional monetary policies only started in 2010, when, following the onset of the sovereign debt crisis in Greece, Portugal and Ireland, ECB started to purchase sovereign bonds. „During the 1st and 2nd Covered Bonds Purchase Programmes – which have respectively been implemented during the 2009-2010 and the 2011-2012 periods – a total amount of 100 billion Euro has been created by the ECB." [8].

Further, at the beginning of 2015, the European Central Bank adopted the Asset Purchase Programme, which consisted of four securities purchase programmes: corporate sector purchase programme (CSPP); public sector purchase programme (PSPP); asset-backed securities purchase programme (ABSPP) and third covered bond purchase programme (CBPP3). As in the case of the Federal Reserve, in the case of the European Central Band, its total assets have also appreciated, from 1.2 trillion euros in 2007 to 3.5 trillion euros.

3. Unconventional monetary policies in the Central and East European countries

Regarding the Central and East European countries, almost all countries were affected by the aftermath of the Lehman bankruptcy. The monetary policy and the monetary system of each Central and East European countries was somewhat different when the crisis started, and each country was affected in somewhat different ways by it. As a result, „the National Bank of Poland introduced the *Trust Package*, while the National Bank of Hungary started the *Self Financing Programme* and the *Funding for Growth Scheme*. (...) Also, the Czech National Bank decided to launch an unconventional monetary instrument – the exchange rate control." [13] „Monetary authorities in smaller European advanced economies outside the euro area have had to respond to a range of unforeseen and unprecedented circumstances during the past decade." [6]

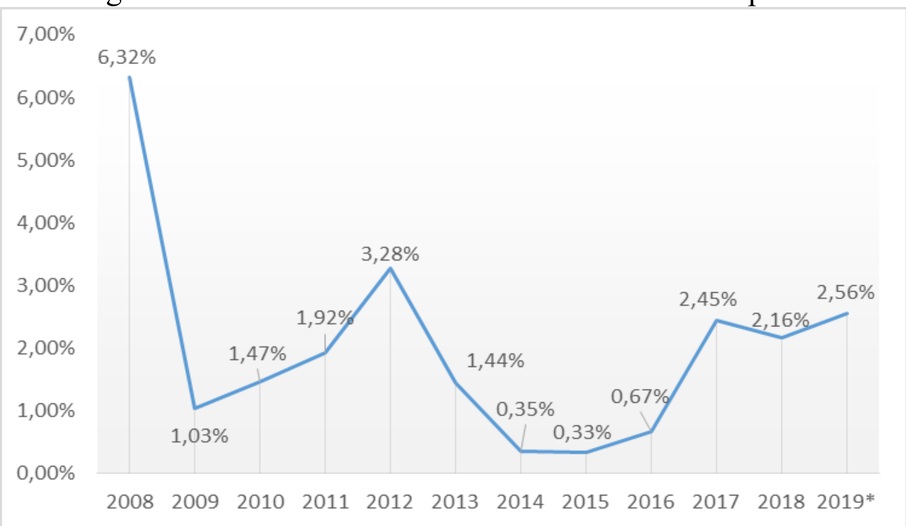
Further, we will discuss the main unconventional monetary policies used in Central and East Europe, namely, the unconventional monetary policies used by the Czech National Bank (CNB) and the Hungarian National Bank (HNB).

At the beginning of the financial crisis, the CNB opted for traditional financial instruments by lowering interest rates. Between 2007 and 2012, the Czech National Bank cut its monetary policy rates by approximate 4% and introduced a series of liquidity-providing repo operations in order to prevent commercial banks from experiencing liquidity problems. However, the spilling over effect created as a result of the weakness in the euro area, which translated into low inflation, made the Czech National Bank to progressively lower the policy rate to 0,05% by November 2012.

„Under such circumstances, within the forward guidance policy, the CNB signaled that it was considering using the exchange rate as an additional instrument of monetary policy." [1] In this regard, in November 2013, CNB proceeded to make a change by replacing the floating rate regime with an exchange rate floor (CZK27=EUR1), but the target variable continued to remain the inflation rate. „As a result of the CNB's interventions, the exchange rate of the crown remained above the fixed borderline. From that point of view, the effects desired were reached. However, the inflation level remained below the expectations of the CNB." [14]

As a consequence of the crown depreciation, it was assumed that during November 2013 – December 2015 the inflation rate will increase by 1.6%, but, due to some factors, both endogenous (deflationary - reducing the indirect taxes rates) and exogenous (pro-inflationary - increased energy prices), the inflation rate rose only by 1.1%, according to Figure no. 1. Likewise, according to Opatrny (2017) [13], we could see an increase in jobs (about 120,000 new jobs were created between November 2013 and December 2015), as well as a consistent growth in GDP.

Figure No. 1 Evolution of inflation rate in Czech Republic



Source: processed after https://www.statista.com/

According to Franta M. et. al., „the use of the exchange rate as an instrument at the ZLB is defined as an approach where the central bank chooses – and possibly also publicly declares – the specific exchange rate level it wants to attain and is prepared to intervene in the foreign exchange market in unspecified and potentially unlimited amounts to attain that level." [7]

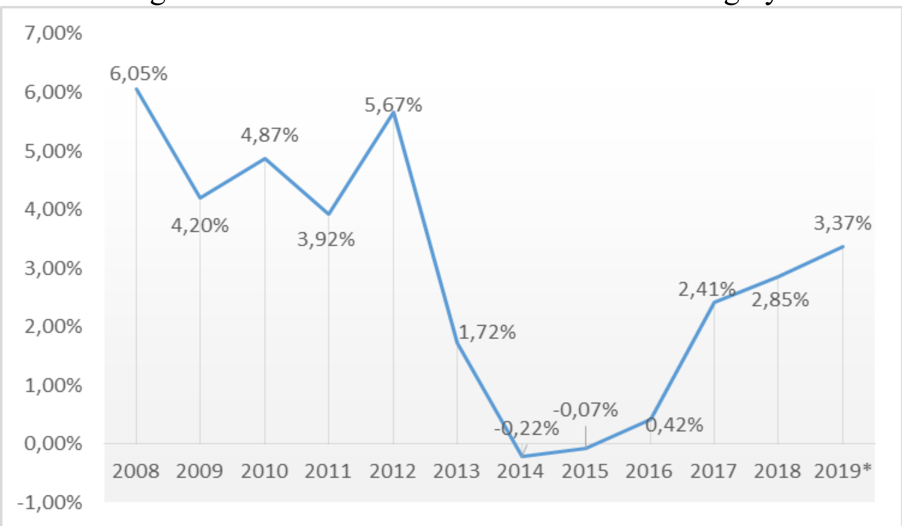
McCallum, in 2000 [11], showed that, at zero lower bound, central banks from open economies can devalue the domestic currency in order to stabilise inflation, as well as the real economy. In the more recent studies, like the ones made by Stone et. al. [18] and Borio et. al. [4], the exchange rate policy is mentioned as a potential form of unconventional monetary policy that can be used at zero lower bound.

Regarding the Hungarian National Bank, as a result of the rate cut cycle started in 2012, the key monetary policy rate went from 7% to 0,9%. Due to the fact that, under these circumstances, the conventional monetary policy instruments reached their limits, the HNB began to implement a series of unconventional monetary policy instruments affecting short-term yields.

Starting with the summer of 2016, these unconventional instruments began to occupy a more important place in the monetary strategies used by HNB. As a result, the Hungarian National Bank has introduced a series of six unconventional monetary policy instruments affecting short-term yields:

- „the interest rate corridor was made narrower and asymmetric in several steps, while the utilization of the lower bound of the interest rate corridor has strengthened from the summer of 2016;
- the restriction of banks' access to the 3-month deposit facility commenced by organizing the formerly weekly announced tenders less frequently from August 2016, and from October a quantitative restriction was introduced;
- the reform of the BUBOR market commenced in May 2016; a dealing obligation-based quotation system was introduced;
- forint liquidity providing foreign exchange swaps were introduced in autumn 2016, simultaneously with the application of quantitative restriction;
- in December 2016 the required reserve ratio was reduced from 2% to 1%;
- the preferential deposit linked to the Market-based Lending Scheme (MLS) is available to the banks from the beginning of 2016, and banks use it more actively from autumn 2016." [10]

Figure No. 2 Evolution of inflation rate in Hungary



Source: processed after https://www.statista.com/

Following the introduction of these instruments, the Hungarian National Bank was able to reconstruct the transmission of monetary policy, which was damaged by the crisis. Additionally, the financial stability was consolidated and the real economy was stimulated. As seen in Figure No. 2, the inflation rate increased and approached 3% by the end of 2018.

Additional to these unconventional monetary policies, on 21st November 2017, the HNB decided to introduce two more unconventional instruments, starting with January 2018, in order to „allow the loose monetary conditions to take hold on the longer section of the yield curve, and both programmes support the growth in the share of loans with long-term fixed interest rates” [20]. The two instruments are: an unconditional five-year and ten year interest rate swap instrument and a targeted program to purschase 3-year or longer-term mortgage bonds.

4. Conclusions

This paper aimed to create an overview image of the concept of unconventional monetary policy, as well as to identify the main types of contemporary monetary policies together with the main unconventional instruments that are used by central banks in the Central and East European countries. The paper also highlights the fact that, currently, worldwide, the most known unconventional monetary policies are quantitative easing, forward guidance and negative interest rates.

In this paper we identified that the main Central and East European central banks that chose to use unconventional monetary policies are the Czech National Bank and the Hungarian National Bank.

As a conclusion, we can say that, even though most of the countries have overcome the shocks caused by the outbreak of the recent crisis, their current state does not rise to the financial robustness they had in 2007.

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