Monetary Policy in the Eurozone

Arbiana Govori
University for Business and Technology, arbiana.govori@ubt-uni.net

Monetary Policy in the Eurozone

Dr.Sc Arbiana Govori,
UBT - University for Business and Technology Kosovë
Dr. Sc Qemajl Sejdija Universiteti "Haxhi Zeka" në Pejë, Kosovë

Abstract

The main goal of the ECB monetary policy is to keep prices stable and the inflation rate below or close to 2% in the medium term. The legal basis for the single monetary policy is set out in the Treaty on European Union, the Treaty on the Functioning of the European Union, and the Statute of the ECB and the ESCB. The monetary policy strategy of the Eurozone countries is also associated with the stability of the balance of payments

To achieve its main objective, the ECB uses a set of monetary policy instruments as well as various procedures. The Euro system operations framework consists of the following set of instruments: Open market operations; Instruments available (permanent); Minimum reservation

Inflation represents an increase in the price of goods and services, thus reducing the role of money as a medium of exchange, acting as a tax on the holding of money. An environment with inflation makes it difficult for firms and individuals to make decisions, thus reducing economic efficiency.
Not much attention has been paid directly to the exchange rate, but the main objective (price stability) of the ECB-led monetary policy depends on exchange rate movements

Interest rates play a very important role for a country's economy; they are the main aggregate for securing or absorbing liquidity in the banking market.

Key terms: Monetary policy, single monetary policy, monetary policy instruments, ECB, euro area, member states, interest rate, exchange rate, inflation.

JEL Classification: E5, E50, E51, E52, E58, E4, E42

1. Introduction

The main goal of the ECB monetary policy is to keep prices stable and the inflation rate below or close to 2% in the medium term1. The institutional structure of the single monetary policy is based on two basic principles or "pillars" that are necessary for the design and successful implementation of sound policies:
- Economic analysis, aims at short-term to medium-term assessment of price development factors, and
- Monetary analysis aims at the medium to long term assessment of price development factors.

Bank must be independent.
The ECB has been responsible for the development of monetary policy in the Eurozone since 1 January 1999 (governments are First, the mandate of the Central Bank must be clearly and clearly focused on maintaining price stability, and second, the Central responsible for fiscal policy) which includes 17 of the 27 member states of the European Union. So not all EU countries have the euro as their national currency and as a result there is also the European System of Central Banks (ESCB) which includes the ECB and the National Central Banks of all EU member states regardless of whether have accepted the euro as their national currency or not, and the Eurosystem includes the ECB and the National Central Banks of those countries that use the euro as their national currency. Therefore, as long as there are EU member states whose currency is not the Euro, a distinction must be made between the Eurosystem and thThe legal basis for the single monetary policy is defined in the Treaty on European Union, the Treaty on the Functioning of the European Union, as well as the Statute of the ECB and the ESCB.e European System of Central Banks.
2. Monetary policy goals

. The main goal of the ECB monetary policy is to keep prices stable. Historically, the Maastricht Treaty did not provide a precise definition of price stability, however in October 1998, the ECB General Council defined price stability as: the year-on-year increase of the Harmonized Index of Consumer Prices (HICP) for the euro area, which does not exceed the level of 2% in the medium term2. This is set out in the Treaty on the Functioning of the European Union, Article 127 (1): The main objective of the European System of Central Banks (hereinafter ESCB) will be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies of the Union, with a view to contributing to the attainment of the objectives of the Union set out in Article 3 of the Treaty on European Union. The ESCB will operate on the principle of an open economy with free competition, favoring an efficient allocation of resources, and in accordance with the principles set out in Article 19"[3].

From the article quoted above, we understand that the treaty creates a clear hierarchy of objectives for the Eurosystem, and attaches great importance to ensuring price stability, presenting it as the most important contribution that monetary policy can make to achieve a favorable economic environment and a high level of employment,

[1] ECB, "The European Central Bank, The Eurosystem, The European system of Central Banks" ECB, Frankfurt, 2011, fq. 20

[2] H. Jakob, E. Sylvester, Ë. Sandra „The European Central Bank" CESifo Book Series, USA 2005, fq.11

[3] Official Journal of EU,, Consolidated Versions OF THE TREATY ON EUROPIAN UNION AND THE TREATY ON THE FUNCTIONING OF THE EUROPIAN UNION" 2008, fq.1

and it is also stated that the ESCB will also support the general Economic policies in the Union to achieve the objectives of the Union set out in Article 3, such as a high level of employment, and growth economically stable and non-inflationary. The monetary policy strategy of the Eurozone countries is also associated with the stability of the balance of payments.

3. Monetary policy instruments

The European Central Bank is responsible for the development of the single monetary policy in the euro area, therefore to achieve its main objectives the ECB must intervene in the money market, to regulate the monetary measure, thus affecting the level of short-term interest rates. Short-term interest rates in the money market have an important role in the development of monetary policy, influencing these rates, monetary policy affects short-term nominal interest rates, thus influencing the spending decisions of households and enterprises, in financial and monetary developments, and ultimately affecting the price level which is also the main objective of the single monetary policy. To achieve its main objective, the ECB uses a set of monetary policy instruments as well as various procedures. The Eurosystem operations framework consists of the following set of instruments:
Open market operations,
Available (permanent) instruments,
Minimum reserves.

Table 1. Euro system and monetary policy operations

Monetary Policy Instruments	Types of Transactions Liquidity assurance	Liquidity absorption	Maturity	Frequency	Procedura[4]
Open market operations					
Main refinancing operations	Canceled transactions	-	A week	weekly	Standards tender
Long-term refinancing operations	Canceled transactions	-	Three months	monthly	Standards tender
Adjustment operations	Canceled transactions Foreign exchange exchange	Canceled transactions Collection of fixed rate deposits	Non-standardized	Non-regularly	Immediate tenders Bilateral procedure foreign-tram

		Currency exchange			
Structural operations	Canceled transactions	Issuance of ECB debt certificates	Standardized / non-standardized	Regularly and irregularly	Standards tender
	Direct purchase	Direct sales	-	non-regular	Bilateral procedure
Instruments available					
Marginal lending instruments	Canceled transactions	-	Overnight	Access to the discretion of the parties	Access to the discretion of the parties
Deposit instruments	-	Deposit	Overnight	Access to the discretion of the parties	Access to the discretion of the parties

Source: ECB "The Monetary policy of The ECB" ECB, Frankfurt 2011, p.95

4 For standard tenders, a maximum of 24 hours pass from the announcement of the tender until the confirmation of certain results, immediate tenders are executed within 90 minutes from the announcement of the tender until the confirmation of certain results, the bilateral procedure is a procedure where the Central Bank agrees with a or some parties, not using tendering procedures, ie includes operations performed with stock exchanges and commercial agents.

The monetary policy framework seeks to ensure the participation of a wider range of parties, and should be consistent with the principles of simplicity, transparency, continuity, security, and cost-effectiveness. Only institutions subject to minimum reserves can access permanent instruments and participate in open market operations based on standard tenders. These institutions may have access to financial instruments based on standard tenders only through the National Central Banks of the Member State in which it is involved.
The Eurosystem uses two types of operations. We have tried in Table 1 to illustrate the mechanisms of their operation by type, manner and time. The most important are open market operations.

4.1. Open market operations

Successful monetary policy development is closely linked to monetary policy instruments, especially open market operations, which are one of the most important instruments that play a role in guiding interest rates and subsequently affect the liquidity of the market. banking sector in the euro area. In Table 1, we have presented this instrument as well as the mechanisms (operations) of its functioning for the money market.5 Open market operations are divided into four categories:
Main refinancing operations. They affect interest rates, thus affecting the liquidity situation in the market. The main refinancing operations are included as liquidity operations which are

executed by the National Central Banks, through standard tenders on a regular basis every week (they have a maturity of one week).
Long-term refinancing operations. This category of open market operations is intended to affect interest rates thus affecting the liquidity situation in the market but the difference lies in the fact that the maturity is 3 months, and are executed by the National Central Bank regularly every month through standard tenders.
Adjustment operations. They are intended to affect interest rates, thus affecting the liquidity situation in the market, in any situation when interest rates move from any sudden fluctuation of liquidity in the market. So they are used in emergency situations, to regulate market stability. Maturity and frequency are not standardized, they are used as security and liquidity absorption operations. They are executed by the National Central Bank (they can also be executed by the ECB, decided by the General Council), through direct tenders and bilateral procedures. Liquidity assurance operations are executed through standard tenders but the possibility of execution through bilateral procedures is not excluded. Liquidity absorption operations are fully executed through bilateral procedures.
Structural operations. They aim to regulate the structural position of the Eurosystem with the financial sector, which can be achieved through liquidity improvement operations, and are executed by the National Central Banks through standard tenders; maturity is not standardized, and the frequency may be regular and irregular.
Above we explained the categories of open market operations, but as we see in Table 1, for the development of any of the categories of open market operations open market instruments are used, such as6:
- Canceled transactions. They represent the main instrument of open market operations which can be used in all categories of open market operations, and refer to operations where the Eurosystem buys or sells suitable assets under a repurchase agreement or carries out credit operations with collateral against suitable assets.
Direct transactions (purchase, sale). Refers to operations where the Eurosystem buys or sells suitable assets directly on the market.
- Foreign exchange exchanges. They are executed for monetary policy purposes, and consist of both immediate and future euro transactions, against a foreign currency. Used for the purposes of adjustment operations mainly to regulate the liquidity situation in the market as well as to drive interest rates.
- Collection of deposits with fixed rates. It is intended only for adjustment operations, in order to absorb liquidity.
- Issuance of ECB debt certificates. The ECB may issue debt certificates in order to adjust the structural position of the Eurosystem vis---vis the financial sector, in order to create (or expand) a lack of liquidity in the market.

5 Refers to the market in which the maturity is less than one year
6 ECB "The Monetary Policy of the ECB 2011" ECB, Frankfurt 2011, p.1

4.2. Instruments available (permanent)

To achieve monetary policy objectives, the use of available instruments is more than necessary. Characteristic of the available instruments is that for the parties they offer liquidity assurance or absorption with overnight maturity, with a certain interest rate. Access to instruments is achieved only in accordance with the objectives and considerations of the ECB monetary policy. The ECB may adjust the terms of the instruments available or suspend them at any time. Two categories of available instruments are available and managed in a decentralized manner by the National Banks of the euro area member countries.
Marginal lending instruments. This instrument is intended for the parties to provide overnight liquidity from the National Central Bank at a predetermined interest rate as well as on the basis of acceptable collateral. Institutions subject to minimum reserves (which meet the eligible criteria) have access to these instruments and provide them through the National Central Banks in the Member State. Maturity is overnight. The interest rate on marginal lending instruments is set as the ceiling interest rate.
. Deposit instruments. Present the opposite of marginal lending instruments. The parties use deposit instruments to create overnight deposits with the National Central Banks at a predetermined interest rate. The interest rate on deposit instruments is like the floor interest rate. Institutions subject to minimum reserves (which meet the eligible criteria) have access to these instruments and provide them through the National Central Banks in the Member State.

4.3. Minimum reservation

The European Central Bank requires that minimum required reserves be held by financial institutions in the amount of 2% of the total amount of transactional deposits as well as other short-term deposits in the accounts with the Central Banks of the Member State to which they belong. The minimum reserve plays a very important role in the development of monetary policy in the euro area. The Eurosystem minimum reserve system mainly performs the following monetary functions7:
. Stabilization of interest rates in the money market (short-term). It aims to contribute to the stabilization of interest rates in the money market, giving institutions an incentive to calm down the effects of temporary liquidity fluctuations.
Creating or expanding a structural lack of liquidity. This can be useful in improving the Eurosystem's ability to act efficiently as a liquidity supplier.
The subject of minimum reserves are all credit institutions operating in the euro area. Eurozone subsidiaries of non-euro area credit institutions are subject to minimum reserves, while euro area subsidiaries of euro area-based credit institutions are not subject to minimum reserves. In Table 2, we see that there are two minimum reserve requirements, where the 2% rate is subject to short-term liabilities and the 0% rate is subject to long-term liabilities. This table shows the balance of liabilities subject to minimum reserves at the end of January 2011. For credit institutions available is the facility of 100,000 euros which is deducted from the base of minimum reserves in each Member State where they operate. This is rather intended as a facility for institutions, to reduce the costs arising from the management of very small reserves.

7 ECB "The Implementation of Monetary Policy in the Euro Area" ECB, Frankfurt 2011, p.82

The European Central Bank pays interest rates to financial institutions on minimum required reserves and interest rates. This remuneration corresponds to the average, during the maintenance period of the “fixed margin rate” (measured on the basis of calendar days), of the main refinancing operations. Marginal rates are usually very close to short-term market interest rates, so minimum reserves are normally rewarded very close to market rates8.

5. Analysis of inflation rate movement

Inflation represents an increase in the price of goods and services, thus reducing the role of money as a medium of exchange, acting as a tax on the holding of money. An environment with inflation makes it difficult for firms and individuals to make decisions, thus reducing economic efficiency.

The main goal of the ECB monetary policy is to keep prices stable. Historically, the Maastricht Treaty did not provide for a precise definition of price stability, however in October 1998 the ECB General Council defined price stability as: the year-on-year increase of the Harmonized Index of Consumer Prices (HICP) for eurozone, which does not exceed the level but close to 2% in the medium term. This quantification of price stability was initially heavily criticized and later fully accepted, so the General Council confirmed this definition in May 2003, after a full review of the ECB's monetary policy strategy. special attention is also paid to deflation to ensure a sufficient margin to avoid its risk.

The Harmonized Index of Consumer Prices represents a set of consumer price indices in the EU. It is calculated based on a harmonized approach and a single set of definitions where the main indices are9:

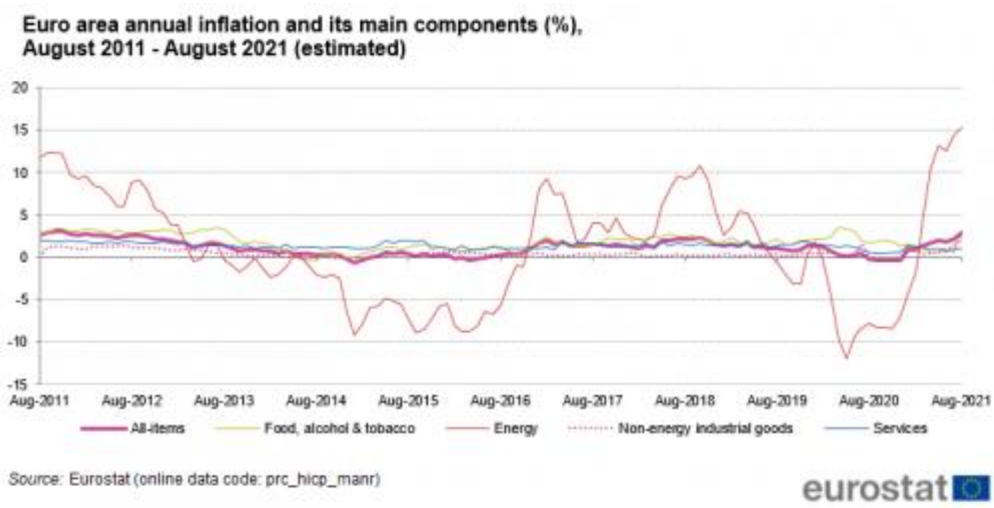
- Monetary Union Consumer Price Index (MUICP) - aggregate indices covering countries within the Eurozone;
- Evrop European Consumer Price Index (EICP) - applies to the Eurozone plus other EU countries;
- Harmonized National Consumer Price Index - for each EU member state.

The Harmonized Index of Consumer Prices provides comparable measures of inflation in the Eurozone, in the member states of the European Union, the European Economic Area and for other countries, including candidate and accession countries.

Inflation rate data based on the Harmonized Index of Consumer Prices, published by Eurostat are available from 1 January 1996, and the average rate of the Harmonized Index of Consumer Prices from 1 January 1996 until November of the year 2011 is 2%, ie close to the main monetary policy objective of the ECB.

Changes in the conditions of supply and demand of goods and services will inevitably affect their prices as well. Our following analyzes will include the general index of the Harmonized Index of Consumer Prices, the inflation rate for the Eurozone countries, where the minimum height was reached in July 2009 by 0.6%, while the maximum inflation rate is recorded in July 2008, with a positive inflation rate of 4.0%. In 2009, we have a negative rate that represents the opposite of inflation, ie deflation. But now lately, from last year,2020 we are facing a pandemic which is affecting both the health, emotional and psychological state. The phrase "It is an economic tsunami" is being widely used to describe the state of the economy and international financial markets by all analysts and experts in the world economy. Coronavirus is pushing economies towards economic recession, at a time when all parameters and trends were in positive trend. As the pandemic situation worsens, everyone finds it difficult to decide which conversations are most frightening: the conversations we have with epidemiologists or the conversations we have with economists and company executives. Social distancing is turning into economic distancing. People are being restricted from going to shops, theaters, cinemas, museums, bars, restaurants and workplaces. To prevent the spread of the COVID-19 pandemic, it is inevitably heading towards economic recession, and more likely, if it lasts at all, even towards economic depression, to the extent we have not seen in the modern economy. Despite a large part of the restrictions imposed, for prevent the spread of the COVID-19 pandemic, will be phased out, consumer reluctance will slow economic growth for a much longer time after the end of the COVID-19 pandemic. In the fourth wave, businesses that have planned investments will give up any new investment, whether in new product lines, new product development, or investments in new workspaces and thus an engine. significant economic growth will be paralyzed.

Euro area annual inflation is expected to be 3.0 % in August 2021, up from 2.2 % in July 2021.



The figures presented in this article are early estimates of the Harmonised Index of Consumer Prices (HICP).

Data collection for HICP has been affected by the COVID-19 crisis in all euro area countries. Eurostat and the Member States' national statistical institutes have agreed a set of procedures to estimate prices that could not be collected due to mobility restrictions or closures of outlets. All information on the compilation of the HICP during the COVID-19 crisis can be found in the HICP Methodology page of Eurostat's website.

https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Inflation_in_the_euro_area

6. Monetary policy and exchange rate policy

Not much attention has been paid directly to the exchange rate, but the main objective (price stability) of the ECB-led monetary policy depends on exchange rate movements. So the exchange rate is seen as a result of other economic policies. Thus, an appreciation of the euro would make imported goods cheaper, thus directly affecting the reduction of the inflation rate in the euro area. If imported goods are used as inputs we will have a lower price of final output, which represents lower inflation in the country, while in the international market we will be more competitive. If we had a devaluation of the euro, the opposite would happen, so the prices of imported goods would be higher, affecting the increase of the inflation rate. The appreciation of the euro would reduce exports while devaluation would make export goods cheaper.

In addition to the Central Bank, the Ministry of Finance or the Treasury in some countries is also responsible for exchange rate policy. There are two reasons for this division of responsibilities. The Central Bank carries out direct or indirect exchange rate operations, buying or selling foreign currency or moving interest rates. The Treasury (Ministry of Finance) has traditionally 'spoken' se because the exchange rate has a strong impact on external competition and the Treasury is often the owner of state reserves.10

European Union member states that are not yet members of the EMU are part of a revised exchange rate mechanism called the ERM II (Exchange Rate Mechanism revisited). ERM II means a wider fixed exchange rate area, but adjustable with a fluctuation of (+ 1.5%, only the Danish Krone has a fluctuation limit of + 2.25%). Decisions on exchange rates are taken on the basis of an agreement between the Member State concerned with the Eurozone countries, the European Central Bank and other countries participating in the ERM II mechanism. All participants in ERM II, including the ECB, have the right to initiate a secret procedure in order to change the central norms (reconstruction) 11. ERM II is presented as necessary to limit countries outside the Eurozone, not to manipulate the valuation or devaluation of their currencies for certain benefits, depending on the policies they pursue, as well as to meet one of the convergence criteria that have emerged from the Maastricht Treaty, ie the criterion exchange rate stability.

Euro Foreign Exchange Reference Rates

30 August 2021

Currency		Spot
USD	US dollar	1.1801
JPY	Japanese yen	129.66
BGN	Bulgarian lev	1.9558
CZK	Czech koruna	25.566
DKK	Danish krone	7.4361
GBP	Pound sterling	0.85748
HUF	Hungarian forint	348.30
PLN	Polish zloty	4.5678
RON	Romanian leu	4.9343
SEK	Swedish krona	10.1813
CHF	Swiss franc	1.0798
ISK	Icelandic krona	149.80
NOK	Norwegian krone	10.2395
HRK	Croatian kuna	7.4935
RUB	Russian rouble	86.7119
TRY	Turkish lira	9.8909
AUD	Australian dollar	1.6167
BRL	Brazilian real	6.1529
CAD	Canadian dollar	1.4867
CNY	Chinese yuan renminbi	7.6347
HKD	Hong Kong dollar	9.1891
IDR	Indonesian rupiah	16916.81
ILS	Israeli shekel	3.7998
INR	Indian rupee	86.5035
KRW	South Korean won	1375.03
MXN	Mexican peso	23.8273
MYR	Malaysian ringgit	4.9057
NZD	New Zealand dollar	1.6844
PHP	Philippine peso	58.786
SGD	Singapore dollar	1.5881
THB	Thai baht	38.271
ZAR	South African rand	17.2578

Source: http://www.ecb.europa.eu/stats/eurofxref/

7. Interest rates in the Eurozone

Interest rates play a very important role for a country's economy; they are the main aggregate for securing or absorbing liquidity in the banking market. Low interest rates are associated with a development of the real economy, where firms and individuals would buy money at a lower price, but in this case we would be at risk of bad debts, ie overloading of firms and individuals with debt, such as and the other risk is that the low interest rate stimulates the movement of capital in the foreign market. Everyone wants to deposit their money at a higher interest rate, and that
Capital movements in the foreign market will increase the demand for foreign currency, devaluing the domestic currency, making goods and imported raw materials more expensive, which would then affect the price level by increasing inflation. On the contrary, high interest rates do not help economic development, ie firms and individuals, but stimulate the movement of capital from abroad, increasing the demand for local currency and making it more expensive. A stronger domestic currency increases the purchasing power of the currency by making the commodity as well as the imported raw material cheaper, thus reducing inflation and making it the most competitive country in the foreign market.

The Governing Council is the ECB's main decision-making body, formulating monetary policy for the euro area and setting key interest rates. In December 1998, shortly before the ECB became responsible for monetary policy in the euro area, interest rates were lowered by a decision coordinated by the National Central Banks.
The European Central Bank (ECB) is based on three main interest rates:
Interes Interest rates of major refinancing operations, which provide liquidity in the market banking and adjust the interest rate to the desired rate;
 Rates on deposit instruments, which banks use to make overnight deposits in Eurozone;
 Rate on marginal lending instruments, which provides overnight loans to banks, from
. euros system.

The General Council at the ECB, in its meetings, decides on changes that may be made to any of these interest rates, and the change takes effect from the date it is set, and is valid until the next change, if required by the General Council.

8. Conclusion

The main goal of the ECB monetary policy is to keep prices stable and the inflation rate below or close to 2% in the medium term. The legal basis for the single monetary policy is defined in the Treaty on European Union, the Treaty on the Functioning of the European Union, as well as the Statute of the ECB and the ESCB. The monetary policy strategy of the Eurozone countries is also associated with the stability of the balance of payments.

To achieve its main objective, the ECB uses a set of monetary policy instruments as well as various procedures. The Euro system operations framework consists of the following set of instruments: Open market operations; Instruments available (permanent); Minimum reservation.

Open market operations are divided into four categories: Main refinancing operations; Long-term refinancing operations; Adjustment operations; Structural operations. Open market instruments are used for the development of any of the categories of open market operations, such as: Canceled transactions; Direct transactions (purchase, sale); Foreign exchange barter; Collection of fixed rate deposits; Issuance of ECB debt certificates.

To achieve monetary policy objectives, the use of available instruments is more than necessary. Characteristic of the available instruments is that for the parties they offer liquidity assurance or absorption with overnight maturity, with a certain interest rate.

The European Central Bank requires that minimum required reserves be held by financial institutions in the amount of 2% of the total amount of transactional deposits as well as other short-term deposits in the accounts with the Central Banks of the Member State to which they belong.

Inflation represents an increase in the price of goods and services, thus reducing the role of money as a medium of exchange, acting as a tax on the holding of money. An environment with inflation makes it difficult for firms and individuals to make decisions, thus reducing economic efficiency.

Not much attention has been paid directly to the exchange rate, but the main objective (price stability) of the ECB-led monetary policy depends on exchange rate movements.

Interest rates play a very important role for a country's economy; they are the main aggregate for securing or absorbing liquidity in the banking market.

Reference

. 1) ECB, “The European Central Bank, The Eurosystem, The European system of Central Banks” ECB, Frankfurt, 2011

. 2) H. Jakob, E. Sylvester, Ë. Sandra, “The European Central Bank”, CESifo Book Series, USA 2005

. 3) Official Journal of EU, “ Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union”, 2008

. 4) ECB, ”The Monetary policy of the ECB”, ECB, Frankfurt 2011

. 5) ECB, „The Implementation of Monetary Policy in the Euro Area”, ECB, Frankfurt 2011

. 6) https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Inflation_in_the_euro_area

. 7)https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/index.en.html