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PRICE AND FINANCIAL STABILITY FROM THEORY TO MONETARY STRATEGY – DIRECTIONS FOR ROMANIA'S SITUATION

Theoretical article

Keywords
Equilibrium,
Balance,
Sustainability,
Risks,
Monetary

JEL Classification
E50

Abstract

Under the current conditions of conducting international economic relations, there is a risk of failing to accomplish the monetary policy objectives due to reasons pertaining to the mechanisms that convey shocks cross-border. The conceptual review of object definition, under such conditions, leads to the necessity of attaching to them these risks of unfulfillment; this requires an additional chapter of macroeconomic policy design, chapter that identifies the possible risks emerging from the integrated cross-border regime of the European economies, as well as the possible solutions to absorb such shocks. This implicitly presumes the quantification of the whole phenomenon or risk emergence and of its possible effects, with the view to determine the effort necessary to be undertaken in order to absorb the associated shock.

Introduction

Considering the situation of Romania, characterized by the fact that most of its international economic relations are within the European Union, we may say that one of the main features of the economic framework is given by one of the outcomes of the process of economic integration, i.e. removal of barriers hindering the economic relations between the member states (Mishkin, F. - Financial Policies and the Prevention of Financial Crises in Emerging Market Countries, NBER, Caiet de studii nr. 8087, 2001),

This set of facilities directed towards increasing the efficiency of the interstate economic relations has a high risk attached to it, namely, the cross-border propagation of the economic shocks and cross-border conveying of the risks (Trichet, J.-C. - The Euro: A Major Structural Reform of the European Economy, discurs susţinut la Simpozionul Nikkei Euro, Londra, 5 noiembrie 2001).

Consequently, the macroeconomic policies are also confronted with an additional category of macroeconomic risks generated by the possibility of importing adverse economic phenomena whose underlying causes are not related to the internal environment. Thus, an additional and permanent task for the macroeconomic policies is to provide a potential for shock absorption – which acts best if the design of the policies allows for enough mobility by providing additional funding (Barta, V. Interactions Between Monetary Policy and Financial Stability; the Czech Experience, prezentare susţinută în cadrul Conferinţei „Regional Financial Market and Financial Stability: A Concept between National Sovereignty and Globalization”, Banca Albaniei, Tirana, 2006).

The crisis found the Romanian banking system dominated massively by the foreign capital, and the financing from the mother banks for their local branches tends to decrease, which makes it more difficult to access funds from the banks. The foreign direct investments in Romania also display a decreasing trend, in agreement with the regional evolutions. It is therefore absolutely necessary to identify alternative sources of financing.

Another particularly important problem for the national economy is the decreasing demand for credits, because of the shrinking economic activities and lower purchasing power, which diminished the function of financial intermediation (. Isărescu, M. - „Spre o nouă strategie de politică monetară: ţintirea directă a inflaţiei”, dizertaţie cu ocazia decernării titlului de Doctor Honoris Causa al Universităţii din Craiova, Craiova, 17 octombrie 2003).

1. Methodology

The paper is an analytical and critical overview for the problem of price and financial stability. As the method used, the analysis starts from the already known literature elements speaking about the concept of price and financial stability. It tries to further clarify the relationship between price stability and financial stability and the European institutional regulations and conduct. The paper analyses also the consequences of capital flows on the macroeconomic and financial stability, finally presenting some suggestions regarding the necessary elements of the system of macroeconomic policies in order to function properly. As references, the analysis uses numerous papers and reports, as well as an important profile, concepts, development directions and results

2. General objectives of the monetary policy

As it is well known, the monetary policy, component of the macroeconomic policies system, derived its objectives from the general objectives of this system, namely, from the strategic objective represented by the macroeconomic sustainability; within this context, the main objectives of the monetary policy are:

- Ensure price stability;
- Ensure national currency stability;
- Ensure financial stability;
- Ensure the monetary conditions for the establishment of an efficient economic flow on the market.

The accomplishment of these objectives is understood as the involvement of the monetary policy within the system of macroeconomic policies.

Theoretically speaking, price stability is an economic concept which is approached via elements such as:

- What real economic aspect is referring to;
- How does it prove that it is a real phenomenon or process.

Thus, price stability:

- Refers to the aggregate level of the prices measured by indices;
- It is accomplished when:
  - o The money maintain their value in time, or when
  - o The rate of purchasing power erosion is very slow.

The literature doesn't provide a recognized definition of the financial stability because of the continuous novelty of this aspect, which regards matching the new and unsettled needs for macroeconomic administration with the needs of a theoretically studied problem, synthesized in a quantification indicator.

The following points of view can be approached regarding the concept of financial stability:

- In the broad meaning, with accent on the overall functioning of the financial system, the financial stability is defined as the situation in which the financial system is able to draw and place efficiently monetary funds, while withstanding shocks without bringing any damages to the real economy;

It results from here, that the prudential monitoring by the central bank is essential for the maintenance of the financial stability.

- In a narrower meaning, with accent on the avoidance of crises, financial stability is the situation in which no bank crises occur and when asset prices and, particularly, the interest rate, are highly stable.

The interest rate policy is very important for the financial stability; a conflict may even arise between the price stability objective and the financial stability objective.

3. Relation between price stability and financial stability - literature overview

According to the theory (Haugland, K., Vikøren, B. - Financial stability and monetary policy – theory and practice, Norges Bank, Economic Bulletin, nr. 1, 2006), there are two approaches, although the theory is yet to be recognized because of the novelty of aspects, which requires further studies and practice in order to add conceptual elements:

- Conventional approach: the two types of stability mutually support and potentiate each other, on the long-term;
- The novelty aspect, verified as hypothesis: as inflation stabilizes at low levels, a new economic environment is established, in which the financial stability is not guaranteed.

According to BNR Governor (M. Isărescu, 2011), the macro prudential policies comprise measures that aim to secure the proper health state of the financial system, or that can avoid losing control on some sector-specific problems.

According to the studies of Borio (2003), a successful macro prudential policy will accomplish its goal, so that the micro prudential policy is subordinated to the policy that encompasses the entire financial system. José Viñals (2011) considers that irrespective of the macro prudential policies performance, they cannot be regarded as sufficiently good replacement of efficient macroeconomic policies, and he suggests the use of a combination of macroeconomic and prudential policies to avert shocks within the economy. In the opinion of Clement (2011), the macro prudential policy differentiated from the other economic policies not just through flexibility and minimal costs, but also through the two dimensions it approaches, the temporal dimension and the structural dimension, so that it marks the major distinction between the macro prudential and micro prudential policies in term of objectives, mechanisms and instruments of transmission.

The macro prudential policy targets the viability of the financial-banking system as a whole, as essential relation for the operation of an economy, with the main objective of avoiding macroeconomic costs resulting from the instability of the financial system and of decreasing the systemic risk. The macro prudential policy is considered to be complementary to the micro prudential one, while it also has interactions with different types of economic policies, which have a particular impact on the financial stability; thus, it acts towards the build-up of financial imbalances by enhancing protecting barriers, by the joint identification and approach of the exposures, of the risk concentrations, of the relations and interdependencies as risks of contagion.

The macro prudential policy is regarded as complementary to the micro prudential policy, and it interacts with different types of economic policies which have a sizeable impact on the financial stability, working towards the elimination of financial imbalances by enhancing the protecting barriers, by identifying and joint approach of the exposures, of the risk concentrations, of the relations and interdependencies as risks of contagion.

Thus, what was the purpose of these measures? The authorities acted in a consistent manner just in order to avoid a collapse of the financial system, to ensure its sturdiness, because the financial system plays a primordial role in ensuring the financial stability, being cleaned and consolidated in time. There is a positive direct relation between the macro prudential policy and the financial stability, so that a solid and credible transparent policy will potentiate the financial stability, implicitly accomplishing the basic goal of the monetary policy too.

The financial stability is seen in a new approach, because the prevention of the systemic vulnerabilities is not any more done exclusively by temporising the accumulation of risks through the requirement for capital, but also by working on the amplitude of the financial risk cycle. Furthermore, the anti-cyclic role of the macro prudential policy is consolidated (additional capital reserves), including by proactive measures to temper the demand for credits, while the capital reserves accumulated during the periods of expansion are to be used in periods of economic adjustment.

4. European institutional aspects in the field of financial stability ensuring

Because of the importance ascribed to the provision of an economic climate proper for the objectives developing from the economic sustainability goal, the European Union has established several institutional mechanisms that provide financial stability (Barta, V. Interactions Between Monetary Policy and Financial Stability; the Czech Experience, prezentare susținută în cadrul Conferinţei „Regional Financial Market and Financial Stability: A Concept between National Sovereignty and Globalization”, Banca Albaniei, Tirana, 2006).

Thus, the European Financial Stability Facility (EFSF) has been established by the Euro zone member countries following the decisions that the Ecofin Council took on May 9th, 2010. EFSF mandate is to protect the financial stability within Europe by granting financial assistance for the Euro zone member countries. EFSF can use, under certain conditions, several instruments such as: loans to the countries experiencing financial difficulties, interventions on the primary and secondary credit markets and recapitalization of the financial institutions by loans granted by governments.

The European System of Financial Supervisors (ESFS) has been also established, in association with an intricate network of regulatory and supervisory institutions. Its objectives are to facilitate the cooperation between the national and EU supervisors.

Within the same spirit, three European supervisory agencies have been established on January 1st, 2011: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

Besides the development of the EU regulatory and supervisory institutional structure, just before the onset of the crisis, several mechanisms of cooperation on matters of financial stability have been established in several European countries. The financial stability committees have been established with the purpose to facilitate the cooperation on matters of financial stability between the central banks, the national supervisory agencies and the national governments.

5. The flows of capital and their consequences on the macroeconomic and financial stability

Current account liberalization is one of the most debated decisions of macroeconomic policy because the different theoretical approaches have different interpretations on the opportunity of taking such a measure.

According to the perfect market patterns, the free flows of capital improve the functioning of the financial systems, thus increasing the volume of available funds while decreasing their costs and allowing a better diversification of the risks (Frenkel and Razin, 1996). Obstfeld (1998) showed that such measure would efficientize the allocation of resources. In the opinion of Stultz (1999) and Mishkin (2001), the liberalization pf capital movement stimulates transparency and responsibility, thus decreasing the extent of the problems with adverse selection and moral hazard, while narrowing the liquidity constraints from the financial markets. According to the cited authors, the international financial markets have the trend to impose a stricter discipline on the political factors that would otherwise be tempted to take advantage of a captive local financial market. Bekaert, Harvey and Lundblad (2001), showed that the liberalization of the capital flows stimulates the economic expansion, leading to higher rates of growth than those prior to the moment of liberalization.

According to Brecher and according to Diaz-Alejandro (1977), when there are sectors isolated from the external competition, capital account liberalization may direct the capital towards sectors where a particular country has comparative advantage. Brecher (1983) showed that capital account liberalization, in the economies characterized by rigidity of the real wages, determined the allocation of an excessive volume of resources towards the highly capitalized sectors, replacing the labour force by capital within the production operations, thus aggravating the allocation of resources and causing an adverse impact on the incomes and wealth of the residents; in consequence, the economic growth generates poverty. According to the study of Stiglitz (2000), because the information asymmetries are endemic in the case of transactions on the financial markets, there is no reason to sustain that the liberalization of capital movements would generate wealth, so that there are no guarantees for channelling the capital flows towards destinations where the marginal product exceeds the costs of opportunity; this is much more so for the emergent economies whose capacity of collection and processing of information relevant to the financial transactions is low. The evolutions during the late 1990s, particularly the Asian crisis, determined many economists to consider that globalization went too far, giving birth to highly volatile capital markets and causing costly crises. Furthermore, they pleaded for the return to the old order of the controlled flows. Stiglitz (1999) recommended the developing countries to impose restrictions on the inflow of capital in order to dampen the excessive impact of the economic cycles on the financial markets. Krugman (1998) was in favour of restrictions regarding the outflow of capital, which the literature considered for a long time to be completely inefficient, arguing that such restrictions might manage, even just temporarily, outflows of capital that would otherwise prove to be dishonouring. Rodrick (1998 and 2000) considered that the restrictions on the movement of capital are good, because their free circulation leads to financial crises because of their high volatility. The results of empiric studies don't reconcile the different opinions mentioned above. The literature on crises identified empirically the causes of the currency crises in the excessive fluctuations from the financial markets, the cause of these fluctuations being the financial deregulation. Other authors continued to highlight the advantages of the financial market deregulation and its contribution to the lower cost of capital. According to the study by Kaminsky and Schmukler (2003) there are two weak spots of the research activity, which make impossible a possible reconciliation. First, it is the fact that the empirical studies stress either on the short-term consequences of the liberalization, or on the long-term consequences, without taking into consideration the possible time-varying effects. Second, the absence of a full approach of liberalization because so far the approaches focused either on the liberalization of the local financial sector, or on the capital account, or on the capital market, even when the reforms for liberalization caused the gradual opening of the three sectors. Despite the literature divergences, there is a broad consensus according to which, the financial markets will most probably observe the promise of growth and stability provided they are transparent and properly regulated (Rato, 2007a). The financial globalization has a lower potential to generate instability in those countries where the financial sectors are more developed, the institutions more powerful, the macroeconomic policies more healthy and the commercial systems more opened (Rato, 2007b).

Lately, the Central and Eastern Europe countries have been confronted with significant inflows of capital, after the gradual removal of the restrictions on the free movement of capital during the process of complete liberalization of the capital account, which was a prerequisite for the accession to the EU. On the one hand, the appetite of the investors has been stimulated by the persistence of positive interest differentials. On the other hand, the perspectives of these countries have been appreciated as more favourable within the context of their accession to the EU. Lipschitz et al. (2002) compared the transition countries which are exposed to the international capital markets, following the liberalization, with honest people living in a dangerous world, these countries being vulnerable to the significant inflows of capital with reversible potential. These flows shouldn't be regarded as conjunctural, destabilizing events, because they are intrinsic to the process of transition; therefore, they must be taken into consideration when making the mix of policies. In other words, despite the obvious advantages of the capital inflows (higher economic efficiency, transfers of technology), they can be a serious threat to the macroeconomic stability and to the external competitiveness, because they may generate overheating of the economy when their volume exceeds the capacity of the particular economy to absorb them.

One of the main channels that lead to overheating of the emergent economies is the credit channel, given the dominant position of the banks within the financial system and the increased volume of capital available after the removal of the capital account restrictions. According to Backé, Égert and Zumer (2006), the banks own 85% of all financial assets, while the capital markets play a less important role.

The literature warned that a credit boom may have serious macroeconomic and macroprudential consequences, being often associated to macroeconomic and financial crises because of the macroeconomic imbalances and of the worsening financial situation of the banking sector. Hence, the authorities should maintain a viable equilibrium between providing macroeconomic and financial stability and credit expansion, which contributes to the economic growth and to a higher efficiency of resources allocation. The rapid increase of the credit in Central and Eastern Europe countries can be justified by the very low initial levels of the financial intermediation and by the natural process of convergence towards the levels noticed in the developed EU economies.

The fast rise of the credit has been financed by the massive entries of foreign capitals, particularly through the banking system, stimulated by the very low level of capital endowment of the labour force compared to Western Europe, by the anticipation of a long-term real appreciation of the regional currencies and by the existence of significant positive interest differential. The ascension of the credit also occurred after the successful implementation of macrostabilization policies, which decreased the aggregate risk and, together with the shrinkage of the public sector, released additional resources for the private sector. We must not forget the significant pay rise and the narrowing spreads between the active and passive interest rates – following the enhanced competition within the banking system – which, together with the dominant tendencies of nominal appreciation of the national currencies, increased the solvability of the population and its capacity to take credits in local currency or even in hard currency. The inflow of capital is, most certainly, very good for the banking sector. The presence of the foreign operators on the banking market makes the financial environment more stable, improves the corporate governance and the risk-management capacity. At the same time, it is reasonable to consider that the fast expansion of the credit may exceed the capacity of the banks to evaluate the risks, which leads to a higher asymmetry of information, whose consequence is a higher rate of non-reimbursement. Despite this, the business patterns of the banks from the Central and Eastern Europe countries didn't move upwards from the basic "open and hold" within the balance sheet, to a more sophisticated, "initiate and distribute" outside the balance sheet, and the region didn't confront with the problem of the "frenetic securitization". This is a solid argument to say that the level of sophistication necessary to evaluate the profile of the risks associated to the banking activities in these countries is not that high as that required in Western Europe within the current credit crisis (Barta, V. Interactions Between Monetary Policy and Financial Stability; the Czech Experience, prezentare susţinută în cadrul Conferinţei „Regional Financial Market and Financial Stability: A Concept between National Sovereignty and Globalization", Banca Albaniei, Tirana, 2006).

At the macroeconomic level, the fast expansion of the credit stimulates the aggregate demand, generating inflationist pressure and having a contribution to the development of higher external imbalances. While the inflationist pressure has generally been successfully controlled by the monetary policy in all the countries in that region, the external imbalances increased significantly in the Baltic States, Bulgaria and Romania, countries with the fastest growth of the credit over the last five years. However, the central banks have difficulties in their attempt to restrain credit expansion, both because tempering the growth of the credit in the national currency through a restrictive monetary policy may replace this type of credit by loans in hard currency, and because the administrative measures meant to limit the exposure of the banks may externalize the exposure towards the mother banks. The large current account deficits are dangerous because they are associated to a higher risk of abrupt adjustments of the exchange rate, while the high volatility of the exchange rate has major consequences on the monetary and macroeconomic stability, in general. It is difficult to evaluate the sustainability of the current account deficits in the Central and Eastern European countries, the presence of external imbalances being absolutely natural in the case of countries in full swing of real convergence. However, there is a possibility that the excessive external deficits noticed in some countries, further generate risks to the macroeconomic stability (Trichet, J.-C. - The Euro: A Major Structural Reform of the European Economy, discurs susţinut la Simpozionul Nikkei Euro, Londra, 5 noiembrie 2001). The literature shows (Mishkin, F. - Financial Policies and the Prevention of Financial Crises in Emerging Market Countries, NBER, Caiet de studii nr. 8087, 2001), regarding the risks regarding the financial stability, that the speedy expansion of the credit is one of the warnings for financial turbulences, but don't necessary support the materialization of these crises. The standard warning thresholds from the literature papers, such as the annual rate of financial intermediation increase of 5 percent points of the GDP, on a five-year horizon (Demirgüç-Kunt and Detragiache, 1997), beyond which the probability of a crisis increases significantly, have been exceeded by the evolutions recorded in Bulgaria, Croatia, the Baltic States and Slovenia.

At first sight, the banking prudential indicators in the Central and Eastern European countries, such as the rate of capital adequacy and the proportion on nonperforming credits within the overall loans, maintained at comfortable levels, or even improved lately, in the second case. However, one must also consider the volume of new credits, which might artificially decrease the proportion on nonperforming credits, screening thus out the qualitative problems of the portfolio of credits (Gersl, A., Hermanek, J. (2006). "Financial Stability Indicators: Advantages and Disadvantages of their Use in the Assessment of the Financial System Stability", Czech National Bank Financial Stability Report).

The structure of credit dynamics yields additional risks for the financial stability, besides those caused by the actual expansion of the loans. Thus, the rate of consumer credit expansion outran that of the credit for investments in most regional countries. This means that the risks are mostly associated to population households, which lack the necessary experience to manage the risks of high debts. At the same time, the proportion of loans in hard currency remains high in some countries from this region, under the conditions of real and nominal appreciation and of the availability of funds in hard currencies due to the inflows of capital (Backé, P., Égert B., Zumer, T. - Credit Growth in Central and Eastern Europe, BCE, Seria caietelor de studii nr. 687, 2006). These evolutions might just increase the vulnerability associated to the lack of correlation between the currency denominating the incomes and the denomination of the debt, particularly within the context of the risk of sudden correction of the external imbalances.

The decisions that have to be taken within the context of overheating from the inflow of capital must rely on the economic objectives of the particular country; the exchange rate, the institutional constraints, the determinants and the structure of the capital inflows must be taken into consideration.

One of the characteristics of the Central and Eastern European economies is the predominant role of the exchange rate channel in the transmission of the monetary policy, as a consequence of the high commercial opening of the financial systems which are not yet sufficiently developed in these countries. The capital inflows increase the efficiency of this transmission channel of the monetary policy, ensuring a low rate of inflation on an extremely short interval, both directly, by decreasing the import prices, and indirectly, by the effects on the net exports and, implicitly, on the aggregate demand. Although it is beneficial on the short term, the excessive use of this mechanism of transmission risks to turn into a two-edge weapon, because it may deepen the external imbalances and enhance the vulnerability to the reversibility of the capital flows, which sometimes occurs merely to the shifting sentiments of the investors (Borio, C., (2011), Central banking post-crisis: What compass for uncharted waters?, http://www.bis.org/publ/work353.pdf(. Thus, there may be situations in which the decrease of the interest rates might counteract the sudden appreciation of the exchange rate, but such action or monetary policy would be incompatible with the accomplishment of the inflation target.

Under the conditions of strong inflows of capital, the currency will continue to appreciate, while the external competitiveness of the economy will erode. The imports will increase faster than the exports, contributing thus to the expansion of the aggregate demand. The current account deficit might reach unsustainable levels in reflection of the higher aggregate demand. If these evolutions fail to be brought under control in due time by the implementation of measures which to strengthen the fiscal and revenue policies, the feeling of the investors may change, which will cause the withdrawal of foreign capitals (Adam Alexandra – Noi abordări ale politicii monetare, Economie teoretică și aplicată Vol XIX din 2012). It was observed that the extent of these capital outflows may exceed the capacity of the authorities to protect the value of the national currency, and may produce a steep depreciation, i.e. a currency crisis.

The manner in which the steep depreciation influences price stability is obvious – the effect is both direct, via the import prices, and indirect, via the fuelling of the inflationist expectations. Likewise obvious is the reaction of the monetary policy, whose main goal is price stability. A more restrictive line of the monetary policy will compress the aggregate demand, thus pushing the economy towards recession and generating unemployment.

The financial stability may also be affected by the currency crisis, and the restrictive policies aiming to restore price stability may have an opposite effect. If the public opinion perceives the appreciation of the national currency as a lasting phenomenon, the preference for loans in hard currency becomes unavoidable, conditions in which the monetary policy would not be that efficient. However, as shown before, a steep depreciation might deteriorate the balance of the population households and of the companies, whose net wealth would shrink (Laskar, D. (2003). "Policy-mix: le besoin de coordination des politiques budgétaires entre pays est-il accru en union monétaire?", Louvain Economic Review, 69(3), pp. 267-291 Nelson, W.R., Perli, R. (2005). "Selected Indicators of Financial Stability", Fourth Joint Central Bank Research Conference, ECB, Frankfurt am Main, 8 Noiembrie).

The health of the financial sector too would suffer from the constraints within the real sector. Many bank credits would become non-performing because the economic agents would not make the payments at the due dates (Papademos, L. Price stability, financial stability and efficiency, and monetary policy, prezentare susţinută la Conferinţa „Challenges to the financial system – ageing and low growth", Frankfurt pe Main, 7 iulie 2006). The problems related to the uncorrelated maturities would only add to the existing and sizeable balance sheet uncorrelations of the income currency and debt currency, existing the prerequisites for the onset of a generalized financial crisis.

Some conclusions - necessary elements of the system of macroeconomic policies

The process of real convergence with the European Union of the emergent economies from Central and Eastern Europe is in progress and will continue for many years, given the lags existing in many of these countries.

The real convergence is characterized by the simultaneous manifestation pf the following evolutions:

– Rates of economic growth higher than the average, particularly during the early stages of the catching-up process;
– Sizeable increase of the income per capita;
– Massive inflows of foreign capital;
– Strong tendency for the real appreciation of the national currency.

The accomplishment of the goals of sustained economic growth, on the one hand, and the macroeconomic stability, on the other hand, presume the stimulation of investments and the avoidance of the pro-cyclic character of the macroeconomic policies (Solans, E. - How should monetary policy makers respond to the new challenges of global economic integration?, discurs susţinut la Simpozionul „Global Economic

Integration: Opportunities and Challenges", Federal Reserve Bank of Kansas City, 2000) .

In terms of investments, the authorities should improve their capacity to absorb European funds, while the measures for the betterment of the business environment would allow a higher flow of private investments.

Because the Central and Eastern European economies display overheating trends during their real convergence, the fiscal imbalances must not add to the economic cycle.

The economic policies should capitalise on the periods of sustained growth in order to promote the necessary reforms, thus adding supplementary room for manoeuvre for the monetary policy during the possible subsequent periods of economic decline (Krueger, 2004). This calls the fiscal policy to use the periods of economic boom as a good opportunity for the build-up of fiscal surpluses that can be used as "dampens" in the perspective of the periods of decline, when it will have to control the economic divergences and asymmetric shocks (Trichet, J.-C. - The Euro: A Major Structural Reform of the European Economy, discurs susținut la Simpozionul Nikkei Euro, Londra, 5 noiembrie 2001 and also).

The monetary policy might be confronted with a dilemma in the context of the massive inflows of capital, which is very likely, due to a possible change in the world financial polarity. On the one hand, the evolution of the inflation might claim successive increases of the monetary policy interest rate, which encourage saving, thus providing a balance between the level of saving and the extent of investments, balance which is essential if one wants to avoid an excessive current account deficit. On the other hand, the higher interest rates might create a positive interest rate differential, which would draw additional inflows of capital, with the ensuing pressure towards the appreciation of the national currency. The episodes of sudden appreciation might get reversed subsequently, with the consequences of a higher rate of inflation and tensions within the financial sector. The market could solve this dilemma by setting lower risk premiums for the investments in the transition economies. However, since the risk premiums sometimes have non-uniform evolutions and are sensitive to factors that are not under the control of the authorities, the capital inflows may thwart the efforts towards economic stability (Lipschitz et al., 2002).

Another extremely sensitive aspect is the recommended behaviour of the monetary policy when inflation is under control for the forecasted period, but the financial and macroeconomic imbalances deepen. If the economic policy fails to design and implement a swift response, in an early stage, the authorities passively bring their contributions to the deepening of these imbalances which, sooner or later, might either start a crisis, or involve much higher economic costs in the case of a subsequent intervention, when the financial or macroeconomic problems are already acute. Although theoretically, the necessity for intervention cannot be doubted, the decision of the right time for intervention by the central bank, probably with the support of the other authorities, may rise several hard to solve problems, such as:

1. Is it possible to identify clearly the imbalances in an early stage?
2. If the imbalances that appear in an early stage disappear by themselves/spontaneously, and the authorities adopt swift restrictive measures, the combined effect of the two factors might push the economy in a steep recession.
3. How could a restrictive monetary policy be explained in the absence of inflationist pressures? (Crockett, 2003).

Given the complexity of these aspects, the proper calibration of the monetary policy reaction is much more so difficult. Furthermore, given the limitations imposed by the opening of the capital account, the preservation of the macroeconomic balances cannot be exclusively the task of the monetary policy; the fiscal policy and the income policy should come to aid, by assuming part of the efforts towards stabilization.

More precisely, the fiscal policy should hold the main role in correcting the current account imbalances. This means that the countries must thus calibrate their budgets so as to cope with the increasing demand from the private sector and take appropriate measures of protection against a possible crisis, because the size of the fiscal deficit contributes directly to the magnitude of the current account deficit. At the same time, through its component of incentives creation, the fiscal policy might encourage the exports and the productive activities in general. Besides the restrictiveness of the fiscal policy, the government should also implement a prudent policy of incomes by limiting the pay rise in the public sector, action which might also narrow the copying effect which the excessive pay rise in the public sector may have on the wages from the private sector. This would avert the uncorrelated evolution of the wages with the evolution of work productivity. (. Mishkin, F. - Financial Policies and the Prevention of Financial Crises in Emerging Market Countries, NBER, Caiet de studii nr. 8087, 2001).

Looking in perspective, the process of real and nominal convergence of the Romanian economy will be accomplished at a rate which depends largely on the general coherence of the economic policies implemented by the authorities.

The process of adopting the Euro presumes a realist, visionary management, which to take into consideration that the Romanian economy needs a period of adjustment before joining the ERM II.

This period must be regarded as an opportunity to finish the structural reforms and to consolidate the macroeconomic stability, rather than a "break" that might relax prematurely the macroeconomic policies. The central bank must ensure, maintaining its inflation targeting strategy (Oros, C. . "Macroeconomic Stabilization in a Heterogeneous Monetary Union: Some Insights into the Effects of Fiscal Policy Coordination", Economics Bulletin, 5(34), pp. 1-12, 2008), the gradual nearing of the inflation rate to the levels that are compatible with the Maastricht price stability criterion. Once the reduced inflation has been consolidated, favourable conditions will be set up for the sustainable accomplishment of the nominal convergence criteria regarding the long term interest rate and the exchange rate stability. At the same time, the implementation of a prudent fiscal policy will support the sustainability of the public finances. Under these conditions, Romania might join the Euro zone by 2019.

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