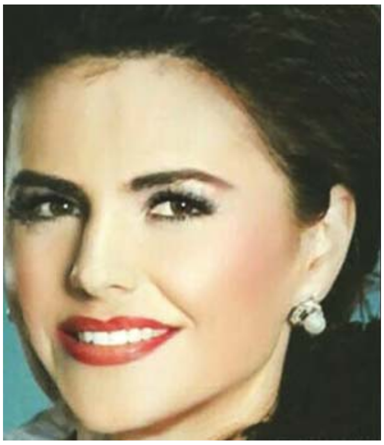
ECB POLICY IN THE TIME OF VAGUE RHETORIC OF CENTRAL BANKS



Ingrid Šabíková
Ing. PhD.,
Department of Finance and Accounting,
Faculty of Economics Matej Bel University
in BanskáBystrica,

Vlastimil Vicen
Dr.h.c. JUDr. Ing., PhD. Honor. Prof.
School of Economics of Public Administration
Management in Bratislava, Slovakia

Abstract Supervision of the financial market in Slovakia is conducted by the National Bank of Slovakia.Financial system is a part of the economic system whereby for the latter it is important the financial sector to be as stable as possible. The article is dedicated to a theoretical base of the financial market regulations and it describes situation on the financial market from short term as well as long term perspectives. Based on the method of the contents analysis and herein stated literature there have been formulated theoretical and practical conclusions.
Key words: *rhetoric of central bank, illusions growth, makroprudencialpolicy, debt crisis, financial crisis*

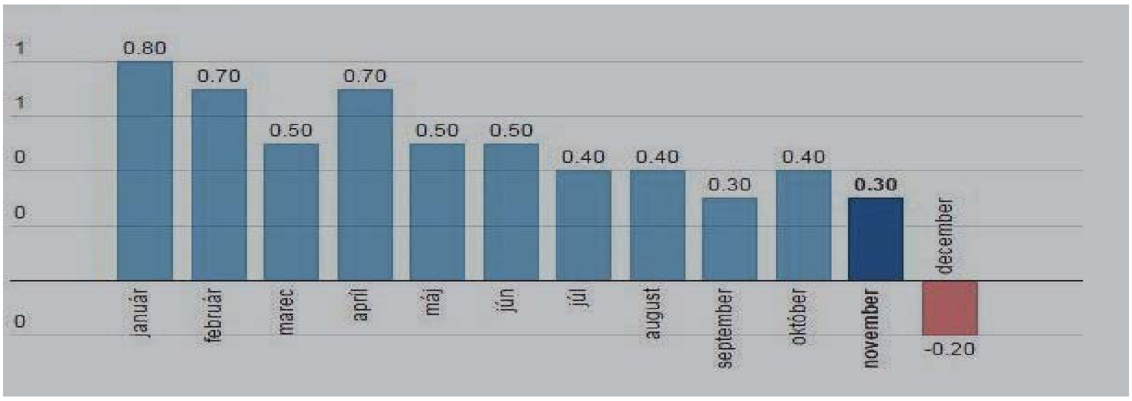
1. Introduction

There have many changes occurred on the financial markets during last few years having significant impact on the financial markets character. Supervision of the financial market in Slovakia is conducted by the National Bank of Slovakia. Slovak Republic was thus included among the countries that in terms of the institutional structure of the supervision utilized the option of the integrated regulatory body. Main reason why the NBS supervises activities of all subjects is that activities of individual subjects of the financial markets are closely interwoven and the fact of having financial conglomerates established. Regulation and supervision are interconnected in the practice. Strategy of the ECB currency policy is based on two analytical pillars – economic and monetary ones. Economic pillar is aimed at the fiscal goals (i.e. analyses of economic growth, employment rate, prices, foreign exchange rate and international trade). Monetary pillar is aimed at longer period than the economic one. Currency analysis in general draw from the wide range of currency, financial and economic data and it utilizes a whole set of auxiliary tools and techniques. Generally accepted opinion is that monetary policy can contribute to the economic wealth by maintaining of the price stability (a goal is to maintain the inflation rate measured as the annual increase in the harmonised index of consumers prices (hereinafter to be referred to as HICP) in the medium-term perspective around 2 % level and increase of the M3 monetary aggregate on the level of 4.5 % per annum).

2. The Makroprudencial Policy Bases

Stability of the EU financial system is secured on the macroprudential level executed by the European Systemic Risk Board (ESRB). ESRB task is to help in avoiding and eliminating systemic Risks for the financial stability in EU. Further, the European Board ensures cooperation with other ESFS bodies, international and national institutions. An important role of ESRF is to analyse and monitor connections between individual countries and EU financial institutions, to monitor channels through which external shocks are spread from a region to region and joint and several avoidance and elimination of risks. Since March 2015 ECB has implemented a quantitative easing of money mass into the circulation because a problem of EU countries is inflation as being depicted in the Graph 1.

Graph 1: Eurozone Inflation 2014 in %



Source: NBS as per the indicators of circumspectness on the macro-level, 12/ 2014.

Based on the Graph 1 data the consumers prices decreased annually to a minus (- 0.2 %) and Eurozone had thus first time got to deflation in 2009. Whereby an ideal level of inflation is 2 % achieving of which is one of the ECB key-objectives. Quantitative easing of the monetary policy (QE) represents a European Central Bank Strategy by the means of which the domestic economy is to be stimulated in the situations when interest rates are kept on the zero level[5]. European Central bank buys from commercial banks (and other financial institutions) securities in order to increase the mass of cash within the economy. ECB performs this in order to invigorate banks to provide loans and credit lines to businesses and to increase tempo of the economic growth. This is followed by the increased job opportunities and supported households' consumption resulting in elimination of low inflation rate. An important part of the macroprudential policy is an anti-cyclic capital buffer[3]. In the case of uncertainty resulting from the adverse macro-economic development in the EU States a role of creating of the anti-cyclic capital buffer is always getting much important. Its role is to create reserves in periods of economic growth and growth of credit markets [1]. Business as an economic subject enters into financial market when it needs funds for business or when it wishes to invest. Nowadays the Eurozone, banks upon the strict vertical regulation, must meet the capital adequacy requirements (Sheet 1). This will be reflected in the volume of loans, credits provided to businesses.

Sheet 1. Capital Requirements (CR) of Banks

Years	**2015**	**2016**	**2017**	**2018**	**2019**
CR for Core Tier 1	4.5	4.5	4.5	4.5	**4.5**
Conservative Capital Buffer	-	0.625	1.25	1.875	**2.5**
Core Tier 1 + Conservative Capital Pillow (Buffer)	4.5	5.125	5.75	6.375	**7.0**
Tier 1 Capital Requirement (bank´s own capital)	6.0	6.0	6.0	6.0	**6.0**
Own Capital requirements without a conservative buffer	8.0	8.0	8.0	8.0	**8.0**
Own Capital Requirements + Conservative Capital Buffer	**8.0**	**8.625**	**9.25**	**9.875**	**10.5**

Basel Capital Accord (Basel I) regulatory guideline set capital requirements for the banks compared to the credit risk in a minimum level of 8%. There have been new types of risks occurring on the financial markets (operative risks) therefore Basel I Guideline was replaced by the Basel II Guideline which also be proven as ineffective in time of financial crisis. And therefore it was replaced by the Basel III Guideline. In order banks to avoid problems with their liquidity and sufficient capital they have implemented conservative capital buffer and anti-cyclic capital buffer. Conservative capital buffer equal to 2.5% shall be applied by banks in the case of possible adverse future situations. Anti-cyclic capital buffer is supposed to be applied at the level of 0.625 % [2].There is a requirement an anti-cyclic buffer to be applied in countries with extra high debts (not meeting the fiscal pact, increased debt of EU countries). In the case of risky countries (high rate of debts growth exceeding 60% for instance Italy) there shall be applied an anti-cyclic buffer at the level of 2.5% and their total capital requirements can reach up to 13%[2].Concept (Regulatory Guideline) Basel will lead to the further increase of the capital adequacy of banks. Stricter requirements on increased capital adequacy of banks will cause the banks will reflect their capital increase into the price of loan, credits or banks will reduce the volume of loans provided to their clients. Loans will become inaccessible for the businesses and in the future this can lead to slump of their business activities and to the depression. Regulatory measures of the Eurozone´s Central Banks will most likely cause limitation of credits in the real economics. Decrease in loans will lead to the decrease in the production and GDP, decrease of GDP will cause slowing and decrease of the economic growth.Commercial banks obviously will not be willing to accept the pressure from the excessive regulations. *Excessive regulations result in general cycling of the economic system.* Eurozone Banks should first of all be on the side of the entrepreneurs and businesses and support their business and investments.

Stability of the financial sector is an inevitable assumption of healthy real economy and its functioning. Stability will depend from the development and course of the fiscal consolidation within the EU countries. The major problem is not adhering to 2% inflation rate and increasing debt rates in the Eurozone countries. By its *Decree No. 8/2016, since January 2016, NBS has set an anti-cyclic capital buffer on the level of 0%.* Similarly the NBS Banking Board as the first among the Eurozone countries approved (on October 25, 2016 with the effective date as of August 1, 2017) an anti-cycling capital buffer to be generated on the level of 0.50 %. Anti-cycling buffer is to be mandatory generated in countries with excessive debts (not adhering to the fiscal pact – EU countries´ debt increase to 60 %). Based on the herein stated data we suppose that strict regulatory measures applied by the ECB and individual central banks can most likely cause two scenarios in the economic sector – *either* the commercial bank would stay on the financial markets with an increased sufficient capital and with having so called buffers generated at the expense of the customers; *or*commercial banks will not be willing to accept the strict pressure and strain resulting from the regulatory measures and their financial activities start to be moved to so called “shadow” banking, what at the end can cause deeper instability of the financial market. ECB regulatory measures will affect decisions made by banks and economic subjects too. Strict ECB regulatory measures will cause the banks in general will increase their own capital and this will be reflected in the increased fees, growing prices of loans and financial products at the financial market.

3. Ineffective ECB measures

There is an uncertain situation on the European financial market. Before EURO currency has been introduced each EU country had a task to meet strict convergent criteria. In 2008 Eurostat confirmed Slovakia had met the Maastricht criteria - inflation rate 2.2%, public finance deficit 2.2 %, public debt 29.4 % of GDP and an average long-term interest rate 4.5%. Slovakia´s entry into the Eurozone was definitively acknowledged on June 20, 2008 and Slovakia has implemented EURO currency since 1.1. 2009. How has the situation changed since then? European Central Bank (ECB) is a central bank of the Eurozone countries incl. Slovak Republic. ECB avoids a low inflation rate and applies policy of cheap money (quantitative money mass easing - release into the circulation – abbreviated QE – Quantitative Easing)[5]. Euro is not a gold-backed currency and ECB is the one deciding on the cheap money tool (QE). A Bail-In Act - system for the banks salvation has been valid in the European Union since June 27, 2013. The first „Bail in“we could see in Austria where this Act had been applied first. The Slovak Republic implemented the Bail In into the Act No. 371/2014 of the Coll. on resolving critical situations on the financial market. Implementation of this institute in the practice means that should the financial market stability be jeopardized (insufficient capital adequacy of the banks) the banks stop guaranteeing the deposit guarantee schemes for the consumers and they waive their liabilities and responsibility to the clients. In other words we can lose our money one day. Eurozone´s problem is the banks have been hiding billions of losses caused by the bad debts, loans most of all those provided by Italian banks - in amount of approx. 360 billioneur. Other problem the EU countries face to are the increasing sovereign debts (especially that of Italy equal to about EUR 2 trillion). According to the Slovak Ministry of Finance the public debt of Slovakia reached 53.1 % in 2016. Whereby at the end of 2019 the gross debt should decrease and be equal to 48.7 % of the GDP. At the same time if we add debts currently generated from the PPP Projects (they are included into the balance sheet of the public administration only upon having the toll paid) to the sovereign debt we are approaching the fiscal pact margin at the level of 60%. Nevertheless, if the Eurozone countries breach the fiscal pact and the public debt exceeds margin of 60%, countries will be forced to generate additional reserves again and the banking institutions (banks) will have to increase the requirements on their capital adequacies. It is obvious that the prognosis of the fiscal development in Slovakia as well as in EU is not positive and this has been confirmed by the fact that the National Bank of Slovakia (NBS) which apart from the monetary issues has been conducting also a circumspection policy on the macro-level. On October 25, 2016 the NBS Banking Board as the first within the Eurozone approved – with the effective date as of August 1, 2017 – the anti-cyclic capital buffer to be at the level of 0.50 %. Indicator of the anti-cyclic capital buffer reflects the fiscal situation resulting from the financial system stability[3]. In other words, NBS generates sufficient additional reserves in advance (in good times) and these are to be used to cover losses occurred in the future (in the crisis). That means, the government tries to fill-in the buffer in good times and this filled-in buffer will be spent (emptied) in bad times. Other problem of the EU countries is the fact that the sovereign debts have been increasing faster compared with the GDP growth. Again, the cheap money policy supports so called reverse course when the mass of cheap money in the circulation - quantitative easing (QE) supports neither inflation objectives nor real economy. There are no doubts about situation in the EU being complicated and leading to the cyclic economic system.

3.1 The Debt Crisis Versus Economic Growth

Stock exchange markets have always been sensitive on the illusions occurrence. Recently there can be some illusions observed on the US stock exchange markets. One of them is the US President Donald Trump and his political style and his businessman´s negotiating abilities and capacities to make the USA again the most powerful country of the world in time, when the USA have been – in the ranking of the completely democratic countries – ranked among so called imperfect (defective) democratic countries. Other illusion is represented in the value of the US Dow Jones Index. An average value of the Dow Jones index reached its historical maximum (21 thousand points) after having the new US President elected. Stock exchange index is affected not only by the behaviour of the businesses but also by the political events (war) and natural disasters. Recently, the US economy has followed a policy of having total inflation at the level of 2 %. That means the FED´s objective is to reach an annual growth in 2 %. Moreover, there is an increasing pressure from the European Central Bank (ECB) to tighten the monetary policy and achieve increase in prices and this can cause the policy of cheap money – QE to be terminated. In present time we can see the policy of cheap money (QE) is not helping the real economy as being expected and sovereign debts of the EU countries keep growing faster compared to the GDP growth.

Problem of the cheap money policy is that the money pumped into the economy are accumulated in the hands of wealthy people and financial groups and their wealth is then growing. US President Trump realizes this and therefore he tries to apply tax cutbacks and corporate taxes decrease in order to increase private investments. One of the wealthiest men in USA - and former Minister of Finance Andrew Mellon – promoted decreased taxes for the wealthy men in the past because he believed that success of wealthy men also helped to poor ones. Simply said, the inflation occurs as a result of economic imbalance. Increasing inflation represents devaluation of the currency resp. Decreased purchase power of the money. A high inflation causes deformations on the market and results into the uncertainty. Contrary, zero inflation is an unexplained issue and it is subject of many expert discussions. Current Eurozone´s problem is increasing sovereign debt especially that of Italy, France - debt crisis. A trigger of the economic, financial crisis can be a debt crisis in China, corporate bankruptcies in USA or financial instability of Italy (Italian banks bad loans, credits in amount of approx. EUR 360 billion, accumulated debt in amount of EUR 2 trillion). In period of increasing global uncertainties, conflicts, global migration, climatic changes, technological growth and uncertain situation at the financial markets we may expect to have less work and most of all less space for quality life and life itself[4]. Less work and intensified illusion will cause social uncertainties and decrease in standard of living.

The pressure the European Central Bank(ECB) makes on implementing a stricter monetary policy and achieving a price inflation rate of 2% has become more intense and it results into an ending of Cheap EU funds policy. Increased inflation causes devaluation of currencies and their lower purchase power. Etymology of the word “inflation” is in a Latin word „inflare“ – that means to increase or to inflate a mass/volume. A Zero inflation is an unclarified issue and it has been a subject of many expert and professional discussions. On the other side, a high inflation rate has been causing market deformations and followed by uncertainty on the financial markets. Price levels are measured by the means of price indexes – Consumer price index, Producer price index, GDP deflator. An annual price inflation rate in Slovakia measured by the Consumer Price Index (CPI) increased to 1.7% in October 2017. According to the European Central Bank (ECB) estimations a Eurozone inflation rate should reach 1.4% in 2017 and 1.5% in the next year whereby Eurozone's GDP growth is expected to be 1.5% in the years 2017-2019. The problem the Eurozone is currently facing to is an extraordinary growth of public debts (i.e. debt crisis). Further, increasing political expectations for implementing anEurope-wide taxation are not good indicators concerning the anticipated EU countries’ economic growth[9].

Economists and media have been currently associated the term, expression “bubble” with real estates and stocks traded on the global financial markets and being excessively overpriced circa in 9-16%. This trend of inflated prices has been ongoing in the USA, Canada as well as in EU countries. A recently published IMF (International Monetary Fund) Report on Global Financial Stability, October 2017 even sets a prognosis of next financial markets crash to take place at the beginning of 2020 and it shall consequently lead to another economic crisis[8].

Triggers of an economic and financial crisis will be first of all: debt crisis in EU, USA and China, inflated prices of real estates and stocks in the global stock exchange markets, unrealistic expectations of the EU representatives (an expected doubled budget), financial instability of EU countries like Italy, Spain, Greece, BREXIT and stricter regulation of the Central Banks’ monetary policies. Yet the International Monetary Fund (IMF) considers a vague resp. New rhetoric of central banks to be a main trigger of the financial crisis as a consequence of risks existing on the financial markets [7].

Nowadays we can see how public debts of EU countries have been growing faster than their GDP. Then money pumped into the EU economies (by the means of QE instrument) end most of all in the hands of rich individuals and financial groups that have been accumulating the wealth and concentrated it in one spot. Private investments are another crucial issue the ECB has concerns about and therefore it searches for an instrument to be used for pushing the private investments to support real EU economics.

In time of increasing global risks like migration crisis, climate changes and vague rhetoric of central banks a man can expect there will be less space for a quality life or life itself. Pressure put on politicians in terms if expectations and stricter regulations applied by central banks will cause social insecurity and upheavals or riots. This situation is also depicts in the „Global trends 2035“ document in which there are expressed worries of a dark future, risks of increasing polarization and worsened social and economic situation of the global world. An Indicator of the uncertain situation on the global financial markets is the fact the market has been again searching a safe anchoring in GOLD (precious metals and gemstones) value of which has been growing continuously

Conclusion

We pointed out to the regulation of the EU financial market during the period of uncertainty and reviewed an impact the regulation of the financial market has on the economic subjects[5]. In the period of uncertainty there are following risk factors – intensified globalization, weakened Euro currency and increase in illusions. There has been a new framework of critical situation prevention and resolving applied on the financial market[6]. The Council for resolving of critical situation and Fund for collecting monetary contributions from the selected institutions. In short-term perspective the banks in Slovakia are stable. In the long-term perspective the stability of the Eurozone´s financial sector is questionable[7]. Strict ECB regulatory measures as well as decisions made by the Eurozone´s central banks will be crucial as these will be subsequently reflected into the decisions made by the commercial banks, businesses as well as consumers. Nevertheless, the inevitable assumption for having the stability of the financial sector secured will be positive Eurozone economic development in medium and long-term perspectives, which is questionable too. Stability and regulation of the Eurozone´s financial sector in medium and long-term perspective will depend on the development and course of the fiscal consolidation and structural reforms. A crucial problem of the Eurozone is not adhering to 2% inflation rate and persistent increase in EU countries´ debt. Serious problem is related with the labour market both in term of the persistent unemployment of young people as well as in terms of the labour taxation itself (high taxation of the labour). Another major issue is also pertinent trend of increasing debts of households, businesses, government and self-governments. A recently published IMF (International Monetary Fund) Report on Global Financial Stability, October 2017 even sets a prognosis of next financial markets crash to take place at the beginning of 2020 and it shall consequently lead to another economic crisis[8].An Indicator of the uncertain situation on the global financial markets is the fact the market has been again searching a safe anchoring in GOLD (precious metals and gemstones) value of which has been growing continuously.

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