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Monetary Policies and the Economic Growth.

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Abstract: *Talking about the economic growth, is to be stressed the essential contribution of the investment to a country economic development, role which is unanimously recognized and accepted. It is well-known that even the most developed market economies were built up with notable investment efforts, in order to enable a high efficiency of the fixed assets and to ensure a rational use of the natural resources and of the labour force. The investment process is mainly conditioned by the imprevisible action of certain elements, both immanent to the economic system and exogenous to it, as well, such as: technology, politics, optimistic and pessimistic forecasting, population confidence, taxes and government expenditures, monetary base fluctuation etc.*

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Nowadays, the economists are facing with great troubles. "Why can't you tell how long will last this period of crisis? Why don't you put together on what should be done?" There are only two of the concentric fire missiles' they have to cope with.

Cause of the human and social behaviour's complexity, macroeconomics can not pretend the precision assigned to the exact sciences, this is the answer. We can not carry out the controlled experiments of chemist or biologist, which once formalized they get a general applicability. The same as the astronomer, the economist has mainly to confine himself to observe. But the economic phenomena and statistic data have, unfortunately, on neither side, the accuracy of the heavenly bodies' trajectory.

But if the *just direction* of the economic "events"` causes and events (possible, happily to be determined) is perceived, this is a huge step forward.

One of the most important macroeconomics concept there is *the economic growth*, whose anatomy and evolution are indispensable for understanding and influencing of unemployment, inflation, final product (materialized, usually, from more recurrent elements point of view, in GDP), a nation welfare, in a single word.

All these above mentioned affect the day by day life, respectively the easiness/difficulty to be employed, to change the actual job with a better one, to be promoted or the interest rate level applied for loans/paid for deposits and also the degree to which the purchasing power of the incomes achieved by the economic effectors is eroded by the prices growth, in other words.

Talking about the economic growth is to be stressed the essential contribution of the investment to a country economic development, role which is unanimously recognized and accepted.

It is well-known that even the most developed market economies were built up with notable investment efforts, in order to enable a high efficiency of the fixed assets and to ensure a rational use of the natural resources and of the labour force.
Otherwise, stepping over the extensively development stage (inherent for the evolution phase of any economy), there is the efficiency use of production factors which induced the competitivity disparities acting today in the world.

Though the economic theory concerning investment is fine tuned, the lack of a general theory regarding transition and emergence (of course, next to other endogenous and exogenous factors) conveyed to several inexperienced measures taking, with adverse effects on the overall evolution of the Romanian economy.

The dramatic shrinkage of investments, in the first years of the transition to the market economy, induced the GDP decrease – total and per capita – which was scarcely recovered after one and a half decade. The consequent effects on life standard are well-known and were felt by the most part of the Romanians.

A little digression: companies are in the middle of a revolutionary changes. Competition, as it was known within industrial era is transforming into specific competition to informational era. During the industrial era (approximately from 1850 to around 1975), companies were successful according to the degree they could turn to account the benefits stemming from industry peculiarity and from the scale economy. Technology had itself importance, but at last, those companies succeeding in including new technology in tangible assets able to generate the efficient, mass output of standardized products, were successful.

The emergence of informational era, in the last decades of XX century, put many fundamental conditions of competition within industrial era, in a cone of shadow. Therefore, companies were no longer able to gain a steady advantage only from rapid implementation of new technologies in fixed assets and from an excellent management of financial assets and liabilities.

Informational era surroundings in which act, both economic entities from production and from services area, as well, urge the necessity of other capacities in order to get the competitiveness success. A company's ability to mobilize and to operate its intangible or invisible assets has become much more important than investment in fixed, tangible assets and their management, as well. The intangible assets allow a company to:

- develop PR with the customers in order to maintain the existing customers` loyalty and to permit the efficient and effective service of a new segments of customers and market areas, as well;
- introduce innovative products and services required by target segments of customers;
- create individualized, high quality products and services with less costs and time;
- mobilize the employees' abilities and motivation to continuously improve the capacities, their quality and responding time within the business processes;
- use technology, data bases and IT systems.

I was saying, thus, that the indicator chosen (by convention used by all analysts) to materialize and to measure the economic growth is *gross domestic product* (GDP). [1]

This exposition is focused on total expenditures, as they are determined by the interaction of the monetary and fiscal vectors, mainly represented by saving and

investment. A peculiar feature of saving and investment is that they are made by different entities (either individuals, or companies or government) and with different reasons.

Net capital formation (investment) is mainly effected by companies. At the same time, saving is prevalent for another category: individuals (understood as sum of households).

A person may want to save for a variety of reasons: to enjoy oneself for a quiet old age; for a future expense (holyday, a car and so on); for bequeathing to his children or grandchildren; or perhaps out of habit, become almost a conditioned reflex whose origin he doesn't know even himself.

But whatever would be the individuals' motivation to save, it has little in common with the real investment process.

This truth is concealed in the day by day speaking, in which "to invest" hasn't always the same meaning as in macroeconomics. From economic point of view net investment is defined as the net increase of the society real capital (equipments, buildings etc.). In common language is used the expression *"to invest money in something"*. That means that what a person buys, another one sells. In these cases there is no net investment, which assumes a real capital addition.

The investment magnitude is much different itself from a period to other. This volatile behaviour can be easily perceived when we'll be able to understand that a profitable investment is subject to *new* discoveries, *new* products, *new* resources and *greater* output and incomes.

The investment process is mainly conditioned by the imprevisible action of a certain elements, both immanent to the economic system and exogenous to it, such as: technology, politics, optimistic and pessimistic forecasting, population confidence, taxes and government expenditures, monetary base fluctuation etc.

The independence of the forces operating on saving and investment is alike as of the forces acting on supply and demand. Once we recognize this independence, we have also to accept two qualifications:

- most frequently, at the level of a company, the decision to invest is strongly related to the availability of own funds allotted to this aim;
- in any period, peculiarly when the credit is "tight" and interest rate has an considerable climb, the possibilities and the desire to invest are subject to available financing from the individuals savings.

As the independent forces acting on supply and demand are "kept on a tight hand" by the occurrences on the prices "market", the same as, the saving and investment decisions are controlled and influenced by what happens at the level of income (fiscal policy domain) and of monetary base → money supply → interest rate (monetary policy attribute).

The different economic schools representatives' dispute becomes sharp when the pre-eminence of one or the other of the two economic policy major components is discussed.

Leaving place other time for detailing this delicate topic, let's see how monetary policy is acting on economic growth.

Little components of the economic policy are so, as important for the welfare of a nation as monetary policy. Its acting field consists of the terms and conditions money and credit are supplied to the economy.

It is worth to be mentioned that monetary policy is neither a scope itself, nor an universal panacea. In the very moment the general expenditures are too large thus

allowing prices to have an inflationist trajectory, monetary authority (central bank) will shrink the growing rhythm of money supply (*draining reserves*). If unemployment has reached alarming levels and investments are languishing, the sense of the central bank action will be reversed, it operating to expand the money supply (*liquidity injection*).

In its approach to the scope, National Bank of Romania (NBR – monetary authority) disposes of more instruments, out of which:

- *open market operations* – the purchase or sale of governmental titles;
- minimum reserve requirements (MRR) – acting to adjust the demand for reserve money (high powered money). Banks are bound by law [2] to keep in accounts with National Bank of Romania a certain level of reserves. The existing MRR sustain the relation between the volume of banks' reserves and deposits, as part of money supply. This mechanism is very used by the countries facing with a high budgetary deficit. The other "mission" of MRR regime is to protect the deposits of the banks' customers. The main advantage of MRR is that it is unitary set on all the banks and has a strong impact on monetary aggregates, as well;

And moreover: 25% level of minimum reserve requirements for deposits in Euro settled by National Bank of Romania (monetary authority, which by its preeminent goal – to ensure the prices stability – contributes to the attempt of maintaining Romanian economy equilibrium strongly dismayed commercial banks cause this percentage affects their cost of resources and implicitly their profit margins. Today having been confronted with massive withdrawals of Euro, the banks tacitly agree this level of MRR.

- *discount rate* paid by banks when they borrow from NBR is the instrument which can influence the access of the deposit money banks to supplementary resources (reserves). By comparing the interest rate paid to NBR with the interest rate charged for their placements, commercial banks will decide how much they'll borrow. When the inflation rate is high, discount rate is also used for maintaining a positive interest rate in real terms.

A negative interest rate in real terms occurs when the nominal interest rate doesn't match inflation rate. Such an interest rate gives advantages to debtors and induces the decrease of population confidence in the national currency.

It is well-known that interest rate is the heaven key of the monetary policy conducted by the central bank, rejoicing itself at a great attention paid by al the macroeconomic decision makers.

Not only the economic theory, but also the realities from economy show that as much as salutary could appear the negative interest rate in real terms, they foster the dysfunctions from economy and waste and stimulate inflation, as well.

One of the fundamental hypotheses of the financial equilibrium is that the saved resources to be able to match the credit demand. And that because behind money supply there are real resources such as raw materials, output capacities etc. When the savings (of individuals and companies) decrease that means the real resources the former are backed on are depleted, they can't any more be redistributed through credit. That's why the general economic equilibrium and that financial, as well presumes the macroeconomic decision makers are concerned to correlate as much judiciously as possible the resources supply, from the potential creditor with the resources demand from the potential debtor.

Here it is the problem of the relationship between the nominal and real interest rate. Nominal rate – stated in the credit contract – represents, in essence, the nominal price paid by the debtor for the right to use the temporarily available monetary resources of the creditor. But if the inflation rate is higher than nominal interest rate, the creditor will find out the purchasing power of the reimbursed amount (altogether with the interest) is smaller than the amount he lent. By the other hand, the debtor will pay back – in real terms – less than he received. It's impossible in these conditions an equilibrium between supply and demand, because there is no doubt, no one is stimulated to save anymore, on the contrary, all being willing to consume. As minimal condition, the equilibrium recovery presumes that the one saving to can preserve the initial purchasing power. This fact may happen only if the savings (whatever would be their provenance) are positively remunerated. As naturally today the nominal wage increase isn't measured any more, but only the purchasing power of the available incomes, it is the same rationally that only real interest rate to be analyzed. Namely the difference between nominal interest rate and inflation rate.

Only in relationship with the real interest rate we can issue valuable judgments regarding a "reasonable" or "exaggerated".

It is also important to say a real terms negative interest rate means that the one who is saving pays to whom borrows.

It is thus created a counterproductive redistribution of the resources, losses of the inefficient companies being supported from the savings of population and of profitable organizations, in other words. Just the one who is a good manager and saves, supports from his work and gains the inefficiency (otherwise, the incapacity of some debtors to size the expenses to their resources). This anomaly (to practice a negative interest rate in real terms) could involve some of more harmful effects to economy.

In this way a strong increase of credits demand could be induced, simultaneously with a marked decline of the credit resources supply.

In the second time, directly affecting the goods production, abnormal economic behaviours could be stimulated: overstocks, output without any demand, as well.

In the third time, investments could be discouraged at least through two ways: generating saving decline, by one hand and creating an inflationist environment which induces a high degree of uncertainty regarding any project, by the other hand.

Also, the capital owners are tempted to make deposits in hard currencies (which are not depreciating in real terms) in the attempt to protect the purchasing power of the money they have. The supplementary demand for hard currencies thus created, will increase the pressure on the national currency parity and consequently amplifying the inflationist depreciation.

Finally, and on long term this is the most important vector, real negative interest rates don't permit an economic criteria based on hierarchy (toward the most profitable sectors or activities), that obstructs the competition (the principal superiority element of the market economy) to freely manifest.

If credit is necessary for economic entities, peculiarly when the own funds are not enough to put in force different projects, the same true is a prudential attitude of debtor is required in order to permit an efficient use of the borrowed resources, namely a reasonable profitability which enables him to reimburse in due time the principal and the interest and to gain a profit, as well.

There is the proper place to make some remarks, in the case of Romania, related to the opinion (becoming more and more beloved by inexperienced people) in accordance with (taking into account the peculiarities of Romanian economy which suffers, yet, from an inadequate sectors' structure and from an obsolete technology) a preferential crediting policy (and I'm not referring here to the normal facilities – one or two percent for interest rate and smaller fees, as well – given to the prime rated customers) should be applied.

Differentiating the interest rates in accordance with the sector the credit applicant belongs to is a wrong practice from more reasons: besides it distorts the normal process of resources' allocation, this practice stimulates resources' distribution just toward less profitable sectors and at the same time lowers the companies' interest for capitalizing. It is unfounded the opinion to which a great part of resources will migrate to commerce, domain having a high profitability and an accelerated velocity of inventories. This sector will attract funds only within social need limits revealed by solvent demand.

More over, this differentiating assumes that for the same service offered by different banks, different prices are charged, what denies the price reason to be and shrinks the interest of banks as intermediaries of this process, as well.

But there is a viable solution in accordance with the rules of market economy: Government. Subject to it economic priorities and to available funds, Romanian government has the competence to subsidize the interest rates for certain domains, considered as priority. In this way the mechanism transparency is in force and the real costs of this option are precisely known.

As easily we can see from the information of below table, credit is having a constantly ascendant trajectory, trend which continues its evolution from the previous period, not comprised into analysis. The explanations are given by the features of the Romanian economic environment and a little digression is welcome.

Romania has an emergent economy what also implies, for an attentively analysis, the peculiarities of the transition period to the market economy to be taken into consideration. The comprehensive essence of that period was the appeal to flexible prices and to the free market in order to reconciliate the goods and services supply and demand and to a rational allocation of restrictive resources.

- Millions lei, Euro; - end of period -

Year	Total	out of which			
		Companies	Individuals	Currency	
				Lei	Euro
2004	46.915	42.243	4.006	13.280	23.330
2005	65.577	53.841	10.284	24.126	33.035
2006	105271	79.167	23.473	45.574	52.230
2007	167.957	113.244	50.348	65.547	89.416
2008	229.005	145.525	77.523	82.195	127.681
2009 August	226.708	143.408	77.794	80.277	128.727

Table 1. The evolution of credits granted by banks [3]

The state giving up the direct control over the supply and demand within the principal economic sectors didn't bring from the beginning the desired effect on the economic entities. These hadn't succeeded, for a while, to ensure the adequate use of the production capacities.

Romanian industry structure, having large primary and secondary sector, hadn't necessarily reflected, the competitive advantage, too. The machineries, installations, equipments were to a large extent, inefficient and unproductive. All these reflected, at the beginning of `90 in the last century, on the skidding of the main macroeconomic indicators.

Hardly at the end of the mentioned period, has GDP constantly begun to increase on healthy basis. The recovery has started. Investment multiplier has taken magnitude year by year. But this process implies funds of equal amplitude also. Own funds of the economic effectors were and are not by a long chalk sufficiently.

This is the direct explanation of the credit spectacular ascension and of its massive share within overall banking placements, in Romania There is also an indirect explanation: the insufficient, still, development of the financial market which can not offer, for the time being, a diversified and attractive range of derivatives products to the investors.

As far as economic growth is concerned, its next three years horizon, according to a SWOT analysis, will be influenced by:

- The main weak points of the productive sector consist in a too large weight of the reduced value added sectors and in a limited scale of the industrial base both from qualitative and quantitative point of view. This is a major challenge, Romania being faced with two parallel risks:
- increasing competition from China and South-Eastern Asia countries regarding law cost sectors and those claiming large labour force;
- economic crisis within EU – its principal export market – what delays the development of a sophisticated sector, the demand being already saturated.

Strong points:

- Romania disposes from some natural advantages insufficiently exploited by now, but having a great economic growth potential. There are here included primary sector (agriculture and silviculture), food industry and very attractive touristic zones as well, both in urban and rural areas;
- turning to account its internal human resources Romania has developed a strong IT industry;
- Romania still has *a good system of education and research* and its *labour force has on average a high educational level*.

References

1. GDP = C + I + G + (X - Im), where:

- C = Consumption
- I = Investment
- G = Government expenditures (the transfers are excluded)
- X - Im = net difference between exports and imports

2. According to NBR regulations, banks are bound to keep a specific level of reserve settled by computing a certain percentage on the total of deposits with the banks. Starting with the application period 24th November – 23rd December 2009, the level of required reserves is 15% for deposits in lei and 25% for hard currency deposits

(Euro). The interest rate paid for deposits in lei is 3.36 % p.a., respectively 1.26% p.a. for deposits denominated in Euro.
3. Source: the data were processed from NBR Monthly Bulletin nr. 8/2009.
Notice: within table columns I didn't include the item "other", that's why adding values of "out of which" columns, it doesn't match the total.

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