THE CONFERENCE "BUILDING MARKET ECONOMIES IN EUROPE: LESSONS AND CHALLENGES AFTER 25 YEARS OF TRANSITION",

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GOVERNOR MUGUR ISĂRESCU'S INTERVENTION AS CHAIRMAN OF THE PANEL "THE FOUNDATION: MONETARY AND EXCHANGE RATE POLICIES"

Ladies and Gentlemen,

I am greatly honoured by the invitation to chair this panel, all the more so that monetary and exchange rate policies stand out as a very relevant topic, always high on the agenda of a central banker. Talks on this matter are more than welcome, since the lessons and challenges of the past 25 years – the underlying theme of this year's conference – have been quite numerous. Nothing seems to be set in stone anymore, no matter how many textbooks and research papers are written – and there have been quite a few!

And since we are speaking of the past 25 years, I cannot help remembering that in the early nineties, when I took over as Governor of the National Bank of Romania, a tremendous effort was needed – not only in Romania, but in the other former communist countries in Central and Eastern Europe as well – to put into practice the transition from a monobank-type system to a two-tier system. The effort was even bigger (herculean, I would dare say) in a country like Romania, where – after the attempts to implement some reforms in the sixties and seventies – the economic and financial system had become ever more centralised, more Stalinist-like in the final decade of the communist regime.

In hindsight, now that things have settled, the transformations of the time may seem like a piece of cake, but please try to imagine how difficult it was to take the reins of an institution that had operated in the context of centralised state planning of the entire economic activity – to which added, of course, the inexistence of any trace of monetary policy – and to separate commercial banking operations (which were taken over by *Banca Comercială Română*, later part of the Erste Bank group) from central bank operations, which remained the responsibility of the National Bank of Romania. The "parting of the waters" occurred pretty quickly, but the new NBR only counted less than 5 percent of the former central bank employees, most of them in the cash management and accounting units! Therefore, we had to build from scratch several departments that are key to the functioning of a modern central bank, such as monetary policy, economic research, banking supervision and regulation...

Back then, in the early nineties, monetary strategies based on a nominal anchor (be it the exchange rate or a monetary aggregate) still prevailed, while in terms of exchange rate arrangements almost two thirds of countries worldwide had some form of managed float.

However, there were some sweeping changes pretty soon. Monetary targeting fell into oblivion by the end of the decade, for reasons of a break in the relation between monetary aggregates and inflation, whereas inflation targeting gradually became the monetary policy framework in most countries that did not have fixed exchange rate regimes in place. As a matter of fact, Mishkin and Estrella had wondered, as early as 1996, "Is there a role for monetary aggregates in the conduct of monetary policy?" in an article that stirred heated debates. "Not really", was their conclusion. And at the time exchange rate arrangements moved towards what Stanley Fischer called "corner solutions". Fischer looked upon this trend as a response to the impossible trinity amid free capital movements.

But the change in the views on monetary policy and exchange rate did not stop there. In the aftermath of the global financial and economic crisis, inflation targeting is put to a difficult test: it will have to rely more on its flexible component, be it constrained, in order to be successful in an environment where financial stability calls for increased attention. As regards exchange rate arrangements, the "managed floating plus" concept (introduced by Goldstein in 2002, the year when the Argentine currency board collapsed) has gained increasing recognition among theorists and policymakers alike. A „managed-floating plus" regime is deemed as the most suitable policy regime choice for an emerging-market economy involved in the global capital market as it combines the managed float part, allowing for FX market interventions in order to smooth out excessive volatility, with an inflation targeting monetary policy strategy and an active pursuit of measures to limit the degree of currency mismatches in the economy. It is safe to assume that theory and practice have moved full-circle: from managed float to corner solutions and back again.

Aside from monetary and exchange rate policies tailored to the current economic and financial context, the non-euro area EU Member States that do not have an opt-out clause need to define their path towards the Eurozone. A few questions are mandatory in order to shape a balanced and coherent vision: How long should the trip last? How can hurdles be overcome and risks minimised along the way? How safe are the possible shortcuts?

Let me briefly address these issues by starting from the observation that in the five countries which joined the European Union in 2004 or in 2007 and which have not yet adopted the euro, namely Bulgaria, the Czech Republic, Hungary, Poland and Romania, the nominal convergence criteria have either been met or are within reach. Nonetheless, the authorities in the aforementioned countries do not contemplate a quick euro area accession, but are rather in favour of a wait-and-see approach. With the exception of Romania, they currently do not have a target date for joining the euro area.

This state of affairs may appear paradoxical, given that, shortly after these countries' accession to the European Union, their euro adoption target dates were very ambitious, despite the scant progress at the time in fulfilling some of the Maastricht criteria. In fact, the more cautious stance currently prevailing is indicative of a substantial shift in approaching the euro changeover as a whole rather than of the inability or difficulty to comply with the reference values of nominal convergence criteria. Prompted by some of the euro adoption benefits becoming less obvious, to which added the increasingly evident costs, the approach has gradually shifted from plain compliance with the Maastricht criteria to choosing the best timing for switching to the single currency.

Prior to the outbreak of the global financial and economic crisis, the prevailing opinion was that meeting the nominal convergence criteria, as laid down in the Maastricht Treaty, was enough – or almost enough – to join the euro area. Even though the same Treaty mentioned the achievement of a "high degree of sustainable convergence" as a prerequisite for euro adoption by an EU Member State, it was only after the global crisis hit that everyone realised that fulfilment of the Maastricht criteria does not necessarily guarantee a country's economic success within the single currency club. In this context, the approach relying on the "bigger picture" of the economy – such as that provided by the Macroeconomic Imbalance Procedure Scoreboard – gained ground, with much higher importance being attached to real convergence criteria.

These topics stir heated debate, which will rage on for some time to come. Conferences such as the one we are attending are a great opportunity for particularly fruitful discussions, because the clash of ideas between theorists and practitioners will foster not only the clarification of concepts, but also the problem-solving in defining economic policies. This being said, I give the floor to Ms/Mr... .

SOME CONCLUSIONS

I would like to thank you all for the interesting presentations!

This being said, it seems obvious that, regardless of the objectives and rules set for monetary policy formulation and implementation, they should not be pursued or applied mechanically. A central banker cannot afford to live in an ivory tower; quite on the contrary, he needs to keep informed at all times of the latest developments and trends economy-wide and in the financial system. Such an approach should not be assimilated to promoting a discretionary stance, but rather to a solid anchoring in the day-to-day realities, which often prove more complex than imagined by policymakers or theorists.

Hence, the benefits and drawbacks of any theory need to be carefully weighed in the context of the peculiarities of each national economy. Please allow me to say a few words about the case of a country which I know very well: Romania. The National Bank of Romania shifted to inflation targeting in 2005, a few years before the outbreak of the global crisis. I will look upon my country's experience from the perspective of rendering the monetary policy framework more flexible by taking into account the importance of ensuring financial stability.

Opting from the very beginning for a light version of the inflation targeting strategy, the National Bank of Romania focused on the medium-term achievement of the pursued objective rather than on the fulfilment of each annual inflation target. In so doing, we sought not only to ensure the sustainability of the disinflation path, but also to avoid the widening of macroeconomic imbalances and the build-up of risks to financial stability. The approach was warranted by the peril of overheating of the domestic economy, especially via the quick-paced expansion of foreign currency credit, at a time when the massive capital inflows generated by the capital account liberalisation and by the forthcoming EU accession triggered nominal appreciation, excessive current account deficits and increasing currency mismatches of bank assets and liabilities. A disorderly correction of the external imbalance would have implied not only the risk of considerably higher inflation, but also of a significant economic downturn and a more fragile financial system.

Such a context called for the interest rate, which is the key monetary policy tool available to an inflation targeter, to be complemented by instruments of a different nature as well, ranging from differentiated minimum reserve requirement ratios on banks' leu- and foreign currency-denominated liabilities to moral suasion. Among these non-monetary instruments, a major role was assigned to administrative measures (also known as "unorthodox"), which – although controversial at the time – have in the meantime been legitimated by the crisis and are now part of the macroprudential toolkit.

As a matter of fact, nowadays one can no longer refer to monetary policy without paying due attention to its complex interplay with financial stability. We owe a meaningful portrayal of this reality to Jaime Caruana, General Manager of the Bank for International Settlements, who looks upon price stability and financial stability as part of the same public good which the society expects to be delivered by central banks.

Let me say just a few words about Romania's approach of euro adoption. After sharing for one year the same wait-and-see approach as the other countries I have mentioned, in the spring of 2014 the euro changeover target date was set for 1 January 2019. Such an objective – feasible, yet ambitious – acts as both a policy anchor, thus fostering coherent policy action, and a catalyst for the needed structural reforms.

The remaining years to the so-called "euro-day" constitute a reasonable period for demonstrating that the progress already made is sustainable, while also allowing sufficient strengthening of the achievements thus far. The adoption of the euro once Romania is prepared for this step – by sustainably fulfilling all requirements and criteria, not only the Maastricht ones – will enable the domestic economy to cope with the rigours implied by the membership in the single currency club.

Thank you for your attention!