THE EUROPEAN CENTRAL BANK'S MONETARY POLICY UNDER GLOBALIZATION

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Globalization has fundamentally changed many areas of modern society, such as media, culture, politics and, even more, modern finance. National financial systems have become inter-dependent and moved towards an integrated financial system on a world level. Financial markets are now increasingly globalized, information flows much more rapidly around the globe and, through the telecommunication systems, can change the expectations of market participants in a split second. The euro area is an important part of this globalized world, and the Eurosystem, as one of the major players, has in this respect a special responsibility. Stability in the euro area through a stable internal value of the euro is the only means by which this responsibility can be met and the single monetary policy can contribute to the stability of the world economy.

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1. Introduction: business, trade and financial globalization

When Marshall McLuhan has introduced in 1962 his famous concept about the world being a global village, he didn't predict how fast will advance the globalization process. Since then, globalization has fundamentally changed many areas of modern society, such as media, culture and politics. This is particularly true in the case of business activities and trade, as production and trade became globalized and companies adopted international approaches for sales and marketing strategies. The process of globalization has shaped the modern financial world and even more. The national financial systems have become increasingly interdependent and progressed to an integrated financial system on a world scale. This is a result of the ongoing process of markets and financial institutions liberalization in the main industrialized countries that has been going over the last two decades and has driven to an enormous growth in the international capital flows. Nevertheless, this is also a result of the development in the communication technologies and computers.

Financial globalization can be characterized by the development of new financial products, integration of national financial markets and clients into a global financial market, the segmentation value between financial institutions and markets, the emerging of financial conglomerates, and last, but not least, the increased importance of the institutional investors. Regarding the latter, insurance companies, investment funds and pension funds have increased their share in the capital of holdings, thus, having a larger impact on the financial markets and on the decisions for saving and investments.

In this setting, the introduction of euro was a crucial moment. The states from the euro area entered in a new era of monetary integration by adopting a single currency. The euro area economy managed to cope with the United States and Japan's economy in terms of economic power and openness. The euro zone has a population of 307,8 millions inhabitants, which is slightly bigger than the population of 287,5 millions in United States and more than twice the Japan's population of 127,3 millions. As for the share of GDP in the world GDP, USA has

21,1%, bigger than euro zone who provides 15,7% of the world GDP, and almost triple the Japan's share in the world GDP, the GDP per capita being fairly comparable (Table 1-1). Japan has the best results for unemployment rate, with only 5,4%, followed by USA with 5,8% and the Eurozone with 8,4%. On the other hand, the euro zone has an economy with a higher degree of openness than the economies of USA and Japan. The international trade, calculated by the sum of imports and the exports as a percentage in GDP is 33%, while in the US is only 24%. Moreover, since the beginning, the euro was the world's second major currency after the dollar. Thus, it is expected that euro and the monetary policy to play major roles in a globalized financial world.

Table 1-1 the real economy of Euro area, USA and Japan

	Euro area	USA	Japan
Population (millions)	307,8	287,5	127,3
GDP (share of world GDP)	15,7%	21,1%	7,1%
GDP per capita (thousands euro)	23,0	32,3	23,4
Sectors of production (share of GDP)			
- Agriculture, fishing, forestry	2,3%	1,3%	1,3%
- Industry (including construction)	27,4%	21,6%	29,4%
- Services	70,6%	77,1%	69,3%
Unemployment rate (share of the labour force)	8,4%	5,8%	5,4%
Exports of goods and services (% of GDP)	19,7	9,3	10,7
Imports of goods and services (% of GDP)	17,7	13,3	10,1
Exports (share of the world exports)	31,2%	12,4%	5,8%
Current account balance (% of GDP)	0,9	-4,6	2,8

Source**:** Eurostat and ECB calculations, 2008; IMF, *Global Financial stability report*, 2008

2. The setting for the Eurosystem's monetary policy

The most important contribution to economic growth, increasing the active labour force and the financial stability which the monetary policy of the Eurosystem may bring in this context of financial globalization is to achieve the main objective, preserving the prices stability, as it was mentioned in the Maastricht Treaty. This treaty created the foundation for the monetary policy which will help secure the price stability, generating the necessary framework in order to benefit from the Monetary Union opportunities.

For achieving the primary objective, i.e. price stability, the European Central Bank's Governing Council adopted the monetary policy strategy which is neither pure conventional monetary targeting, nor is it only direct inflation targeting, but a combination of the two. The monetary policy strategy has three important elements.

The first element is its essence, defining the price stability. According to The Governing Council "price stability is defined as inflation (measured by the Harmonized Index of Consumer Prices) of below 2%". Moreover, The Governing Council stipulated that the price stability, by this definition, must be sustained on a medium term. By specifying "below 2%" it is created an explicit superior limit of the HICP which is consistent with the price stability objective. The other two elements of the Eurosystem's strategy are what we call "pillars": the first is the prominent role played by money, and the second, is an estimation based on the price evolution forecast.

According to all evidence, the long term relation between money (money supply) and prices has been robust for the last years in the euro area. However, it is risky to mechanically adjust the monetary policy to all monetary evolutions. For short periods of time the evolutions might be

volatile and it's always necessary to analyze the causes of these evolutions in order to determine whether they are distortioned by special factors or they present serious risks to price stability.
The second pillar, beside the analysis of the monetary conditions, leads to an estimation based mainly on the forecast of price evolution and risks for price stability. This is obtained by analyzing many variables and indicators as well as using various estimations for the price evolution. Some observers mistakenly interpreted this process as an inflation forecast, which is usually the core of the direct inflation targeting strategy, and asked the ECB to publish this forecast.

3. The monetary policy in the financial globalization setting

From a general perspective, the monetary policy decisions are aimed on the financial markets and use these channels for transmitting monetary stimulus. As these financial markets have become more and more globalized, the information now flows much more rapidly around the globe and, using modern telecommunication systems, can change the expectations of the financial market participants in a split second. In this matter, Alan Greenspan commented: "the present environment for the central banks and, of course, for the private participants on the financial market, is characterized by immediate communication". Thus, in implementing the monetary policy, the central banks must consider this increase in sensibility of the financial markets regarding expectations, which is, for a central bank, one of the most important issues of the globalization process.
Considering the increasing role of players' expectations, it is most important that the Eurosystem is perceived as strongly involved and very clear about its objective: price stability. This is the monetary policy most important contribution on the expectations in today's global financial world. Inflation has clearly raised its ugly head as risk covering and high interest rates under financial market globalization. This experience was a real source of inspiration for fighting against inflation.
The euro area is an important part of the growing globalized world, and the Eurosystem, one of the major players, having a special responsibility in achieving its primary objective. Stability in the euro area, through a stable internal value of euro, is the only possibility for satisfying this responsibility and the unique monetary policy is able to maintain the global economic stability.
For such a large economic area like the euro area stability needs to be created and maintained. The euro area, unlike a small and highly open economy, can not efficiently conduct a monetary stabilization policy with a fixed exchange rate. That is why, the Eurosystem, similar to the Federal Reserve, never considered a strategy involving a fixed exchange rate. The euro exchange rate is, however, observed as an important indicator of the monetary policy in the second pillar. If the exchange rate threatens the price stability in the euro area, this threat must be evaluated, and a response is to be expected if necessary.
As for euro area contribution to the economic stability in the globalization setting, it is clear that the monetary policy can't accomplish this task on its own. The benefits derived from an European single currency are not complete unless there is an additional support from other policies, especially fiscal policy and labour policy, and if the structural reforms are continued in these areas.
In this matter, it is extremely important that member states governments to continue applying solid fiscal policies, aimed to achieve the objective of a fiscal balance close to equilibrium and even surplus on the medium run. This condition is mentioned in the Stability and Growth Pact, which ensures the long term sustainability of fiscal policies. From the Central Bank's perspective, a major reason for including this requirement in the pact was the concern that the lack of fiscal discipline will distress the Eurosystem's ability of achieving its primary objective. Thus, the Stability and Growth Pact is one of the most important guarantees that the price stability remains a cornerstone of the Economic and Monetary Union.

The biggest concern for Europe at this point is the high level of unemployment, a source of deep worries which should be dealt with fundamental measures. There is no doubt that the roots of this high unemployment rate in the EU are the structural rigidities of the labour and the strict legislation regarding the market products. Moreover, taxes and redistribution policies obviously play their part. It becomes obvious that the structural problems must be dealt with structural measures, even if structural reforms are not always easy to implement. The benefits are often on a medium term, while on the short run the costs for some groups could determine a serious opposition on these reforms. But the structural reform is the only way to accomplish the necessary reduction in the unemployment rate.

4. Conclusions

It should be clear that there is no other alternative to a monetary policy aimed to price stability, especially in a globalized financial world. Closely related with this objective is the best possible contribution of the Eurosystem to avoid costly and undesired ruptures in expectations in the financial market, who play a key role in today's globalized financial world. In this uncertain world it should be applied those policies that have proved successful in reducing risks and gaining the financial markets confidence. This is also the case for other policies, other than monetary policies, and, especially, for fiscal policy and labour policy. Implementing only consistent policies aimed to achieve stability will prove to the financial markets players the determination of those who construct the European policies to gain the maximum benefits from the EMU.

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