Economic and monetary union

International Finance

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Content

- Economic and monetary union
- EMU, history and development
- Maastricht criteria
- Euro adoption
- ECB
- Tools of ECB

Integration

- Integration: process of combining or bringing together 2 or more economies, cultures, religions etc.
- people of different countries choose to function jointly in governance, economic interests, currency, etc.

Economic integration

- is a term used to describe how different aspects between economies are integrated
- As economic integration increases, the barriers of trade between markets diminishes
- The degree of economic integration can be categorized into stages:
  1. Free trade area
  2. Customs union
  3. Common market
  4. Economic and monetary union
  5. Political union

Economic integration

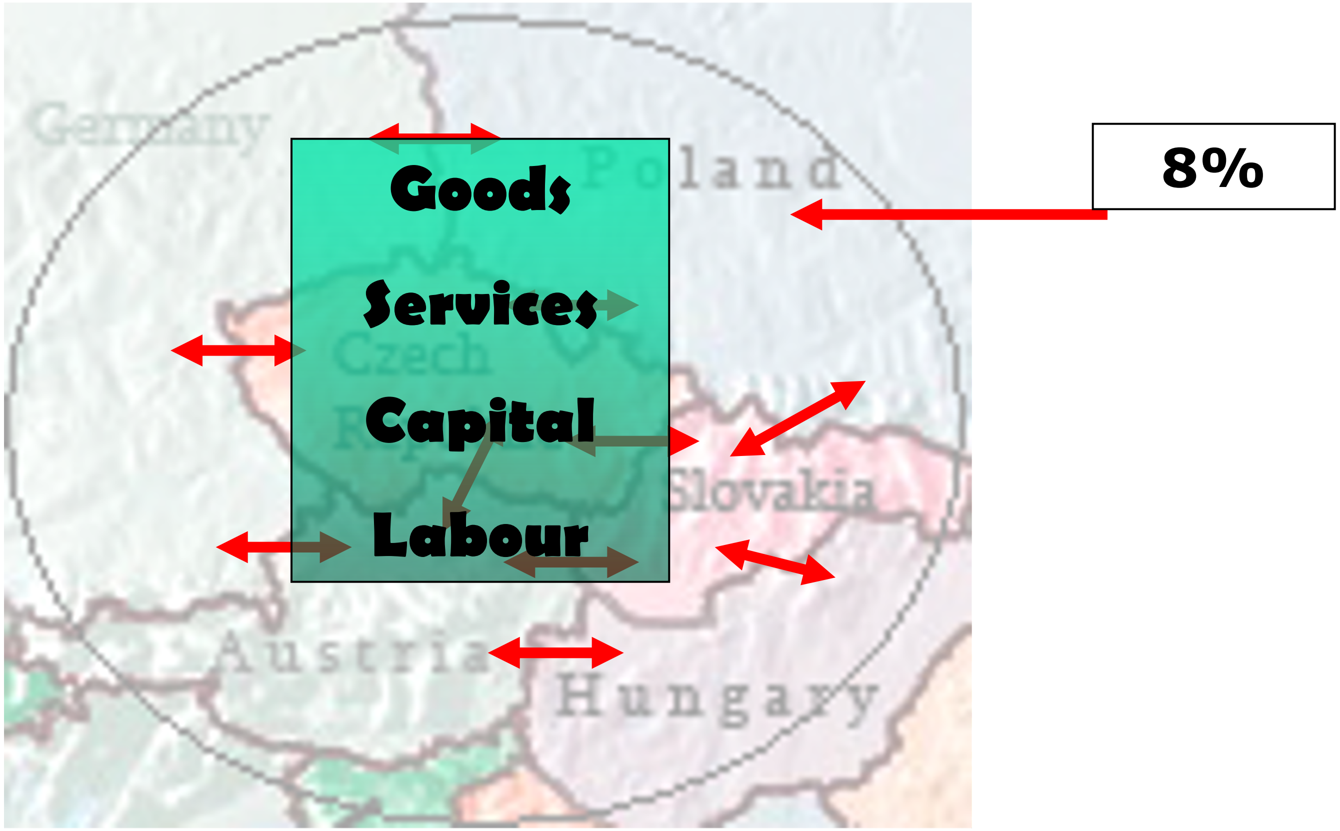
1. Free trade area – without duty and quantitative restrictions between the countries inside. But outside – the countries have own duty policy – own customs tariff.

Economic integration

2. Customs union – single customs tariff

Economic integration

3. Common market – free circulation (goods, services) and other norms (prohibition of State aid)



Economic and monetary union

4. Economic and monetary union

- a single market with a common currency
- the largest economic and monetary union at present is the Eurozone

- The most integrated economy today - the European Union and its Eurozone.

Political integration

5. **Political union**

- Common **constitution**
- Common policy against other countries out of union

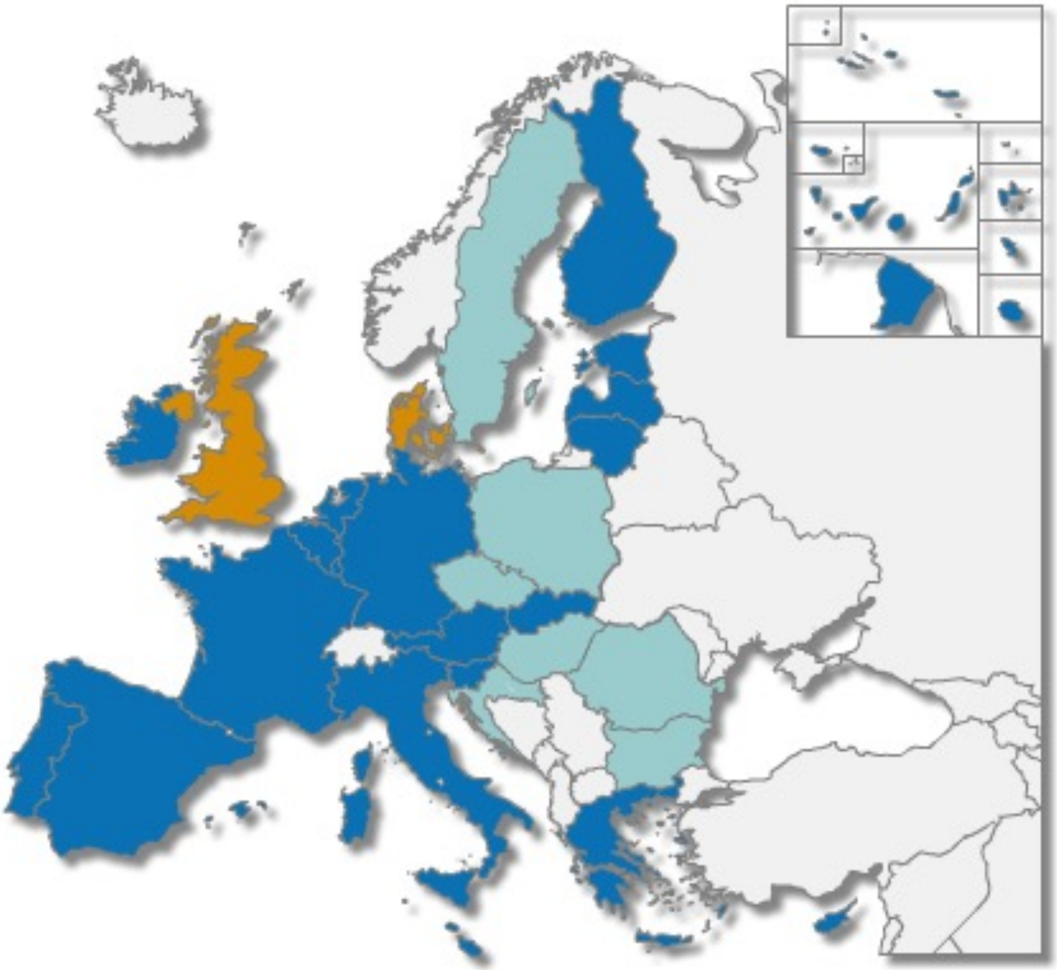
Quick test

1. What is the difference between EU and Eurozone?
2. What is the difference between Eurozone and Euro area?
3. When did we enter EU? Eurozone?
4. How many members has EU? Eurozne?

European union

- The European Union (EU) is an economic and political union of 27 member states which are located in Europe.
  - Slovakia joint the EU – 1st May 2004
- Eurozone, officially called the euro area, is an economic and monetary union (EMU) of 19 European Union (EU) member states that have adopted the euro (€) as their common currency.
  - Slovakia joint the Eurozone – 1.january 2009

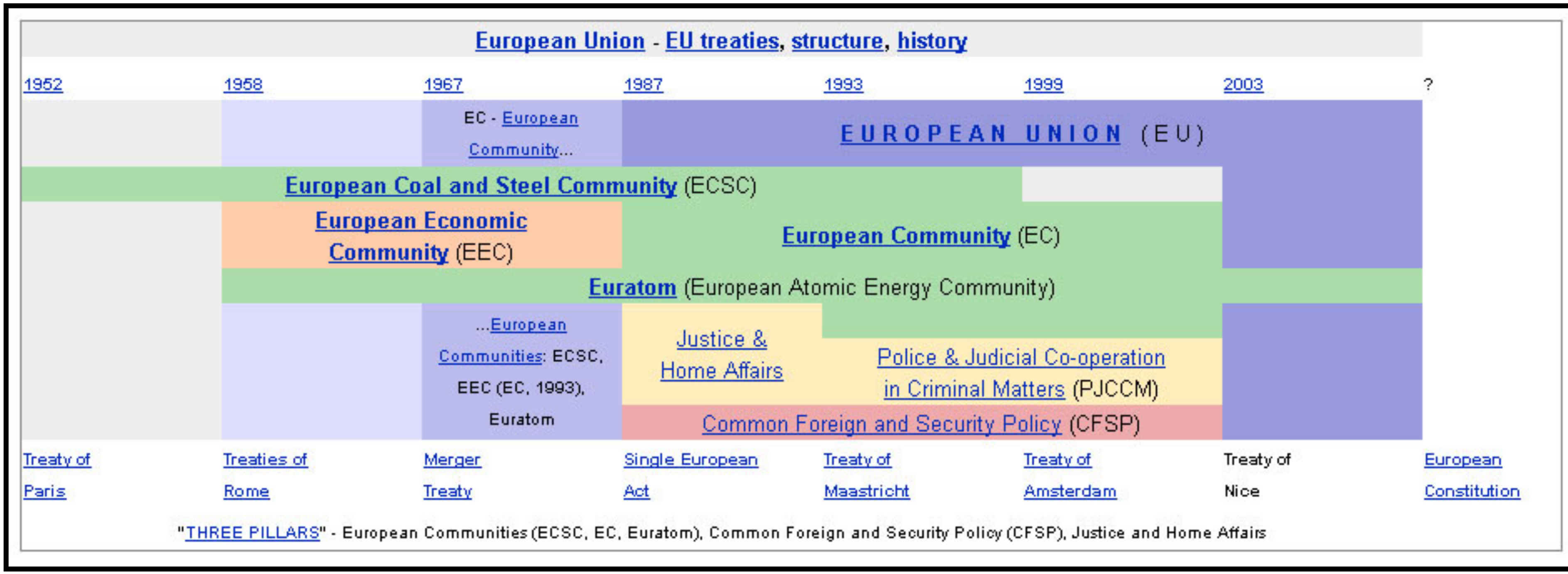
EU vs. Eurozone



Euro-area Member States	Non-euro area Member States	Member States with an opt-out
Belgium	Bulgaria	Denmark
Germany	Czech Republic	United Kingdom
Ireland	Hungary	
Greece	Poland	
Spain	Romania	
France	Sweden	
Italy	Croatia	
Cyprus		
Luxembourg		
Malta		
The Netherlands		
Austria		
Portugal		
Slovenia		
Slovakia		
Finland		
Estonia		
Latvia		
Lithuania		

UK left on 31 January 2020

The EU history and treaties



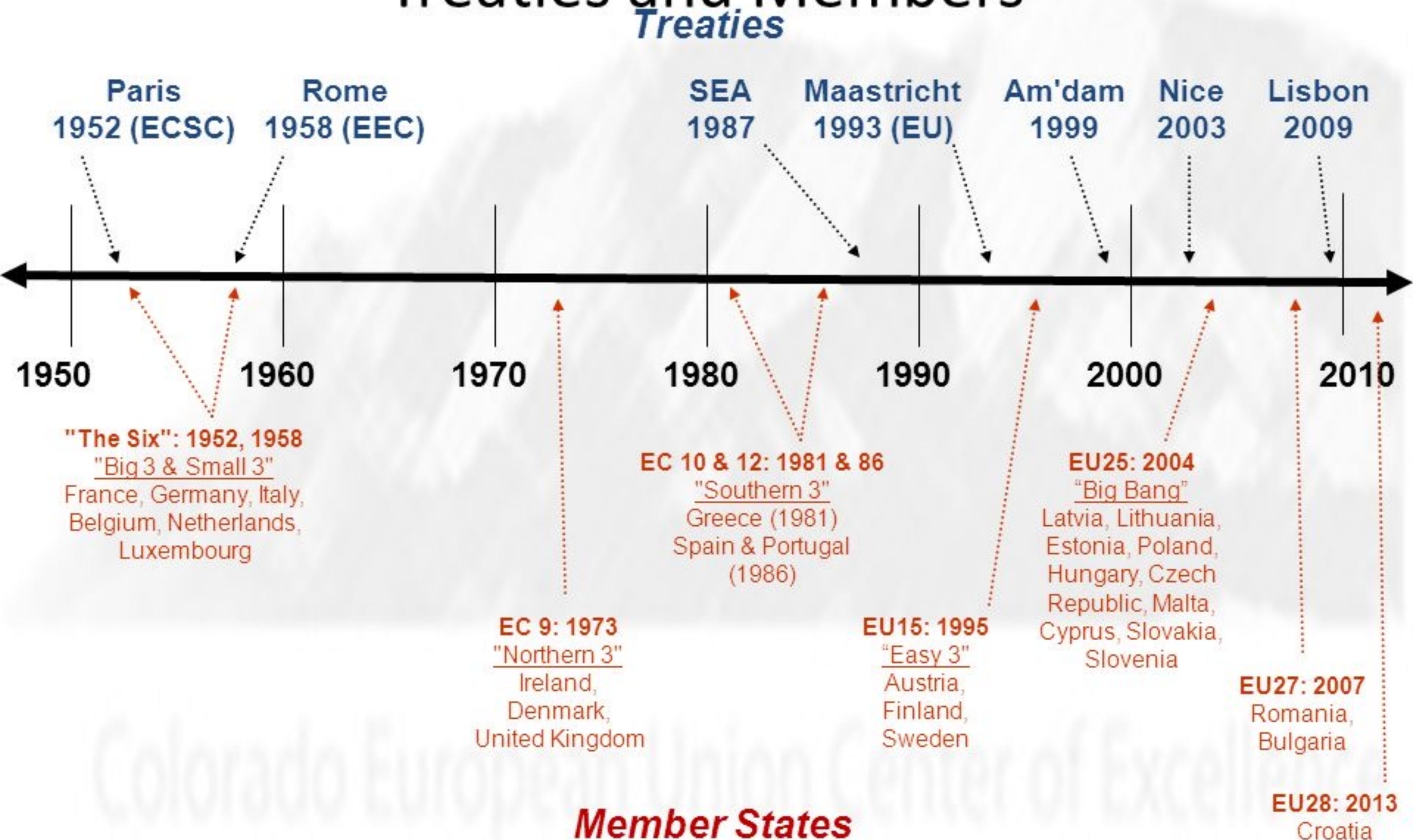
The EU history and treaties

The Treaty establishing a Constitution fo Europe was signed on 29 October 2004 by representatives of the then 25 member states of the European Union.

It was later ratified by 18 member states, which included referendums endorsing it in Spain and Luxembourg.

However, the rejection of the document by French and Dutch voters in May and June 2005 brought the ratification process to an end.

Historical Development: Treaties and Members



History of EMU
(European monetary union)

- Created based on Delors report (plan)

1. Stage one: 1st july 1990
   - Complete freedom for capital transactions (elimination of capital controls among the Member States);
   - Increased co-operation between central banks

History of EMU

2. Stage two: 1st january 1994

- European Monetary Institute is established as the forerunner of the European Central Bank
- name of the new currency (the Euro) is decided
- On 1 June 1998, the European Central Bank (ECB) is created,
- initial 11 countries that will participate in the third stage from 1 January 1999 are selected
- Preparation of single currency

History of EMU

3. Stage three: 1st january 1999

- Eleven countries fixed their exchange rates.
- The national currencies of the eleven were replaced by the euro, the euro is now a real currency.
- The ECB took over responsibility for monetary policy in the euro area.
- On 1 January 2001, Greece joins the third stage of the EMU.
- The euro notes and coins are introduced in January 2002.

Convergence criteria

- also known as the Maastricht criteria
- criteria for European Union member states to enter Monetary Union (EMU) and adopt the euro

- 1. Iflation rate
- 2. Government finance
- 3. Exchange rate
- 4. Long-term interest rates

Maastricht criteria

1. Inflation rate

- No more than 1.5 % higher than the 3 best-performing member states of the Eurozone.

2. Government deficit and debt

- Annual government deficit:
  - The ratio of the annual government deficit to gross domestic product (GDP) must not exceed 3% at the end of the preceding fiscal year.
- Government debt:
  - The ratio of gross government debt to GDP must not exceed 60% at the end of the preceding fiscal year.

Maastricht criteria

3. Exchange rate

- Applicant countries should have joined the exchange-rate mechanism (ERM II) for 2 consecutive years and should not have devaluated its currency
- Central exchange rate +/- 15%

4. Interest rate

- The nominal long-term interest rate must not be more than 2 % higher than the 3 best-performing member states .

Zdroj: https://www.kurzy.cz/kurzy-men/grafy/SKK-EUR/

Timetable of the euro changeover in Slovakia

Video – How have Europeans benefited from the euro?

Benefits of Monetary union

Direct benefits	Indirect benefits
+ *Elimination of Exchange rate risk*	+ *Increase of foreign trade*
+ *Elimination of transactional costs*	+ *Foreign investments flow*
+ *Reduction of acquisition costs of capital and low interest rate*	+ *Price stability*
+ *Transparency of prices*	+ *Elimination of speculative flows of capital*

TRUE ???

Costs of Monetary Union

Direct costs	Indirect costs
- *Loss of independent monetary policy and exchange rate policy*	- *Long-run inflation*
- *Inflation / increase of prices*	- *Deepening of regional imbalances*
- *Administrative and technical costs*	
- *Specific costs of banks and loss of profitability*	

Eurozone

- When the euro was first introduced in 1999 – as 'book' money –, the euro area was made up of 11 of the then 15 EU Member States.
- The only country that wished to participate in 1999 but failed to meet the convergence tests was Greece (Greece joined in 2001)
- Slovenia in 2007,
- Cyprus and Malta in 2008,
- Slovakia in 2009,
- Estonia in 2011,
- Latvia in 2014
- Lithuania in 2015.

Monetary policy

You have to distinguisch:

- European System of Central Banks - comprises the ECB and the national central banks of all EU Member States whether they have adopted the euro or not.
- Eurosystem - comprises the ECB and the NCBs of those countries that have adopted the euro.
- European Central Bank – responsible for monetary policy in Eurozone.

- The main objective of the Eurosystem/ECB is price stability:
  - ECB aims at maintaining inflation rates below, but close to, 2% over the medium term

THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB)

- € European Central Bank
- 1 Nationale Bank van België / Banque Nationale de Belgique
- 2 Bulgarian National Bank
- 3 Česká národní banka
- 4 Danmarks Nationalbank
- 5 Deutsche Bundesbank
- 6 Eesti Pank
- 7 Central Bank and Financial Services Authority of Ireland
- 8 Bank of Greece
- 9 Banco de España
- 10 Banque de France
- 11 Banca d'Italia
- 12 Central Bank of Cyprus
- 13 Latvijas Banka
- 14 Lietuvos bankas

- 15 Banque centrale du Luxembourg
- 16 Magyar Nemzeti Bank
- 17 Bank Ċentrali ta' Malta/ Central Bank of Malta
- 18 De Nederlandsche Bank
- 19 Oesterreichische Nationalbank
- 20 Narodowy Bank Polski
- 21 Banco de Portugal
- 22 Banca Naţională a României
- 23 Banka Slovenije
- 24 Národná banka Slovenska
- 25 Suomen Pankki – Finlands Bank
- 26 Sveriges Riksbank
- 27 Bank of England

© EUROPEAN CENTRAL BANK

THE EUROSYSTEM

ORGANISATION

€ European Central Bank

1 Nationale Bank van België / Banque Nationale de Belgique

2 Deutsche Bundesbank

3 Central Bank and Financial Services Authority of Ireland

4 Bank of Greece

5 Banco de España

6 Banque de France

7 Banca d'Italia

8 Central Bank of Cyprus

9 Banque centrale du Luxembourg

10 Bank Ċentrali ta' Malta / Central Bank of Malta

11 De Nederlandsche Bank

12 Oesterreichische Nationalbank

13 Banco de Portugal

14 Banka Slovenije

15 Národná banka Slovenska

16 Suomen Pankki – Finlands Bank

ECB

- Since 1 June 1998 the European Central Bank (ECB) has been responsible for conducting monetary policy for the euro area
- The European Central Bank and the national central banks together constitute the Eurosystem, the central banking system of the euro area.
- The main objective of the Eurosystem is to maintain price stability: safeguarding the value of the euro.

The ECB's Eurotower in Frankfurt, Germany

ECB

- **The ECB President** represents the Bank at high-level EU and international meetings. The ECB has the 3 following **decision-making bodies**:
- Executive Board – handles the **day-to-day running** of the ECB. Consists of the ECB President and Vice-President and 4 other members appointed for 8-year terms by the leaders of the eurozone countries.
- Governing Council – the **main decision-making body**. Consists of the Executive Board (see above) plus the governors of the national central banks from eurozone countries.
- General Council – has more of an **advisory & coordination role**. Consists of the ECB President and Vice-President and the governors of the central banks from all EU countries.

Source: https://europa.eu/european-union/about-eu/institutions-bodies/european-central-bank_en

The Executive Board

- consists of the President, Vice-President and four other members
- **Responsibilities**
  - to prepare Governing Council meetings;
  - to implement monetary policy for the euro area in accordance with the decisions taken by the Governing Council. In so doing, it gives the necessary instructions to the euro area NCBs;
  - to manage the day-to-day business of the ECB;

The Governing Council

- is the **main decision-making body** of the ECB
- consists of the **six members** of the Executive Board, plus the governors of the national central banks of the **euro area** countries. **(19)**
- **Responsibilities -** to adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the Eurosystem;
- to formulate monetary policy for the euro area. This includes decisions relating to monetary objectives, key interest rates, the supply of reserves in the Eurosystem, and the establishment of guidelines for the implementation of those decisions.
- usually meets twice a month

Appointment of the European Central Bank Executive Board

European Central Bank Governing Council

ECB Executive Board

Governors of euro area National Central Banks

President:
Christine Lagarde
since 11/2019

Vice-President:
Luis de Guindos
since 03/2018

Other members of the ECB executive board

Philip Lane
since 06/2019

Fabio Panetta
as of 01/2020

Yves Mersch
since 12/2012

Isabel Schnabel
as of 01/2020

- **8** — **appointed for 8 years**
- **not renewable**
- **must be a national of a euro area member state**
- **has recognised standing and professional experience in monetary or banking matters**

283

Appointment of ECB Executive Board members defined in Article 283 Treaty on the functioning of the EU

The General Council

- comprises the President and Vice-President of the ECB, plus the governors of the national central banks (NCBs) of the 27 EU Member States
- can be regarded a transitional body - will be dissolved once all EU Member States have introduced the single currency
- The General Council contributes to
  - the collection of statistical information;
  - the establishment of the necessary rules for standardising the accounting and reporting of operations undertaken by the NCBs

European Central Bank - ECB

- **Basic tasks**
  - the definition and implementation of monetary policy for the euro area;
  - the conduct of foreign exchange operations;
  - the holding and management of the official foreign reserves of the euro area countries
  - the promotion of the smooth operation of payment systems.
- **Further tasks**
  - Banknotes: exclusive right to authorise the issuance of banknotes
  - Statistics: in cooperation with the NCBs, the ECB collects statistical information necessary for fulfilling the tasks.
  - Financial stability and supervision
  - International and European cooperation: the ECB maintains working relations with relevant institutions, bodies and fora both within the EU and internationally in respect of tasks entrusted to the Eurosystem.

Video – ECB and the Eurosystem

NBS

- What happend to National Bank of Slovakia?
- Is it still our central bank?

THE NCBs AS INTEGRAL PART OF THE EUROSYSTEM

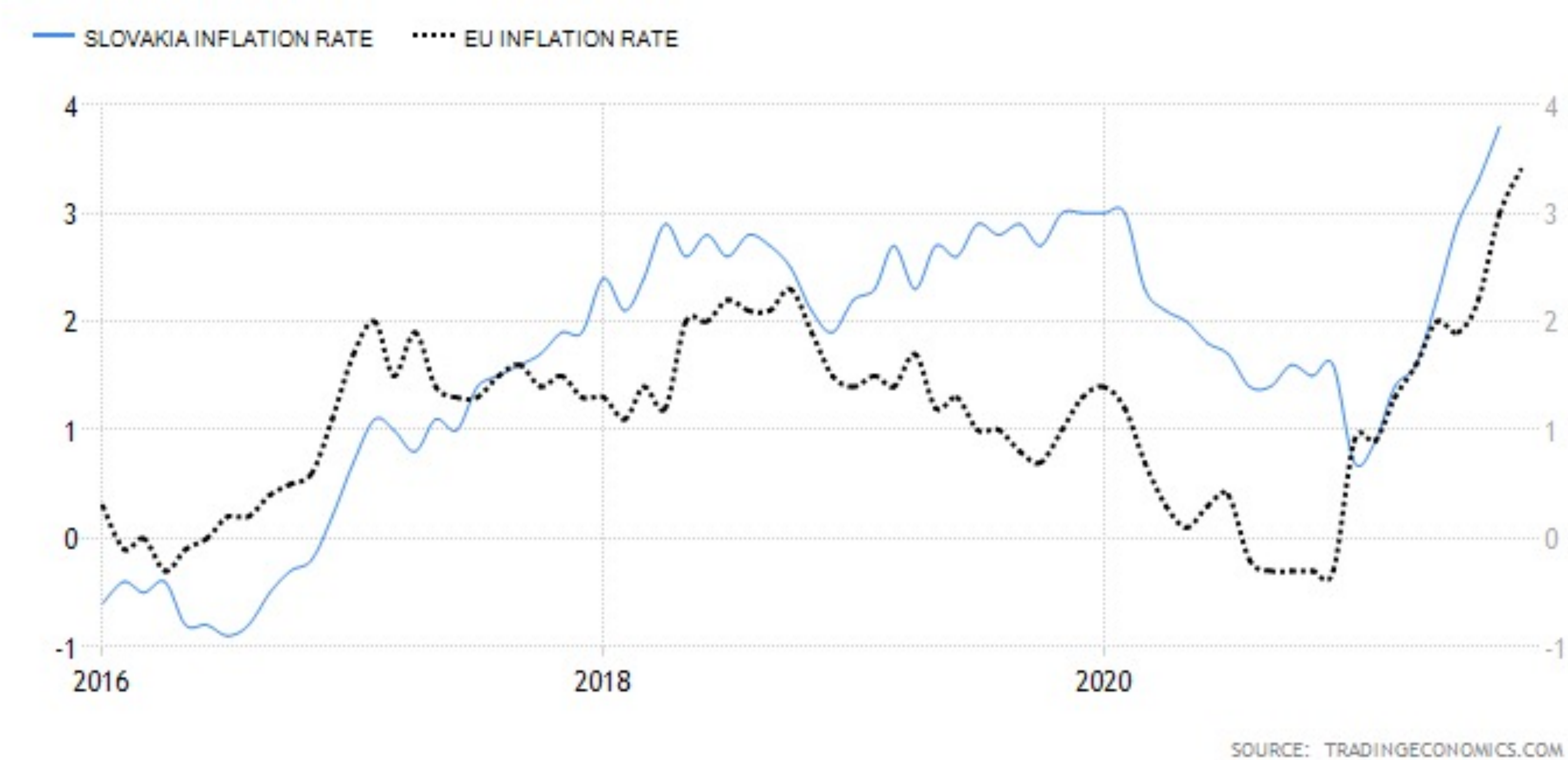
Article 14.3 ESCB Statute: "The national central banks are an integral part of the ESCB [Eurosystem] ..."

The Eurosystem

Role of NBS in EZ

- ECB is decision maker
  - What is the quantity of money (money base)
  - What is the inflation aim
  - What are the interest rates
- NBs implement the decisions of ECB in countries

Inflation rate



Source: https://tradingeconomics.com/slovakia/inflation-cpi

Inflation rate

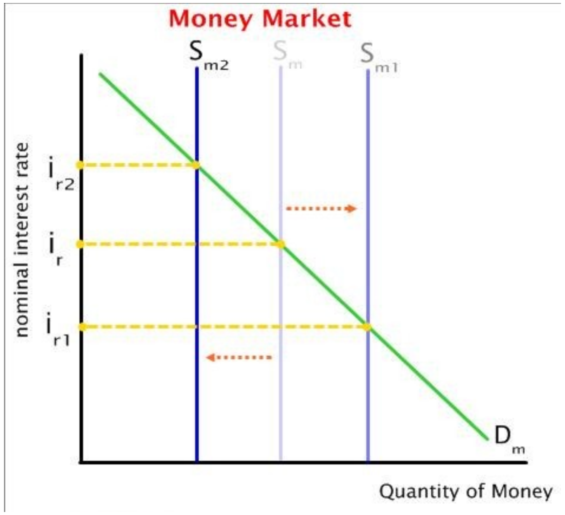
Slovakia Inflation Rate Quickens to Near 9-Year High

Consumer prices in Slovakia climbed 4.7 percent in August of 2021, faster than the 3.3 percent rise in July and above market estimates of a 3.7 percent increase. It was the highest inflation rate since October of 2012, primarily underpinned by prices of transport (11.1 percent vs 10.5 percent in July); food & non-alcoholic beverages (3.6 percent vs 2.6 percent); and alcoholic beverages & tobacco (8.6 percent vs 8.9 percent). The annual core inflation rate, which excludes volatile items such as energy and food, advanced to 4.5 percent in August, the highest since October of 2008, beating market forecasts of 4.1 percent. On a monthly basis, consumer prices went up 0.4 percent, easing from a 0.4 percent increase in the prior month but faster than market expectations of a 0.3 percent gain.

Source: https://tradingeconomics.com/slovakia/inflation-cpi

Monetary policy

- **Objective of monetary policy**
  - To maintain **price stability**
  - The Eurosystem is responsible for defining and conducting monetary policy in the euro area.
  - It regulates the money supply M3



- Main instruments

1. Open market operations
2. Standing facilities
3. Minimum reserve requirements

Monetary aggregates

- **M1** is the sum of currency in circulation and overnight deposits;
- **M2** is the sum of M1, deposits with an agreed maturity of up to two years and deposits redeemable at notice of up to three months; and
- **M3** is the sum of M2, repurchase agreements, money market fund shares/units and debt securities with a maturity of up to two years.

1. Open market operations

- Are used to influence the interest rates and manage the liquidity
- instrument control national money supply by buying and selling government securities, or other instruments
- Expanding or contracting money supply
  - **Main refinancing operations** (MRO) with maturity of one week - provide the amount of liquidity to the banking system. Is the interest rate which banks do have to pay when they borrow money from the ECB. Banks do so when they are short on liquidities.
  - **Longer-term refinancing operations** (LTRO) monthly
  - **Fine-tuning operations**
  - **Structural operations**

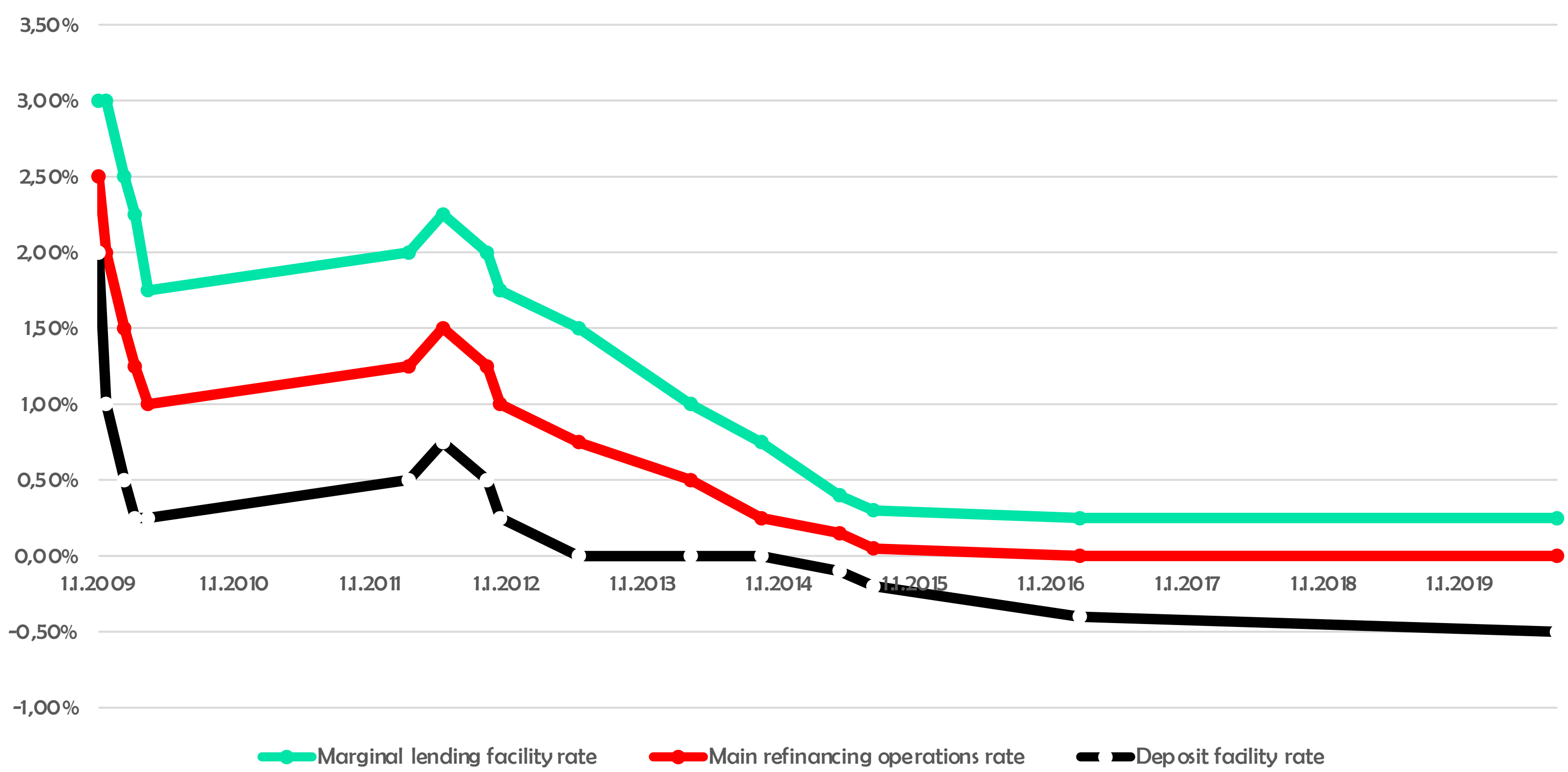
2. Standing facilities

- aim to provide and absorb overnight liquidity
  - **Marginal lending facility** in order to obtain overnight liquidity from the central bank, against the presentation of sufficient eligible assets;
  - **Deposit facility** in order to make overnight deposits with the central bank.

Standing facilities rates (Effective from 18. 9. 2019)	
Marginal lending facility rate:	0.25 %
Deposit facility rate:	- 0.50 %

Monetary policy nowadays

- Decrease of interest rates



With effect from	Deposit facility rate	Main refinancing operations rate	Marginal lending facility rate
18.9.2019	-0,50%	0,00%	0,25%
16.3.2016	-0,40%	0,00%	0,25%
10.9.2014	-0,20%	0,05%	0,30%
11.6.2014	-0,10%	0,15%	0,40%
13.11.2013	0,00%	0,25%	0,75%
8.5.2013	0,00%	0,50%	1,00%
11.7.2012	0,00%	0,75%	1,50%
14.12.2011	0,25%	1,00%	1,75%
9.11.2011	0,50%	1,25%	2,00%
13.7.2011	0,75%	1,50%	2,25%
13.4.2011	0,50%	1,25%	2,00%
13.5.2009	0,25%	1,00%	1,75%
8.4.2009	0,25%	1,25%	2,25%
11.3.2009	0,50%	1,50%	2,50%
21.1.2009	1,00%	2,00%	3,00%
1.1.2009	2,00%	2,50%	3,00%

3. Minimum reserve requirements

- Amount of reserves, that the commercial banks must deposit in the central bank
- contributes to the stabilization of interest rates when influencing liquidity.
- The higher the reserves the lower money base (supply)

Reserve maintenance statistics (EUR millions) and remuneration and penalty rates

Reserve maintenance period start:		2020-06-10
Reserve maintenance period end:	6 weeks	2020-07-21
Average reserve requirements (EUR millions):		141,186
Excess Reserves:		2,204,787
Deficiencies:		2
Current account holdings:		2,345,979
Remuneration rate:		0%
Penalty rate for deficiencies:		2.75%

SOURCE

Video – Monetary policy instruments

Monetary policy nowadays

- Quantitative easing – video1
  - European central bank began buying government bonds in March 2015
  - quantity of money on market increases – expending money supply
  - Decrese of Interest rates
- AIM:
  - stimulate the economy: recovery, growth
  - Stop deflation, reach and keep iflation at 2% level
  - Boost investments
  - …

Monetary policy nowadays

During the net asset purchase phase, monthly purchase pace averaged:

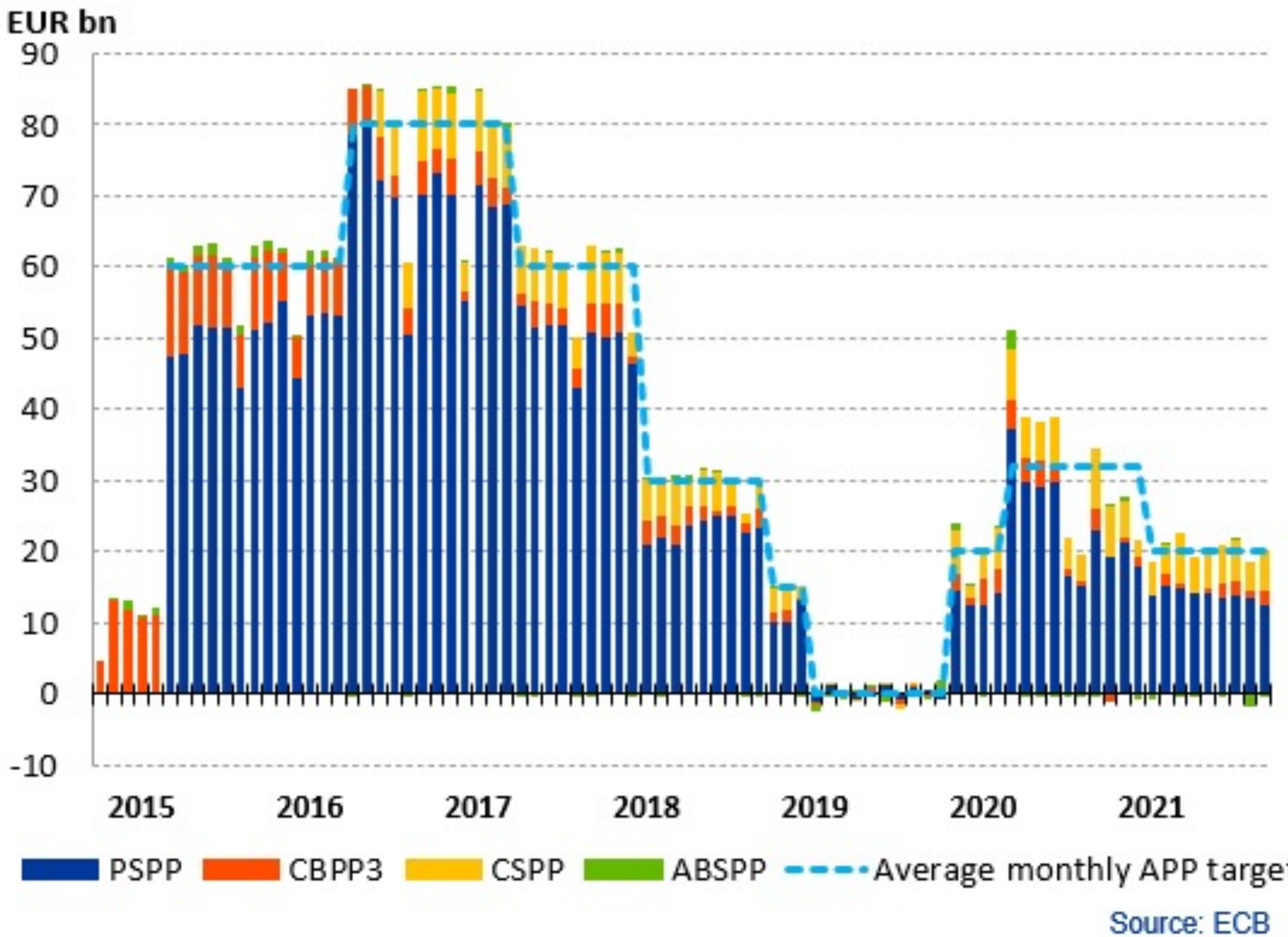
- €60 billion from March 2015 to March 2016
- €80 billion from April 2016 to March 2017
- €60 billion from April 2017 to December 2017
- €30 billion from January 2018 to September 2018
- €15 billion from October 2018 to December 2018

Monetary policy nowadays

- Between January 2019 and October 2019, the Eurosystem fully reinvested the principal payments from maturing securities held in the APP portfolios.
- On 12 September 2019 the ECB Governing Council decided that “net purchases will be restarted under the Governing Council’s asset purchase programme (APP) at a monthly pace of €20 billion as from 1 November 2019.

more - https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html

Monetary policy nowadays



Asset purchase programmes

Pandemic emergency purchase programme (PEPP)

- The ECB's pandemic emergency purchase programme (PEPP) is a non-standard monetary policy measure initiated in March 2020 to counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the coronavirus (COVID-19) outbreak.
- The PEPP is a temporary asset purchase programme of private and public sector securities. The Governing Council decided to increase the initial €750 billion envelope for the PEPP

- https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html

Thank you for attention!