Chapter 14

Most emerging market economies established their central banks after wwII, a few years after their independence from colonialism.

The functions of central banks throughout the world expanded from the exclusive issuance of banknotes, policing banks, ad monitoring international payments to regulating the value of the national currency, financing the government, and acting as a “lender of last resort” to banks suffering from liquidity and/or credit crises.

The three main decision-making bodies of the European Central Bank are the Governing council,the executive board, and the general council.

The governing council is the chief decision-making body of the ECB responsible for formulating monetary policy in the euro area.

The main function of the governing council of the ECB is to conduct monetary policy and its primary objective is to maintain price stability in the euro area

The European council appoints the Executive Board of the ECB.

The third decision-making body is the general council of the ECB, which comprises the preseident and the vice-president of the ECB in addition to the governors of the NCBs of the 28 EU member states.

The governing council of the ECB sets the following three key policy interest rates: Deposit facility rate, which is the re on tenders to banks, it provides the bulk of liquidity to the banking system and determines how the ECB’s quantitative easing program affects sovereign bond yields. Refinancing rate, which is the rate on overnight deposits with the Eurosystem. Marginal lending facility rate, which is the rate on overnight credit to banks from the Eurosystem.

The ECB’s oerational frameworks consists of the following set of conventional monetary policy instruments: Open market operations; standing facilities to provide and absorb overnight liquidity; minimum or required reserve requirements for credit institutions.

The ECB has introduced a number of unconvential or non-standing monetary policy measures to complement the regular operations of the Eurosystem when standard monetary policy has become ineffective at combating a falling money supply and economic recessions. The first of these unconventional monetary policy measures provide emergency liquidity assistance (ELA)-- that provides liquidity and loans exceptionally to solvent banking and financial institutions that are facing temporary liquidity problem. Second, the ECB has pursued quantitative easing, where central banks buy sovereign bonds and/or other finanical assets from commercial banks and financial institutions to increase money supply and stimulate the economy. APP, SMP; The APP includes purchases of public sector securities, private sector bonds, and asset-backed securities.

These regional federal Reserve banks act as the operating arm of the Fed that carry out most of its activities and implement the Fed’s dual mandate of long-term price stability and macroeconomic stability through creating jobs.

The federal reserve system consists of the following: The federal reserve board of governors (FRB), which mainly assumes regulatory and supervisory responsibilities over member banks. The Federal open market committee (FOMC).

The different between the structure of Eurosystem and Federal Reserve system: first, the ECB and the Fed has different mandates or objectives and accordingly adopt different method to achieve these objectives. Second, the board of governors controls the budgets of the federal reserve banks, whereas the national central banks control their own budgets and the budget of the ECB in Frankfurt. Third, the monetary operation of the Eurosystem are conducted by the national central banks in each country, so monetary operations are not centrailized as they are in the federal reserve system. Fourth, in contrast to the federal reserve, the ECB is not invloved in supervision and regulation of financial institutions. Finally, in order to finance fiscal budget deficits, the fed buys government bonds outright, while the ECB accepts them as collateral for new loans to the banking system.

The British central bank or the banks of England (BoE), known as the “Old lady” of thread-needle street, was founded in 1694.

The bank act of 1946 gave the government statutory authority over the bank of England.

The MPC accordingly sets interest rates to fultill its mandate and monetary policy objectives: to deliver price stability and to support the government’s economic objectives including those for growth and employment. Raising the lowering interest rates is the main policy tool that the BoE uses for contrilling growth.

Emerging markets economies (EMEs) are those econmies of Asia, Lain America, and Eastern Europe that are growing at a fast rate and are experiencing booming industrialization and increased exports

central banks in EMEs manage foreign exchange reserves and implement policies that also help promote growth and exports.

The main developmental roles that central banks in EMEs assume are enhancing credit flow to productive fast-growing export-oriented industries and employment intensive sectors, mainly agriculture and small and micro enterprises.

Financial inclusion policies, all of these strategies to make affordable housing and education loans.

The more independent a central banks the more effective monetary policy is, there are two key dimensions to this. The first dimension, Goal independence, encompasses those institutional characteristics that insulate the central bank from political influence in defining its monetary policy objectives. The second dimension, instrument independence, refers to the ability of the central bank of freely implement policy instruments in its pursuit to meet its monetary goals.

Political business cycle, in which these expansionary monetary policies are reversed after the election to limit inflation, unnecessarily leading to macroeconomic instability or booms and busts.

Public distrusts politicians not only because they make politically motivated decisions, but also because the politicians lack expertise in conducting monetary policy.

Principal-agent problem, both politicians and the central bank have incentives to act in their own interest rather than that of the public.

Politicians often opt for more independence for central banks when there is disagreement between policymakers regarding unpopular macroeconomic decisions.

This was the case in many EMEs that were forced to float or liberalize their domestic currencies in order to gain integration with global financial markets.

The main argument against an independent central bank is that macroeconomic stability can be best achieved if monetary policy is properly coordinated with fiscal policy

the theory of bureaucratic behavior suggests that the objective of a bureaucracy is to maximize its own welfare, akin to consumer’s behavior that aims at maximizing personal welfare. The central bank can pursue a course of narrow self-interest to increase its power and prestige at the expense of public interest.