COMPARATIVE ANALYSIS OF MONETARY POLICY OF EASTERN EUROPEAN COUNTRIES AND GEORGIA

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Introduction

Relevance of the study: Central banks exert their influence on the economy by changing the money supply using appropriate instruments in a free financial market. The combination of these tools gives us the operational framework of the National Bank.

Aim of the research: to study the instruments (operational framework) of monetary policy regulation of Georgia, Moldova and Montenegro, to identify problems and to find ways to solve them.

Research Methods: Use of comparative analysis method based on the database of the National Bank of Georgia, Geostat and the International Monetary Fund.

Topic structure and content:

Introduction

1. The impact of Georgia's monetary policy regime and instruments on the country's macroeconomic indicators, such as inflation and GDP growth rates.

2. Analysis of the macroeconomic parameters, monetary policy regime and regulatory instruments of Moldova and Montenegro.

3. Comparative analysis of the operational framework of the monetary policy of Georgia, Moldova and Montenegro and ways to solve the identified problems.

Monetary policy only changes the future outlook for inflation, and central banks respond to one-time exogenous factors when those factors are so strong that they reflect long-term inflation expectations. Therefore, further tightening of monetary policy (already tightened) will lead to a slowdown in GDP growth and unemployment. According to current forecasts, the inflation rate in 2022 will remain high.

Given that the role of temporary and exogenous factors in inflation remains to be determined, while monetary policy is still in a tightening phase, the National Bank has decided to maintain the current level of interest rates. However, in the face of strong supply shocks, the threat of further growth in inflation is still relevant. Against the background of these inflationary risks, a tightening of monetary policy or an increase in interest rates is probably still expected.

Impact of Georgia's Monetary Policy Regime and Instruments on GDP Growth Rates and Inflation

The National Bank of Georgia, which is the country's central bank, is responsible for developing and implementing monetary policy in Georgia. It is an independent body from the government and conducts the process within the powers defined by the Organic Law on the National Bank of Georgia and the Resolution of the Parliament of Georgia on the Main Directions of Monetary Policy. Monetary and exchange rate issues are considered by the Monetary Policy Committee of the National Bank, which makes decisions on monetary policy measures.

Over the past few decades, central banks have developed a new technical management called "inflation targeting" that will control the growth of the price index. As part of this practice, central banks check and detect full target inflation, and then try to get closer to the planned with the help of daily credit policy instruments. This monetary policy regime is considered to be the most effective compared to the existing regimes.

40 countries have chosen the inflation targeting regime, including Georgia since 2009. The IMF is considered to be the most flexible mode of inflation targeting. However, a developed country like Turkey does not agree with him. The inflation targeting regime also has its challenges. Given that controlling inflation is difficult because monetary instruments need large time lags (4-6 quarters) to influence inflation.

Because inflation decreases from high rates, the probability of errors in forecasting inflation is quite high. The National Bank finds it difficult to explain to the public the reasons for the deviation, which weakens its credibility. High dollarization may complicate inflation targeting. The balance sheet structure of companies, households and banks in Georgia is dollarized.

Since floating nominal exchange rates are required to target inflation, exchange rate fluctuations are inevitable, although a sharp depreciation increases the debt service burden on dollar-denominated debt, leading to massive imbalances and increased risks of financial crisis.

The world central banks set the inflation rate at 2% as the norm. In developing countries, the initial target was an average of 6%, compared to 4.3% in the current period. The inflation target of the National Bank of Georgia is 3%. The target was initially 6% in 2009, then decreased to 5% in 2015, to 4% in 2017 and is set at 3% from 2018. This fully complies with internationally set limits. The position of the National Bank is to maintain this figure.

There are 4 types of inflation targeting. These are:

• Point target;
• Point target with tolerance limit;
• Target “range";
• Midpoint range target.

From here we have a point pattern, while it would be better to use a point target like the 23 developing countries with a tolerance limit of +/- 1. Georgia is characterized by high inflationary fluctuations, therefore it is difficult to approach the point limit, and systematic failure weakens the credibility of the National Bank.

The main goal of the National Bank of Georgia is price stability, but it also takes care of the stable functioning of the financial system, if possible in a way that does not jeopardize the fulfillment of its main task.

High rates of economic growth and financial stability are equally important in Georgia. Thus, a country's monetary policy should pursue broader goals than price stability, including stimulating economic activity.

We now consider the monetary instruments of the National Bank of Georgia:

National Bank Monetary Policy Rate (refinancing rate). It is the main instrument of monetary policy and is a kind of benchmark for market rates.

The decision to change the monetary policy interest rate is made by the Monetary Policy Committee of the National Bank of Georgia as a result of monitoring the current and expected economic processes and financial markets.

The forecasting level of inflation is taken into account in the monetary policy-making process, as the outcome of the policy will be reflected in the economy after a certain period. Exceeding the forecast level of inflation target, the National Bank tightened monetary policy and raised interest rates to limit future price increases.

Table 1

Monetary instruments of the National Bank of Georgia

Indicators %%	2013	2014	2015	2016	2017	2018	2019	2020	2021
Central Bank policy rate	3.75	4	8	6.5	7.25	7	9	8	10.5
Treasury Bills Rate	5.16	6.17	8.78	8.39	7.3	7.25	7.22	8.55	8.88
Deposit rate	9.73	8.43	8.91	9.94	9.65	8.83	8.71	10.22	10.31
Deposit rate in foreign currency	6	4.83	4.22	3.38	2.77	2.56	2.54	2.26	1.05
Loan rate	13.59	11.91	12.49	12.62	11.49	11.12	10.85	11.8	12.51
Loan rate in foreign currency	12.64	10.9	10.45	9.56	8.31	8.29	7.31	6.83	6.66

Source: International Monetary Fund https://data.imf.org/?sk=388DFA60-1D26-4ADE-B505-A05A558D9A42

As a result, aggregate demand decreased, which should have affected the rate of price growth. So far we have a record high inflation rate. It is 13.9. Despite rising interest rates and rising inflation, the country is experiencing economic growth and it stands at 10% as of 2021.

We will now review the current monetary policy instruments and try to define their role at the macro level. Refinancing loans. In order to improve the effectiveness of monetary policy, the introduction of the inflation targeting regime in 2010 activated a monetary policy instrument such as refinancing loans. (National Bank of Georgia).

The main thing in Georgia is to achieve high economic growth, which seems to be necessarily related to moderate inflation, but we have economic growth in 2021 against the background of serious inflation. Take for example Turkey where properly high inflation was accompanied by stable and high growth. However, we also see how the Turkish government is trying to reduce inflation and is systematically using all the resources at its disposal.

Part of the experts believe that 3% is a low rate and a 5% template should be more acceptable. However, this view is not shared by the National Bank. At this stage, change in this regard is not considered and on the contrary tend to tend towards a more targeted rate reduction.

The goal of the National Bank is not a one-time economic growth, their goal is price stability, which should be a prerequisite for long-term economic growth and minimization of production gaps. The higher the inflation target, the greater the volatility and the more difficult it will be to control inflation. It is important to measure inflation correctly and to effectively manage the expectations associated with it.

Credit channel. The increase in monetary policy interest rates by the National Bank affects the country's economy through changes in the lending process. The change in monetary policy in the economy is reflected as follows: The increase in the policy rate initially shifts to the money market and reflects the impact of short-term interest rate monetary policy on interest rates. It will also affect long-term interest rates. Rising interest rates make it harder to access credit and also reduce the number of good credit projects. As a result, the volume of loans issued by banks is reduced. Eventually, aggregate demand and price levels decrease.

Exchange rate channel. An increase in interest rates leads to an increase in demand for GEL money market instruments and strengthens the national currency. Strengthening the exchange rate reduces the prices of imported goods and, conversely, the depreciation of the exchange rate leads to an increase in prices for imported goods in the local market. It should be noted that the strengthening and depreciation of the exchange rate are not equally (symmetrically) reflected in the change in the price level: the depreciation of the exchange rate will increase prices more than the strengthening of the exchange rate will reduce them. In addition, strengthening the exchange rate increases the demand for imports and consequently reduces the demand in the local market. In case of exchange rate depreciation, the demand from imports will shift to the local market.

An increase in the interest rate increases the cost of funds raised, which means that businesses and consumers will invest less and consume less. The cost of servicing existing loans is also increasing, which further reduces consumption. Reducing economic growth reduces inflationary pressures. Also, high interest rates lead to a strengthening of the local currency, which reduces the inflationary pressure on imported goods. Despite this regularity, in 2021, the monetary interest rate increased and reached 10%, growing the gross domestic product and GDP (by 10%). Unfortunately, we are not able to analyze GDP in terms of expenditures, because the adjusted annual figures have not been published yet, but with the results of 8 months, this increase comes in terms of consumption and exports. Interestingly, inflation has also increased to 13.9%. It seems that raising the monetary interest rate will not give us its effect in such a short time.

Observations of specific business sectors have shown that changes in the refinancing rate have a strong impact on sectors such as construction, education, finance, trade, and agriculture. The healthcare, tourism and mining industries are the sectors on which a strong correlation of the refinancing rate has not been identified. Thus, a change in the rate of monetary policy is transmitted to the economy through the exchange rate and the channels of monetary aggregates.

Characterization of macroeconomic parameters, monetary policy regime and instruments of Montenegro and Moldova

Montenegro. An important milestone in Euro-Balkan relations came in 2018, when the EU adopted an updated strategy for relations with the Western Balkans, which gave a whole new impetus to the European aspirations of the Balkan countries. The EU then said that by 2025, Serbia and Montenegro were likely to be ready to join the EU. He is already a candidate for EU membership. That's why we chose this country for comparative analysis.

Historically, the Western Balkans is considered an unstable region with numerous ethnic clashes. An important challenge is the unresolved bilateral disputes between the countries of the Western

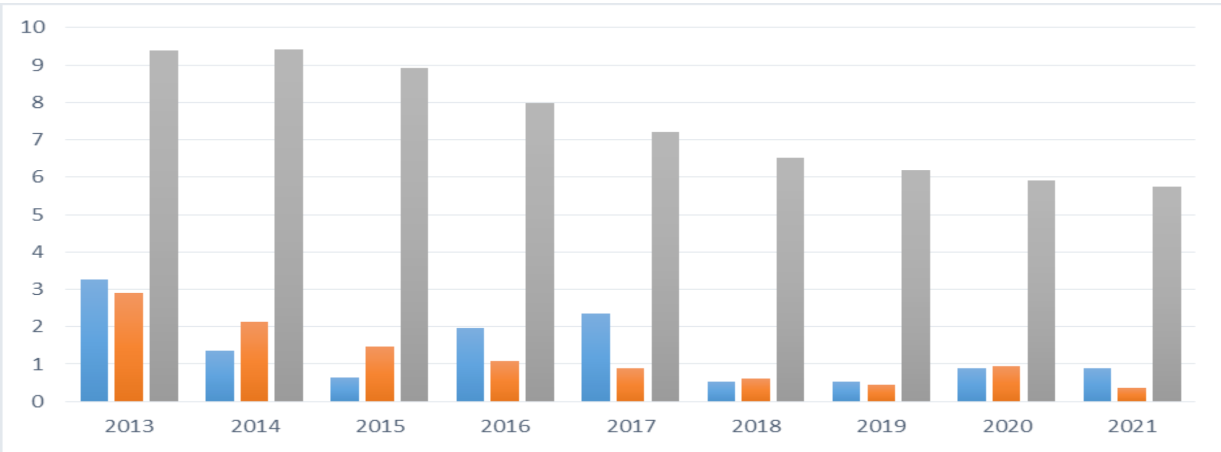
Balkans. Fluctuations are still observed in the region.

The integration of the Western Balkans, which began 20 years ago with the European Union, is making significant economic progress. Demonstrating the consistency of its policy on the part of the EU is essential both to balance Eurosceptic sentiments and in the context of strengthening its influence at the international level in order to minimize the expansion of the influence of other geopolitical players in the region. For example, China, Russia or even Turkey, whose area of interest has historically always been the territories of the former Ottoman Empire.

The Centr a l Bank of Montenegro is already operating in the Eurasian mode. The goals of monetary p olicy set out in the Constitution are aimed at m aintaining the stability of the country. The law a l so stipulates that the central bank's goals are aimed at price stability. Such specific objective s are explained by the lack of monetary policy instruments. That is, with the low efficiency of existi n g tools. Given that the Central Bank of Montenegro is not an issuing bank, it does not have a monetary policy interest rate.

Diagram 1

Monetary instruments of the National Bank of Montenegro



Blue - Treasury liability rate; orange Deposit rate; grey - Loan rate

Source: I nternational Monetary Fund https://data.imf.org/?sk=388DFA60-1D26-4ADE-B505-A05A558D9A42

Open mark et operations in this mode are theoretic ally possible if they use the capital and reserves at the disposal of the central bank. Given their lim itations, in practice it has not yet been used as a tool. There are several lines of credit to maintain the liquidity of banks. The only real instrumen t of monetary policy is the required reserve. Many experiments have taken place in the pa st, which have manifested themselves in stimul ating credit activity, reducing interest rates, an d trying to improve the structure of time deposits. The practice in relation to the tasks set by the Centra l Bank has shown the low effectiveness of this i nstrument. Because of this, the Central

Bank in Montenegro currently serves the function of maintaining financial stability. The second is to increase the resilience of the system to shocks, and the third is to manage crises. All three dimensions are equally important.

Table 2

Monetary instruments of the National Bank of Montenegro

Indicators %%	2014	2015	2016	2017	2018	2019	2020	2021
Treasury Bills Rate	1.35	1.35	1.96	2.35	0.53	0.53	0.9	0.9
Deposit rate	2.14	2.14	1.07	0.88	0.61	0.46	09.43	0.37
Loan rate	9.41	9.41	7.97	7.2	6.53	6.18	5.91	5.76

Source: International Monetary Fund

https://data.imf.org/?sk=388DFA60-1D26-4ADE-B505-A05A558D9A42

The CBCG has developed mechanisms to monitor financial stability. The main challenges facing the CBCG in implementing the operational framework for maintaining financial stability include:

- Limited tools;
- Absence of reliable time series;
- Little experience in implementing this framework.

The main threat to financial stability is the relatively high level of non-performing loans.

Maintaining confidence in the banking sector is vital to maintaining the stability of the financial sector. Fast payments to depositors and limiting the negative economic effects of a bank bankruptcy or liquidation on the rest of the banking sector can boost public confidence. Quick settlement of banking problems implies low costs and minimal loss of value of assets and franchises. Allowing troubled banks to continue operating will lead to market disruption, increase moral hazard, and troubled bank costs.

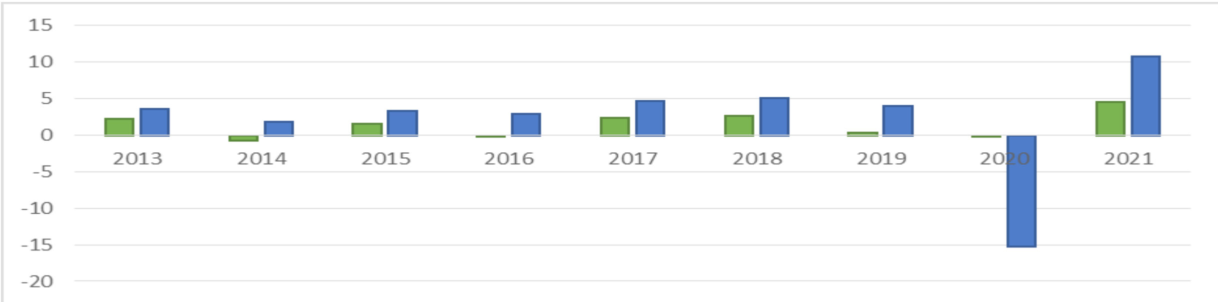
In order to avoid or at least mitigate the crisis in individual banks, the CBCG can help strengthen the solvency and liquidity of these banks, and may in some cases provide financial assistance to prevent the deterioration of the banking sector.

The Financial Stability Board (FSC) has been established in Montenegro. The Board is chaired by the CBCG's Governing Body. The FSC reviews potential risks and coordinates activities aimed at maintaining financial stability. The FSC adopted the National Emergency Action Plan and submitted it to Parliament for approval. The adopted document increases the rights of the institutions included in the resolution of the financial crisis. Moreover, it is allowed to use other additional tools besides the ones established by the existing legislation.

As for inflation as the traditional goal of the central bank, the central bank of Montenegro has a clear position that existing monetary policy instruments will not be able to influence inflation.

Diagram 2

Montenegro Inflation and Economic Growth 2013-2021



Green – inflation(%); blue – growth rate

The euroization system is like a kind of self-balancing mechanism in an open and liberal economy. This means that if the inflation rate is considered over a longer period of time, it actually corresponds to the average inflation rate in the euro area.

In some years, the deviations are noticeable in both directions, but in the long run, the inflation rate returns to the Eurozone average.

Moldova. Analysis and evaluation of the latest macroeconomic information related to the external and internal environment, especially the rapid increase in inflation, led the Board of Governors of the National Bank of Moldova to increase the key monetary policy rate by 2.0 percentage points to 8.50 percent annually.

At present, the monetary interest rate is 6%. (See Table 8) Also, interest rates on overnight loans and deposits will increase by 2.0 percentage points - to 10.50 and 6.50 percent, respectively.

At the same time, the required reserve ratio of funds attracted in Moldovan Lei and non-convertible currencies will increase by 2.0 percentage points and is set at 28.0 percent of the base, from 16 February to 15 March 2022. The required reserve ratio of funds attracted in freely convertible currencies remains unchanged.

Monetary policy configuration aims to mitigate inflationary pressures to reduce the effects of shocks on the economy, and to restore equilibrium more quickly. Central banks use similar measures. Against the backdrop of rising global inflation, the inflation forecast will be revised again in the coming quarters.

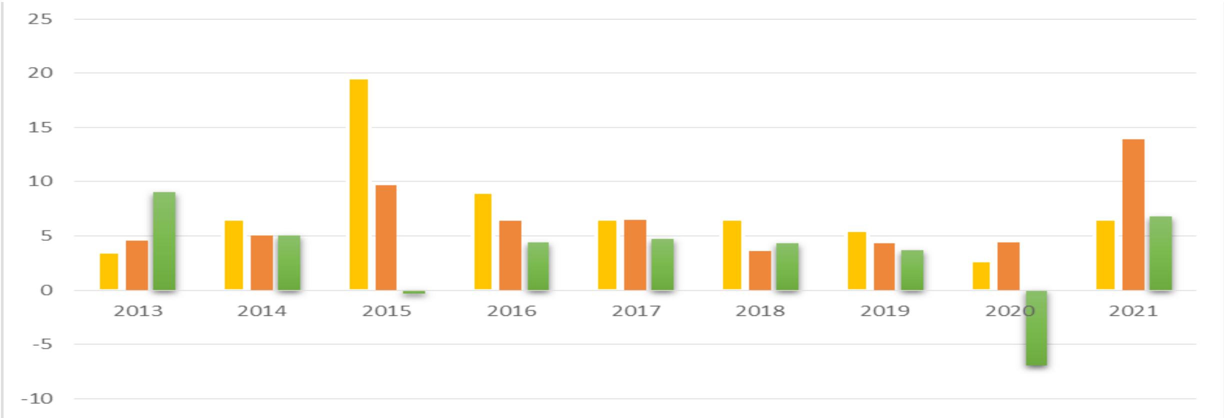
The recent acceleration of inflation indicates the vulnerability of the internal inflation process to external events and explains the recent rise in inflation.

It is mainly caused by supply shocks due to rising international and regional prices for food, energy and other raw materials. At the same time, aggregate demand is putting pressure on inflation in the context of increasing disposable income and consumer credit, which has led to rising prices for the sub-components of core inflation and food.

In this context, new loans in national currency in December 2021 kept the growth trend close to the historical maximum, their volume increased by 46.7 percent on an annual basis. Thus, the increase in the key interest rate together with the increase in the required reserve ratio is aimed at reducing the growth rate of consumer credit, which currently has a strong pro-inflationary effect and increases the current account deficit and exchange rate deficit.

Diagram 3

Moldovan Monetary Policy Rate, Inflation and Economic Growth in Dynamics (2013-2021)



Yellow - Monetary interest rate; orange – inflation; green – growth rate

Source: International Monetary Fund https://data.imf.org/?sk=388DFA60-1D26-4ADE-B505-A05A558D9A42

The National Bank of Moldova continues to monitor developments in the domestic and international environment and is ready to take the necessary measures to achieve its fundamental goal, which is to ensure price stability.

In line with inflation expectations, the Executive Board of the National Bank of Moldova (NBM) decided to increase the key interest rate used for major short-term monetary policy operations by 1.0 percentage point to 6.50 percent. The decision is aimed at creating the monetary conditions necessary to reduce the growth rate of consumer prices.

Moldova has a point inflation target with a tolerance margin of +/- 1.5 percentage points. In Moldova, when inflation is missed by a target, an explanation is required in the form of a formal open letter stating: The central bank's commitment to the target, and it is important that this includes an explanation of what caused the failure, what the National Bank forecasts and what specific measures to take.

Comparative Analysis of the Operational Framework of the Monetary Policy of Georgia, Moldova and Montenegro and Ways to Solve the Identified Problems

The monetary policy rate in Georgia reaches its historical maximum and is 10.5%. In Moldova, cedars have tripled from last year to 6.5%. Montenegro does not have this figure. The historical monetary policy rate for Moldova was even 19.5% in 2015. In the following years it was reduced to an average of 6 percent. In order to implement the expansionary economic policy in 2020, the monetary policy rate was even reduced to 2%.

Nevertheless, the decline in economic growth was -6.9%. The reason is exogenous factors, the crisis caused by the pandemic and the sharp decline in aggregate supply and demand. Instead, the inflation rate was close to the moderate and target rate. Economic recovery in 2021 has also revived

Moldova, with economic growth at 6.8% despite rising monetary policy interest rates.

As the economy grew, so did the inflation rate, which stood at 13.9. We have a similar situation in Georgia. We do not yet have the effect of an increased monetary policy rate on inflation. Inflation is expected to start approaching its target of 3 percent in the medium term.

We do not have a monetary policy interest rate in Montenegro. Inflation 2019-2020. The zero mark was close. It now reaches its historical maximum, 4% due to exogenous factors. The economy is recovering at a serious pace and stands at 10.8%

The inflation targeting regime is considered to be the most effective regime chosen by 40 countries, including all major developed economies and developing countries. Countries with small open economies such as Moldova and Georgia have chosen inflation targeting. Montenegro, as we have already mentioned, does not use the monetary policy rate, it does not take risks.

The impact of monetary policy is not ubiquitous today. There are a number of countries where, given these challenges, monetary policy transmission mechanisms do not work and inflation targeting regimes are not used. The same thing is happening in the country we are considering - Montenegro. The fact that Montenegro is a candidate country for EU membership is clearly not due to the strength of its macroeconomic indicators. Geopolitical factors play a crucial role here.

Conclusions

The challenges that characterize all three countries in terms of inflation targeting regime are: high inflation with corresponding high fluctuations, fiscal deficit and fiscal dominance, high level of dollarization, lack of floating exchange rate (Georgia has a floating exchange rate) and a policy of long-term lag Decisions have a full impact on the economy. Added to this is the Covid-19 pandemic and the recent tensions between Russia and Ukraine.

A study conducted in the present paper showed that both direct and indirect (through inflation control) impacts on the economy and financial stability can be achieved through monetary policy transmission channels and through National Bank instruments.

Monetary policy targeting inflation is in line with the goals of both business development and financial stability. The National Bank of Georgia uses a dot pattern. Georgia, like all developing countries, is characterized by high inflationary fluctuations, therefore it is difficult to approach the inflation target point by point, even in the medium term, and systematic deviation from the target, for whatever reason, weakens the central bank's credibility.

Frequent and significant interventions in the presence of a floating exchange rate, lose the advantage of a real monetary policy template. Developing countries do not have the luxury of ignoring the exchange rate when conducting monetary policy in the context of inflation targeting. Rare interventions in the foreign exchange market are justified in the event of sharp short-term fluctuations, especially in the presence of sufficient foreign exchange reserves, but must clearly serve the purposes of inflation.

It should be noted that the more developed the country, the lower the target. However, this argument alone is not enough to reduce the 3% target. In our opinion, it would not be bad if the National Bank uses the "tolerance threshold of +/- 1 percentage point". Setting the right expectations is possible through active open communication.

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აღმოსავლეთ ევროპის ქვეყნებისა და საქართველოს მონეტარული პოლიტიკის შედარებითი ანალიზი

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საკვანძო სიტყვები: მონეტარული პოლიტიკის განაკვეთები; ინფლაცია; ეკონომიკური ზრდის ტემპი; აღმოსავლეთ ევროპა; ეროვნული ბანკი
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ანოტაცია. *მონეტარული პოლიტიკა ქვეყნის მაკროეკონომიკური პოლიტიკის მნიშვნელოვანი შემადგენელი ნაწილია. ცენტრალური ბანკები თავის გავლენას ეკონომიკაზე ახორციელებენ ფულის მიწოდების ცვლილებით, სათანადო ინსტრუმენტების გამოყენებით თავისუფალ ფინანსურ ბაზარზე. ამ ინსტრუმენტების ერთობლიობა გვაძლევს ეროვნული ბანკის საოპერაციო ჩარჩოს. ესენია: რეფინანსირების განაკვეთი, რეზერვირების კოეფიციენტი და ღია საფინანსო ბაზრის ოპერაციები. როდესაც რეალური საპროცენტო განაკვეთი მაღალია*

რეალური მშპ-ს ზრდაზე, ეს ნიშნავს რომ გამკაცრების პოლიტიკასთან გვაქვს საქმე და მშპ-ს ზრდის ტემპთან ერთად ინფლაციის მაჩვენებელიც უნდა შემცირდეს.

2020 წლის მონაცემებით, სამივე განსახილველი ქვეყნის მაგალითზე რეალური მშპ-ს ზრდის ტემპი მეტია საპროცენტო განაკვეთზე. სამივე შემთხვევაში საქმე გვაქვს გამკაცრების პოლიტიკასთან. ამ ქვეყნების საოპერაციო ჩარჩოს კომპონენტების განხილვის შემდეგ შევძლებთ გავნსაზღვროთ დინამიკაში რომელი რეგულატორები გვაძლევენ მშპ-ს ზრდისა და ინფლაციის შემცირების ტენდენციებს.

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