ECB LEGAL MEASURES ACCORDING TO THE FINANCIAL CRISES

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Abstract: *The 2008 financial crisis hit the European financial system especially during 2010 and early 2011 where market confidence fell again The Eurozone knew the hardest time in the so-called debt crisis.*
The ECB came up by presenting some technical measures. The question needs to be addressed is if the ECB monetary policy has been extremely accommodating in recent years and has been effectively accommodating to address the threat of deflation in the Eurozone?

Key words: *Financial crisis, monetary policy, legal measures, European Central Bank, Eurosystem, Fed and BoE*.

1. INTRODUCTION

The financial crisis of 2007–2008, is considered by many economists to have been the worst financial crisis since the Great Depression of the 1930s. The Eurozone crisis has made it very difficult or impossible for some countries in the euro area to repay or re-finance their government debt without the third parties assistance. The purpose of un-conventional monetary policy is to increase liquidity and reduce lending costs to an economy in order to promote consumption and investment.

Non-traditional monetary policy ideas rely on the fact that an economy is influenced by interest rates beyond the nominal rate. Reducing of interest rates of these instruments through central bank operations may further stimulate the economy - this is what is often called a monetary policy with the balance sheet monetary policy.

Given the economic justification, the central banks of some of the developed economies began to make extensive use of non-traditional monetary policies after the 2008 financial crisis. Mainly asset purchases focused on two main directions: buying long-term government bonds so that reduce the long-term rates of the economy and affect ever more remote investment as well as the purchase of private assets but mainly securities based on mortgage loans.

Much of these theories were discussed during the economic crisis in Japan in the 1990s and beyond. Not by chance, one of the chief economists who focused their studies on this event was Ben Bernanke, the Federal Reserve Governor in the US during the 2008 financial crisis. Were the events in Japan that had created his economic thinking but also other econmists, for non-traditional monetary policy options.

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ECB MONETARY POLICY FRAMEWORK

The legal basis for the single monetary policy based in the Treaty on European Union (TEU), the Treaty on the Functioning of the European Union (TFEU)[86], the Statute of the European System of Central Banks and the European Central Bank (the Statute of the ESCB).[87] According to Article 127.1 and Article 282.2 of the Lisbon Treaty on the Functioning of the European Union (TFEU). The European System of Central Banks (ESCB) price stability shall act in accordance with the principle of an open market economy with free competition[88], favoring an efficient allocation of resources, and in compliance with the principles set out in Article 119 of the Treaty on the Functioning of the European Union.[89]

The Outright Monetary Transactions (OMTs) is new monetary policy mechanism with limited transactions in secondary markets for sovereign bonds and attached to an appropriate European Financial Stability Facility (EFSF)/European Stability Mechanism (ESM) .

The ECB Governing Council guarantees that the purpose in OMTs is one of monetary policy to maintain the inflation rate below, but close to 2% over the medium term.[90]

ECB UNCONVENTIONAL MONETARY POLICY

In the euro area sovereign crisis in started in 2010. At that time, markets faced the problems of the solvency of countries with higher debt and fiscal deficits. The European-banking crisis started during 2011, when the sovereign debt crisis bubbles over Spain and Italy. The unconventional measures implemented by ECB are; Direct Quantitative Easing, Direct Credit Easing, Indirect Quantitative/Credit Easing and Exit strategy.

The main Policy Actions provided by the ECB are *Supplementary Long Term Refinancing Operations (SLTROs), with maturity between six months, one year*, and “Very” *Long Term Refinancing Operations (VLTROs), with maturity of three years*. The ECB changed the maturity structure by providing collateralized loans over longer than usual time horizons by introducing. Three month long term refinancing operations (LTROs / SLTROs), in March 2008.

In December 2011, as the sovereign crisis intensified and bank-funding conditions further deteriorated, the ECB announced two “very” long-term refinancing operations (VLTROs) with three-year maturity.

The liquidity created by bond purchases under the SMP was sterilized by the ECB via weekly liquidity absorbing operations. From May 2010, purchases were limited to Greek, Portuguese and Irish Government bonds.[91]

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[86] Both treaties known as Lisabon Treaty, which is the latest Treaty of the EU.
[87] European Central Bank, 2011. *The MoneTary Policy of the ECB 2011*. Frankfurt:
[88] This is a formulation that is written in all Constitutions of the member states of EU as a guarantee of well functioning of the economies of each members.
[89] Official Journal of the European Union, 2012. *Protocol (No 4)on the Statute of the European System of Central Banks and the European Central Bank.* C 326/230 ed. Frankfurt:
[90] Cour-Thimann, Philippine; Winkler, Bernhard, 2013. *The ECB’s non-standard monetary policy measures the role of institutional factors and financial structure.* 1528 ed. page no.5 paragraph 1,2.
[91] Marcel Fratzscher DIW Berlin, Humboldt-University Berlin and CEPR, 2014. *ECB Unconventional Monetary Policy Actions: Market Impact, international Spillovers and Transmission Channels.* Washington DC: IMF

The market conditions improved during early 2012, the ECB stopped purchasing bonds it was the end of SMP and introduction of the ECB new instrument OMT in order to stabilize the markets. This instrument consists of unlimited purchases of government bonds to the three year maturity issued by countries under a European Stability Mechanism (ESM).[92]

End of October 2014, ECB Governing Council decided to launch an ABS Purchase Programme (ABSPP) and a third Covered Bond Purchase Programme (CBPP3). This was followed by the decision to launch a Public Sector Purchase Programme (PSPP) in addition to the existing purchase program, on 22 January 2015. On 10th of March 2016, ECB adds corporate sector purchase program (CSPP) to the asset purchase Programme (APP).[93] These purchases started in June 2016. ECB and National Central Banks (NCBs) conducting purchases with their existing monetary policy counterparties, including counterparties they trade within the context of their own investment activities.[94]

Asset Purchases Programme (APP) had a significant impact on government bond spreads across Eurozone issuers. ECB will end asset purchases in the end of 2018.[95]

ECB CONVENTIONAL MONETARY POLICY

Before the financial crisis, central banks of advanced economies followed a standard monetary policy where the short-term interest rate was the main instrument of monetary policy.

The result of conventional monetary policy proved ineffective. Unconventional monetary policy takes many forms, for instance Denmark and Sweden, it involves the use of negative interest rates.

The Federal Reserve implemented policies known as 'credit easing' when they purchased mortgage-backed securities. The Federal Reserve has also implemented 'Operation Twist' by selling short-term government bonds and uses the proceeds to buy long-term bonds whereas drives up their price and lowers long-term interest rates.

The ECB acted in response to the financial crises with decisions as early as 9 August 2007 by using the conventional actions with low and stable inflation which is the aim of monetary policy. The depth of the recession in many countries meant that Taylor rules[96] would recommend negative nominal interest rates but market interest rates are effectively close to zero and negative because agents can always hold non-interest bearing cash.

Banks were holding onto funds to improve their viability rather than on-lending to the private sector, requiring some central banks to intervene with the direct provision of credit.[97] ECB

[92]Marcel Fratzscher DIW Berlin, Humboldt-University Berlin and CEPR, 2014; *Unconventional Monetary Policy Actions: Market Impact, International Spillovers and Transmission Channels* *. JEL Codes: E52, E58, F32, F34, G15. ed. Washington: IMF Paper presented at the 15th Jacques Polak Annual Research Conference page number 5,6 &7 .

[93] Gregory Claeys, Álvaro Leadro and allison Mandra, March 2015, 2015. ECB *Quantitative Easing : The detailed Manual.* na ed. Belgium: BruegelPolicy Contribution.

[94] ECB Press Release, 2015. *ECB announces expanded asset purchase programme.* 1 ed. Frankfurt:

[95] European Central Bank (ECB), 2018. *Public sector purchase programme (PSPP) - Questions & answers* .

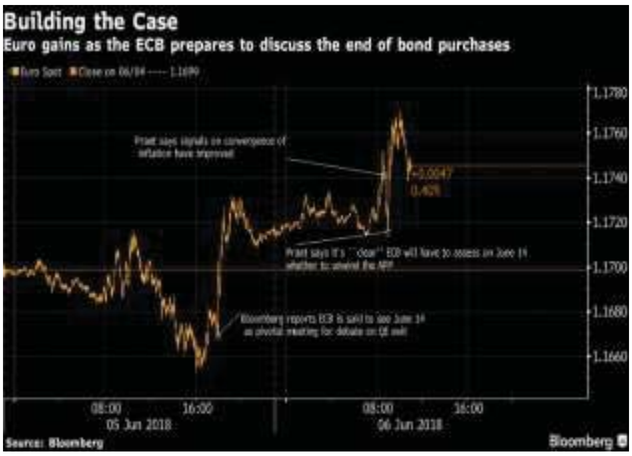
[96] The **Taylor rule** is a reduced measure for each one-percent increase in inflation, the central bank tends to raise the nominal interest rate by more than one percentage point. Taylor rule was proposed by John B. Taylor.

[97] Michael Joyce, David Miles, Andrew Scott and Dimitri Vayanos, 2012. QUANTITATIVE EASING AND UNCONVENTIONAL MONETARY POLICY – AN INTRODUCTION*. F271–F288;

meeting on June 5, 2018, interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility would remain unchanged at 0.00%, 0.25% and -0.40% respectively and asset purchase target at EUR 30bn per month. It will be better for ECB to end the QE and solve potential Italian and other euro area political problems with more appropriate instruments.[98]

Date		Deposit facility	Main refinancing operations		Marginal lending facility
With effect from			Fixed rate tenders	Variable rate tenders	
2016	16 Mar.	−0.40	0	-	0.25
2015	9 Dec.	−0.30	0.05	-	0.3
2014	10 Sep.	−0.20	0.05	-	0.3
	11 Jun.	−0.10	0.15	-	0.4
2013	13 Nov.	0	0.25	-	0.75
	8 May.	0	0.5	-	1
2012	11 Jul.	0	0.75	-	1.5
2011	14 Dec.	0.25	1	-	1.75
	9 Nov.	0.5	1.25	-	2
	13 Jul.	0.75	1.5	-	2.25
	13 Apr.	0.5	1.25	-	2
2009	13-May	0.25	1	-	1.75
	8 Apr.	0.25	1.25	-	2.25
	11 Mar.	0.5	1.5	-	2.5
	21 Jan.	1	2	-	3
2008	10 Dec.	2	2.5	-	3
	12 Nov.	2.75	3.25	-	3.75
	15 Oct.	3.25	3.75	-	4.25
	9 Oct.	3.25	-	-	4.25
	8 Oct.	2.75	-	-	4.75
	9 Jul.	3.25	-	4.25	5.25

Table no.1. ECB Interest rate veils in percentage per annum[99]



Source: Bloomberg

[98] Swedbank, 2018. ECB Preview: all eyes and ears on the end date of the QE. *Macro focus,* Issue
[99] ECB Key Rate

UNITED STATES UNCONVENTIONAL MONETARY POLICY

FED's strategy focused mainly on two financial instruments, long-term bonds and mortgage-backed securities (MBS). The acquisition of both instruments aimed at reducing long-term interest rates as the mortgage market is considered one of the main channels of the US monetary transmission mechanism, as it represents a significant long-term investment.

In this way the Fed tried to persuade agents that the rates would remain low over a prolonged period. Buying MBS was very important in maintaining the value of housing by a drastic reduction. The Federal Open Market Committee (FOMC) to lift the federal funds target rate range another 25 basis points (bps) to 1.75% to 2.00% when the committee meets second week of June 2018. Majority of Committee members' seems to be comfortable with further gradual rate increases as 25 bps increase according to the monetary policy outlook.

Both the global economy and the US economy are on a much sounder footing compared to when similar episodes of market turmoil caused the FOMC to postpone rate increases in 2016.

The unemployment forecast for the end of 2018 was median 3.8% in March, which is considered to be revised down of the 3.8% as of May as upward revision to the median number of hikes foreseen in 2018. There is an expectation of insistence on the symmetric inflation target and on the appropriateness of further gradual rate hikes whereas federal funds rate approaching levels that are more neutral.[100]

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In 2008, she completed Master studies at the same University. In the course 2014, Ms. Nahi became a PhD Candidate, Banking and Finance, University of Pristina.
From 2011 until 2015 she was working part - time as Teaching Assistant for Financial Decision and Financial Strategy-Master Program and Lecturer for Risk Management - Bachelor Program to the Universum College.
Ms. Nahi joined Central Bank of the Republic of Kosovo (CBK) from 2001. Currently she is Director of the CBK's Asset Management Department.
She is also member of the CBK's Investment Committee and the Macro-Prudential Advisory Committee and Liquidity Committee. In her role as Director of the Asset Management Department, she works for recommendations to the CBK's Investment Committee for the CBK investment strategy and on changes to the CBK investment Policy.
In 2011, she was appointed as Project Manager for the Government Securities Project.
During her professional career, Ms. Nahi has participated in a number of international conferences, trainings and various workshops closely related to the field of Asset Management and Financial Investments.

[100] Swedbank Macro Research, 2018. Market turmoil will not deter FOMC from a hike. Issue

GREAT BRITAIN UNCONVENTIONAL MONETARY POLICY

The other major case of a developed economy that has taken similar measures to non-traditional monetary policy is the Bank of England. The Bank of England (BoE) is oriented as FED towards mortgage-backed assets and UK government long-term bonds. Unlike the Fed where the targeted unemployment rate was used, the BoE has consistently repeated that low rates will stay for a prolonged period.

Between 2009-2012 the BoE, via its Asset Purchase Facility (APF), was authorized to purchase assets valued at £375 billion. QE was implemented to address the threat of deflation with the official Bank Rate being cut to 0.5 per cent in March 2009. Asset purchases affected by purchases of long-term securities with greater duration or higher credit risk. BoE commits to a monetary policy by reducing short and long-term interest rates and increasing bank deposits and reserves created by asset purchases from non-bank institutions.

The BoE applied QE by involved the purchase of public and private sector assets using central bank money while supporting price stability and the government's economic policies for growth and employment. The BoE electronically creates new money and uses it to purchase from private investors such as pension funds and insurance companies. With low yields and low return, tend to use it to purchase other assets, such as corporate bonds and shares. That lowers longer-term borrowing costs and encourages the issuance of new equities and bonds.[101]

ECB ROLE DURING FINANCIAL CRISES

The ECB's reaction is based on monetary policy framework based on two pillars the monetary policy strategy, to maintain price stability and the operational framework, whereas ECB has the desired interest rate.[102]

The euro area crisis is facing the weaknesses of financial and banking system by lacking of a properly banking policy framework. Another aspect of the crisis is a big divergence development between northern countries such as Germany, France and southern European countries such as Greece, Portugal, Spain and Italy. The divergence of the southern euro states are structural, acting on productivity and economic growth.[103]

*Mr. **Flamur Mrasori** was born on September 5, 1983 in Gjakova. In 2005, he has completed his bachelor studies at the Faculty of Law of the University of Prishtina. In recognition of his achievements during the studies, he was given the "Distinguished Student" award by the University of Pristina. In 2008, he completed the Master studies at the Faculty of Law of the same University. In the course of his academic development, in 2016, Mr. Mrasori has completed his doctoral studies in the field of International Law at the University of Prishtina. Currently, he is Professor at the Faculty of Law in the University of Pristina, the International Law Department. His focus is on the European Union Right and Private International Law. During his academic career, Mr. Mrasori has published various scientific works from the field of jurisprudence and European integrations. He has also participated in a number of international conferences and workshops, which are closely related to the field of jurisprudence and integration in general, and particularly in financial integration.*

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[101] Timothy Sharpe and Martin Watts, 2013. Unconventional Monetary Policy in the UK: A Modern Money Critique. 18, Part 2(Economic Issues, pp. 43-46.

[102] Angelos Delivorias European Parlament, February 2015. Monetary policy of the European Parlament., p. 3.

[103] Magdalena RADULESCU, 2015. ECB'S MONETARY MEASURES DURING THE FINANCIAL CRISIS.

Italian impact on the economy of the Eurozone is rather limited and government proposals are completely out of line with the European budget rules. It is necessary to convince Northern Eurozone Member States of the benefits to increase mutual risk sharing.[104]

Italy's anti-establishment coalition proposed to issue securities which are called as mini-BOTs as short term Treasury Bills as a form of money to be "spent anywhere, to buy anything."

Italy's public debt, already is the highest in the euro zone after Greece's. It could be out of EU rules giving the ECB exclusive power to issue new currency in the euro zone.[105]

The ECB has interefered about outstanding Italian government debt through its QEP and net supply of government bonds is projected to be negative for the remainder of the year. Italy's high debt-to-GDP ratio, is 130%, the second largest in the Eurozone after Greece and the world's fourth largest.[106] Italian bonuses offered the alternative with better returns and at the same time higher risk. In this scenario, alluding that there will be no government breaks in Italy and will continue with the measures to reduce the budget deficit; the horizon seems unclear until the end of 2018. Of course, debt instruments from Germany, Belgium, France and the Netherlands will continue to offer minimal returns to investors as the level of risk is not so clear until the monetary policy measures of the ECB show expected results or show that it has need for stronger new measures. Until then, investors in these markets may eat not well but sleep safely.

CONCLUSION

Treaty of Lisbon had rapidly improved the legal base for ECB to take the adequate measures in order to pass the challenges that comes from the crisis. Especially the extension of the ECB competences on the member states banks supervision shows that the legal measures mention about performed by ECB was and are necessary.

Compared to the FED and non-Eurozone countries (CBs) the ECB legal measures was more effective and not only on supporting the price stability and monetary policy as key duties of ECB but they had effect also on recuperation of member states banking sector and its economies in general.

ECB interventions so far have been limited by the purchase of government bonds of so-called "peripheral" countries during the Euro 2011-12 crisis to calm the financial markets and prove that a lender of last resort existed in the Eurozone. Since that time, the ECB has used its communication more than concrete actions with the balance.

Recent economic developments, where low inflationary pressures dominated are urging the ECB to seriously consider further actions similar to BeE and FED. Lending in the Eurozone is still largely dependent on the traditional banking sector and not from the financial markets. Consequently, the purchase of various financial assets may not be the optimal solution for the ECB. Italian bond yields have come down, as the government has been approved by the

[104] RaboResearch Global Economics & Markets mr.rabobank.com, June 2018. And the it happened; Is the Eurozone (economy) in trouble?. *RaboResearch* , Issue

[105] Reuters, 2018. How Italy's mini-BOT 'parallel currency' would work. *World news,* Issue p. 1

[106] Goldman Sachs -Asset Management, Investment Commentary June 2018 . *Global Fixed Income Monthly - European Politics: Italy Update.* s.l.:Goldman Sachs –Asset Management;

president, but future policy remains very uncertain. Confrontation with the EU, reversing past reforms, expansion of fiscal deficit could create fear and volatility again.
Italy will increased uncertainty regarding ECB policy normalisation and risk of contagion to Spain, Portugal, and France.

The three main problems that highlighted the financial crisis were; firstly in advanced countries, a lack of monetary policy transmission through interest rates, between different asset classes and credit spreads, was noted; Secondly, the weaknesses and uncertainties of the increased contractures of some markets; Third, the sharpness of the recession brought monetary policy to react more, bringing interest rates to their zero rates.

Lastly, as a counter-response to the above-mentioned problems, central banks acted through non-trivial policies to address mainly two objectives: return to good functioning of financial markets and financial intermediation, as well as providing a major stimulation to monetary policy. These are different, but at the same time very linked, as they aim to support the country's macroeconomic stability, and reduce the risks posed by the crisis to emerge from the financial system's collapse, depression and deflation.

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