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MONEY AGGREGATES IN EUROPEAN COUNTRIES

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A B S T R A C T

Monetary aggregates play a crucial role in understanding the financial landscape of any economy, serving as key indicators of its monetary policy effectiveness and economic health. In the European context, where monetary policy decisions are shared among multiple countries within the Eurozone, analyzing monetary aggregates becomes even more significant. This article delves into the concept of monetary aggregates and examines their relevance in the context of European countries.

K E Y W O R D S

Monetary Aggregates, Eurozone, Central Banks, M0, M1, M2, M3, Liquidity, ECB (European Central Bank), Monetary Policy.

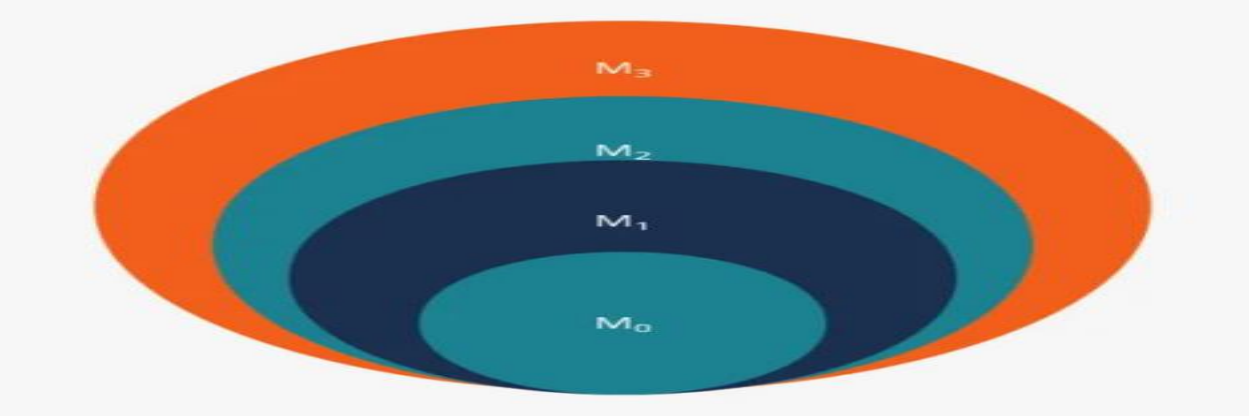
Introduction

The main objective of the Eurosystem, which consists of the European Central Bank (ECB) and the national central banks of the member states that have adopted the euro, is to maintain price stability. Since there is broad agreement that price level developments in the medium and long term are monetary phenomena, changes in the amount of money held by the public can reveal useful information about future price movements and thus can offer an important compass for keeping one's self. monetary policy. In addition, the analysis of monetary aggregates helps to make an overall assessment of developments in the financial system and the wider economy[1].

A monetary aggregate can be defined as a unit of money in circulation and, broadly speaking, the outstanding amount of certain liabilities of financial institutions that have a high level of "moneyness" or liquidity. The Eurosystem defined a narrow (M1), "intermediate" (M2) and broad aggregate (M3). These aggregates differ according to the monetary level of the assets included. According to analysis by the IMF and its predecessor, the European Monetary Institute, broad monetary aggregates in the euro area may be less controllable in the short term, but narrower in terms of stability and price information content over the medium term. has more convenient features than others.

The monetary policy strategy of the Eurosystem requires defining a monetary aggregate that is a stable and reliable indicator of inflation in the medium term. Therefore, the Governing Council of the YMB decided to play an important role in the monetary policy strategy by announcing the reference value for the annual growth rate of the broad monetary aggregate M3.

[1] Euro area monetary aggregates - Czech National Bank (cnb.cz)



M1 - sum of currency and overnight deposits in circulation;
M2 - the amount of M1, deposits with an agreed term of up to two years and deposits that can be paid with a notice of up to three months;
M3 is the sum of M2, repurchase agreements, money market fund shares/units, and debt securities with maturities of up to two years[2].

Liabilities	M1	M2	M3
Currency in circulation	X	X	X
Overnight deposits	X	X	X
Deposits with a term of up to 2 years		X	X
Refundable deposits with up to 3 months notice		X	X
Repurchase Agreements			X
Money Market Fund (MMF) Shares/Units and Money Market Paper			X
Debt securities up to 2 years			X[3]

Monetary aggregate refers to the important parameters of the money supply. So, first, let's have a brief understanding of the latter. Money supply refers to the circulation of cash and its equivalents in the economy. However, it is cash, bank accounts, investments and other assets held in hand. Therefore, the supply must be optimal. Otherwise, macroeconomic problems may arise.
For example, if supply is high, people will have more money to spend, which increases demand. As a result, demand increases the price level leading to inflation, which is a serious concern for the central bank. Likewise, if the money supply is lower, people will have less money, which will stifle their ability to purchase basic goods. Moreover, it slows down the economy and harms the country. So the relationship between the money supply and inflation can be complicated. Therefore, central banks use monetary policy tools such as adjusting interest rates and reserve requirements to control the growth rate of the money supply and manage inflation[4].

[2] Monetary aggregates (europa.eu)
[3] Euro area monetary aggregates - Czech National Bank (cnb.cz)
[4] Monetary Aggregates - What Is It, Types, Vs Liquidity Aggregates (wallstreetmojo.com)

Given the sensitivity of the issue, the government regularly checks the money supply. One of the best ways to do this is by measuring monetary aggregates. Using this parameter, the central bank can understand how much money is locked up at different liquidity levels.

Monetary aggregate and liquidity aggregate are two different ways of measuring the amount of money or financial assets in the economy. Let's take a look at the difference between the two.

When both monetary aggregates and liquidity aggregates are used to analyze aspects of money supply and financial liquidity, monetary aggregates provide a broader view of money in circulation, while liquidity aggregates pay particular attention to the availability and sale of liquid assets in the financial system.

Monetary aggregate	Liquidity aggregate
It refers to the wide range of money supply, which includes different types of money and financial assets	Liquid aggregate refers to financial investments that can be easily converted into cash.
Includes less liquid assets such as savings deposits, time deposits and institutional money market funds	These include highly liquid assets such as cash, checking deposits and money market instruments
It is used to monitor the overall growth of the money supply and measure the effectiveness of monetary policy	It is used to assess the liquidity position of individuals, enterprises and financial institutions
M1, M2, M3 are commonly used measurements	Examples of liquid aggregates include cash, checking accounts, and short-term, low-risk debt securities[5].

The role of monetary aggregates in European monetary policy is the subject of ongoing debate and scrutiny among economists, policy makers and financial analysts. While some argue that monetary aggregates remain relevant indicators for policy decision-making, others argue that financial markets and the Eurozone economy

under the conditions of complexity, they emphasize that their importance has decreased. In this commentary, I explore both perspectives and offer insights into the role of monetary aggregates in shaping European monetary policy.

Supporters of the traditional view emphasize the importance of monetary aggregates as the main tool for effective management of monetary policy for central banks. From this perspective, measures such as M1, M2, and M3 provide valuable information about the level of liquidity in the financial system, inflationary pressures, and overall economic activity. By closely monitoring changes in monetary aggregates, central banks can assess the effectiveness of their policy interventions and make timely adjustments to achieve policy objectives such as price stability and sustainable economic growth[6].

In addition, proponents of monetary aggregates argue that these measures serve as useful benchmarks for evaluating the transmission mechanism of monetary policy. Changes in monetary aggregates can indicate the extent to which changes in central bank interest rates are transmitted to the broader economy through channels such as bank lending and consumer spending. By analyzing the

[5] Monetary Aggregates - What Is It, Types, Vs Liquidity Aggregates (wallstreetmojo.com)
[6] Mishkin, F. S. (2007). The economics of money, banking, and financial markets (8th ed.)

relationship between monetary aggregates and economic variables, policymakers can improve their policy strategies and increase the effectiveness of their interventions.

However, critics of the traditional view argue that the importance of monetary aggregates in the management of monetary policy has declined in the context of the Eurozone economy. They point to several factors that have undermined the usefulness of these measures, such as financial innovation, globalization, and the integration of national economies into a single currency area. In particular, the proliferation of new financial instruments and the disappearance of traditional distinctions between money and credit have made it increasingly difficult to accurately measure and interpret monetary aggregates.

In addition, skeptics argue that too much focus on monetary aggregates can lead policymakers to overlook other important factors shaping the economy, such as asset prices, exchange rates, and fiscal policy. In today's interconnected and complex financial markets, a narrow focus on monetary aggregates may not capture the full spectrum of dynamics that drive economic outcomes. As a result, policymakers need to adopt a more holistic and forward-looking approach that takes into account a broader set of indicators and considers the interplay between monetary, fiscal and structural policies[7].

Based on these arguments, it is clear that the role of monetary aggregates in European monetary policy is subject to interpretation and debate. While traditionalists advocate their continued use as key indicators for policy decision-making, skeptics question their relevance in the face of changing economic realities. Ultimately, the effectiveness of monetary aggregates in shaping European monetary policy depends on the ability of politicians to adapt to changing conditions, incorporate new information, and maintain a balance between tradition and innovation within their policies.

The European Central Bank (ECB), which is responsible for setting monetary policy in the Eurozone, closely monitors monetary aggregates to assess the effectiveness of its policy decisions. Changes in monetary aggregates can provide insight into the level of liquidity in the financial system, inflationary pressures, and overall economic activity. By adjusting interest rates and implementing other policy instruments, the IMF aims to influence monetary aggregates to achieve its policy objectives, such as price stability and sustainable economic growth.

However, according to the information, various problems arose when YMB chose money as the first pillar. First, changes in the broad monetary aggregate cannot be controlled by the Central Bank, since the monetary base is a small part of M3, while other components of M3 can change independently depending on the changes in the monetary base, which the YMB can directly control. Second, M3 growth was well above the 4.5% target, while inflation was close to its 2% target. The average annual growth rate of M3 was about 7.2%, while inflation was only 2.1%. 1999-2007 years. Therefore, the YMB's strategy of price stabilization through monetary controls appears to have failed, perhaps due to velocity instability over time, especially in the last decade. Finally, the OECD (2007) found that monetary indicators are less reliable than other indicators such as the output gap or GDP growth in predicting inflation, and that the "noise-to-signal" ratio of monetary growth is significant. emphasizes. As a result, YMB seemed to ignore the money supply numbers, which caused credibility problems[8].

[7] Goodhart, C. A. E. (2007). Whatever became of the monetary aggregates? In The Role of Money: Money and Monetary Policy in the Twenty-First Century (pp. 185-207). Edward Elgar Publishing.

[8] Monetary Aggregates In The European Monetary Policy Strategy Economics Essay | Free Economics Essay (essays.pw)

Therefore, the focus on the monetary pillar disappeared and the YMB adapted its strategy to an inflation targeting regime, where monetary analysis became the second pillar, while the previously dominant economic analysis was evaluated on the first. As a result, the role of monetary aggregates in the monetary policy strategy gradually decreased.

Seasonal adjustment is the process of estimating and removing seasonal effects from a time series. Seasonal adjustment procedures used by YMB also serve to adjust the calendar where appropriate.

The approach used for seasonal adjustment of euro area monetary aggregates and counterparts relies on multiplicative decomposition using the X-12-ARIMA method. Outliers are taken into account to minimize distortions in estimated seasonal and calendar adjustments[9].

To ensure that seasonally adjusted components are additional to seasonally adjusted aggregates, some seasonally adjusted series, notably M3, are derived indirectly. The difference between direct and indirect valuations of euro area monetary aggregates is regularly monitored and generally proven to be insignificant.

Seasonal forecasting factors are applied and revised when the models used are statistically insufficient, for example, when large amounts of data are revised or when new data are introduced. For this purpose, an adjustment is made at the same time every month to assess the validity of seasonal factors in use.

Summary

In conclusion, monetary aggregates serve as fundamental metrics for understanding the monetary policy environment in European countries. However, their analysis requires a nuanced approach, considering the diverse economic structures and policy priorities across the region. While these aggregates offer valuable insights into the money supply and its implications for inflation, economic activity, and financial stability, they should be interpreted alongside other economic indicators and contextual factors. Moreover, policymakers must remain vigilant and adaptive in their approach, recognizing the evolving nature of monetary dynamics and the potential impact of global economic trends. A comprehensive understanding of monetary aggregates is crucial for crafting effective monetary policies that promote sustainable economic growth and stability in European countries.

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