Chapter 51
Monetary Policy Operations of Central Banks in the E7 Economies

Hasan Dinçer
İstanbul Medipol University, Turkey

Serhat Yüksel
İstanbul Medipol University, Turkey

ABSTRACT

Both monetary and fiscal policies have a crucial role in the financial markets of the countries. In this framework, policies can be used for mainly two different purposes, which are contractionary and expansionary policies. Hence, it can be said that monetary policies play a key role especially for the emerging economies. The main reason is that these are the economies that aim to be a developed economy. In order to reach this objective, they aim to make investment to obtain sustainable economic growth. Similar to this aspect, this chapter aims to identify different monetary policy operations of the central banks. Thus, various monetary policy instruments are explained. After this issue, necessary information is given related to the central banking operations of E7 economies. As a result, it is defined that central banks of these countries play an active role especially during the recession period.

GENERAL INFORMATION ABOUT MONETARY POLICIES

Monetary policy and fiscal policy are two important tools used to regulate a country's economic activities. Monetary policy usually deals with interest rates and control of money supply (Wu and Xia, 2016). That is to say, by changing interest rates or the amount of money in the market, central banks aim to take some actions to reach their objectives. Another important point in this circumstance is that the central bank is the only authority in the country that can implement monetary policies. The main reason behind this issue is to provide independence of the central banks (Bruno & Shin, 2015; Gali, 2015).

DOI: 10.4018/978-1-6684-7460-0.ch051

On the other side, fiscal policy is a general name given to government regulations on tax and government expenditures. In other words, governments can increase or decrease the tax ratio in order to reach their purposes (Gertler & Karadi, 2015). Similar to the tax ratio, expenditures made by the governments have an important influence on the financial market and economic development of the country as well. As it can be understood from this definition that fiscal policies are implemented by the governments (Bergsten, 2017; Rendahl, 2016).

In summary both monetary and fiscal policies have a crucial role in the financial markets of the countries. In this framework, policies can be used for mainly two different purposes which are contractionary and expansionary policies. The aim of the contractionary monetary policy is to reduce the money supply in the market. Hence, it is obvious that this kind of policy is usually applied to reduce inflation in the country. In this context, it is aimed to reduce consumer demand by reducing money supply (Nelson et al., 2018).

In addition to them, central banks aim to increase the money supply in the market through expansionary monetary policy. The important point in this circumstance is that central banks implement these policies when there is no inflation problem in the country. Because of this situation, central banks aim to obtain financial stability. Thus, the actions are taken mainly to increase investment amounts. With the help of these policies, unemployment can be decreased in the country as well (Neely, 2015; Coibion et al., 2017).

On the other hand, if a government does not think there is enough economic activity in the country, it aims to implement expansionary fiscal policies. Within this framework, it is possible to improve the economy by increasing government expenditures. In addition to this policy, the government can also reach this objective by changing tax rates. When the tax rates are decreased in the country, this situation has an increasing effect on the investment amount (Fratzscher et al., 2016; Rey, 2016). Therefore, it plays a very important role to increase economic activity. Similarly, these policies can be implemented on the opposite way. It means that the government can implement contractionary fiscal policy by increasing tax rates and reducing government expenditures (Dellepiane-Avellaneda, 2015).

Monetary policies play a very key role especially for the emerging economies. The main reason is that these are the economies that aim to be a developed economy. In order to reach this objective, they aim to make investment to obtain sustainable economic growth. However, if this strategy is implemented with an uncontrolled manner, there may be some problems in the economy, such as inflation. Therefore, it is obvious that central banks of these countries have a great importance for this situation (Angrist et al., 2018; Obstfeld & Duval, 2018).

Parallel to the issues emphasized above, in this section, first of all, monetary policy instruments of the central banks are explained. In this scope, necessary information is given related to the required reserve ratio, rediscount rate, open market operations, standing facilities and asset purchase program. After this topic, central banking in the major seven emerging economies (E7) is identified.

MONETARY POLICY INSTRUMENTS OF CENTRAL BANKS

The policies implemented by central banks to achieve price stability, employment growth and economic growth in a country are called monetary policies. In order to reach this objective, central banks can change interest rates and money supply in the financial market with respect to the monetary policies. The basis of the monetary policy is to influence the consumption and investment expenditures in the country by changing the interest rates. The only authorized institution in the implementation of monetary policy is