

A Comparative Analysis of FED and ECB Reactions to the Global Financial Crisis

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Abstract

This paper will emphasize the evolution of the most important financial indicators of the Eurozone and USA, during 2008-2018. The purpose of this paper is to analyze the actions taken by Federal Reserve and European Central Bank in order to diminish the negative effects and to counteract the 2007-2008 crisis.

Key words: FED, ECB, financial indicators, global financial crisis

J.E.L. classification: E52, E58

1. Introduction

Through this paper, I propose to present a brief analysis of the two most important central banks in the world (Federal Reserve and European Central Bank) response to the global crisis, which debuted in 2007 in the USA, as a subprime crisis. I will do an analysis of US economy and Eurozone economy during 2008-2018. I will try to look at the same indicators as "the main difference between the two central banks is how they looked at the evolution of the economy" (Hetzel, 2012).

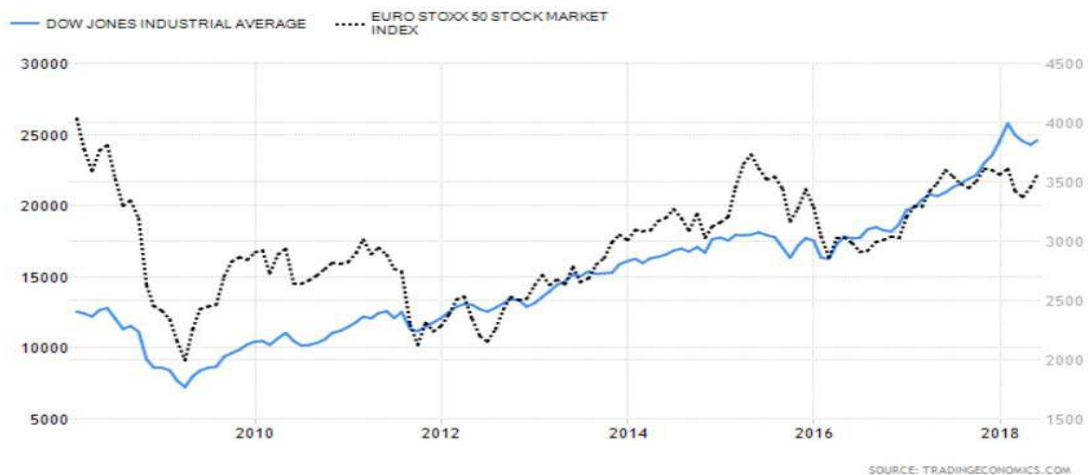
2. Theoretical background

The last crisis showed that central banks monetary policy instruments were not enough. Before the crisis, inflation targeting was considered the most appropriate solution to maintain financial stability, but after this financial challenge, central banks were pressed to focus on finding new ways to create liquidity and maintain stability into the market.

After the crisis, governments pressured central banks to extend their responsibilities beyond the role they were designed for and this could lead to losing their independence. Stephen G Cecchetti (2013) is of the opinion that central banks are pressed by governments to address the structural problems of macroeconomic and financial stability, although it is not their job (Cecchetti, 2013).

Although this crisis was seen at the beginning as a rather US issue, its effects have been felt by the Eurozone even from the start as can be seen in the chart below, illustrating the evolution of stock indices.

Figure no.1. Stock prices 2007-2018



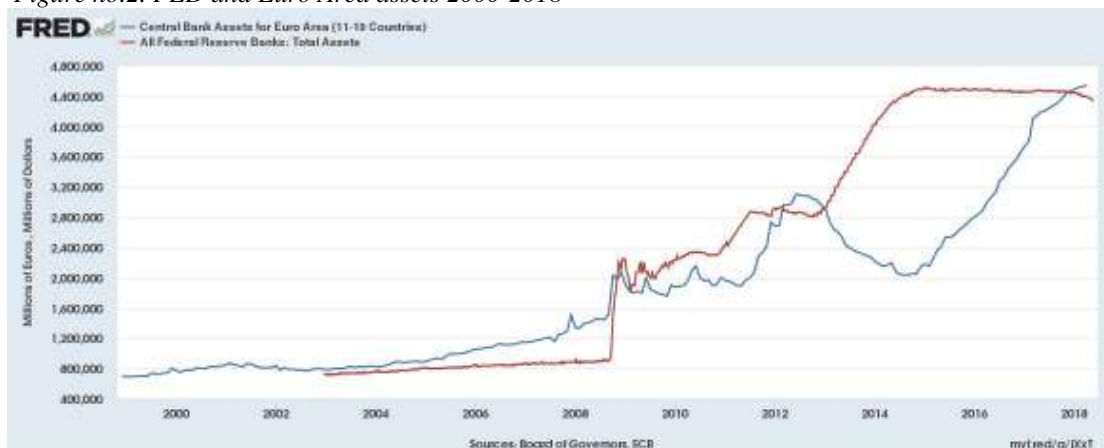
Source: Chart processed by the author using data from <https://tradingeconomics.com/united-states/stock-market> (Access:29.05.2018)

US stock prices and GDP regained pre-crisis levels by the end of 2011 while the Eurozone reached this stage only in 2015. Fiscal stimulation was more strongly used in the United States than in the Eurozone, as special emphasis on solving the situation in the banking system. This has been overlooked for some time by the ECB. Overall, the EDF's monetary policy approach was far more aggressive than the ECB's.

3. Financial indicator analysis

Over the period 2007-2013, both central banks have increased their assets by about 300%, as you can see in the chart below. This increase is equivalent to money creation.

Figure no.2. FED and Euro Area assets 2000-2018



Source: Chart processed by the author using data from <https://fred.stlouisfed.org/series/ECBASSETS#0> (Access:29.01.2018)

Most of the money created was held as reserves, precisely to avoid inflationary repercussions.

Both central banks have had the same approach to lowering the interest rate, but the ECB has been more pervasive and not as radical as the FED. The two central banks we analyze in the present paper have different objectives. ECB's objective is to keep inflation rate below 2% and FED's objective besides the inflation is also to maintain a high GDP growth and maximize unemployment.

The ECB must avoid fragmentation of the euro area financial market (Oganessian, 2013). Unlike the FED, the ECB initially raised the interest rates before cutting them. The monetary policy rate was brought to near 0% in November 2013. Only in March 2015, the ECB launched an asset acquisition program, through which interest rates in the euro area registered negative levels.

The US economy managed to surpass the level reached before the crisis (2007) in the third quarter of 2011. This results came to confirm the economic measures adopted by the FED in the fight against the crisis, through their positive effects.

We cannot say the same for the EU Member States. If we analyze the level of GDP, at EU member states level in 2015, we see that 10 countries have so far failed to reach the 2008 GDP level (Cyprus, Greece, Italy, Portugal, Spain, Latvia, Slovenia, Croatia, Denmark and Finland). In 2017, the Eurozone countries recorded faster economic growth than the US. According to the 2017 Eurostat report, the GDP rose by 2.5% in the 19 countries that adopted the single currency (Eurostat, 2017). This is the best performance since 2007, before the global economic crisis.

Figure no.3. US vs European Union grow rate 2008-2018

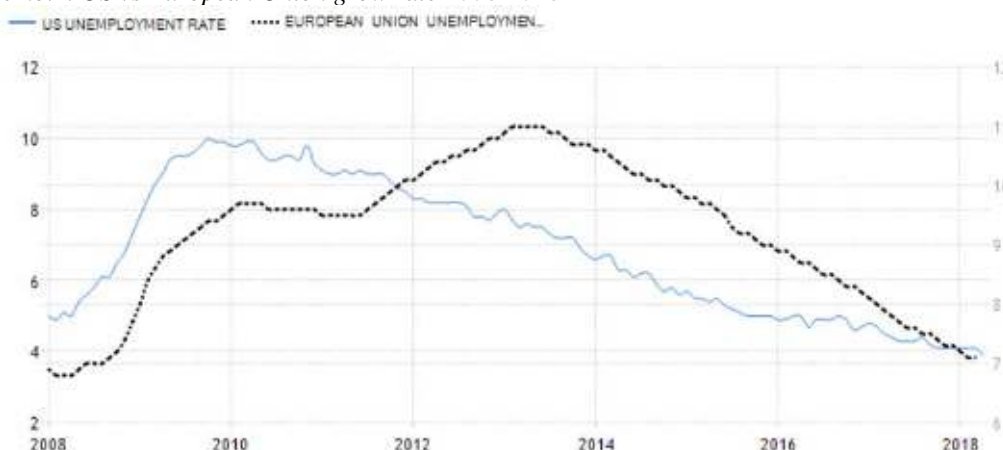


Source: Chart processed by the author using data from <https://tradingeconomics.com/country-list/gdp-growth-rate> (Access:29.05.2018)

The above graphs show the GDP situation in the two areas during 2008-2018. At first glance, we can see that US GDP growth has been much faster than the Eurozone GDP.

In the above chart, we will see the unemployment evolution between 2008-2018.

Figure no.4. US vs European Union grow rate 2008-2018



Source: Chart processed by the author using data from <https://tradingeconomics.com/united-states/unemployment-rate> (Access:29.05.2018)

In terms of unemployment rate, we can conclude that it was much higher in the euro area compared to the United States. Only at the end of 2017 started to be at a similar level.

In the first quarter of 2018, US gold reserves increased to 8,134 tons. The US gold reserves average in the period 2000-2015 was 8135.56 tons. The highest level of 8149.05 tons was recorded in the 3rd quarter of 2001. The lowest level of gold reserves was registered in the third quarter of 2005 (8133.46 tons). Eurozone gold reserves didn't change (504.77 tons) in the fourth quarter of 2015 compared to the third quarter of the same year. The average of the Eurozone gold reserves in the period 2000-2015 was 618.50 tons. The highest level of 766.88 tons was registered in the fourth quarter of 2001. The lowest level of gold reserves was registered in the second quarter of 2009 (501.45 tons). Eurozone Gold reserves are reported by the World Gold Council.

The euro area economy and the United States economy are rising and do not cause inflationary pressures on the labor market. Both provide for a gradual increase in credit costs, although political and economic circumstances are extremely different. These will be reflected in an increase in employment, changes in tax policies.

The US economy increased in 2017 by an annual rate of 2.2%, marking a considerable acceleration from 1.4% in the same period of 2016. In September 2017, the unemployment rate dropped to 4.2%, as in the previous year was 4.9%. The increase in real average earnings was 0.7% in the analyzed period (FED, 2016).

Basic commodity prices increased by 1.7% in 2017, Consumer Price Index (PCEI) stabilized at 1.4%.

The euro area economy grew to 2.3% in the second quarter of 2017. The euro area economy is growing, but the labor market is still huge. Tax policy is in a more delicate situation, political instability can affect consumer spending and business investment.

4. Transparency measures

I can say that the FED has made significant improvements related to transparency. FED was more transparent than ECB with its monetary policy decisions as FED published after each meeting all the necessary information and explanations related to the decision taken. Press conferences with details about the decision taken, economic projections and the evolution of the most important financial indicator, including the federal fund rate are held every quarter.

Also, the FOMC participants have the possibility to explain their views through speeches. William C. Dudley, FED New York executive president considers that this attitude, to greater transparency, "has led the Fed to the right direction" (Dudley, 2016).

The ECB gave only general information on its funding programs, especially related to Securities market program (SMP), publishing only the weekly values of the purchased shares, without giving details of the amount planned for this program, their composition or their maturity. It was speculated that Greek shares were acquired in the first phase of the SMP. Solving the situation in Greece has been a great hurdle for the ECB because it has had to find a way to accept those guarantees but at the same time not to lose credibility.

5. Conclusions

As their objectives are different, the European Central Bank has been more focused more on price stability. The Federal Reserve has been more focused on maintaining the unemployment rate at an appropriate level. The actions taken were different as the structure and the monetary system of the United States and the euro area are different. While the FED has had to support commercial banks and large companies, the ECB has directed its actions in particular to commercial banks.

Although the ECB has not faced the same situations as FED due to its different structure, we can say that both banks accomplished their objectives in saving the financial system for collapse. Indeed, FED's actions were proactive and more firm than the ECB's.

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