Jean Monnet Module

"Economic Policy in the European Union"

Session 2.3. The interaction of the ECB and the Fed during the crisis: a comparative analysis

Dr Marcin Roman Czubala Ostapiuk

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WHAT IS A CENTRAL BANK?

THE ROLE OF CENTRAL BANKS

Central banks are public institutions, generally independent from governments, in which the monetary authority resides.

Its primary functions are:

- Issue the legal money of each country
- Design and execute monetary policy:
  - Setting interest rates on money
  - Preserving currency value and price stability
  - The central bank is the bank of banks, it governs the financial system and ensures its stability

THE ROLE OF CENTRAL BANKS

ECB, or ESCB (European System of Central Banks), is the Central Bank of the European Union.

National central banks are part of its integrated structure.

Within this structure, we must distinguish the **Eurosystem**, which is the monetary authority of the **Eurozone** (a group of States that belong to the **Euro**), in which the Central Banks do not have their own autonomy.

It was born because not all the Member States of the European Union adopted the single currency.

THE EUROSYSTEM (FUNCTIONS)

Made up of the European Central Bank and the national central banks of the Member States whose currency is the euro, it constitutes **the monetary authority of the euro area.**

The fundamental objective of the Eurosystem is to **define and implement monetary policy**, while maintaining price stability.

Furthermore, as a financial authority, it is responsible for **preserving the stability of the financial system,** promoting European financial integration and employing banking supervision.

Las funciones del BCE (1/2)

- **Políticas del Eurosistema**
  - Definición
- **Operaciones de política monetaria**
  - Decisión, coordinación y vigilancia
- **Orientaciones /instrucciones**
  - Conferidas por el Tratado
  - Por delegación del Consejo de la UE
- **Billetes**
  - Planificación estratégica, coordinación y armonización
  - Vigilancia
- **Mercados de divisas**
  - Intervención (en ocasiones, conjuntamente con los distintos BCN)
- **Sistemas de pago**
  - Funcionamiento
  - Supervisión de las infraestructuras del mercado financiero y los instrumentos de pago
  - Promoción de la integración de las Infraestructuras de los mercados financieros y los servicios de pago

Las funciones del EUROSISTEMA (2/2)

Otras funciones del BCE y del EUROSISTEMA

- Funciones de asesoría
- Recopilación y elaboración de estadísticas
- Cooperación internacional
- Emisión de billetes
- Contribución a la supervisión prudencial y la estabilidad financiera
- Supervisión bancaria desde noviembre de 2014

EUROPE, THE CENTRAL BANKS AND THE CRISIS

The impact and solutions to the crisis were diversified according to the central banks: the US, the EU, Japan, Emerging Countries (China, Brazil, India...).

USA:

- FED (Federal Reserve or Central Bank) that directs the Monetary Policy. Goal: lower unemployment by 6.5% (currently 4.4%, Aug. 2017)
- Federal political institutions under sole presidential responsibility

UK:

- Bank of England: direct intervention
- Mass purchase of assets (off balance sheet with the guarantee of the British Government)

Criterios	FED	ECB
Mandato y objetivos	La entidad de último recurso Variedad de objetivos principales Supervisor y regulador bancario único La entidad de último recurso desde el comienzo de la crisis	Sistema Europeo de Bancos Centrales Artículo 127 del TFUE – control de la inflación Unión Económica y Monetaria incompleta
Independencia	Carácter multidimensional	BCE = el banco central más independiente del mundo
Rendición de cuentas	Rinde cuentas ante el Congreso de los EEUU y debe aplicar cualquier cambio en sus estatutos que éste exija	Rendición de cuentas ante el PE y (periódicamente) Consejo de la UE
Interlocutor	Capacidad de trabajar con una sola voz Interlocutor único en relaciones con el gobierno	Incapacidad de trabajar con una sola voz (intereses diferentes/representación) Diferentes realidades defendidas por gobiernos de los EEMM; la misma política para todos los países miembros
Relación con la política fiscal y de pagos	Es UN BANCO CENTRAL de UN SOLO PAÍS	Eurozona

FED VS. ECB: ACTION DURING THE CRISIS

FED

Conventional monetary policy:
Interest rates (2007-2009)
Open market operations

Unconventional monetary policy:
shifts in the FED balance: QE (2008-2014)

A single fiscal policy
-Fiscal stimulus (2008)

Government action
(2008)

ECB

Conventional monetary policy:
Interest rates (2008-2014)
Open market operations

No conventional monetary policy:
shifts in the ECB balance: QE (2015-

-19 Tax Policies
- Rescue Greece, Ireland, Portugal and Spain
- Different government action

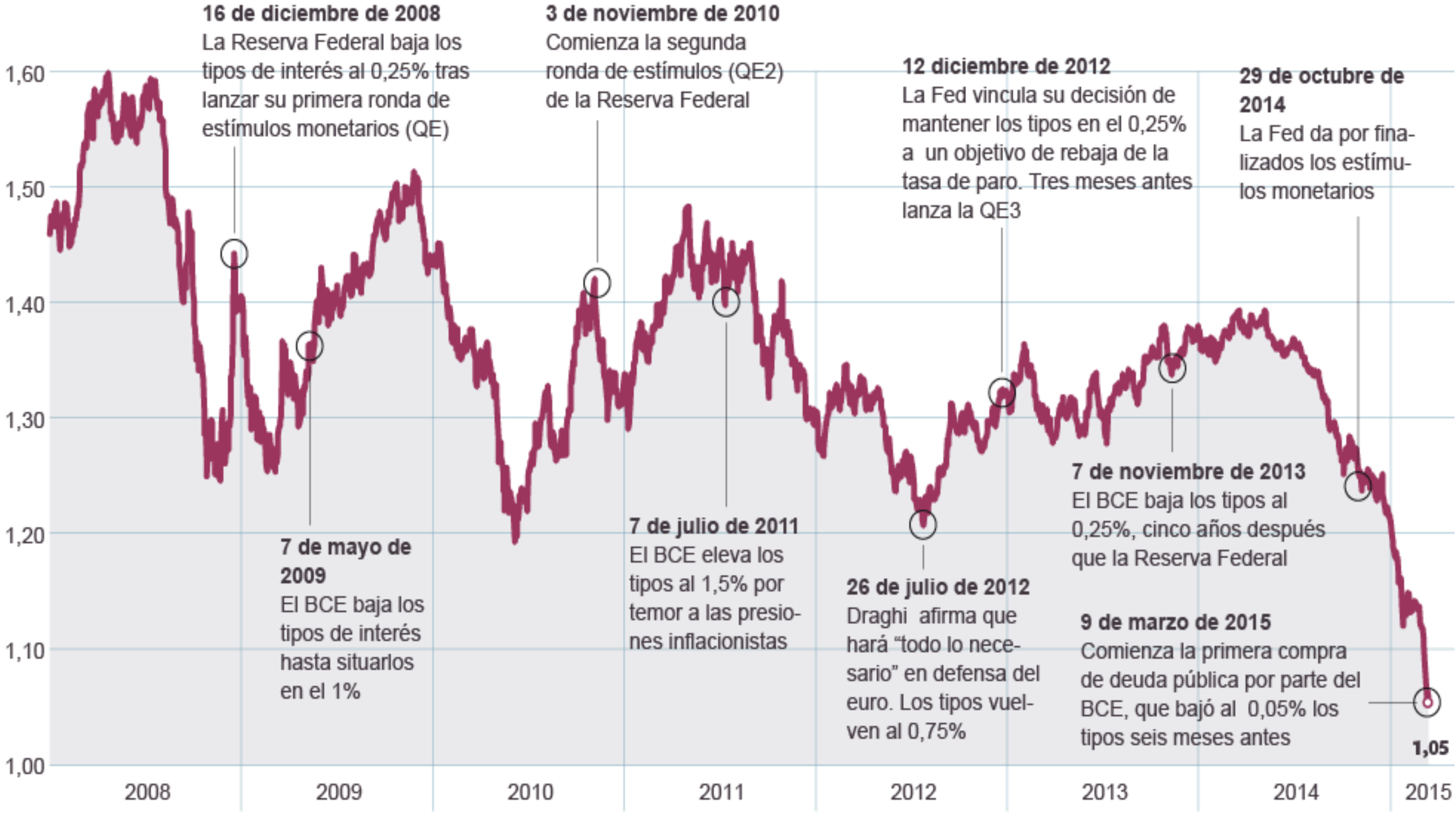
Political crisis

Asymmetric monetary policy

New model of Economic governance (2011)

EVOLUCIÓN DEL EURO

En dólares por unidad

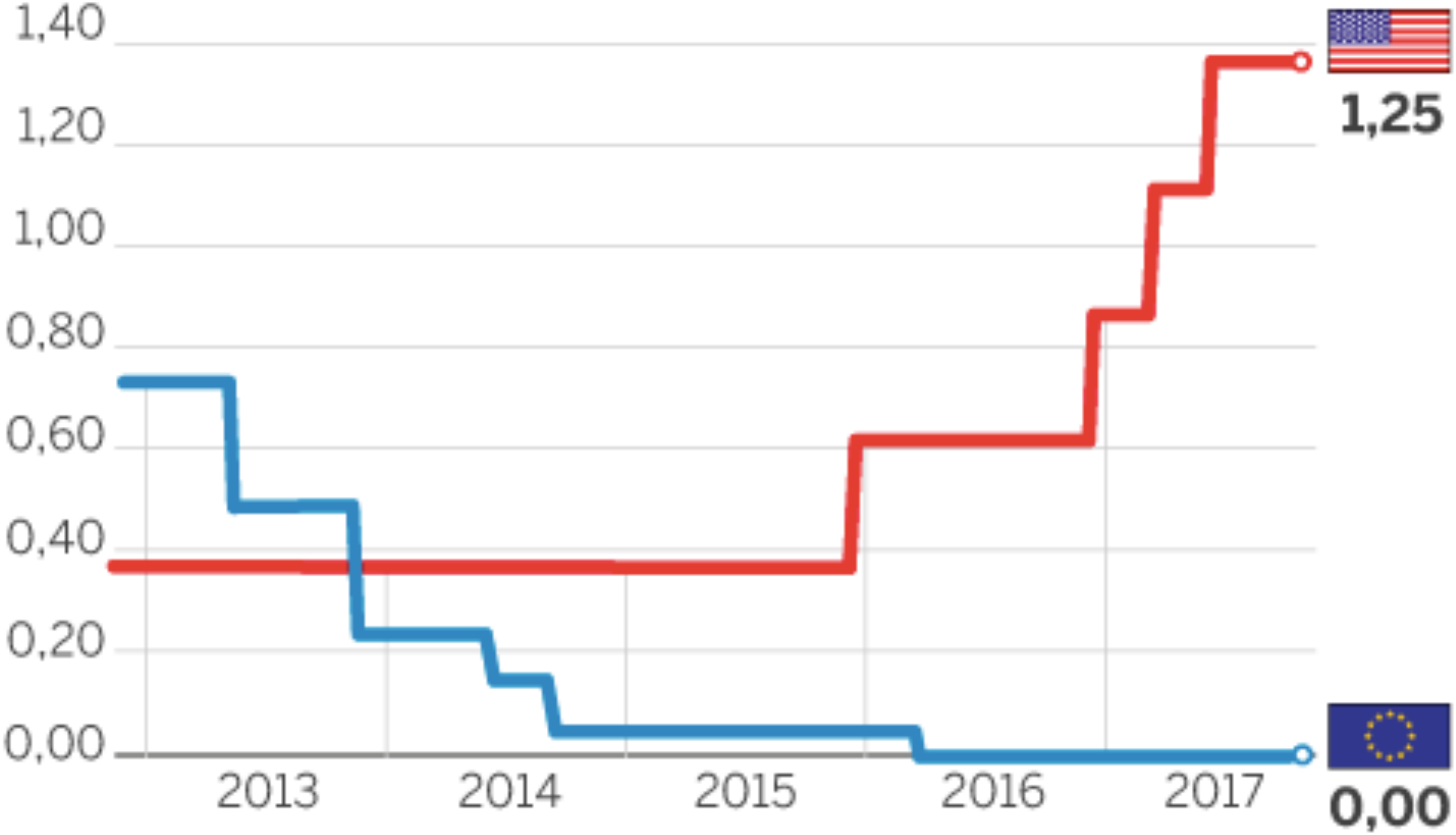


Fuente: Bloomberg y elaboración propia.

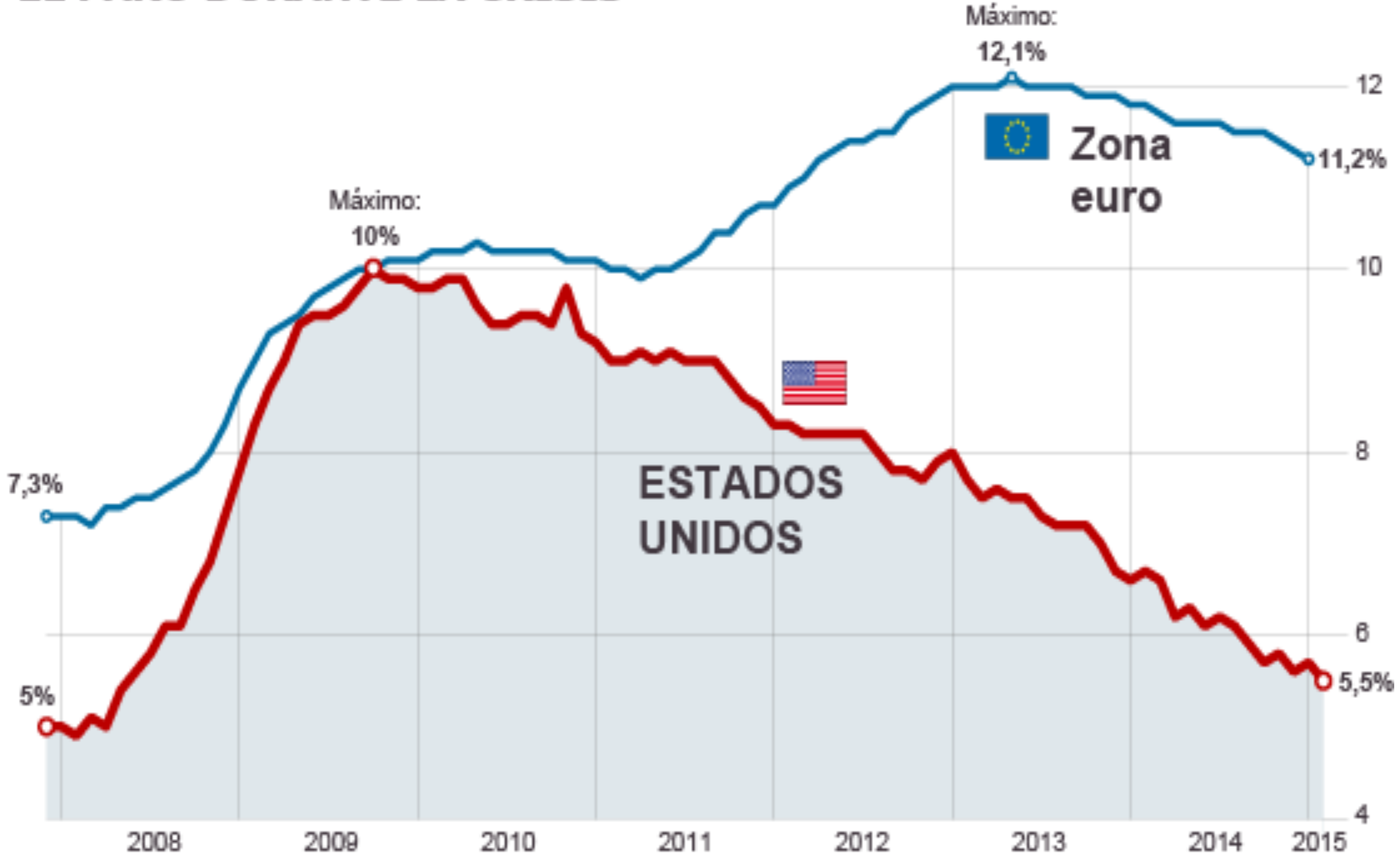
EL PAÍS

TIPOS DE INTERÉS

En %



EL PARO DURANTE LA CRISIS



THE WEAKNESSES OF THE ECB (UNTIL MARCH 2015)

Despite the aforementioned functions, the ECB:

- It does not inject unlimited liquidity against the attacks of the markets against the Sovereign Debt to stimulate the economy, as would be necessary
- Therefore, it does not have the functions of a true Central Bank as a lender of last resort
- Article 123 of the Treaty on the Functioning of the EU prohibits the financing of Governments and Article 125 prevents the financial rescue of States

THE ROLES OF THE ECB AND THE CRISIS

The functions of the ECB have been forcibly altered during the crisis.

Despite the restrictions (Treaties and Statutes): it is expressly forbidden to monetize public debt; it has acted indirectly in this direction.

The crisis in Greece first, and those in Spain and Italy later, have forced him to act even through subterfuge.

Finally, in March 2015 the ECB has the possibility of buying the sovereign debt of the countries of the euro zone.

INTERVENTION MECHANISMS

Earlier, the following mechanisms were put in place to deal with financial turmoil in the Eurozone:

- The European Financial Stability Facility (EFSF)
- The European Financial Stabilization Mechanism (MEEF: European Financial Stability Mechanism)
- LTRO Loans (Long-Term Refinancing Operations)

THE LTRO (LONG TERM FINANCING OPERATIONS)

ECB lending program to banks (one of the two means of monetary expansion of the Central Banks).

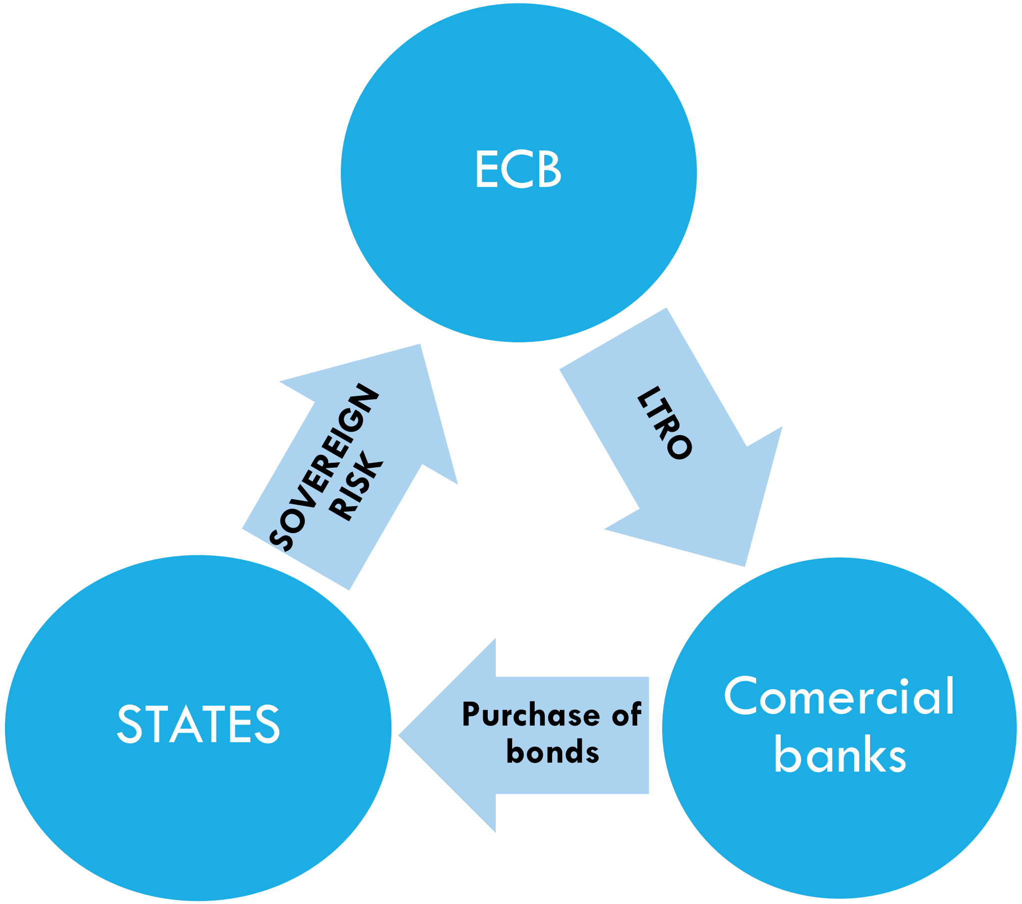
"Free bar" of liquidity for banks, largely for the Spanish, in order to temporarily replace the interbank market.

3-year loans at 1% interest.

Banks buy Sovereign Debt at an interest rate three or four times higher.

The ECB subsequently carried out two TLTRO operations (eg. December 2011 and February 2012; up to and including 2017)

INDIRECT WAY OF STATE FUNDING



THE BANK RESCUES

This "Free Bar" provides liquidity to banks when the interbank does not work, as it did.

Another thing was the bailouts for **insolvent** entities (Bankia, Caixa Cataluña, NCG and Banco de Valencia, Banco Mare Nostrum, Banco CEISS, Caja 3 and Liberbank).

The bank rescue (2012/2013) was a long-term, low-interest loan to the Spanish State by the European Union (from the MEDE to the FROB).

This Entity becomes a shareholder of the rescued banks, placing that money in them as capital.

€ 100,000 million were granted, of which only € 41,330 million were needed, which are computed as debt and accrue interest.

Spain will pay the main part of the loan between 2022 and 2027.

THE ACQUISITION OF DEBT BY THE ECB (THE SMP)

Previous mechanisms: Insufficient (virulence of the crisis and insolvency of Greece): they trigger the risk premium.

May 2010: ECB launches a program of **massive acquisition of Debt in the secondary market**, until September 2012.

The SMP (**Securities Market Program**) acquires securities in the secondary public debt market of the countries with the greatest financial pressure.

It does not take into account country risk, interest or term.

The ECB breaks the spirit of art. 123 of its Statutes, which expressly prohibits monetizing the debt, doing so indirectly, although it achieves the same effects.

THE ACQUISITION OF DEBT BY THE ECB (THE SMP)

In January 2013, the ECB published the balance sheet for the acquisition of bonds carried out under this Securities Market Program (2010-2012), data in blue, of which it had, as of December 31, (data in black).

- Italian: € 102,800 million. 47.2% of the total. (€ 89,700M)
- Spanish: € 44,300 million. 20.2% of the total. (€ 38,800M)
- Greek: € 33,900 million. 15.6% of the total. (€ 27,700M)
- Portuguese: € 22,800 million. 10.5% of the total. (€ 19,800M)
- Irish: € 14,200 million. 6.5% of the total. (€ 9,700M)

“HIS ONE WORD…”

"I will do whatever it takes to save the euro and believe me, it will be enough."

(Mario Draghi, President of the ECB, July 26, 2012)

Decisive blow by the President of the ECB to the problems of the crisis in countries such as Spain and Italy and the possible breakdown of the Euro.

There were other measures, but this was taken seriously by the markets (unlimited purchase of bonds from the most affected countries). It was not necessary to implement it.

THE PURCHASE OF DEBT BY THE ECB (THE OMT)

The OMT (**Outrigth Monetary Transactions**) was the program of massive purchase of Public Debt (bonds to one, two and three years) in the secondary markets after **"the dangerous summer"** that was lived in Spain in 2012 , on the verge of suspension of payments and with the 10-year bond above 7%.

With the accompaniment of Italy in the territory of maximum risk, Draghi made the aforementioned statements, in which the ECB was willing to use all its **"heavy artillery"** to save €.

The size of both countries required it.

THE PURCHASE OF DEBT BY THE ECB (THE OMT)

This OMT program is the renewal of the SMP bond purchase program decided in May 2010 after the Greek crisis.

The ECB would buy the bonds on the secondary market from their previous owners, the banks.

It would be activated in the event that an EEMM asks for help.

Such operations would have to be "sterilized" (as in the case of SMPs) with equivalent withdrawal of money to avoid inflation (an inflation that does not exist, but which is the "atavistic German terror").

Following Draghi's statements, the markets and the "risk premium" improved. Likewise, **none of the "target countries" came to benefit from this program** (it never goes into operation).

THE SOVEREIGN DEBT PURCHASE (QUANTITATIVE EASING)

Why has the ECB decided to buy sovereign debt?

Quantitative Easing, a stimulus program whose main element is the purchase of public debt as an investment by a central bank, as a materialization of the OMT.

The purchase of the public and private debt of the euro zone (in the secondary market) by the ECB (worth 60,000 million euros per month) starts from March 2015.

What are the goals of introducing QE?

THE SOVEREIGN DEBT PURCHASE (QUANTITATIVE EASING)

The ECB bought sovereign debt (bonds between 2 and 30 years), including negative interest, in the same proportion as the share of each national central bank of the euro area in the capital of the ECB:

- Bundesbank - 25.7%,
- The Bank of France - 20.3%
- The Banca d'Italia - 17.6%
- The Bank of Spain - 12.6%
- The Nederlandsche Bank of the Netherlands - 5.7%
- The rest of the euro area countries - 18%

Greece, the only Member State of the euro zone that could not benefit from this measure

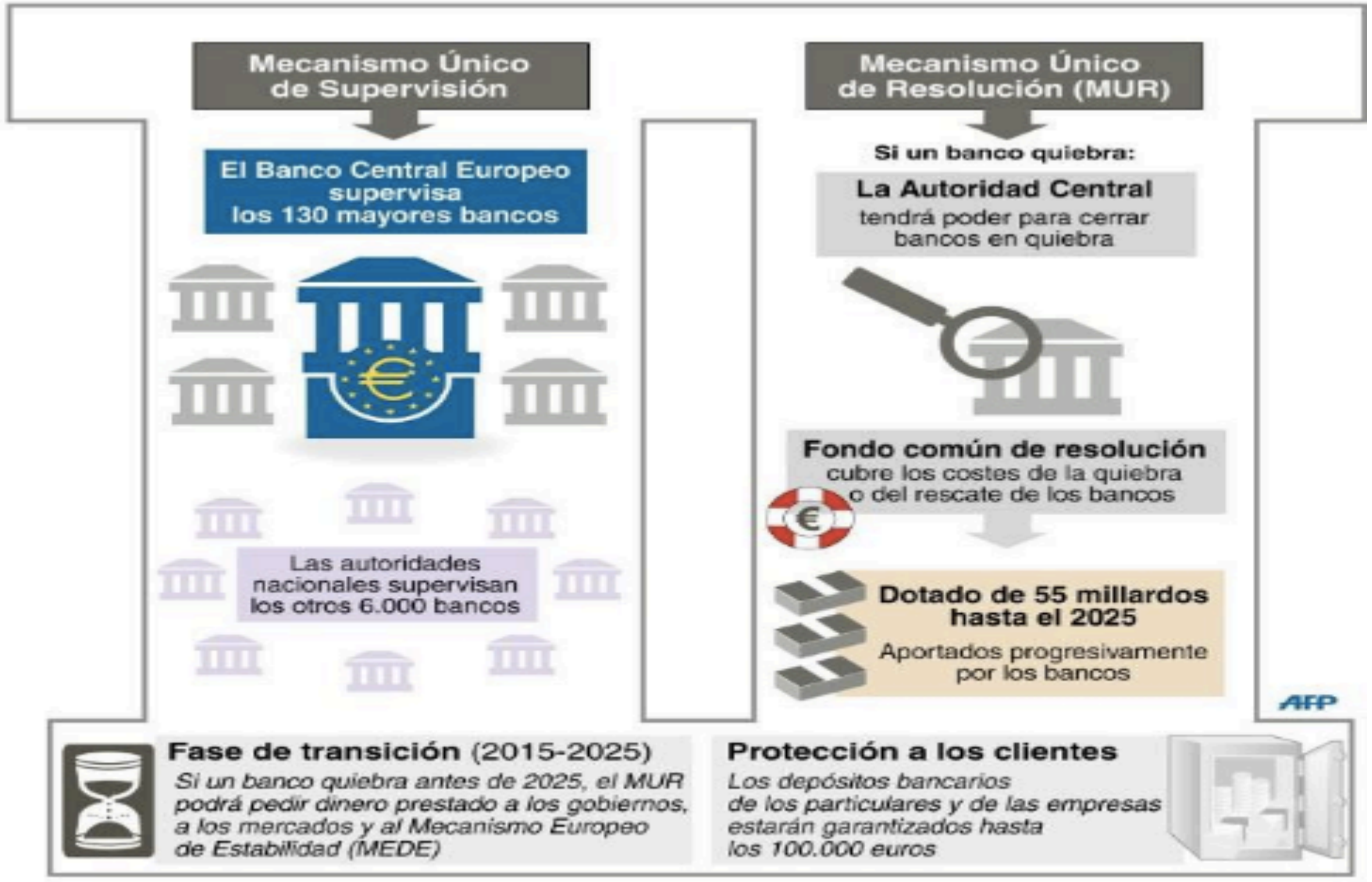
THE SOVEREIGN DEBT PURCHASE (QUANTITATIVE EASING)

In January 2016, the ECB decides that a minimum of an additional 360,000 million will be injected (the maximum limit of its monthly bond purchases was expected to rise from 60,000 million to 70-75,000).

Interest rates remain at their historic lows, at 0.00%, while the deposit facility remains at -0.4%.

In October 2017, the ECB decided to reduce the monthly provision from 60 to 30,000 million (as of January 2018 for 9 months), with the possibility of extending the QE (December 2018, maintaining rates until summer 2019).

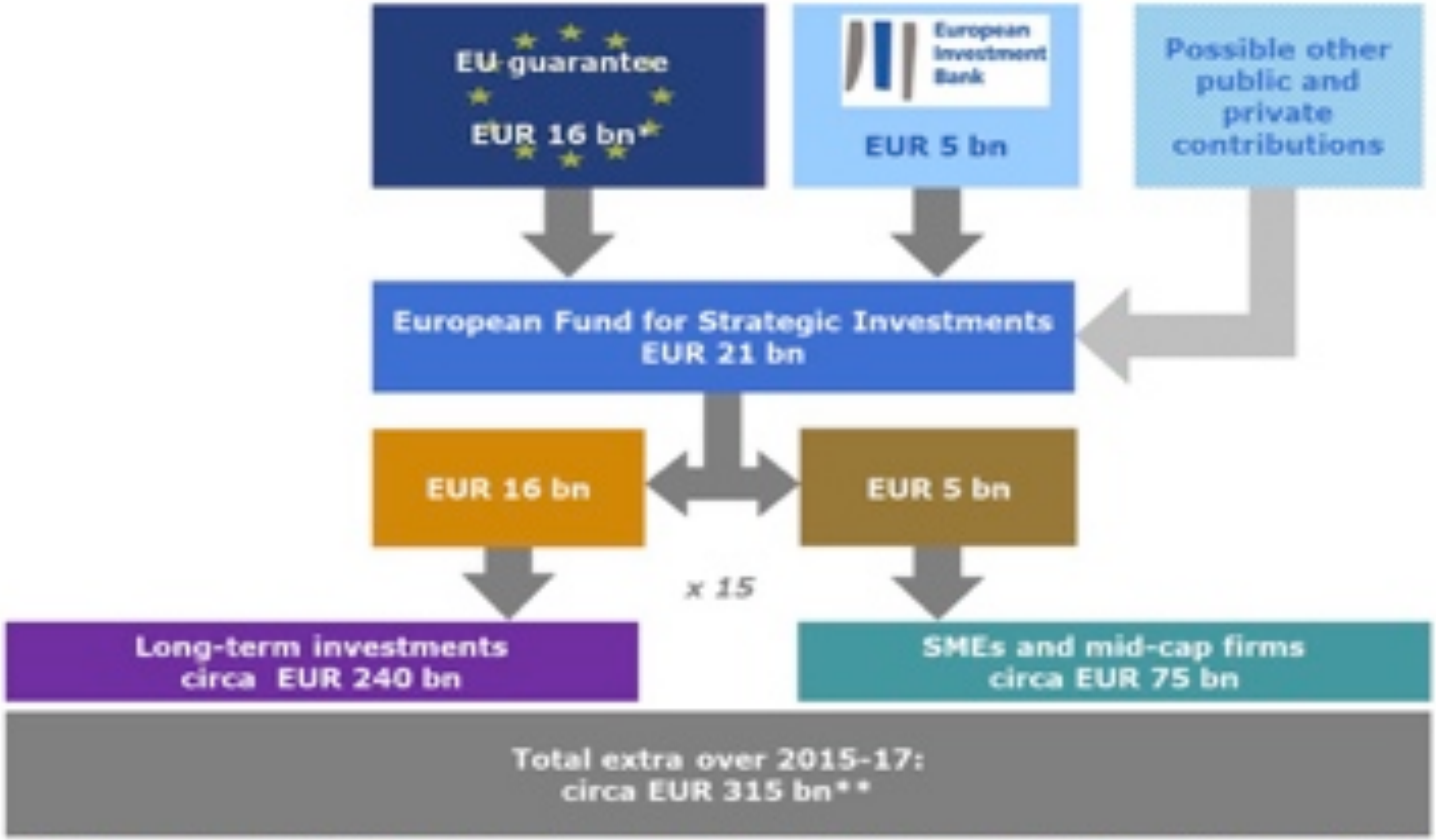
BANKING UNION



SOLUTIONS

- Encourage public spending and investment
- Labour reform, more flexibility
- Avoid political uncertainty
- Reduce interest rates by setting them below the marginal efficiency of capital, but at high costs
- Juncker plan

A new European Fund for Strategic Investments (EFSI)



* 50% guarantee = EUR 8 bn from Connecting Europe Facility (3.3), Horizon 2020 (2.7) and budget margins (2)
** Net of the initial EU contributions used as guarantee: EUR 307 bn


TOI
EN...
...315 milliards!
C'EST
HARRY
JUNCKER!
21 MILLIARDS

CONCLUSIONS

- The monetary policy strategy of the ECB and the Fed during the crisis = divergent and contradictory
- On the other hand, the US central bank and the euro zone acted in a coordinated manner in the management of open market operations
- The ECB and the FED, which act in the context of unequal realities. Their levels of independence are also different
- The new roles of assuming = ECB as banking supervisor and guarantor of last resort. Extensive reform of European governance structures
- New political risk scenarios (Brexit, Catalonia, extreme right, etc.)

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