LUISS "Guido Carli"
Academic year 2012/2013
Department of Political Science – Macroeconomics course

Supervisor
*Professor Marcello Messori*

Candidate
*Giulia Colafrancesco*
*065752*

Undergraduate thesis on:

# *A comparison between ECB and FED monetary policies during the latest crisis*

**ABSTRACT IN ENGLISH**

During the lasts years our everyday life has been overwhelmed by the consequences of the financial crisis which blew up in 2007. Common people have been thrown into a world made of interest rates, GDP and public debt. Suddenly all the economic news transmitted by the mass media became the most important ones and the spread trend became able to bring happiness or sadness in our days. Moreover people started realizing how great the power of monetary institutions is and how much part they have taken in the management of "private business". Since I realized in first person that this change truly happened, I decided to dedicate this thesis to discover some of the countless aspects that characterized this economic world. Since nowadays globalization is driving us more and more beyond our cultural and geographical boundaries, I have decided to focus my analysis out of the context where I live in, pushing it through the ocean, up to USA. Although the European and the North American continents are similar under some cultural aspects, comparing the strategies of the two central bank, ECB and FED, I found out many differences that have caught my attention.

The aim of this thesis is analyze the monetary policy's strategies used by the two central banks, pointing out how much these strategies are influenced by the different objectives written in their statuses and by the different economic tools they are allowed to make use of. In the same way I have analyzed the impact of the crisis of 2007 on monetary policies and more in detail the different responses given by the ECB and the FED. To achieve this goal, firstly I have compared the statuses of the ECB and the FED. The main objective of the first is price stability whereas the Federal Reserve Act shows a wider range of objectives. Following this path and focusing the attention on the economic tools that these institutions are allowed to excerpt we can realized that there are a lot of differences also in this field. After having completed the comparison between the statuses, objectives and financial tools of the two banks the attention has been focused to the financial shock of 2007, in order to analyze how these differences influenced the reactions to the financial crisis. This crisis, indeed, required

the application of the so called “unconventional measures” and this meant, firstly, to cut to zero the interest rates and to sustain banks in difficulties. The comparison in this scenario has been conducted by a temporal subdivision: in a first phase of the crisis, from 2007 to 2009 and in a second one, form 2010 to 2012. Finally, this comparison has brought to analyze a particular tool used by the ECB and the FED during the crisis. I'm talking about the quantitative easing and the way in which it has been put in use by the two banks.

The results obtained by this examination are, first of all, that during the first lag of the crisis the FED took greater risks by providing no-recurse loans against collateral, which at the time, appeared to be “toxic”. The reason for this can be ascribed to the panic state of the market. Nowadays this judgment has been proved to be correct: the panic subsided and the FED did not make any losses. As the market stabilization had occurred the FED tried to sustain employment by reducing interest rates, starting with the short term ones, and later working on longer term ones through its “quantitative easing” tool. In this first timeframe the ECB policy was similar to that of the FED. However, in the Euro area the general financial crisis mutated into a “euro crisis” when savers in Northern Europe started withdrawing credit to the countries in the Euro “periphery”. This meant that while the ECB was responding massively to the crises through “credit easing”, it was trying to minimize its own risk at the same time. Yet this implies that its policy could not be fully effective. In addition to this, there is now a danger that other instruments of the ECB might also become less effective. This attempt by the ECB to limit its own risk is understandable, as much as the consequences of it on the effectiveness of the “quantitative easing” policy. This approach was significantly different from the one chosen by the FED, which by providing no-recourse loans to the private sector gave a strong signal.

These are the consideration about the impact of the crisis on the monetary policy and about the “unconventional measures” put into use. As I said before, I have finally analyzed the application of the “quantitative easing” by the two banks and its efficacy and impact on financial stability, distribution of credit and economic activity. The main point of my work is that the transmission to the real sphere of the quantitative easing strategy remains ambiguous. As a matter of fact the tension on financial markets at the moment have been definitely loosen, but we are far away from the pre-crisis levels. The out-put gap stays negative, the unemployment rate remains high and the risk of deflation is still present. This mean that the strategy has just amortized the shock after the crisis. As for its consequences on distribution of new credit, it has been demonstrated that families still have the debt reduction as priority and that industries relay mostly on self-financing. This behavior is blocking the recovery of credit activities. This inability of quantitative easing to weigh on the demand explains the

negative variance in the production and the height of the unemployment rate.
This conditions force central banks to keep their positions as watchers and carry on with their obliging monetary policy until the signals of recovery will not be stronger.