

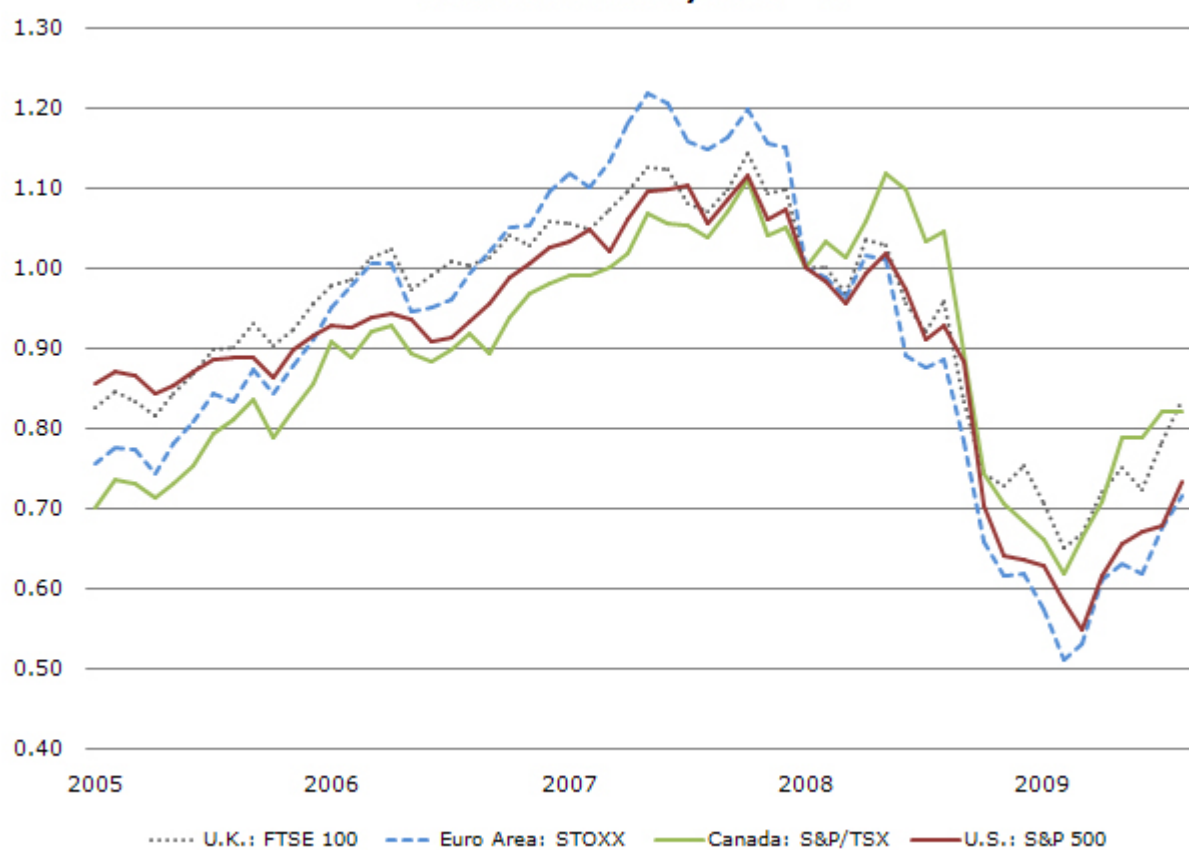
September 1, 2009

Us and them: Reviewing central bank actions in the financial crisis

With all the focus on the financial crisis in the United States, folks in this country might sometimes lose sight of the fact that this crisis has been global in nature. To provide some perspective on the global dimensions of the crisis, we are providing a few summary indicators of financial sector performance and central bank policy responses in the United States, the United Kingdom, the Euro Area, and Canada. Based on this general review, we surmise that some of the experiences have been remarkably similar, while others appear to be quite different. To pre-empt the question: Why these four regions? The reason is simply that the data were readily available. We encourage readers to use data from other areas, and let us know what you find.

The first chart compares relative changes in monthly stock market price indices for 2005 through the end of August. During the crisis, market participants significantly reduced their exposure to risky assets, which helped push equities lower. All indices peaked in 2007, except Canada, which technically peaked in May 2008. Canada outperformed relative to the others in early 2008 but suffered proportionally similar losses thereafter. The United Kingdom, Euro Area, and Canada bottomed in February 2009 while the United States bottomed in March 2009. The Euro Area to date has experienced the strongest rebound in equities, increasing by almost 40 percent since the trough in February. However, Europe also had the largest peak-to-trough decline, almost 60 percent. Canada and the United States have jumped by about 33 percent since their respective lows in February and March, while U.K. stock prices have risen by about 30 percent since February.

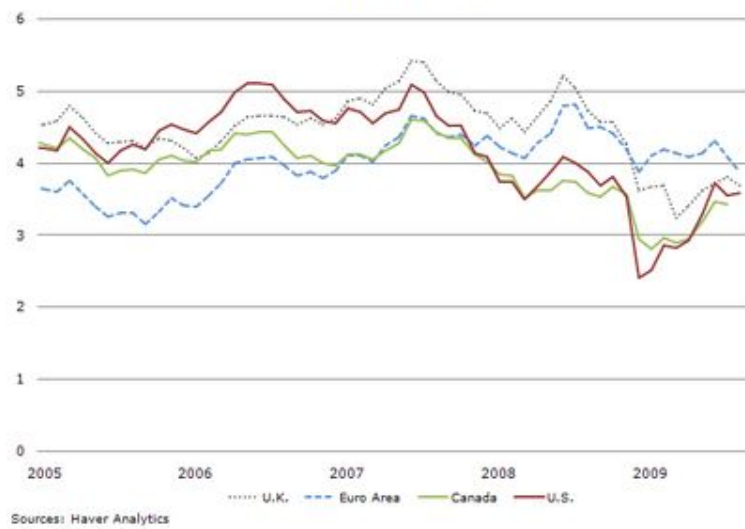
**Stock Market Indexes
Indexed to January 2008 = 1**



Sources: Haver Analytics & Bloomberg

The second chart compares long-term government yields. As the crisis unfolded in late 2007, yields on 10-year U.S. Treasuries sank as global flight to quality helped push yields lower. Yields on U.S., U.K., and Canadian bonds have all moved lower than they were prior to the onset of the crisis. Interestingly, in the Euro Area, prior to the crisis, sovereign yields were at or below bond yields in the other countries but are now slightly above those. In fact, Euro Area yields haven't moved much since the beginning of the crisis in late 2007.

10-year Government Bond Interest Rates
%, monthly average



The third chart contrasts monetary policy rates in the four regions. The chart shows that all the central banks lowered rates aggressively, but there are some subtle differences in the timing. For the United Kingdom, Euro Area, and Canada, the bulk of policy rate cuts came after the financial market turmoil accelerated in the fall of 2008, whereas in the United States the majority of the cuts came earlier.

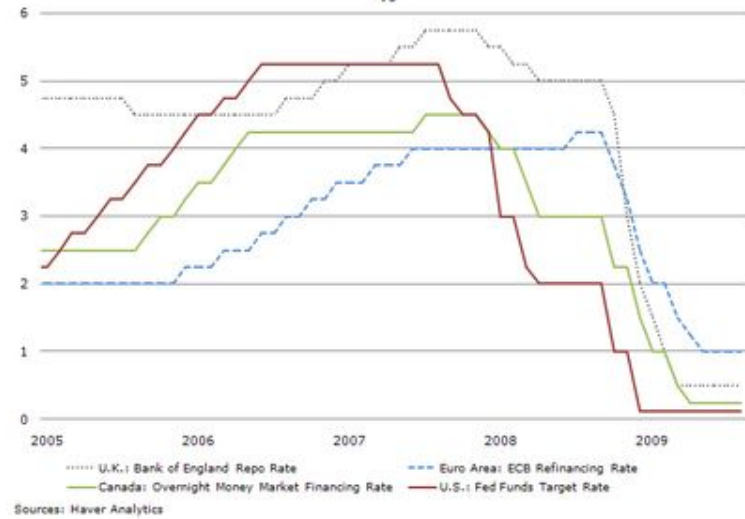
The Fed was the first to lower rates, cutting the fed funds rate by 50 basis points in September 2007 at the onset of the crisis. The Fed continued to lower rates pretty aggressively through April 2008, with a cumulative reduction of 325 basis points. Once the financial turmoil accelerated again in the fall of 2008 the Fed cut rates again by another 200 basis points.

The Bank of Canada's cuts followed a generally similar timing pattern to the Fed but with differences in the relative magnitude of the cuts. In particular, the Bank of Canada rate lowered rates by 150 basis points through April 2008 and then by another 275 basis points since September 2008.

Similarly, the Bank of England cut rates three times in late 2007/early 2008, totaling 75 basis points. But like the Bank of Canada, the bulk of their policy rate cuts didn't come until the increased financial turmoil in the fall of 2008. Between September 2008 and March 2009, the Bank of England cut the policy rate by 450 basis points.

Unlike the other central banks, the European Central Bank (ECB) did not initially adjust policy rates down as the crisis emerged in late 2007. In fact, after holding rates steady for several months it increased its rate from 4 percent to 4.25 percent in July 2008. It started cutting rates in October 2008, and from October 2008 to May 2009 the ECB reduced its refinancing rate by 325 basis points. Of the four regions, the ECB currently has the highest policy rate at 1 percent. For some speculation about the future of monetary policy rates for a broader set of countries, see this recent article from [The Economist](#).

Monetary Policy Rates
%

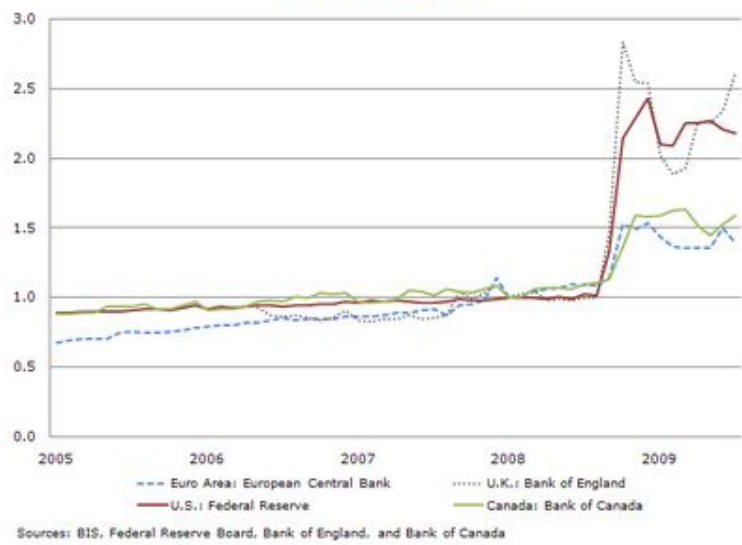


The final chart compares relative changes in the size of balance sheets across the four central banks. The balance sheet changes might be viewed as an indication of the relative aggressiveness of nonstandard policy actions by the central banks, noting that some of the increases can be attributed to quantitative easing monetary policy actions, some to central bank lender-of-last-resort functions, and some to targeted asset purchases.

The sharpest increases in the central bank balance sheets came in the wake of the most intense part of the financial crisis, in the fall of 2008. There had been relatively little balance sheet expansion until the fall 2008. Prior to that, the action was focused mostly on changing the *composition* of the asset side of the balance sheet rather than increasing its size. The size of both U.S. and U.K. balance sheets has more than doubled since before September 2008, although both are now below their peaks from late 2008. Note that in the case of the Bank of England, quantitative easing didn't begin until March 2009, and the subsequent run-up in the size of the balance sheet is much more significant than in the United States. Prior to that, the increase in the Bank of England balance sheet was associated with (sterilized) expansion of its lending facilities.

In contrast, the Bank of Canada and ECB increased their balance sheets by about 50 percent—much less than in the United Kingdom or United States. By this metric, nonstandard policy actions have been less aggressive in Canada and the Euro Area. Why these differences? This recent Reuters article provides a [hypothesis](#) that focuses on institutional differences between the Bank of England and the ECB. In a related piece, this [IMF article](#) compares the ECB and the Bank of England nonstandard policy actions.

Central Bank Balance Sheets
indexed to January 2008 = 1



Note: The Bank of England introduced reforms to its money market operations in May 2006, which changed the way it reports the bank's balance sheet data ([see BOE note](#)).

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