ulm university universität ulm

International Summer Program

July 11th, 2011, Michael Elbert

ECB & Fed
A comparison

Agenda

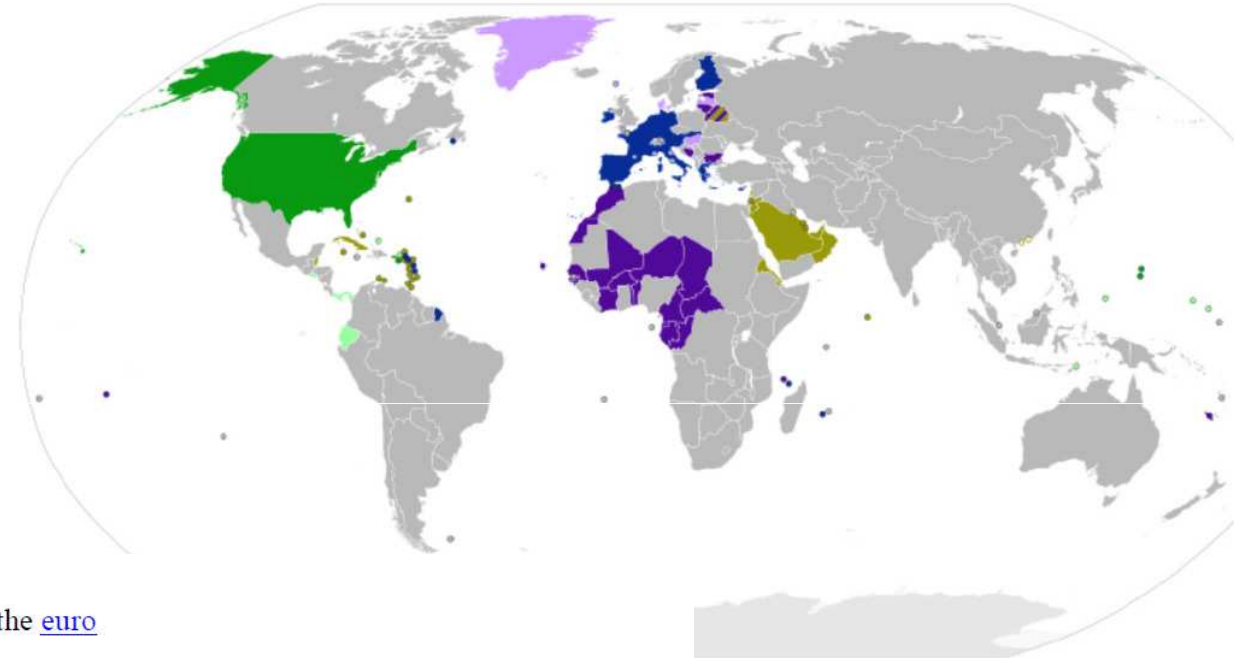
- Introduction
- European Central Bank
- Federal Reserve System
- Summary: ECB and FED

Central Banks

- A **central bank**, **reserve bank**, or **monetary authority** is the entity responsible for the monetary policy of a country or of a group of member states. It is a bank that can lend money to other banks in times of need. Its primary responsibility is to maintain the stability of the national currency and money supply, but more active duties include controlling subsidized-loan interest rates, and acting as a lender of last resort to the banking sector during times of financial crisis (private banks often being integral to the national financial system). It may also have supervisory powers, to ensure that banks and other financial institutions do not behave recklessly or fraudulently.

- Most richer countries today have an "independent" central bank, that is, one which operates under rules designed to prevent political interference. Examples include the European Central Bank and the Federal Reserve System in the United States.

Direct Influence of Euro and US-Dollar in the world



English:

- Eurozone, the originator in control of the euro
- External adopters of the euro
- Currencies pegged to the euro
- Currencies pegged to the euro within a narrow band

- United States, the originator in control of the US dollar
- External adopters of the US dollar
- Currencies pegged to the US dollar
- Currencies pegged to the US dollar within a narrow band

Note that the Belarusian ruble is pegged to the Euro, Russian Ruble and U.S. Dollar in a currency basket.

Key Characteristics

	€-17	EU-27		
Population (millions)	331**	501**	309**	128
GDP (PPP, € trillions)	9.0	12.5	11.2	3.3
GDP per capita (PPP, € thousands)	27.1	24.9	36.3	25.6
Share of world GDP (PPP, %)	15.1	21.3	20.4	6.0
Exports (goods and services, % of GDP)	19.7	13.4	11.1	13.3
Gross fixed capital formation (% of GDP)	19.6	19.1	15.7	21.2
Gross saving (% of GDP)	18.1***	17.7	10.7	22.1

*2009 and ** 2010 figures; *** Euro Area - 16

Sources: for euro area and EU: ECB, Eurostat, national data, IMF and ECB calculations; for the United States and Japan: national sources, IMF.

 E1.010 02/11

Agenda

- Introduction
- European Central Bank
- Federal Reserve System
- Summary: ECB and FED

ECB – History

See ECB History Video:

http://www.ecb.int/ecb/educational/movies/history/html/index.en.html

Collapse of the Bretton Woods System

1944 – 1973

First attempt of European monetary cooperation: **Snake in the Tunnel**

1972 – 1979

European Monetary System (EMS)

4 Stages:

Stage 1: 1979 – 1983
Stage 2: 1983 – 1987
Stage 3: 1987 – 1992
Stage 4: 1992 – 1993

Treaty on the European Union

3 Stages:

Stage 1: 1990 – 1994
Stage 2: 1994 – 1999
Stage 3: Since 1999

Convergence Criteria

Government finance

Annual government deficit:

- Government deficit must not exceed 3% of GDP
- If not, it is at least required to reach a level close to 3%.
- Government debt: The ratio of gross government debt to GDP must not exceed 60%

Exchange rate:

- Applicant countries should have joined the exchange-rate mechanism (ERM II) under the European Monetary System (EMS) for 2 consecutive years and should not have devaluated its currency during the period.

Inflation rate:

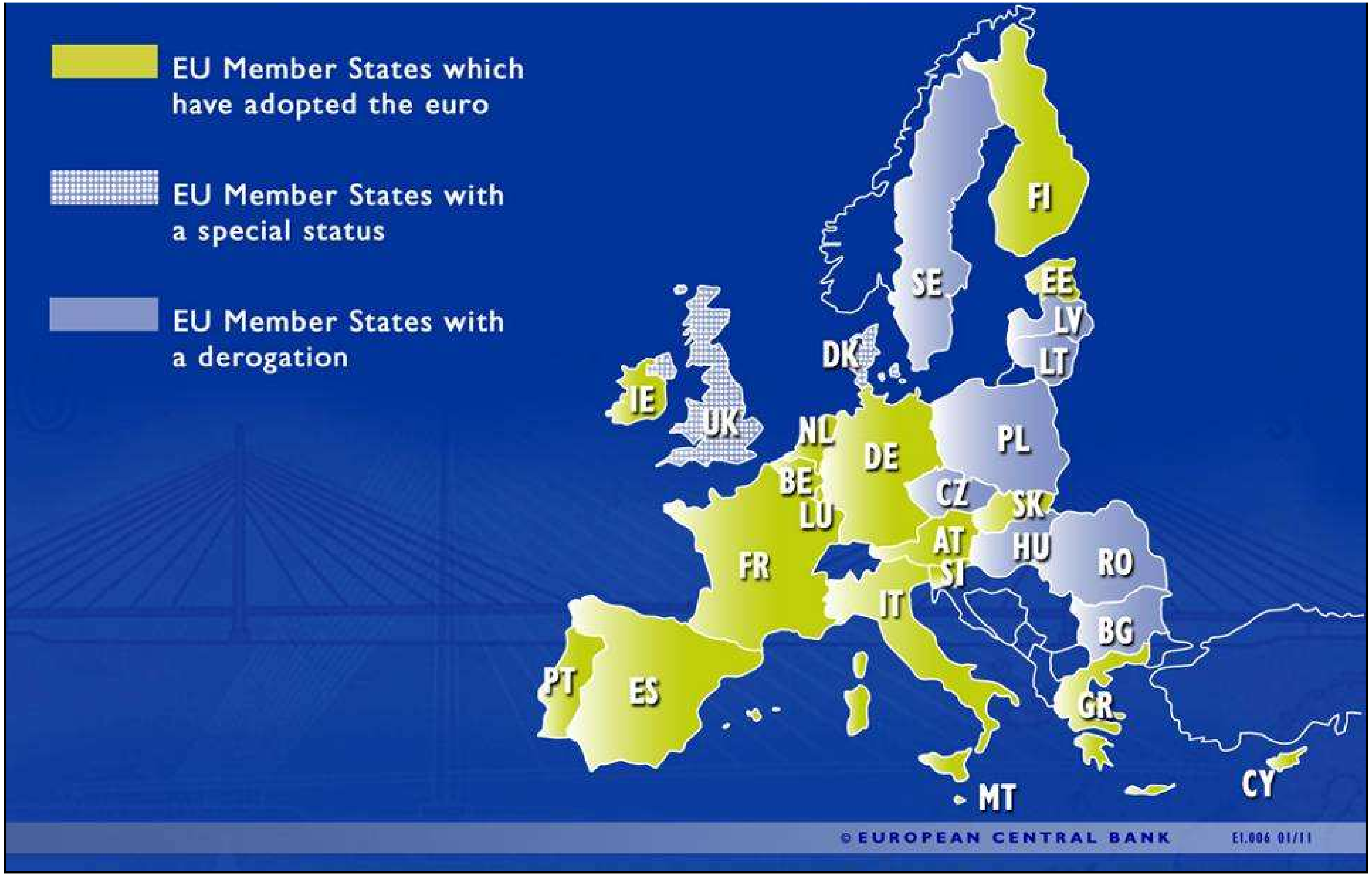
- No more than 1.5 percentage points higher than the three lowest inflation member states of the EU.

Long-term interest rates

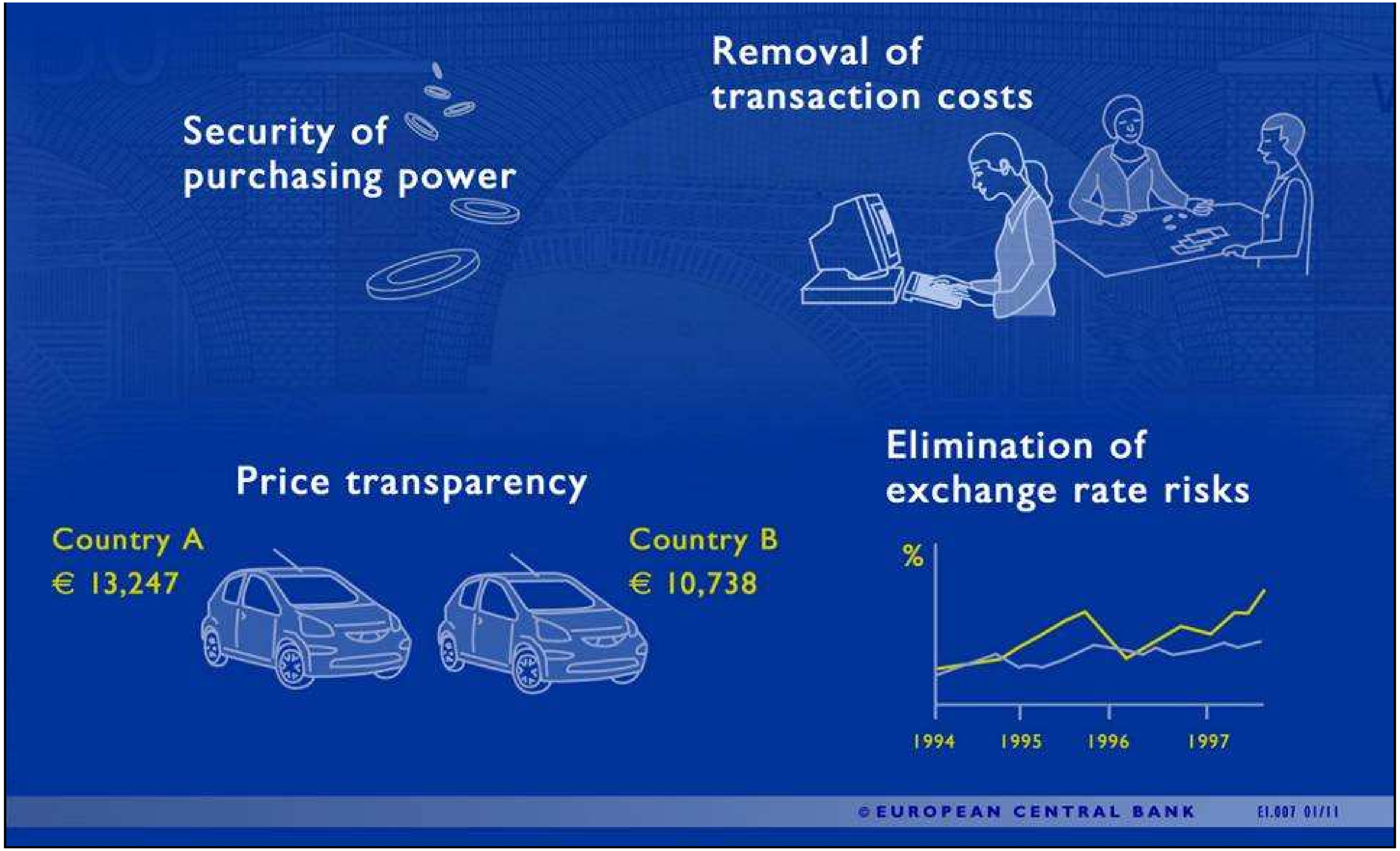
- The nominal long-term interest rate must not be more than two percentage points higher than in the three lowest inflation member states.

► **Purpose of setting the criteria:** Maintain the price stability within the Eurozone even with the inclusion of new member states.

Eurozone


EU Member States which have adopted the euro
EU Member States with a special status
EU Member States with a derogation
FI
SE
EE
LV
LT
DK
IE
UK
NL
DE
PL
BE
LU
CZ
SK
AT
HU
RO
FR
SI
IT
BG
PT
ES
GR
MT
CY
© EUROPEAN CENTRAL BANK
EI.006 01/11

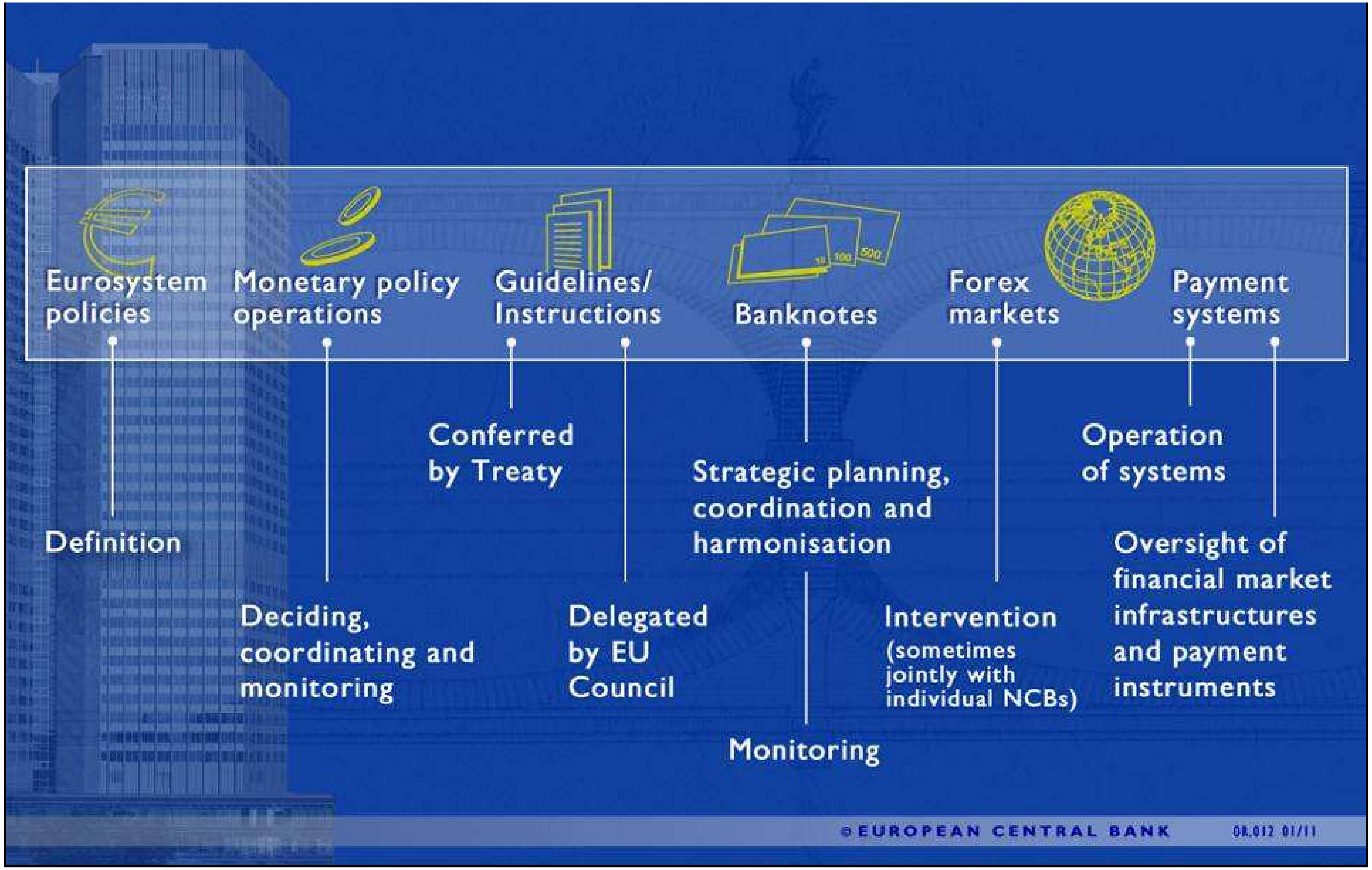
Benefits of the Euro



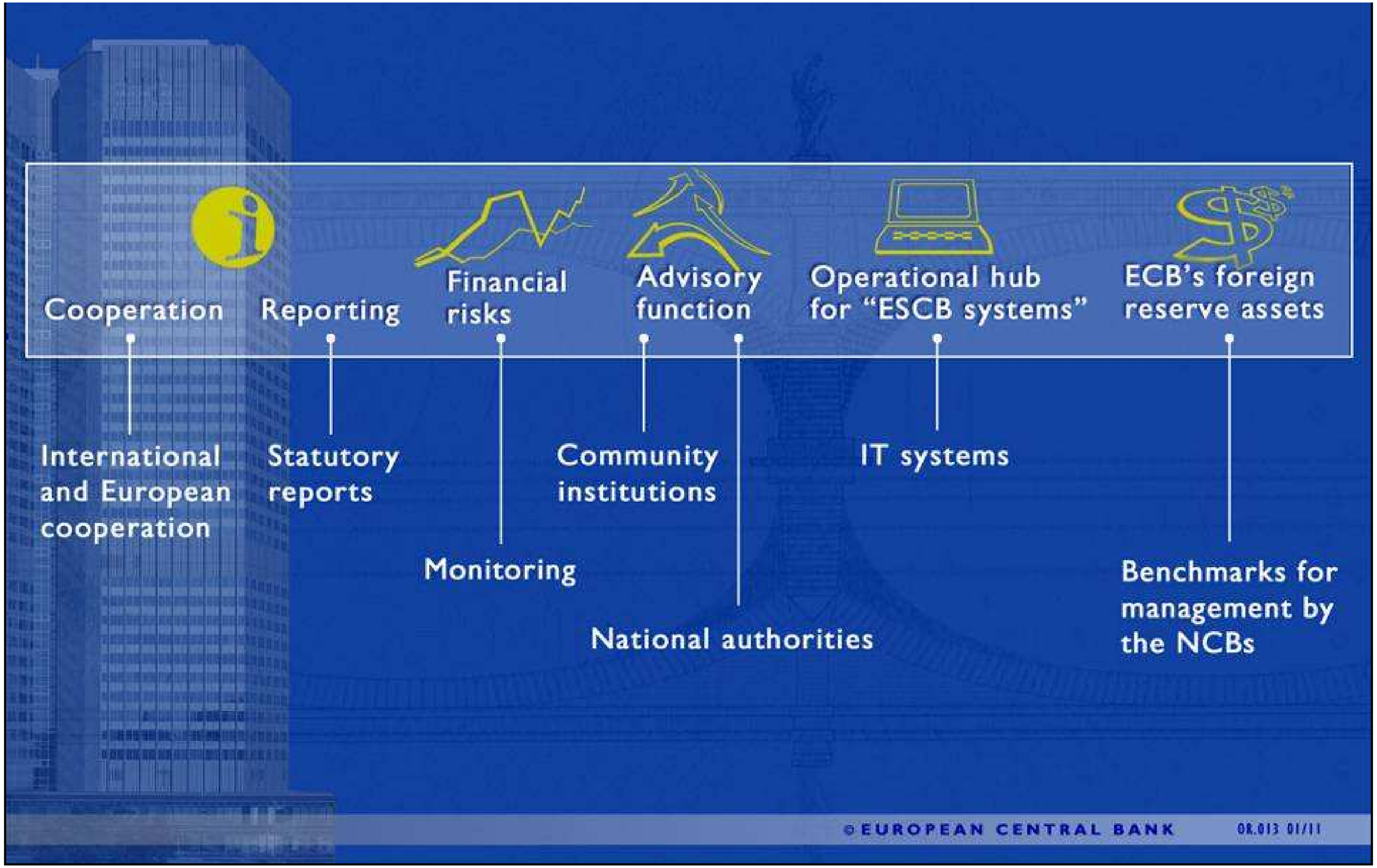
1 Central Bank – 17 National Central Banks

ECB Independence

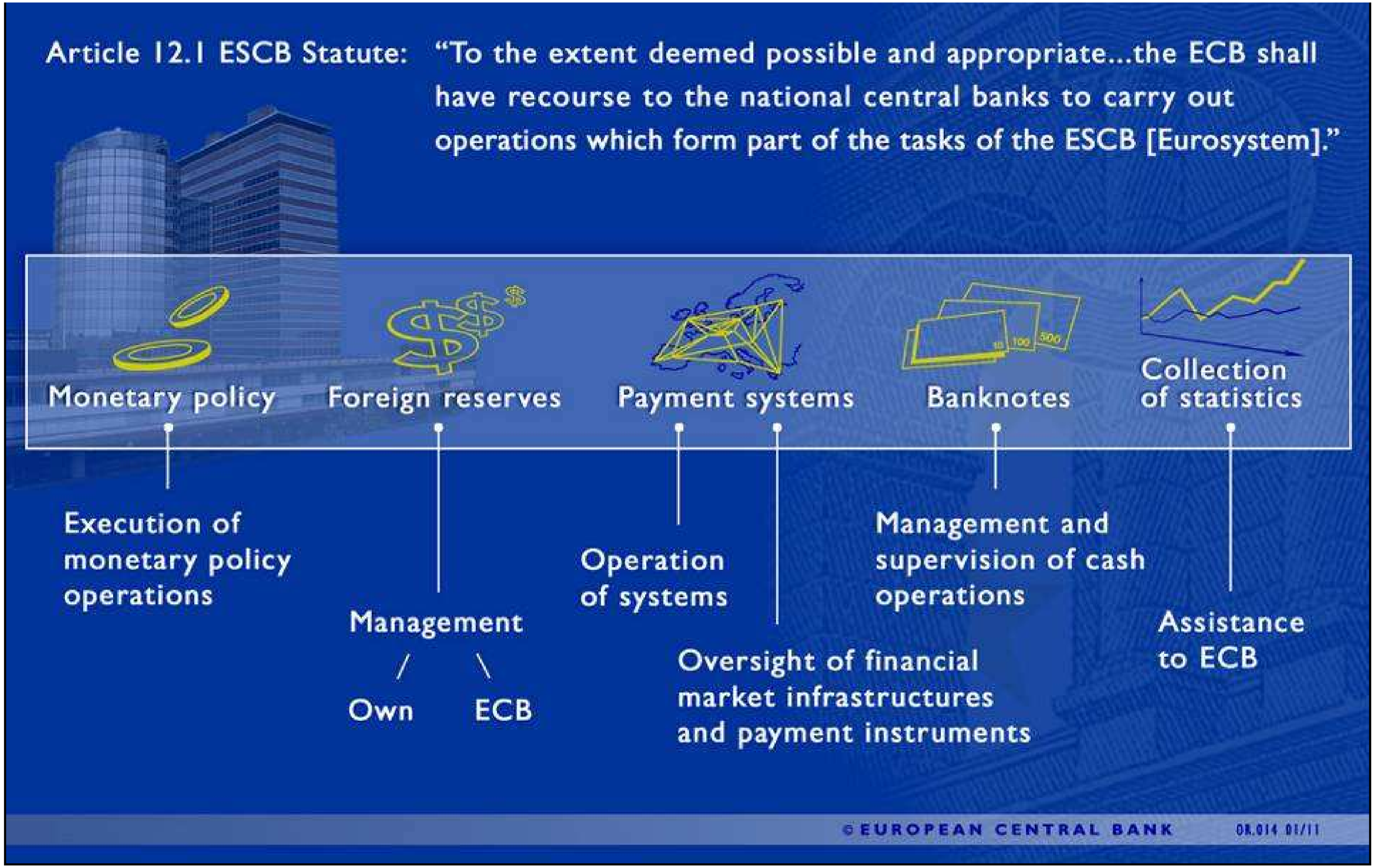
Tasks of the ECB (1/2)



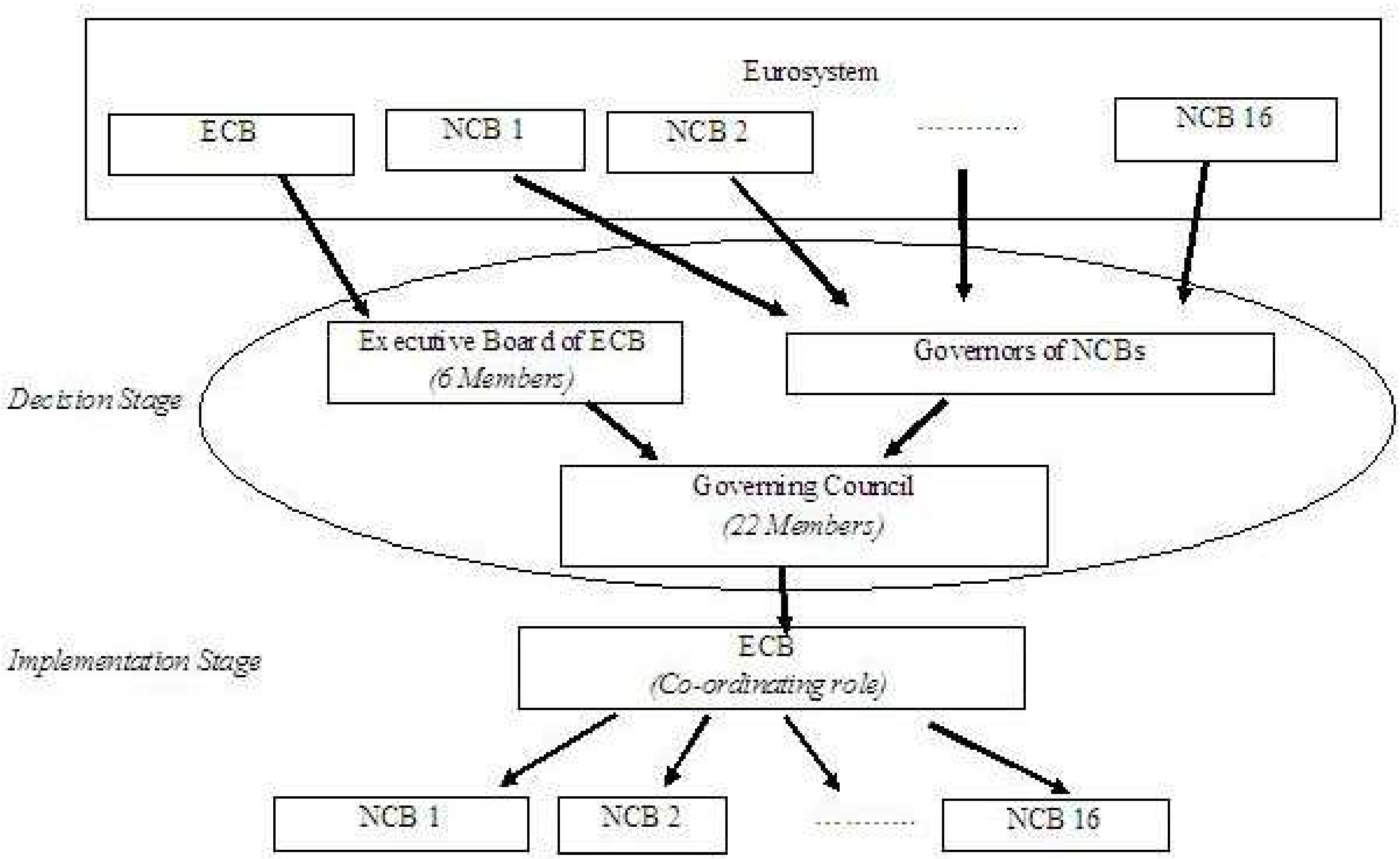
Tasks of the ECB (2/2)



Tasks of the NCBs

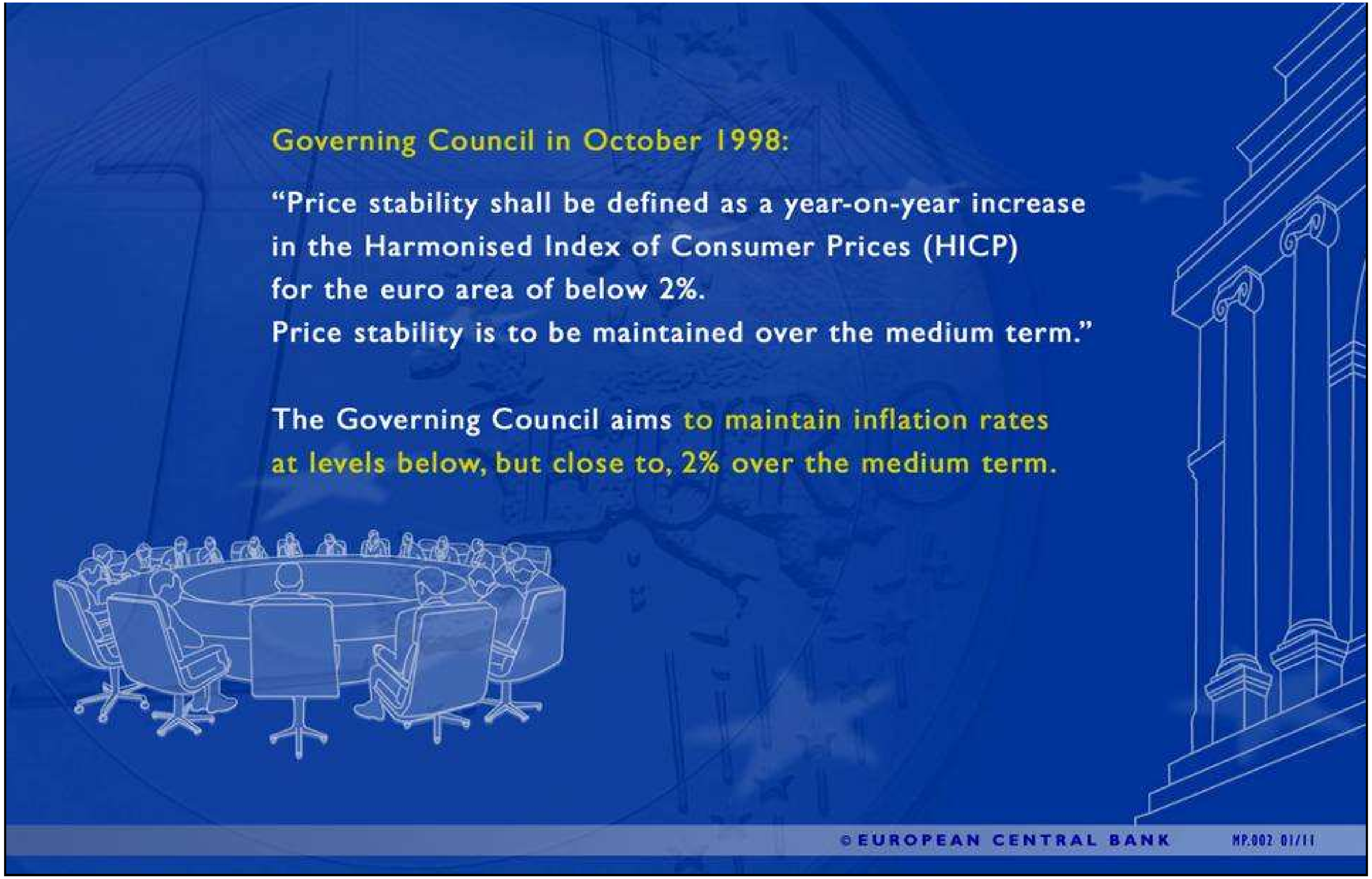


Organizational Framework of the Eurosystem

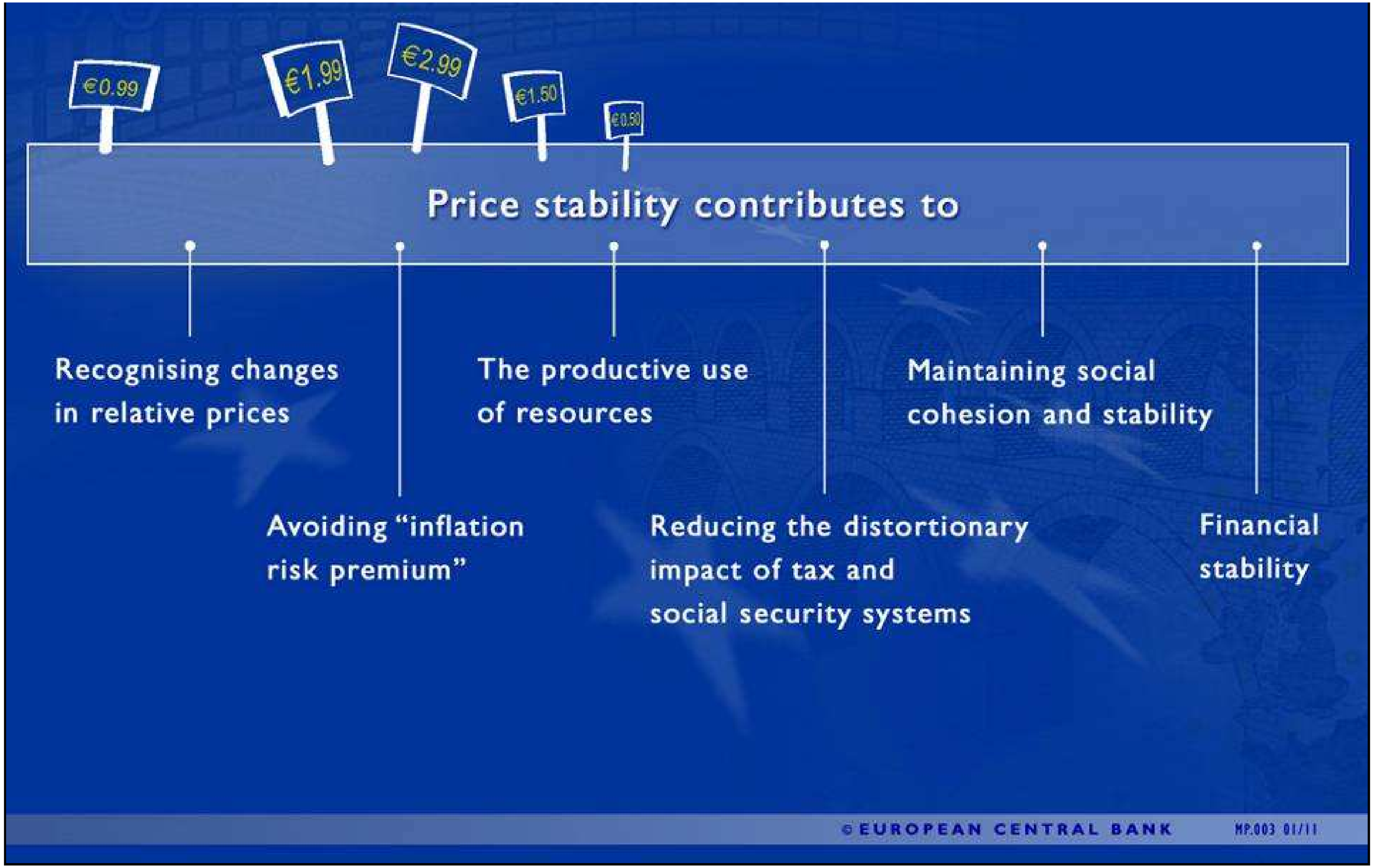


Price Stability – Primary Objective

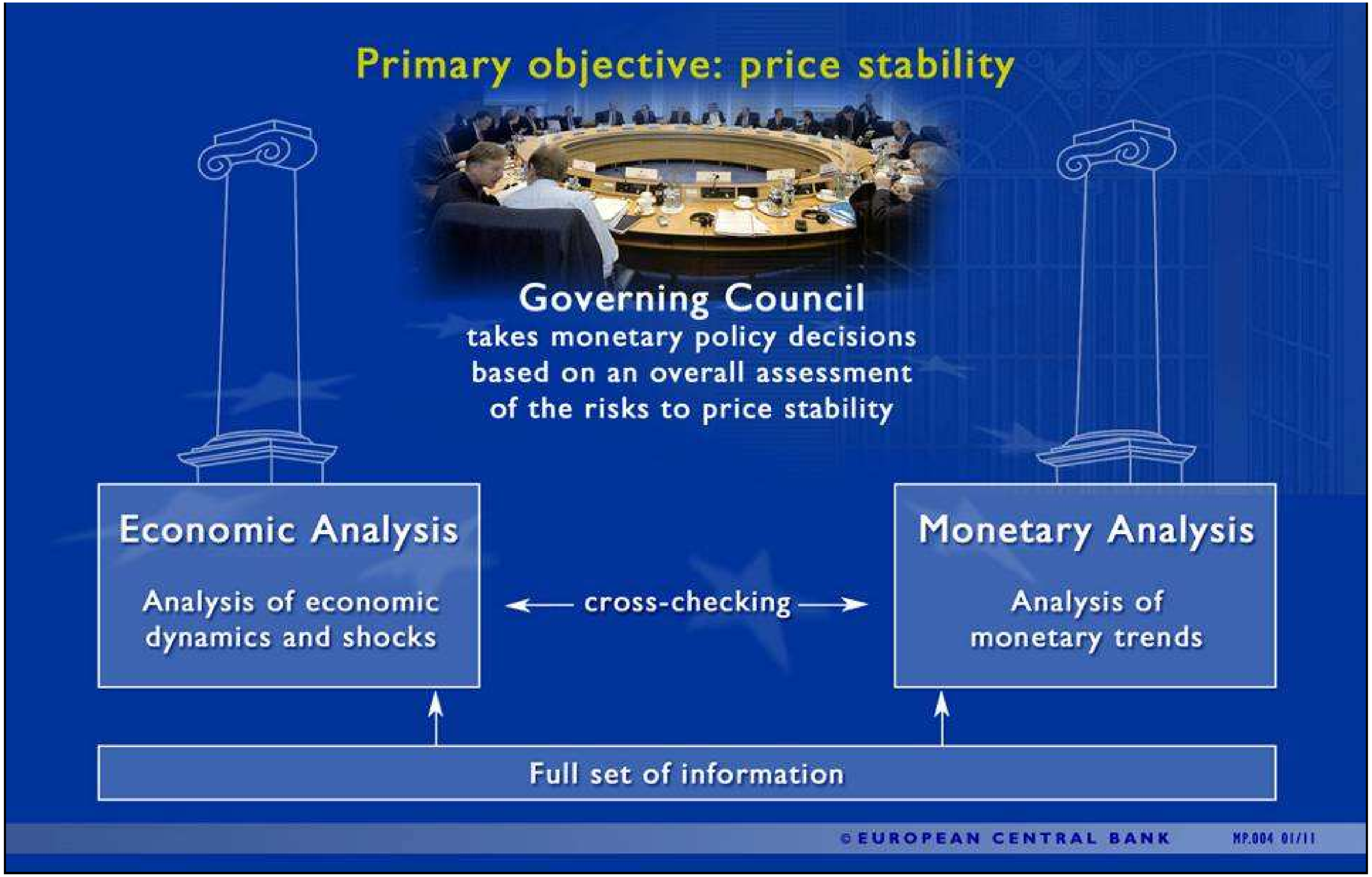
Price Stability - Definition



Benefits of Price Stability



The ECB's Monetary Policy Strategy



The Monetary Policy Instruments

The Monetary Policy Instruments – Non-Standard Measures

Agenda

- Introduction
- European Central Bank
- Federal Reserve System
- Summary: ECB and FED

The Federal Reserve System: Origins

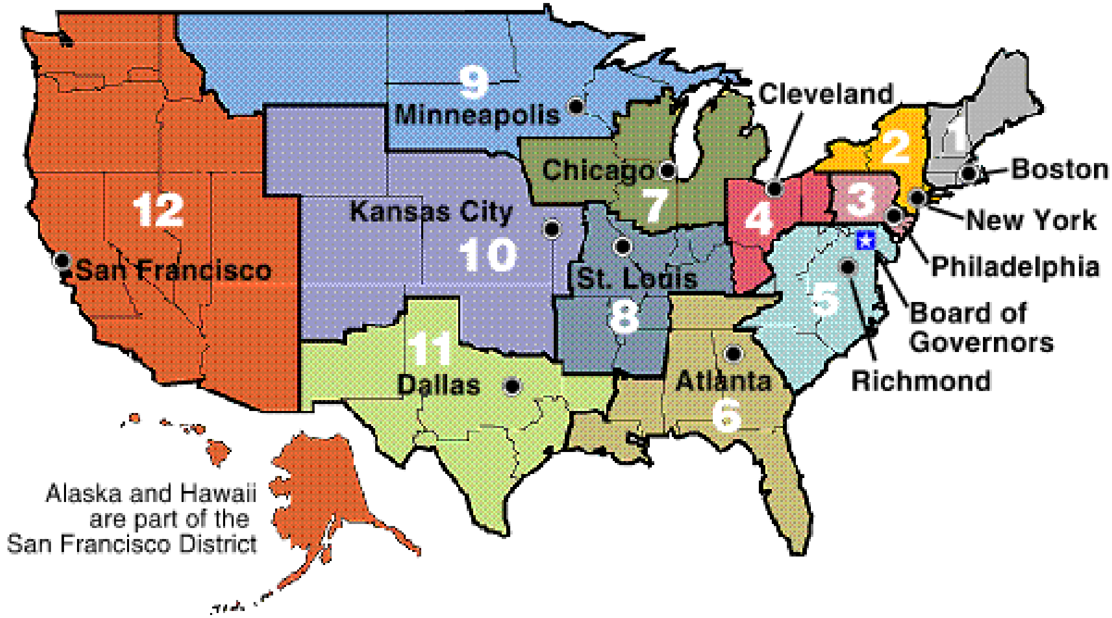
The first Federal Reserve Board, 1914

- 1870 to 1907:
  US had lots of financial panics (bank runs)

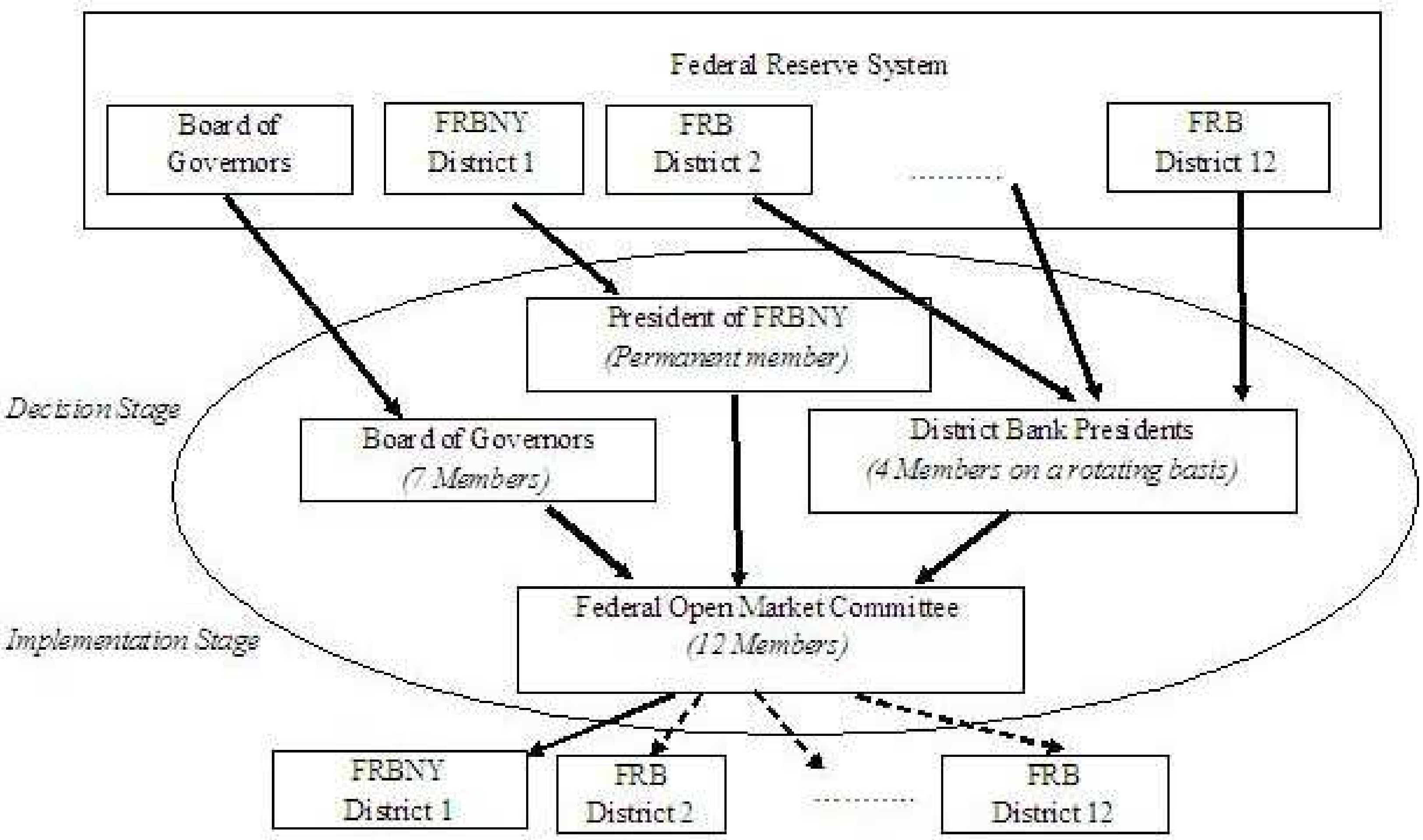
- Banking crisis in 1907
  → Federal Reserve Act was found in 1913 including the foundation of Federal Reserve Banks

Federal Reserve Banks

- 12 Districts:
- Each is a Private Non-Profit Organization and Chartered Banks
- Owned by commercial bank "members"
- Overseen by both
  - Board of Directors
  - Board of Governors in Washington

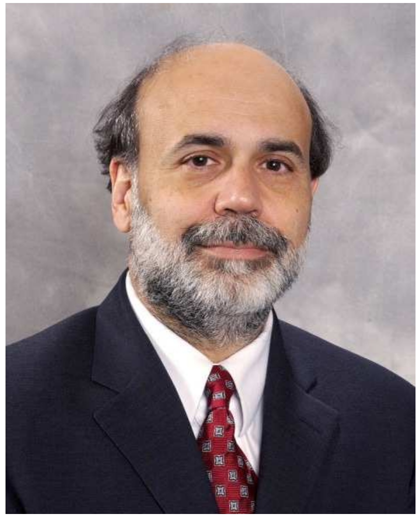


Organizational Framework of the Federal Reserve System



The Board of Governors

- Structure
  - 7 Governors including a Chairman and Vice Chairman
  - Serve 14 year terms
  - Appointed by the US-president



Ben Bernanke, Chairman

- Functions
  - Analyze financial and economic conditions
  - Administer credit protection laws
  - Supervise and regulate the Reserve Banks
  - With Reserve Banks, regulate and supervise the financial system
  - Collect and publish statistics

Federal Open Market Committee

- FOMC Membership:
  - 7 Governors
  - President of the Federal Reserve Bank of NY
  - 4 of the remaining 12 Reserve Bank Presidents in rotation
- Function:
  - Set the Federal Funds Rate

Tasks of the Federal Reserve System

- Government’s Bank
  - Issue currency
  - Maintain the Treasury’s account
  - Manage the Treasury debt

- Bankers’ Bank
  - Hold Reserve Deposits
  - Operate the Payments System
  - Make Discount Loans at the Discount Rate
  - Supervise and regulate financial institutions
  - Collect Data

Federal Reserve Bank of NY

New York Fed Only:

- Auction Treasury Securities
- Foreign Government Services
- Monetary Policy Operations
- **Fedwire**: Large Value Interbank Funds Transfer System

Main Objectives of the Fed

There are 3 equal objectives:

- Price stability
  - not defined, but widely viewed as 1-2% comfort zone
- Maximum employment
- Moderate long-term interest rates

The Monetary Policy Instruments

- Open market operations
  - ✓ Buying and selling of government bonds on the open market
- Discount window
  - ✓ Instrument that allows MFIs (Monetary Financial Institutions) to borrow money from the Fed usually on a short-term basis
- Reserve requirements
  - ✓ sets the minimum reserves each MFI must of customer deposits and notes

New Monetary Policy Instruments – A Response to Financial Crisis 2008

- Term auction facility
- Term securities lending facility
- Primary dealer credit facility
- Interest on reserves
- Term deposit facility
- Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)
- Commercial Paper Funding Facility

Assessing the FED's Structure

- Independence from Political Influence
  - Long terms
  - Irreversible Policy Decisions
  - Budgetary Independence

- Decision-making by Committee
  - 12 voting members

Two events provide the foundation for Fed independence:

1. In 1935 political appointees were removed from the FOMC
2. In 1951 President Truman supported the Fed's refusal to purchase Treasury securities that the Secretary of the Treasury requested they buy

Agenda

- Introduction
- European Central Bank
- Federal Reserve System
- Summary: ECB and FED

Summary – ECB and FED

	Eurosystem	Federal Reserve System
Established/ Made independent	1998	1914
Monetary policy decision-making body	Governing Council, comprising 22 members: the ECB Executive Board (6 members) and the Governors of the 16 NCBs of the Eurosystem	Federal Open Market Committee (FOMC),12 members: 7 Board Governors, President of the New York Fed, and 4 of the 11 other reserve banks FedPresidents on rotating basis; 19 participants
Appointment of policy makers	President and Governing Council members appointed for 8 years by national governments; ratified by European Parliament	Governors (14 year terms)/Chairman(4 year term) appointed by the President and approved by the Congress; Bank Presidents selected by Bank directors (largely local banking/ business community)
Independence from political influence	Yes. Enshrined in the Maastricht Treaty	Yes. Fed is a "creature of the Congress" and must report regularly, but enjoys substantial independence by long-standing tradition

	Eurosystem	Federal Reserve System
Monetary policy objective(s)/ Mandate	Price stability is the primary objective as set in the Maastricht Treaty. The ECB has quantified this as medium-term inflation goal of "below but close to 2%"	Multiple objectives: to promote maximum employment, price stability, and moderate long-term interest rates. Price stability not defined, but widely viewed as 1-2% comfort zone (skewed toward upper portion) for core PCE inflation
Monetary policy strategy	Two pillar strategy. First pillar focuses on shorter-term economic and pricedevelopments ("economic pillar"); Second pillar focuses on longer-term inflation outlook based on monetary analysis	Focus on economic forecasts; rates adjusted to optimise expected outcomes and minimise risks of deviating from those outcomes (factoring in costs of those deviations). Preference forgradualism unless risks dictate more aggressive action
Decision-making style	Consensual, with the President assuming the role of moderator; dissents are rare	Consensual (less so under Bernanke than Greenspan), with Chairman clearly first among equals. Dissents are infrequent, multiple dissents are very rare
Role of monetary aggregates and asset prices	Both play a significant role	Neither plays a significant role independent of their effects on growth and inflation

	Eurosystem	Federal Reserve System
Accountability and transparency	a. Immediate press conference after Council meetings with introductory statement and Q&A (2:30 pm local time) b. Annual Report to EU institutions and presentations to the European Parliament c. Monthly Bulletin published d. Speeches	a. Immediate announcement following the FOMC, with voting record (2:15 pm local time) b. Meeting minutes three weeks later c. Full transcripts of meetings five years later d. Frequent speeches by FOMC participants e. Semi-annual monetary policy report to Congress; other hearings

Conclusion

Rule-based = one response to every economic situation	Discretionary = come to a decision case-by-case
+ consistency + plausibility + predictable + quick decisions !?	+ flexible + best reaction !?
ECB & € - a new central bank and currency - a heterogeneous area	Fed & $ - an established central bank and currency - a homogeneous area

Thanks for Your Attention!