

A Comparison of Unconventional Monetary Policy in the U.S. and Europe

The global financial crisis of 2007-09 affected most countries around the world in a similar way. Deep recessions hit the U.S., Europe and Japan, and even China experienced slower growth. During the early stages of the global economic recovery, the U.S. and the euro area had similar unemployment rates of roughly 10 percent in October 2009. Subsequently, monetary policy in the U.S. and in the euro area took different paths, as did the economic performance of those two economies.

In the U.S., the Federal Open Market Committee (FOMC) undertook unconventional monetary policy after it lowered the federal funds rate target to near zero in December 2008. The FOMC undertook three rounds of quantitative easing, or large-scale asset purchases. The first two programs were for fixed amounts. The third one (QE3) was an open-ended program, in which the FOMC said the purchases would continue at a certain pace until a particular objective was achieved. In addition to quantitative easing, the FOMC used forward guidance, whereby the committee promised to stay at zero beyond the time when it might otherwise have been expected to raise the federal funds rate target. Of these two unconventional approaches to monetary policy, quantitative easing seems to have been more effective.

When the FOMC adopted QE3 in September 2012, the objective was substantial improvement in labor markets. At the time of the FOMC meeting, the latest reading on unemployment was 8.1 percent, and the rate was not expected to drop that rapidly even with the QE3 program. The actual result, however, was that unemployment dropped dramatically faster than anticipated at the launch of QE3. In October 2014, the FOMC declared that substantial improvement in labor markets had occurred and ended QE3.

Meanwhile, the European Central Bank (ECB) lowered its benchmark rate to 1 percent in May 2009 but was reluctant to adopt unconventional monetary policy during and after the 2008-09 recession in the euro area. Not only was the ECB less inclined to promise to stay at zero for any length of time, but it was also less inclined to adopt a quantitative easing program similar to those in the U.S., U.K. and Japan—and with good reason. The ECB is a multinational institution, and the prospect of purchasing sovereign debt of the different nations in the euro area was not envisioned in the Maastricht Treaty, which led to the creation of the ECB. Therefore, the ECB adopted more of a wait-and-see approach to see if the historically low interest rates alone would be enough to spur recovery. However, the European sovereign debt crisis hit in late 2009 and was especially severe in 2011 and 2012, and Europe went back into recession. Euro area unemployment, instead of declining as in the U.S., peaked at 12.1 percent during the second quarter of 2013. The rate remains in double digits (11.3 percent in February 2015), a stark contrast with U.S. unemployment (5.5 percent for the same period).

While the Fed has a dual mandate for maximum sustainable employment and stable prices, the ECB has a single mandate for price stability, which it has interpreted as keeping inflation below but close to 2 percent via an explicit inflation target. During 2014, the ECB's ability to keep inflation close to its target seemed to be eroding as both actual and expected inflation drifted down. Inflation has even been below zero since December 2014.¹ As a result, ECB policymakers overcame their reluctance to adopt unconventional monetary policy.² They decided in January 2015 to implement an open-ended quantitative easing program modeled on the QE3 program in the U.S., with the sovereign



debt purchases beginning in March. The ECB intends to continue the program at least until September 2016 but, if necessary, can continue beyond that until inflation moves back toward target. Based on the U.S. outcomes from QE3, the ECB has a reasonable chance at success with this program.

This is not a story only about Europe. Global yields began to fall during 2014 as it became more likely that the ECB would undertake a sovereign-debt quantitative easing program. From the beginning of 2014 to the end of 2014, yields on 10-year German bonds declined by about 1.4 percentage points, and yields on 10-year U.S. Treasury securities declined by more than 0.8 percentage points. These examples illustrate the big impact that the expectation of quantitative easing in the euro area had on U.S. and global markets. In my view, the ECB's undertaking of quantitative easing was a momentous decision and a major milestone in global monetary policy. [Ω](#)

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ENDNOTES

- 1 Although U.S. inflation has not been what was expected, it has not gone down to zero. Headline inflation has been drifting down in recent months due largely, in my view, to the decline in oil prices. U.S. inflation refers to the year-over-year percent change in the Personal Consumption Expenditures Price Index, and euro area inflation refers to the year-over-year percent change in the Harmonized Index of Consumer Prices.
- 2 After raising its benchmark rate twice in 2011, the ECB has since lowered it to near zero.