

# CENTRAL BANKS COORDINATED ACTIONS

## Impact & Interventions in Financial Markets

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This paper presents some of the events when different central Banks make joint and coordinated actions to impact the financial markets. This paper shed light on these events and their impact on the S&P 500 Index.

## Introduction

We have often hear terms like “Free Market Mechanism”, which implies that the market is only dependent on two factors that includes supply and demand and these two forces naturally balances the market. But, this theory is very powerful in understanding the true concept of market mechanism but the real world is not perfect, perfect imperfection always exist. So, to counter the market imperfection and cause the market to behave in one’s own favor, usually central banks intervene in the market (Financial Markets).

When we use the word “Financial Markets” then it refers to Capital market, Money Market and Foreign Exchange market. The central banks interventions are mostly in FX market because central banks are usually in many countries are the authorities to set the monetary policy and interest rates which will directly impact the FX and money market.

Central’s Banks usually intervene to take advantage of different imperfection of the market. Different Banks Like Federal Reserve Bank (US), Bank of Japan, Bank of Canada, Swiss Bank and other central banks intervene in financial markets. Although some critics says that intervention in the free market mechanism will ultimately reap negative outcomes, but the reality is that no market is actually in the world. But , in today’s world the challenges are so and so dangerous that even these central bank needed to coordinate and joint hands to impact the financial markets. Now, as far as, for the purpose of this paper is concerned we would look at some of the coordinated actions of different central banks (Bagus, Howden, 2010).

## Six Central Banks Coordinated Action

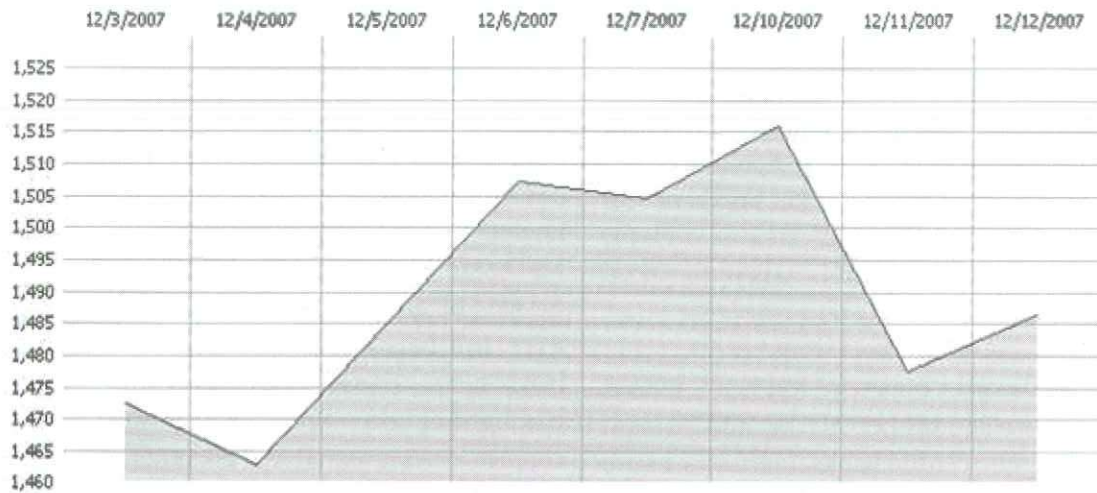
On December 12, 2007, the Federal Reserve Bank and England Central Bank, Central Bank of Canada, and Swiss National Bank announced to coordinate actions to counter global financial crisis. The move was motivated by the fact and necessity to provide liquidity in the short-term credit market. The coordinated

actions was to elevate the pressures' the central banks refer to the fact that, since last summer, market rates at up to around three-month maturities have been pushed up by liquidity and risk premium to levels much higher than implied by the central banks' base rates. For instance, the spread between the 3-month euro-LIBOR and the ECB base rate has increased from around 30 basis points usually to around 60-70 basis points since last summer. Higher market (or interbank) rates have implied that transaction volumes have decreased. The most extreme example of this has been the inability for Northern Rock to renew funding of its mortgages. Moreover, what transactions have still happened has been more expensive for borrowers. These rates determine interest rate throughout the system. As a result, interest rates charged on household and corporate borrowing have generally raised, despite unchanged or even lower central bank rates (Washington, 2008).

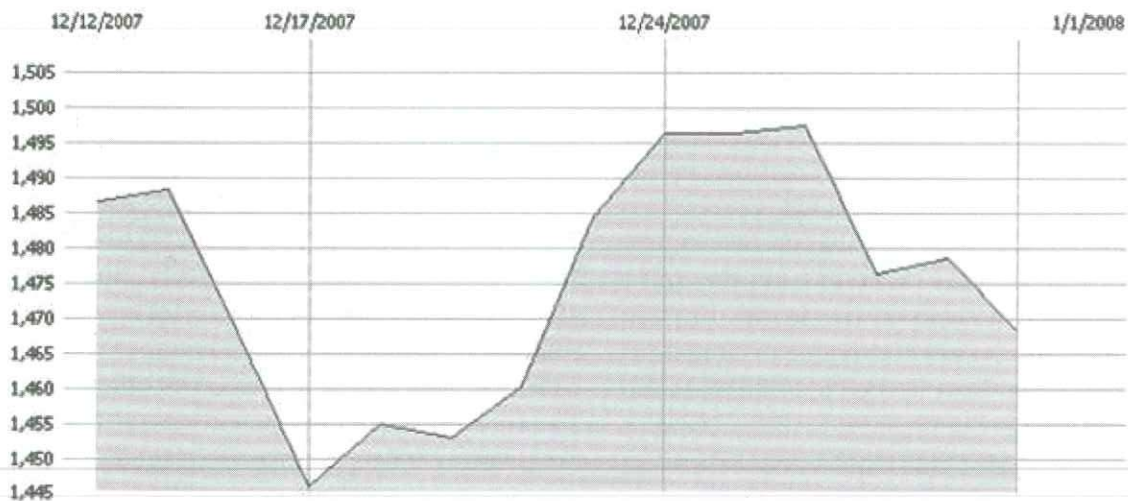
The central banks have announced that they will provide additional liquidity and, in the case of Central Bank of England, the Fed and the Canada Central Bank that they will make it easier for banks to access these funds. By providing additional funds, the central banks hope that private banks will use and leverage these funds and that market transactions will return to normal. The amount of liquidity provided is sizeable, although not as large as during the previous - uncoordinated - injections made by the central banks since last August. On 30 November 2011, central banks can now exchange currencies other than dollars. The ECB could for example provide yen, Swiss francs or Canadian dollars to financial institutions in the euro area, in addition to dollars.

### Graphs

From the close of the day before to the close of the day of the announcement of the action

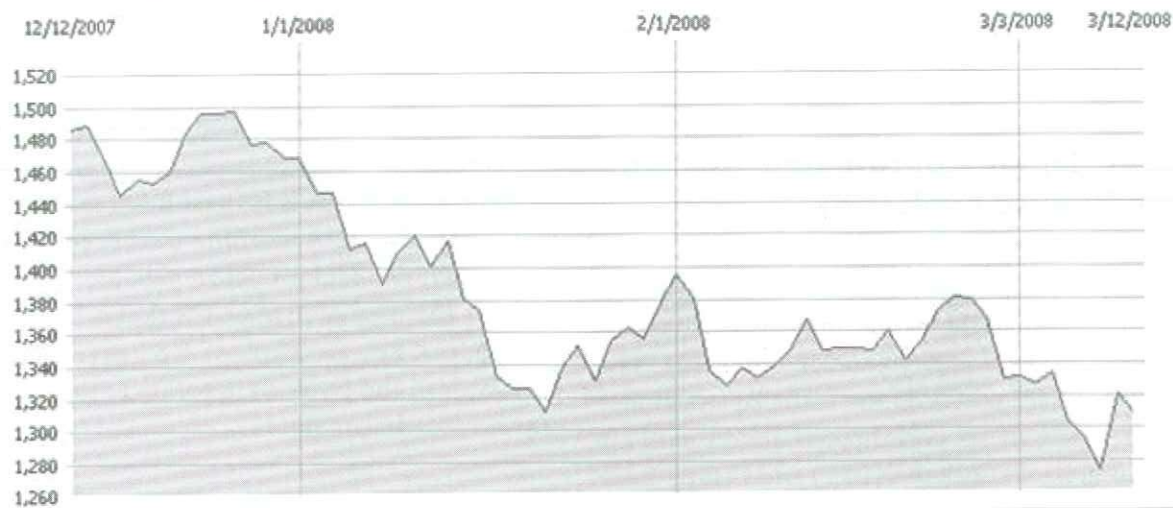


From the close of the day of the announcement of the action to 1 month later

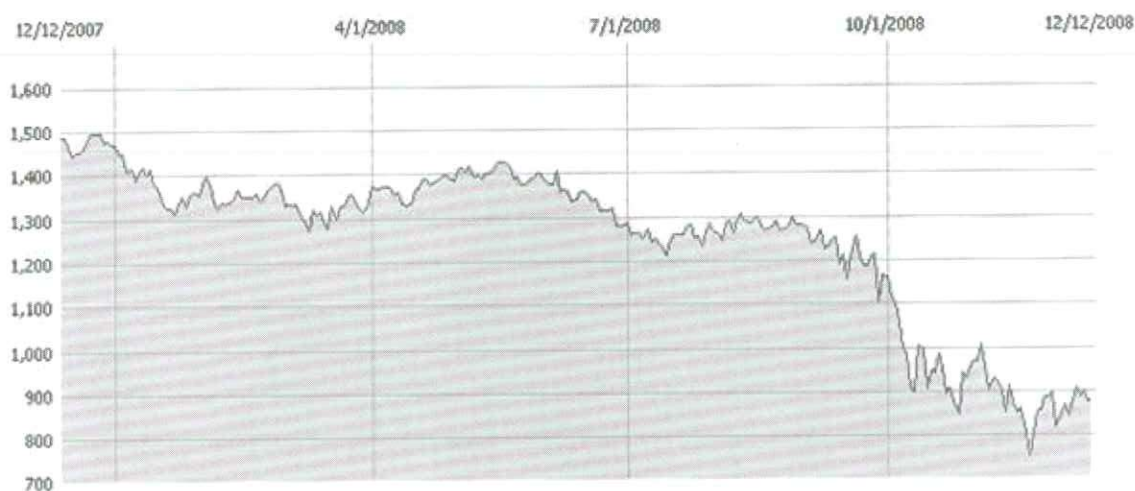




From the dose of the day of the announcement of the action to 3 months later



From the dose of the day of the announcement of the action to 1 year later



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## Tendencies Observed

When announcement was made about the coordination of several central banks then we can see the market reacting to that decision. In the short term, the market definitely improves but after that the market gets back to its normal position and then it rides on the market forces. Central bank's intervention can affect the market performance but only in the short term, which is mainly because of the psychological effect of the announcement on the market and its players' expectations.

## Bank of England Coordinated Act with Federal Reserve Bank (US)

On 16 December 2007, The Fed and the ECB enter swaps to provide up to \$20 billion to the Euro system for up to six months. Another \$4 billion will be provided to the Swiss banking system through a swap between the Fed and the SNB. In addition, the Fed will set up a 'Temporary Auction Facility' to provide \$40 billion over two auctions later this month, with another two auctions planned in January. A wide range of banks will be able to tap this auction, using a broad range of

collateral. The Bank of England has increased the size of the next regular liquidity operation by £8.5 billion to £11.35 billion and has widened the list of eligible collateral assets to include, in particular, high grade mortgage-backed securities.

### Bank of Japan Coordinated Act with Federal Reserve Bank (US)

On 18 September 2008, Bank of Punjab did a coordinated action in the money market. The bank of Japan addresses the liquidity issue of US dollars. The Bank of Japan injected US dollars in the Japan's money market as a part of its coordinated action with six major Central Banks, including FED and Central Bank

of Europe. The coordination is motivated by the concern to address the global financial crisis, which were destructing financial markets and their riskiness (Garcia, 2005).

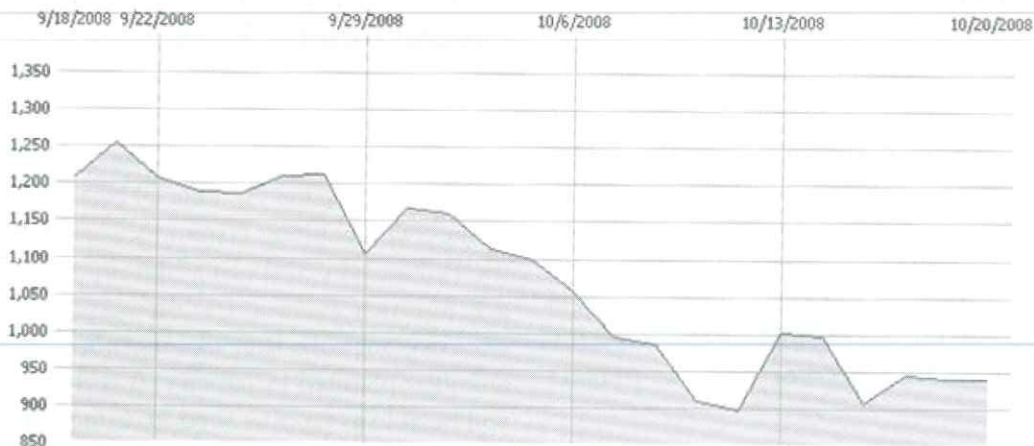
As a part of their coordinated actions, Bank of Japan had entered into a currency swap agreement with the US central Bank that is Federal Reserve Bank (US) of worth \$60 billion. According to this currency swap agreement, the bank of Japan gets the US dollars to address the money market US dollar liquidity issue and Federal Reserve Bank of US get yen. According to this deal, the Bank of Japan gets the capacity to provide US dollars funds.

#### Graphs

From the close of the day before to the dose of the day of the announcement of the action

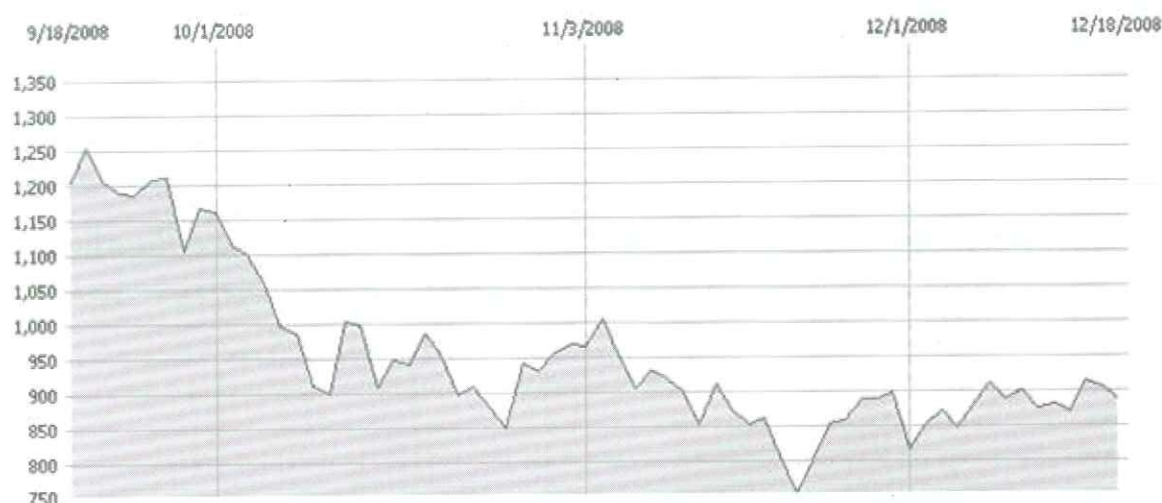


From the dose of the day of the announcement of the action to 1 month later

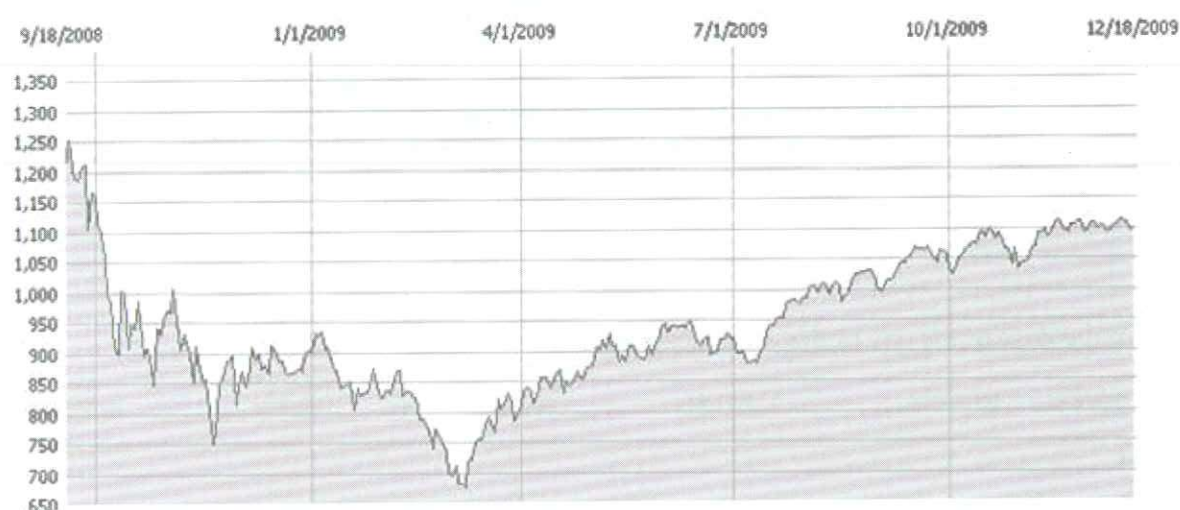




From the dose of the day of the announcement of the action to 3 months later



From the dose of the day of the announcement of the action to 1 year later



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## Tendencies Observed

Again, here we can see that any kind of central bank interventions can cause the market to behave in a certain way in a reaction to that intervention/ coordinated action but ultimately in the longer run it's the market forces that rules. When the Bank of Japan and FED enter into a currency swap agreement, it may improve the market performance in the short term but the in long run the market rules and every tampering will actually be settled by the market forces.

## Banks Coordinated to Cut Interest Rates

On 08 October 2008, the Fed, Central Bank of Europe, ECB, Canada, China, Sweden & Switzerland have announced a 50 basis points of rate (interest rate banks can borrow from the central bank or which are paid by their excess liquidity it), to "curb the global financial crisis." The Bank of Japan expressed its support for this action without cutting rates (Eggertsson et.al, 2003).

In the U.S., the rate is now 1.5% against 2% previously. The monetary authorities have therefore put aside

their inflation concerns to address in priority to the risk of recession, now considered a danger much more serious than a few months ago. Meanwhile, the

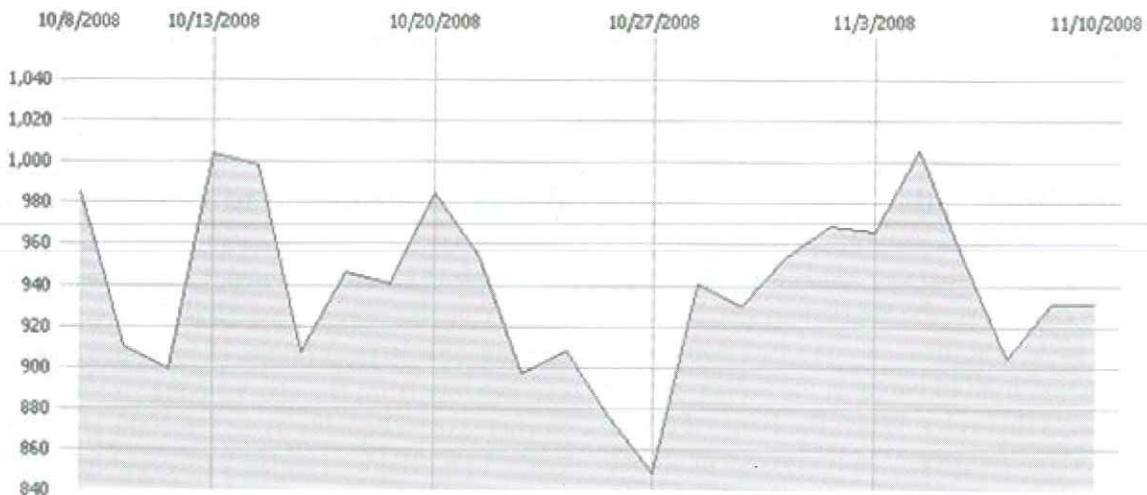
movements of bankruptcies and mergers in the banking sector in the United States and Europe have increased.

### Graphs

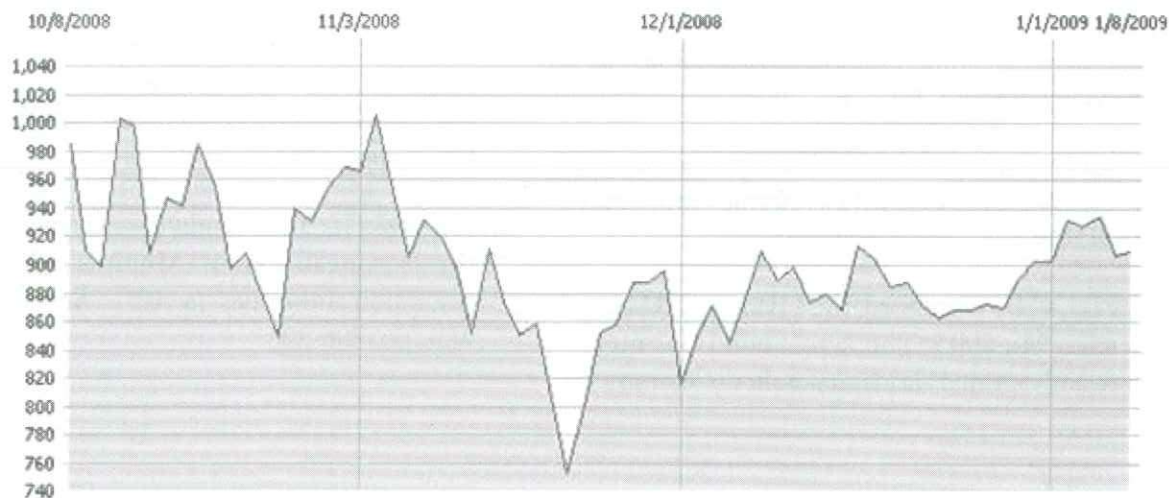
From the close of the day before to the close of the day of the announcement of the action



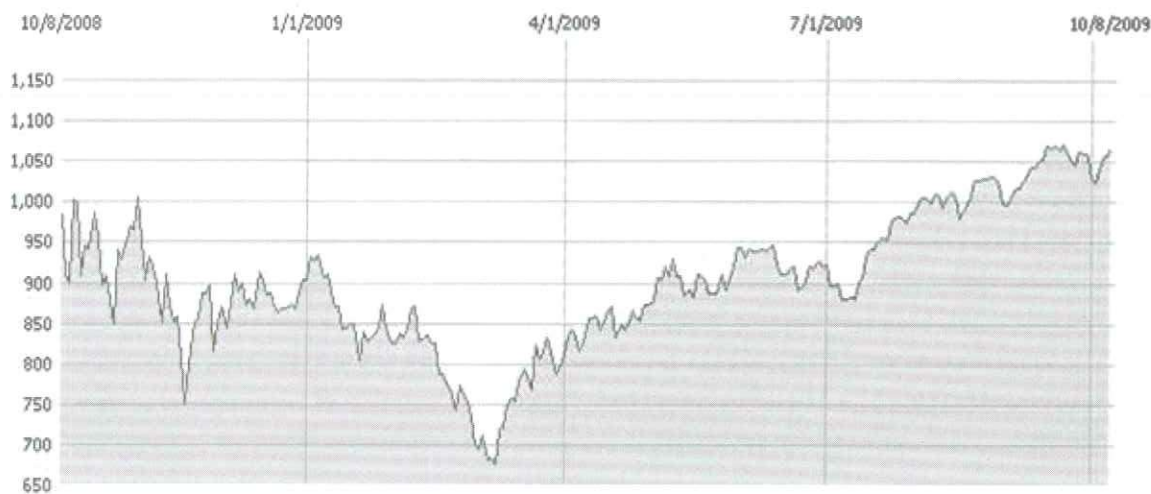
From the close of the day of the announcement of the action to 1 month later



From the dose of the day of the announcement of the action to 3 months later



From the dose of the day of the announcement of the action to 1 year later



### Tendencies Observed

Same phenomenon can also be observed here, when the central banks coordinate in the cut of interest rate, the result of it can definitely be observed in the short run. As given in the above graphs that the market performance improves in the short-term, when we see the graph of market performance on the next day and after month of the coordinated action by the central banks.

### Conclusion

Finally, we can say that if the central bank wants to improve or influence the performances of different financial market, they need to make efforts to involve in the financial markets through proper channel and facilitate market forces. For example: Deregulation for investors might be the one way to improve the market performance in a more persistent manner.



## References

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