THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
www.international-economy.com
editor@international-economy.com

Looking Back at the Great Financial Crisis

A new book examines how human factors played an outsized role.

BY ADITI SAHASRABUDDHE

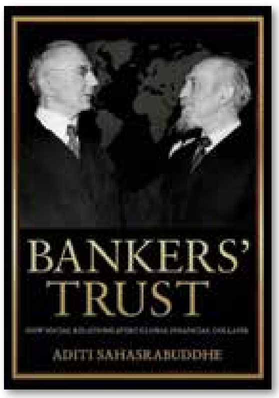
Two of the most significant rescue measures [during the global financial crisis] emerged out of international cooperation between central banks. One is the first ever coordinated interest rate cut in October 2008. The U.S. Federal Reserve, the Bank of Canada, the European Central Bank, the Bank of England, and the Sveriges Riksbank (in Sweden) all cut their primary lending rates by half a percentage point. The Swiss National Bank also cut rates. The Bank of Japan publicly endorsed the move. This coordinated rate cut gets the most attention as an act of unity among central bankers and made front-page news the day after it was announced. Despite this fanfare, the move had at best a modest effect on calming markets.

A more significant cooperative step was extension of liquidity swap lines by several major central bankers, led by the Fed. These steps were unprecedented in their amounts and their coordination. This program was neither an automatic nor an obvious policy response but rather symbolized the adage that situations of such gravity called for "outside the box" thinking.

The largest swap network was established by the Fed, which extended bilateral currency swaps to a select fourteen central banks. The Fed essentially expanded the size of its balance sheet to deploy this program, and it was the institution's single largest crisis-fighting effort during the GFC. The first lines were set up in December 2007 and continued through 2010, peaking with the largest swap amount of USD$170.93 billion to the ECB on October 2008. The Fed alone injected over half a trillion dollars of liquidity using these instruments. The Bank of Japan also extended dollar swaps to a few partner economies such as India or Indonesia, who experienced dollar shortages but did not receive a swap line from the Fed. South Korea received dollar swaps from both the Fed and the Bank of Japan. A euro network and a Swiss franc network also emerged. Of course, euro-denominated loans outside of the euro area were far fewer than those denominated in U.S. dollars. Euro-denominated reserves made up about a fourth of world reserve holdings as opposed to two-thirds of world holdings being denominated in dollars. Poland, Hungary, and the ECB received SNB swaps. The People's Bank of China swap network emerged in 2009 and has since proliferated in its size and global reach. Using these swap lines, central banks injected trillions of dollars and euros into the global economy during the GFC between 2007 and 2010. …

These liquidity lifelines were arranged *bilaterally* between the swap-issuing central banks, here, with the Fed, and the recipient counterparty. Again, these lines emerged in an experimental and ad hoc manner and proved essential to bolstering the rescue measures undertaken by central banks and governments, providing critical measures to patch up the inadequate governance system. To many central bankers at the time, it was not initially clear that they would succeed.

By extending these liquidity lifelines, the Fed played the critical stabilizing role of international lender of last resort. However, per Walter Bagehot's principle of "lending freely against good collateral at a penalty rate," the Fed as an ILLR did not lend freely. Additionally, the collateral in a currency swap is the foreign currency being swapped, and the currency risk was assumed by the Fed's counterparty. But the risks of financial or currency collapse, and so the failure to honor the agreement, were systemic. In other words, *there was no good collateral.* Now, central bankers' discretion was paramount, especially in providing liquidity sans good collateral under conditions of uncertainty, and not risk, where the "probable distribution of outcomes itself is unknown." This is evident in the ambiguous, differentiated, and arguably preferential application of the Fed's criteria in selecting swap recipients. Fed officials at the front line even recognized that the crisis was a period of radical uncertainty. ◆



An excerpt from **Bankers' Trust: How Social Relations Avert Global Financial Collapse** *by Aditi Sahasrabuddhe (Cornell University Press, 2025).*

Aditi Sahasrabuddhe is an Assistant Professor in Political Science at Brown University.