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How the Federal Reserve aided the Peoples Bank of China in addressing its 2015 Stock Market Crash

By Alec Buchholtz

On March 21, 2016, Reuters published an article entitled – *Exclusive: China central bank to Fed: A little help, please?* – regarding an email exchange between Mr. Xiangyan Song, Chief Representative for the People's Bank of China (PBOC) Americas Office in New York and Mr. Steven Kamin, Director of the Division of International Finance at the Federal Reserve Board that occurred in July 2015. Mr. Song and the PBOC sought advice from the Federal Reserve on how to respond to turmoil in the PBOC stock market that the central bank had been grappling with for over a month, "asking it to share its playbook for dealing with Wall Street's 'Black Monday' crash of 1987" and to "[i]nform us ASAP about the major measures you took at that time…" (Reuters 2016, PBOC-Federal Reserve Emails).

According to the article, on July 27, 2015, China's stock market experienced successive days of market turbulence and was down 8.5% at close of business. (Reuters 2016)(See also Dun and Bradstreet 2015). Mr. Song reached out to the Mr. Kamin via email seeking advice on the specific measures that the Federal Reserve had taken in response to similar market conditions that had occurred in the United States in 1987. On October 19, 1987, which would come to be known as "Black Monday," the Dow Jones Industrial Average dropped 22.6 %. (Bernhardt and Eckblad 2013).

Mr. Kamin responded to the request by providing a 259-word summary of the Federal Reserve's actions in October 1987, attaching seven publicly available files related to those actions. Each document was accompanied by a short annotation as shown below:

1. "Greenspan Statement to Congress 1988 – Discussion of Federal Reserve actions
2. FOMC conference call on Oct 20 1987 – discussion of market developments
3. Brief history of 1987 stock market crash – Federal Reserve working paper on events surrounding the crash, and the response of the Federal Reserve
4. Greenbook for FOMC October 28 1987 – See discussion of financial developments starting on page 38 of the pdf.
5. Bluebook for FOMC October 30 1987 – See "Recent Developments" discussion starting in page 1
6. FOMC meeting minutes Nov 3 1987 – See discussion on page -10- on why the Federal Reserve used repos to inject liquidity instead of conducting outright purchases of T-bills.
7. FOMC record of policy actions Nov 3 1987 – See discussion starting on page -5- of Federal Reserve policy actions." (PBOC-Federal Reserve Emails).

The email summary provided by Mr. Kamin highlighted a few key responses to the U.S. market turbulence in mid-October 1987. First, the Federal Reserve issued several statements "pledging to provide ample liquidity" and "recognizing that the conduct of open market operations…required special flexibility." (PBOC-Federal Reserve Emails). One way this was conducted was by injecting cash into the U.S. banking system via repurchase agreements. Second, it expanded the range of collateral open to primary dealers, which suspended the "size limits imposed on loans of securities…and the requirement that such loans not be related to short sales." (Ibid.) Lastly, the Federal Reserve increased supervision services over "primary government securities dealers and interdealer government securities brokers" by placing more Federal Reserve employees on location at those dealers. (Ibid.)

Following the exchange, the PBOC increased its use of repurchase agreements throughout the summer of 2015, similar to how the Federal Reserve had in 1987. (Ibid.) According to the Reuters article, the PBOC's central bank does not have as much autonomy as the Federal Reserve does to conduct monetary policy and largely implements policies decided by political leaders. By contrast, the Federal is a body independent from the U.S. legislative and executive branches. (Ibid.) However, addressing the actions taken that summer, Chinese Premier Li Keqiang believed that the PBOC "did not respond sufficiently but China had fended off systemic risks," having devalued the currency and insuring that financial institutions had access to market operations for short-term liquidity. (Ibid.)

The YPFS's New Bagehot Project seeks to make sharing of information and best practices between central bankers and other policymakers much easier. When it is fully developed, policymakers will be able to access the online platform 24 hours and search out similar "playbook" information as well as the actual implementation documents.

The emails described in the Reuters article were acquired pursuant to a Freedom of Information Act request submitted by the article's author, Jason Lange, an economic correspondent for Reuters. We are grateful to Mr. Lange for providing copies of these to the Yale Program on Financial Stability. The emails and cited documents are available by clicking on the above links or by searching the YPFS Resource Library.

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