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Monthly Report on Credit and Liquidity Programs and the Balance Sheet

February 2010 ([1.35 MB PDF](#))

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System Open Market Account and Liquidity Arrangements with Foreign Central Banks

System Open Market Account (SOMA)

Recent Developments

- The SOMA portfolio has continued to expand, although the pace of Federal Reserve purchases of securities under the large-scale asset purchase programs (LSAPs) has slowed, reflecting the Federal Open Market Committee's (FOMC's) directive to gradually taper purchases under these programs to facilitate a smooth transition in financial markets.
- Under the FOMC's LSAPs, as of January 27, 2010, the Federal Reserve held about \$164 billion in agency debt and also had purchased a total of \$1.15 trillion of agency mortgage-backed securities (MBS) out of its announced target of \$1.25 trillion, of which \$970 billion had settled.

Background

Open market operations (OMOs)—the purchase and sale of securities in the open market by a central bank—are a key tool used by the Federal Reserve in the implementation of monetary policy. Historically, the Federal Reserve has used OMOs to adjust the supply of reserve balances so as to keep the federal funds rate around the target federal funds rate established by the FOMC. OMOs are conducted by the Trading Desk at the Federal Reserve Bank of New York (FRBNY), which acts as agent for the FOMC. The range of securities that the Federal Reserve is authorized to purchase and sell is relatively limited. The authority to conduct OMOs is granted under Section 14 of the Federal Reserve Act.

OMOs can be divided into two types: permanent and temporary. Permanent OMOs are outright purchases or sales of securities for the SOMA, the Federal Reserve's portfolio. Permanent OMOs have traditionally been used to accommodate the longer-term factors driving the expansion of the Federal Reserve's balance sheet, principally the trend growth of currency in circulation. More recently, the expansion of SOMA securities holdings has been driven by LSAPs. The composition of the SOMA is shown in table 2. Temporary OMOs typically are used to address reserve needs that are deemed to be transitory in nature. These operations are either repurchase agreements (repos) or reverse repurchase agreements (reverse repos). Under a repo, the Trading Desk buys a security under an agreement to resell that security in the future; under a reverse repo, the Trading Desk sells a security under an agreement to repurchase that security in the future. A repo is the economic equivalent of a collateralized loan; conversely, a reverse repo is the economic equivalent of collateralized borrowing. In both types of transactions, the difference between the purchase and sale prices reflects the interest on the loan or borrowing.

Table 2. System Open Market Account (SOMA) Securities Holdings

Billions of dollars, as of January 27, 2010

Security type	Total par value
U.S. Treasury bills	18
U.S. Treasury notes and bonds, nominal	709
U.S. Treasury notes and bonds, inflation-indexed ¹	49
Federal agency debt securities ²	164
Mortgage-backed securities ³	970
Total SOMA securities holdings	1,910

Note: Unaudited. Components may not sum to total because of rounding. Does not include investments denominated in foreign currencies or unsettled transactions.

1. Includes inflation compensation. [Return to table](#)

2. Direct obligations of Fannie Mae, Freddie Mac, and Federal Home Loan Banks. [Return to table](#)

3. Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the underlying mortgages. [Return to table](#)

Each OMO affects the Federal Reserve's balance sheet; the size and nature of the effect depend on the specifics of the operation. The Federal Reserve publishes its balance sheet each week in the H.4.1 statistical release, "Factors Affecting Reserve Balances of Depository Institutions and Consolidated Statement of Condition of Reserve Banks" (www.federalreserve.gov/releases/h41). The release separately reports securities held outright, repos, and reverse repos.

The Federal Reserve's approach to the implementation of monetary policy has evolved considerably since 2007, and particularly since late 2008. The FOMC has established a near-zero target range for the federal funds rate, implying that the very large volume of reserve balances provided through the various liquidity facilities is consistent with the FOMC's funds rate objectives. In addition, OMOs have provided increasing amounts of reserve balances.

To help reduce the cost and increase the availability of credit for the purchase of houses, on November 25, 2008, the Federal Reserve announced that it would buy direct obligations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, and MBS guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. The FOMC authorized purchases of up to \$1.25 trillion of agency MBS and up to \$200 billion of agency direct obligations. Subsequently, in November 2009, the FOMC announced that agency debt purchases would be about \$175 billion. This amount, while somewhat less than the previously announced maximum of \$200 billion, was consistent with the path of purchases and reflected the limited availability of agency debt.

The Federal Reserve determined that supporting the MBS "dollar roll" market promotes the goals of the MBS purchase program. Dollar roll transactions, which consist of a purchase of securities combined with an agreement to sell securities in the future, provide short-term financing to the MBS market. Because of principal and interest payments and occasional delays in the settlement of transactions, the Federal Reserve also holds some cash associated with the MBS purchase program.

The FRBNY announced in August 2009 that it would streamline the set of external investment managers for the agency-guaranteed MBS purchase program, reducing the number of investment managers from four to two. The FRBNY announced in November 2009 that it would begin to use its own staff rather than external investment managers on select days to execute LSAP agency MBS purchases. These changes were not performance-related: the FRBNY had anticipated that it would adjust its use of external investment managers as it gained more experience with the program.

In September 2009, the Federal Reserve began to purchase on-the-run agency securities--the most recently issued securities--in order to mitigate market dislocations and promote overall market functioning. Prior to this change, purchases were focused on off-the-run agency securities.

On September 23, 2009, the FOMC announced its intention to gradually slow the pace of its purchases of agency-guaranteed MBS and agency debt. In implementing this directive, the Trading Desk of the FRBNY announced that it would scale back the average weekly purchase amounts of agency MBS and reduce the size and frequency of agency debt purchases. The FOMC anticipates that these transactions will be executed by the end of the first quarter of 2010. The Federal Reserve's outright holdings of MBS are reported weekly in tables 1, 3, 10, and 11 of the H.4.1 statistical release. In addition, detailed data on all settled agency MBS holdings are published weekly on the FRBNY website (www.newyorkfed.org/markets/soma/sysopen_accholdings.html).

In March 2009, the FOMC announced that it would also purchase up to \$300 billion of longer-term Treasury securities to help improve conditions in private credit markets. The Federal Reserve has purchased a range of securities across the maturity spectrum, including Treasury Inflation-Protected Securities (TIPS). The bulk of purchases have been in intermediate maturities. In August 2009, the FOMC announced that it decided to gradually slow the pace of these transactions in order to promote a smooth transition in markets as purchases of these Treasury securities are completed. The FOMC anticipated that the purchases would be completed by the end of October; the purchases were completed as planned.

In December 2009, the FRBNY conducted a set of small-scale, real-value, triparty reverse repurchase transactions with primary dealers. Reverse repurchase agreements are a tool that could be used to support a reduction in monetary accommodation at the appropriate time. These transactions were conducted to ensure operational readiness at the Federal Reserve, the major clearing banks, and the primary dealers, and had no material impact on the availability of reserves or on market rates.

On January, 11, 2010, the FRBNY published a revised policy regarding the administration of its relationships with primary dealers intended to provide greater transparency about the significant business standards expected of primary dealers and to offer clearer guidance on the process to become a primary dealer. Substantive changes from the previous policy include: a more structured presentation of the business standards expected of a primary dealer; a more formal application process for prospective primary dealers; an increase in the minimum net capital requirement, from \$50 million to \$150 million; a seasoning requirement of one year of relevant operations before a prospective dealer may submit an application; and a clear notice of actions the FRBNY may take against a noncompliant primary dealer.

Liquidity Swaps

Recent Developments

- Consistent with the Federal Reserve's previous announcements, the temporary liquidity swap arrangements between the Federal Reserve and other central banks expired on February 1, 2010.
- As of January 27, 2010, total dollar liquidity extended to foreign central banks had dropped to \$175 million. The last outstanding draw under the central bank liquidity swap arrangements matured on February 12, 2010.

Table 3. Amounts Outstanding under Dollar Liquidity Swaps

Billions of dollars

Central bank	Amount as of 1/27/2010	Amount as of 12/31/2008
Bank of Canada	0	0
Banco de Mexico	0	0

Central bank	Amount as of 1/27/2010	Amount as of 12/31/2008
European Central Bank	*	291
Swiss National Bank	0	25
Bank of Japan	*	123
Bank of England	0	33
Danmarks Nationalbank	0	15
Reserve Bank of Australia	0	23
Sveriges Riksbank	0	25
Norges Bank	0	8
Reserve Bank of New Zealand	0	0
Bank of Korea	0	10
Banco Central do Brasil	0	0
Monetary Authority of Singapore	0	0
Total	*	554

Note: Unaudited. Components may not sum to totals because of rounding.
* Less than \$500 million.

Background

Because of the global character of bank funding markets, the Federal Reserve worked with other central banks to provide liquidity to financial markets and institutions. As part of these efforts, the FRBNY entered into agreements to establish temporary reciprocal currency arrangements (central bank liquidity swap lines) with a number of foreign central banks. Two types of temporary swap lines were established—dollar liquidity lines and foreign currency liquidity lines.

The FRBNY operated the swap lines under the authority granted under Section 14 of the Federal Reserve Act and in compliance with authorizations, policies, and procedures established by the FOMC.

Dollar Liquidity Swaps

On December 12, 2007, the FOMC announced that it had authorized dollar liquidity swap lines with the European Central Bank and the Swiss National Bank to provide liquidity in U.S. dollars to overseas markets. Subsequently, the FOMC authorized dollar liquidity swap lines between the Federal Reserve and each of the following central banks: the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Canada, the Bank of Japan, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, Norges Bank, the Monetary Authority of Singapore, Sveriges Riksbank, and the Swiss National Bank. These temporary dollar liquidity swap arrangements expired on February 1, 2010.

Swaps under these lines consist of two transactions. When a foreign central bank (FCB) draws on its swap line with the FRBNY, the FCB sells a specified amount of its currency to the FRBNY in exchange for dollars at the prevailing market exchange rate. The FRBNY holds the foreign currency in an account at the FCB. The dollars that the FRBNY provides are deposited in an account that the FCB maintains at the FRBNY. At the same time, the FRBNY and the FCB enter into a binding agreement for a second transaction that obligates the FCB to buy back its currency on a specified future date at the same exchange rate. The second transaction unwinds the first. Because the swap transaction will be unwound at the same exchange rate used in the initial transaction, the recorded value of the foreign currency amounts is not affected by changes in the market exchange rate. At the conclusion of the second transaction, the FCB compensates the FRBNY at a market-based rate.

When the FCB lends the dollars it obtained by drawing on its swap line to institutions in its jurisdiction, the dollars are transferred from the FCB account at the FRBNY to the account of the bank that the borrowing institution uses to clear its dollar transactions. The FCB remains obligated to return the dollars to the FRBNY under the terms of the agreement, and the FRBNY is not a counterparty to the loan extended by the FCB. The FCB bears the credit risk associated with the loans it makes to institutions in its jurisdiction.

The foreign currency that the Federal Reserve acquires is an asset on the Federal Reserve's balance sheet. In tables 1, 10, and 11 of the weekly H.4.1 statistical release, the dollar value of amounts that the foreign central banks have drawn but not yet repaid is reported in the line entitled "Central bank liquidity swaps." Dollar liquidity swaps had maturities ranging from overnight to three months.

Foreign Currency Liquidity Swap Lines

On April 6, 2009, the FOMC announced foreign-currency liquidity swap lines with the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. These lines were designed to provide the Federal Reserve with the capacity to offer liquidity to U.S. institutions in foreign currency should a need arise. These lines mirrored the existing dollar liquidity swap lines, which provided FCBs with the capacity to offer U.S. dollar liquidity to financial institutions in their jurisdictions. If drawn upon, the foreign-currency swap lines would support operations by the Federal Reserve to address financial strains by providing liquidity to U.S. institutions in amounts of up to £30 billion (sterling), €80 billion (euro), ¥10 trillion (yen), and CHF 40 billion (Swiss francs). The Federal Reserve did not draw on these swap lines, which expired on February 1, 2010.

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