Federal Open Market Committee

Credit and Liquidity Programs and the Balance Sheet

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Credit and Liquidity Programs and the Balance Sheet

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Frequently asked questions: U.S. dollar liquidity swaps

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What is the purpose of the dollar liquidity swap lines?

The dollar liquidity swap lines are designed to improve liquidity conditions in U.S. and foreign financial markets by providing foreign central banks with the capacity to deliver U.S. dollar funding to institutions in their jurisdictions during times of market stress.

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What circumstances led to the implementation of these facilities?

The swap arrangements were introduced to address stresses in U.S. dollar funding in overseas markets. These difficulties were adding materially to pressures in funding and credit markets in the United States and abroad.

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Who authorizes the use of the swaps?

The arrangements are authorized by the Federal Open Market Committee (FOMC) of the Federal Reserve System and the policy boards or executives of the respective foreign central banks. The Federal Reserve has the right to approve or deny requests by foreign central banks to draw on their swap lines. The FOMC has authorized these arrangements through October 30, 2009. The foreign central banks may request draws on their swap lines up to that date.

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Which central banks can currently engage in swaps?

The Federal Reserve has established swap arrangements with the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Canada, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, the Norges Bank, the Monetary Authority of Singapore, the Sveriges Riksbank, and the Swiss National Bank.

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How are the swaps structured?

The Federal Reserve provides U.S. dollars to a foreign central bank. At the same time, the foreign central bank provides the equivalent amount of funds in its currency to the Federal Reserve, based on the market exchange rate at the time of the

transaction. The parties agree to swap back these quantities of their two currencies at a specified date in the future, which may be the next day or as far ahead as three months, using the same exchange rate as in the first transaction. Because the terms of this second transaction are set in advance, fluctuations in exchange rates during the interim do not alter the eventual payments. As such, these swap operations carry no exchange rate or other market risks.

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How do foreign central banks distribute the U.S. dollar funding they receive through these swaps?

The foreign central banks distribute the U.S. dollars they draw through a variety of methods, including variable-rate tenders, fixed-rate tenders, bilateral transactions, and foreign exchange swap tenders against various types of collateral, including both foreign currency and securities denominated in foreign currency. In each case, the arrangement is between the foreign central bank and the institutions obtaining the funding in these operations. The foreign central banks determine the acceptability of the collateral offered and the eligibility of the institutions to participate in the operations they conduct. The terms on which funds are tendered are released to the public by the foreign central banks. The Federal Reserve's contractual relationship is with the foreign central bank and not with the institutions obtaining dollar funding in these operations.

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What revenues and costs arise for the Federal Reserve?

When a foreign central bank draws on its swap line to fund its dollar tender operations, it pays interest to the Federal Reserve in an amount equal to the interest the foreign central bank earns on its tender operations. For its part, the Federal Reserve does not pay interest and commits to hold the foreign currency that it acquires in the swap transaction at the foreign central bank (rather than lending it or investing it in private markets). The structure of the arrangement serves to avoid domestic currency reserve management difficulties for foreign central banks that could arise if the Federal Reserve actively invested the foreign currency holdings in the marketplace.

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What is the impact of swaps on U.S. monetary operations?

The drawing of U.S. dollars by a foreign central bank results in an increase in the level of reserve balances held at the Reserve Banks. Similarly, the repayment of U.S. dollars to the Federal Reserve when a swap is unwound results in a drain of these balances.

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Where can I find information on Federal Reserve swap market activity?

The Federal Reserve Board issues a weekly release that includes information on the aggregate value of swap drawings outstanding. The Federal Reserve Bank of New York also publishes information on the swaps in its quarterly report on Treasury and Federal Reserve Foreign Exchange Operations. In addition, the aggregate value of swap drawings outstanding can be found in section II,2,(a) of the U.S. Department of the Treasury's weekly release on the U.S. International Reserve Position. This information is posted as well on the IMF's website on U.S. International Reserves and Foreign Currency Liquidity.

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These FAQs will be updated periodically as circumstances warrant.