



Federal Reserve Assets: Understanding the Pieces of the Pie

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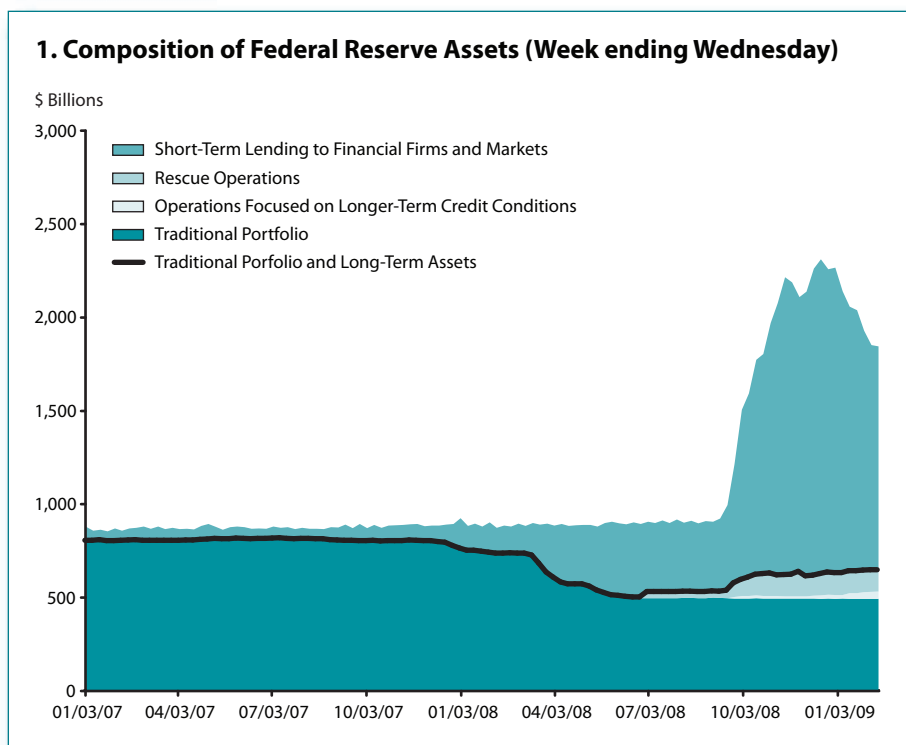
Since September 2007, the Federal Reserve has intervened repeatedly and in various ways to ease credit conditions in financial markets. The Federal Open Market Committee (FOMC) aggressively reduced the federal funds rate target from 5.25 percent to the current range of 0 to 0.25 percent. As financial conditions deteriorated, the Fed established numerous programs (which make use of the asset side of its balance sheet) to increase the flow of credit to households and businesses.¹ Chairman Bernanke described this approach as credit easing.²

The Fed's numerous new programs are not easily summarized by a single number, such as the size of the monetary base. The programs involve purchasing assets of varying types and maturities; moreover, the size of some programs will naturally decline as market conditions improve. It therefore becomes important to track not only the size of the Fed's balance sheet, but also the composition of its assets.

One way to examine the composition of assets on the Fed's balance sheet is to group them according to the objectives of the programs used to acquire them. The first set of programs aim to provide short-term liquidity to financial firms and markets.³ The largest of these programs, at \$413 billion, is the Term Auction Facility (TAF), which allows depository institutions to borrow from the Fed for 28 or 84 days against a wide variety of collateral.⁴ At \$390 billion, currency swap lines are the second largest program. These facilities allow the 14 participating foreign central banks to acquire U.S. dollars to lend to their constituents. In exchange, the Fed receives holdings in foreign currencies.⁵ Combined, these lending programs are designed to ensure that markets have adequate short-term dollar funding. These programs will dissipate as market conditions improve.

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The second set of assets falls under the broad category of rescue operations.⁶ Following the failure of Bear Stearns in March 2008, the Federal Reserve Board invoked section 13(3) of the Federal Reserve Act, which allows the Fed to extend credit through discounts in "unusual and exigent circumstances" when a borrower is "unable to secure adequate credit accommodations from other banking institutions." These include special purpose vehicles to handle assets from Bear Stearns and AIG.⁷ Unlike many of the short-term assets under the first group of lending programs,



these assets may remain on the Fed's balance sheet for some time.

Finally, in January 2009, the Fed began purchasing agency mortgage-backed securities and debt from Fannie Mae and Freddie Mac. These efforts are directed at easing longer-term credit conditions.⁸ Although these programs account for slightly less than 6 percent of the Fed's current balance sheet, future additions to these programs could add another \$500 billion.

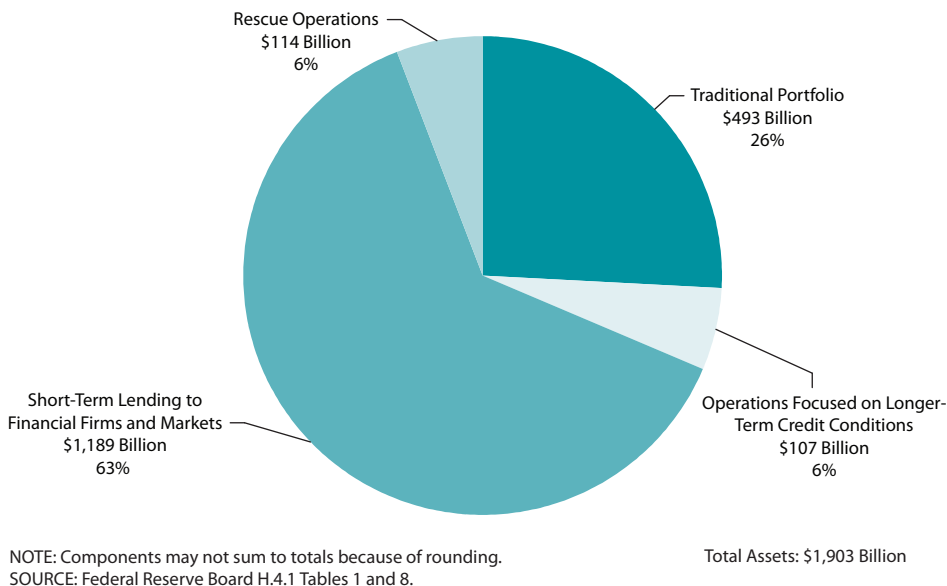
Chart 1 displays changes in the total size and composition of the assets since January 2007. Chart 2 provides additional detail on the composition of the assets as of March 4, 2009. The additional category in these charts, labeled Traditional Portfolio, includes the traditional assets the Fed holds on its balance sheet. Usually, more than 95 percent of this portfolio is Treasury securities held outright.⁹ The black line in chart 1 provides a measure of the Fed's balance sheet minus the assets from the short-term lending programs.

Notice that, until September 2008, total assets remained slightly under \$1,000 billion, because the Fed reduced its supply of Treasury securities to offset new lending programs. Beginning in September, the Fed continued to lend, but stopped offsetting the acquisition of new assets with the accompanying sale of Treasuries: Total assets doubled.

As an alternative to the Fed reducing its holdings of Treasuries, the Treasury agreed to hold a large volume of deposits at the Fed. The deposits by the Treasury offset the creation of new base money, as the reserves created by new programs are placed in the Treasury's account at the Fed.

The black line in Chart 1 indicates that the total assets, net the short-term portion, has actually declined since 2007. According to Chart 2, the sum of these assets comprise 38 percent of the total, or \$714 billion. Tracking the composition of Fed assets, as well as the total size of the balance sheet, provides a more comprehensive summary of the current stance of Fed policy during this time of credit easing. ■

2. Federal Reserve Assets Week Ending 03/04/2009



¹ See www.stlouisfed.org/timeline/ for a chronology and description of these programs.

² See Ben Bernanke's "The Crisis and Policy Response," Stamp Lecture, London School of Economics, London, England, January 13, 2009.

³ The assets included are term auction credit, central bank liquidity swaps, net portfolio holdings of Commercial Paper Funding Facility LLC, net portfolio holdings of LLCs through the Money Market Investor Funding Facility, repurchase agreements, other assets, and other loans (less loans to AIG).

⁴ See David Wheelock's "Another Window: The Term Auction Facility," *Economic Synopses*, 2008, Number 6; and Craig Aubuchon's "The Fed's Response to the Credit Crunch," *Economic Synopses*, 2009, Number 6.

⁵ The loans made to foreign central banks are booked as assets on the Fed's balance sheet, not the foreign currency.

⁶ The assets included are credit extended to AIG and net portfolio holdings of Maiden Lane LLC I, II, and III.

⁷ Special purpose vehicles are legal entities (i.e., LLCs) created by the Fed to fulfill narrow or temporary objectives.

⁸ The assets included are federal agency obligations held outright and mortgage-backed securities.

⁹ Assets also included are gold certificate account, SDRs certificate account, coin, items in process of collection, and assets on bank premises.