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Federal Reserve Announces Extensions of and Modifications to Its Liquidity Programs

Federal Reserve System

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The Federal Reserve on Thursday announced extensions of and modifications to a number of its liquidity programs. Conditions in financial markets have improved in recent months, but market functioning in many areas remains impaired and seems likely to be strained for some time. As a consequence, to promote financial stability and support the flow of credit to households and businesses, the Federal Reserve is extending a number of facilities through early 2010. At the same time, in light of the improvement in financial conditions and reduced usage of some facilities, the Federal Reserve is trimming the size and changing the terms of some facilities.

Specifically, the Board of Governors approved extension through February 1, 2010, of the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), the Commercial Paper Funding Facility (CPFF), the Primary Dealer Credit Facility (PDCF), and the Term Securities Lending Facility (TSLF). The expiration date for the Term Asset-Backed Securities Loan Facility (TALF) currently remains set at December 31, 2009. The Term Auction Facility (TAF) does not have a fixed expiration date.

The extension of the TSLF also required the approval of the Federal Open Market Committee (FOMC), as that facility is established under the joint authority of the Board and the FOMC.

In addition, the temporary reciprocal currency arrangements (swap lines) between the Federal Reserve and other central banks have been extended to February 1. The Federal Reserve action to extend the swap lines was taken by the FOMC.

The Federal Reserve also announced changes to certain liquidity programs in light of the improvement in financial conditions and the associated reduction in usage of some facilities. Specifically, the Federal Reserve trimmed the size of upcoming TAF auctions, because the amount of credit extended under that facility has been well below the offered amount. In view of very weak demand at TSLF Schedule 1 auctions and TSLF Options Program auctions over recent months, auctions under these programs will be suspended. The frequency of Schedule 2 TSLF auctions will be reduced to one every four weeks and the offered amount will be reduced. The authorization for the Money Market Investor Funding Facility (MMIFF) was not extended, and an additional administrative criterion was established for use of the AMLF. If necessary in view of evolving market conditions, the Federal Reserve will increase the size of TAF auctions and resume TSLF operations that have been suspended.

The Board and the FOMC will continue to monitor closely the condition of financial markets and the need for and effectiveness of the Federal Reserve's special liquidity facilities and arrangements. Should the recent improvements in market conditions continue, the Board and the FOMC currently anticipate that a number of these facilities may not need to be extended beyond February 1. However, if financial stresses do not moderate as expected, the Board and the FOMC are prepared to extend the terms of some or all of the facilities as needed to promote financial stability and economic growth. The public will receive timely notice of planned extensions, discontinuations, or modifications of Federal Reserve programs.

TAF and Swap Lines

In recent months, conditions in wholesale funding markets have improved, and partly as a result, usage of the TAF and the dollar facilities provided by foreign central banks has declined notably. For some time, amounts bid at TAF auctions have fallen short of the amounts auctioned. In view of the decreasing need for TAF funding, the Board has reduced the amounts auctioned at the biweekly auctions of TAF funds from $150 billion to $125 billion, effective with the auction to be held on July 13. The Federal Reserve anticipates that, if market conditions continue to improve in coming months, TAF funding will be reduced gradually further.

The extension of the dollar liquidity swap arrangements through February 1 currently applies to the 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, 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. The extension of the foreign currency swap arrangements currently applies to the swap lines between the Federal Reserve and the Bank of England, the European Central Bank, and the Swiss National Bank. The Bank of Japan will consider extensions of the dollar liquidity swap and the foreign-currency liquidity swap arrangements with the Federal Reserve and will announce its decision following its next Monetary Policy Meeting.

TSLF and PDCF

The Federal Reserve extended the TSLF, with certain modifications, and the PDCF through February 1.

In view of the considerable progress to date in deleveraging by primary dealers and dealers' improved access to funding in the market for repurchase agreements, activity at the TSLF has fallen notably. In response, the Board and the FOMC approved certain modifications to the TSLF. In particular, TSLF auctions backed by Schedule 1 collateral (Treasury, agency debt, and agency-guaranteed mortgage-backed securities) will be suspended, effective July 1. Also, the Federal Reserve suspended the TSLF Options Program (TOP), effective with maturity of outstanding June TOP options. TSLF auctions backed by Schedule 2 collateral (Schedule 1 collateral and investment-grade corporate, municipal, mortgage-backed, and asset-backed securities) will now be conducted every four weeks, rather than every two weeks, and the total amount offered under the TSLF will be reduced to $75 billion. The Federal Reserve anticipates that the amounts auctioned under the TSLF will be scaled back further over time as permitted by market conditions. However, the Federal Reserve is prepared to resume Schedule 1 TSLF operations and TOP auctions and to increase the frequency and size of Schedule 2 auctions if warranted by evolving market conditions.

Although the amount outstanding under the PDCF is currently zero, the Board believes it appropriate to continue to provide the PDCF as a backstop liquidity facility for primary dealers in the near term, while financial market conditions remain somewhat fragile.

AMLF, CPFF, and MMIFF

The Board extended the authorizations for the AMLF and the CPFF through February 1, 2010. The authorization for the MMIFF, which expires on October 30, 2009, was not extended.

Usage of the AMLF has declined considerably as market conditions have improved. Nonetheless, in view of the continued fragility in market conditions, the Board judged it appropriate to extend the authorization for the AMLF. To help ensure that the AMLF is used for its intended purpose of providing a temporary liquidity backstop to money market mutual funds (MMMFs), the Federal Reserve established a redemption threshold whereby a MMMF would have to experience material outflows--defined as at least 5 percent of net assets in a single day or at least 10 percent of net assets within the prior five business days--before it can sell asset-backed commercial paper (ABCP) that would be eligible collateral for AMLF loans to depository institutions and bank holding companies. Any eligible ABCP purchased from a MMMF that has experienced redemptions at these thresholds could be pledged to AMLF at any time within the five business days following the date that the threshold level of redemptions was reached.

The Board similarly judged that market conditions warranted the extension of the CPFF through February 1 in order to help ensure the access of U.S. businesses to short-term funding. Interest rates posted on the CPFF are at levels that are increasingly unattractive for many borrowers as market conditions improve, and accordingly usage of the CPFF is declining fairly steadily. In these circumstances, the Board judged that modifications to the CPFF were not necessary at this time.

Given the overall improvement in market conditions and the continued availability of the AMLF and the CPFF, the Board believed that it was not necessary to extend the authorization for the MMIFF.
