



The Federal Reserve System and the Global Financial Crisis
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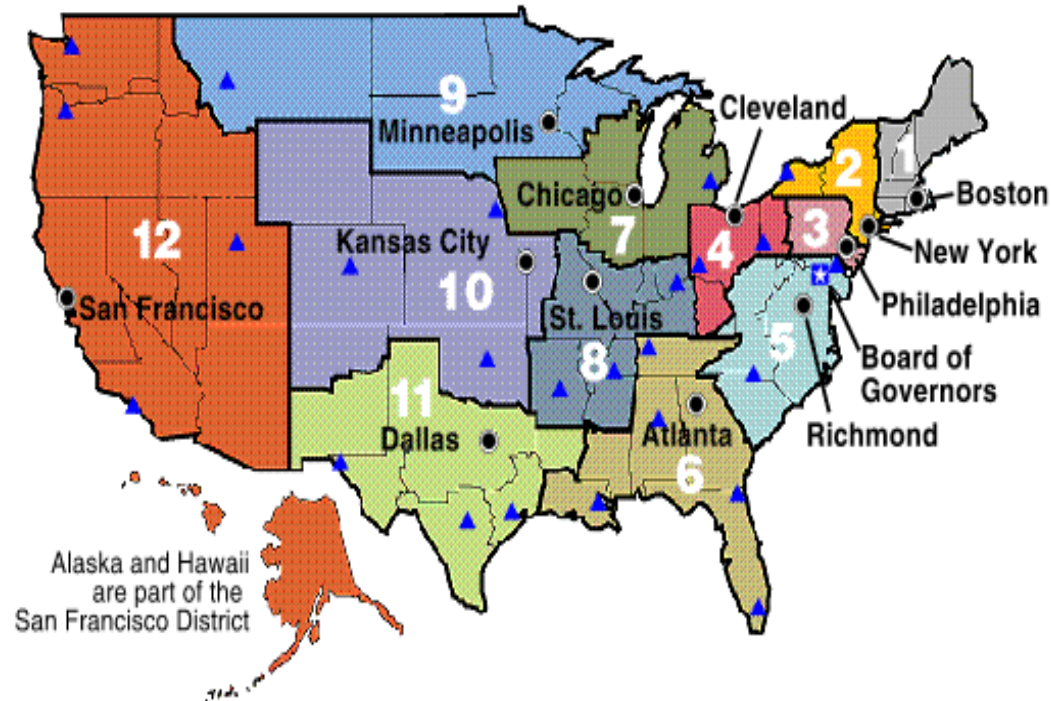
Overview

- History & structure of the Federal Reserve System
- Relationship with the US Treasury
 - Importance of Fed independence
- The financial crisis of 2007-...
- Relationship with foreign central banks

The Federal Reserve System

- Established 1913
- Structure
 - Board of Governors in Washington DC
 - 12 Federal Reserve Banks
- Policymaking bodies
 - Federal Open market Committee (FOMC)
 - Board of Governors

The Federal Reserve System



Federal Reserve Bank of Dallas branches:
Houston
San Antonio
El Paso

The Federal Reserve System

- Purpose:
 - “The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.”
 - Federal Reserve Act, Section 2A(1)
- Main policy instrument
 - Federal funds rate
- Secondary instruments
 - Discount rate
 - Reserve requirements

Unconventional Tools

- “In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System...may authorize any Federal reserve bank, during such periods as the said board may determine...to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank: Provided, ...that ...the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions.”
 - Federal Reserve Act, Section 13(3)

Fiscal and Monetary Policy

- Fiscal policy
 - Province of the US Treasury
- Monetary policy
 - Province of the Federal Reserve System
- Independence
 - “The Federal Reserve’s independence with regard to monetary policy is critical for ensuring that monetary policy decisions are made with regard only to the long-term economic welfare of the nation”
 - Joint Statement by Treasury & Federal Reserve, March 23, 2009

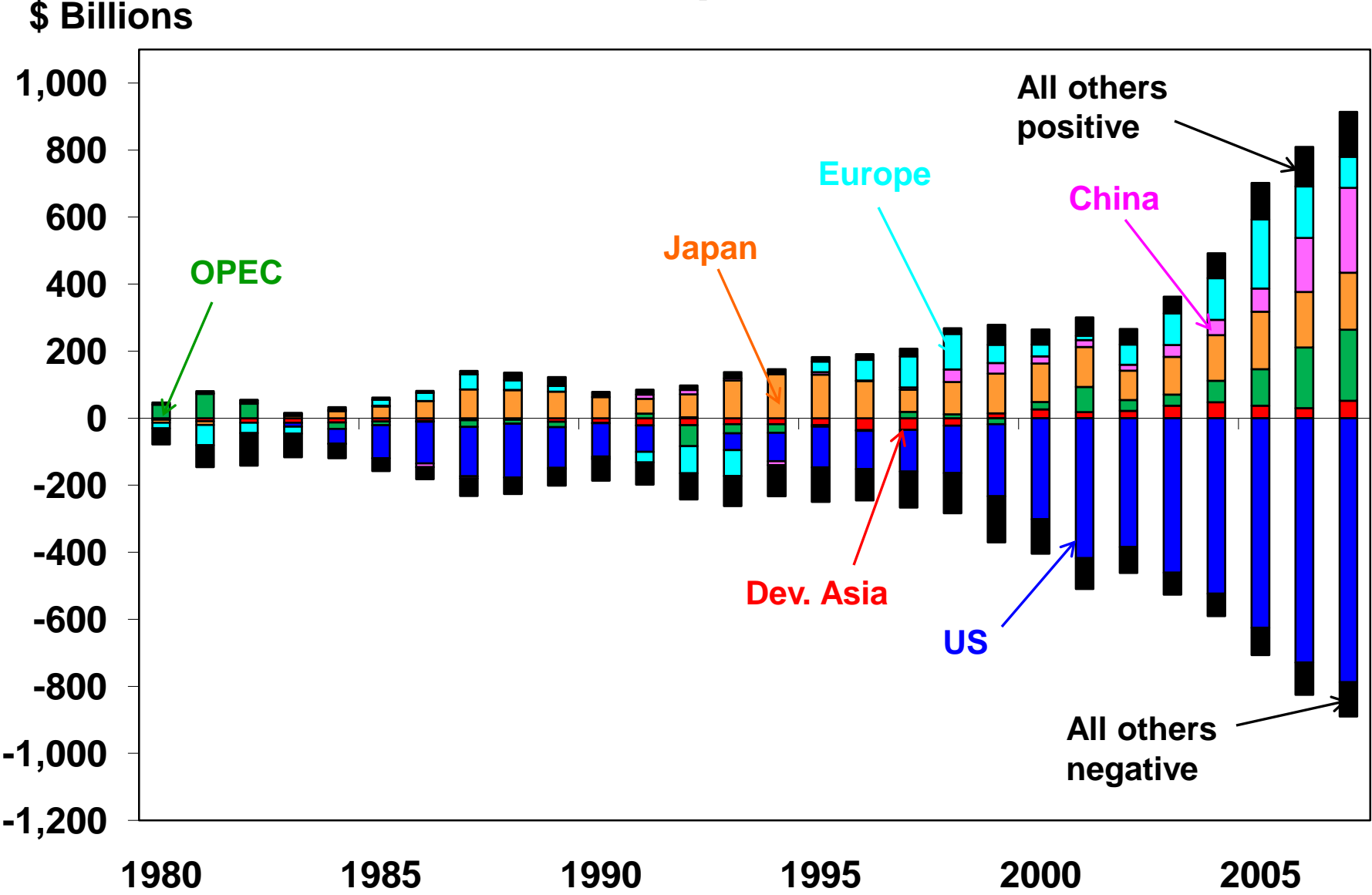
The Federal Reserve System in the Global Economy

- Domestic mandate
- Dominant player internationally
 - ECB an increasingly important player as well
- Coordination
 - G7, G20 forums
 - Informal rather than formal
 - Will this need to change?

The Global Financial Crisis of 2007-?

- Global savings glut
- Consumption and housing boom in the US
- Financial innovation
- Incentives

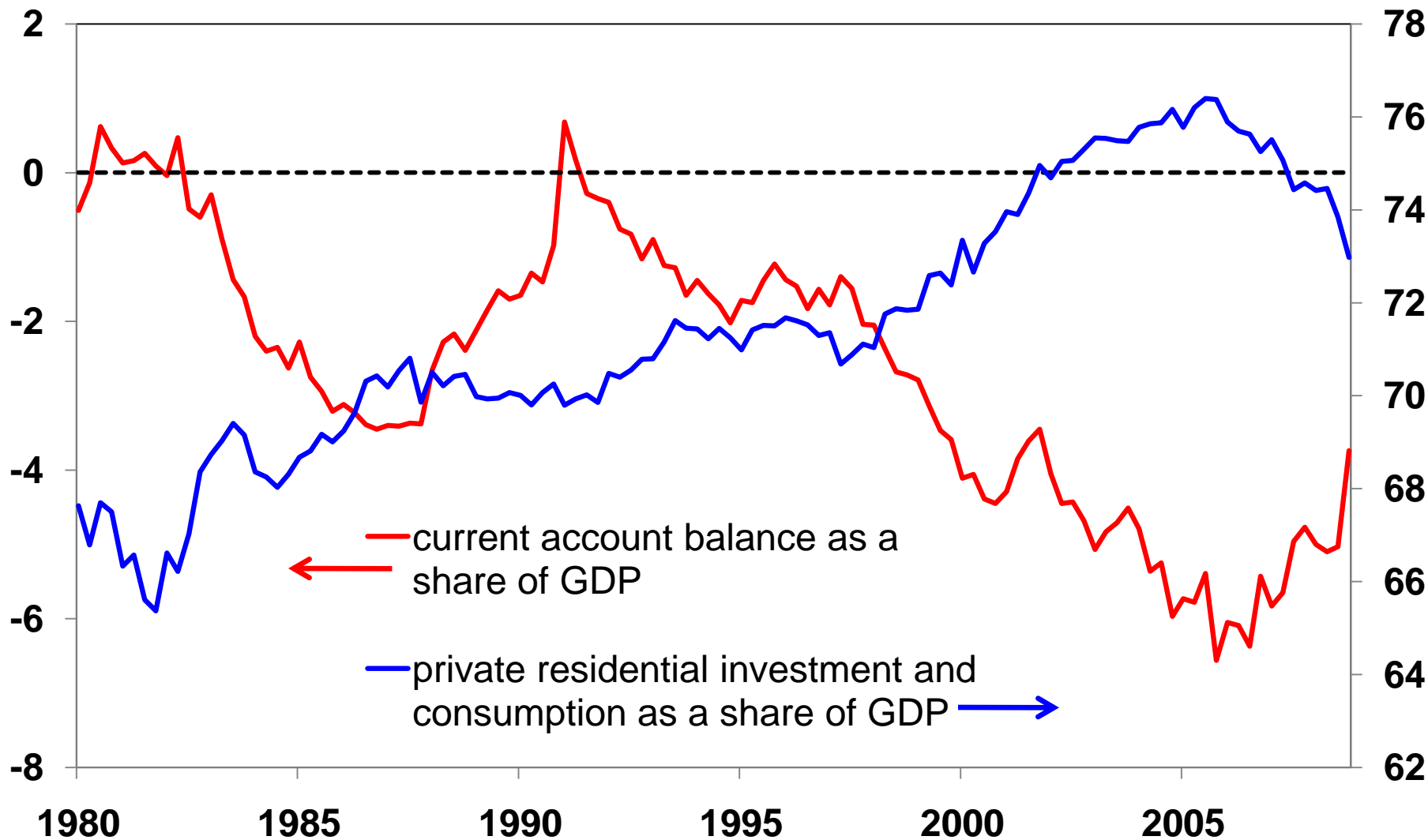
Global Capital Flows



Current Account Balance and Household Spending as a Share of GDP

Percent, SAAR

Percent



Policy response

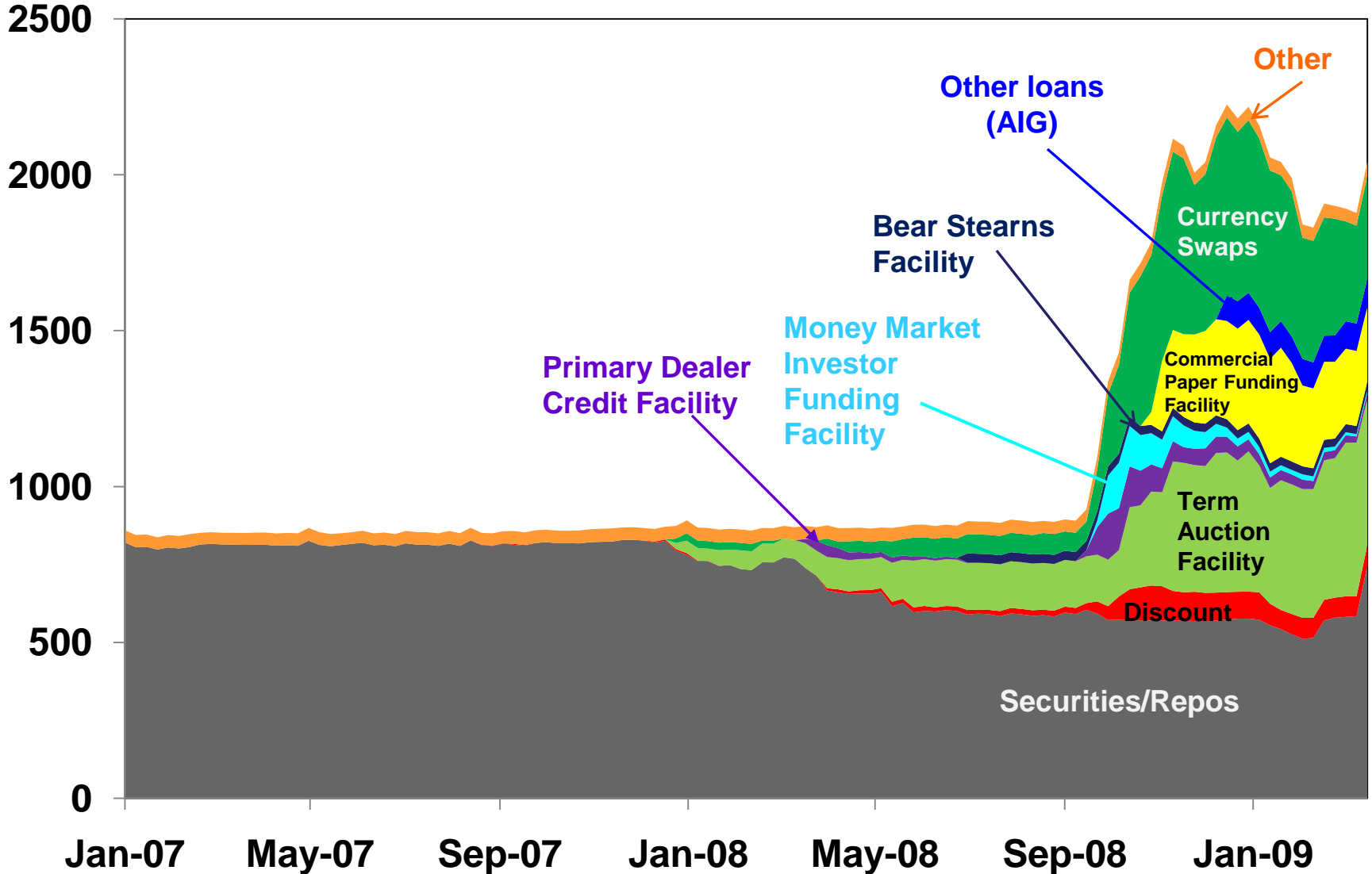
- Conventional policy actions
 - Fed funds rate cut September 2007
 - Series of cuts through 2007 & 2008
 - Floor of 0-0.25 reached in December 2008
- Unconventional tools
 - Policy communication
 - “The Committee ...anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.” March 18 Press Release
 - Creation of new liquidity facilities & purchase of longer term securities

Unconventional Tools

- Provision of short term liquidity to banks & primary dealers
 - Term Auction Facility (TAF)
- Provision of liquidity directly to borrowers & investors in key credit markets
- Purchase of longer term securities
 - Agency debt
 - US Treasuries

Federal Reserve's Balance Sheet

\$ Billions

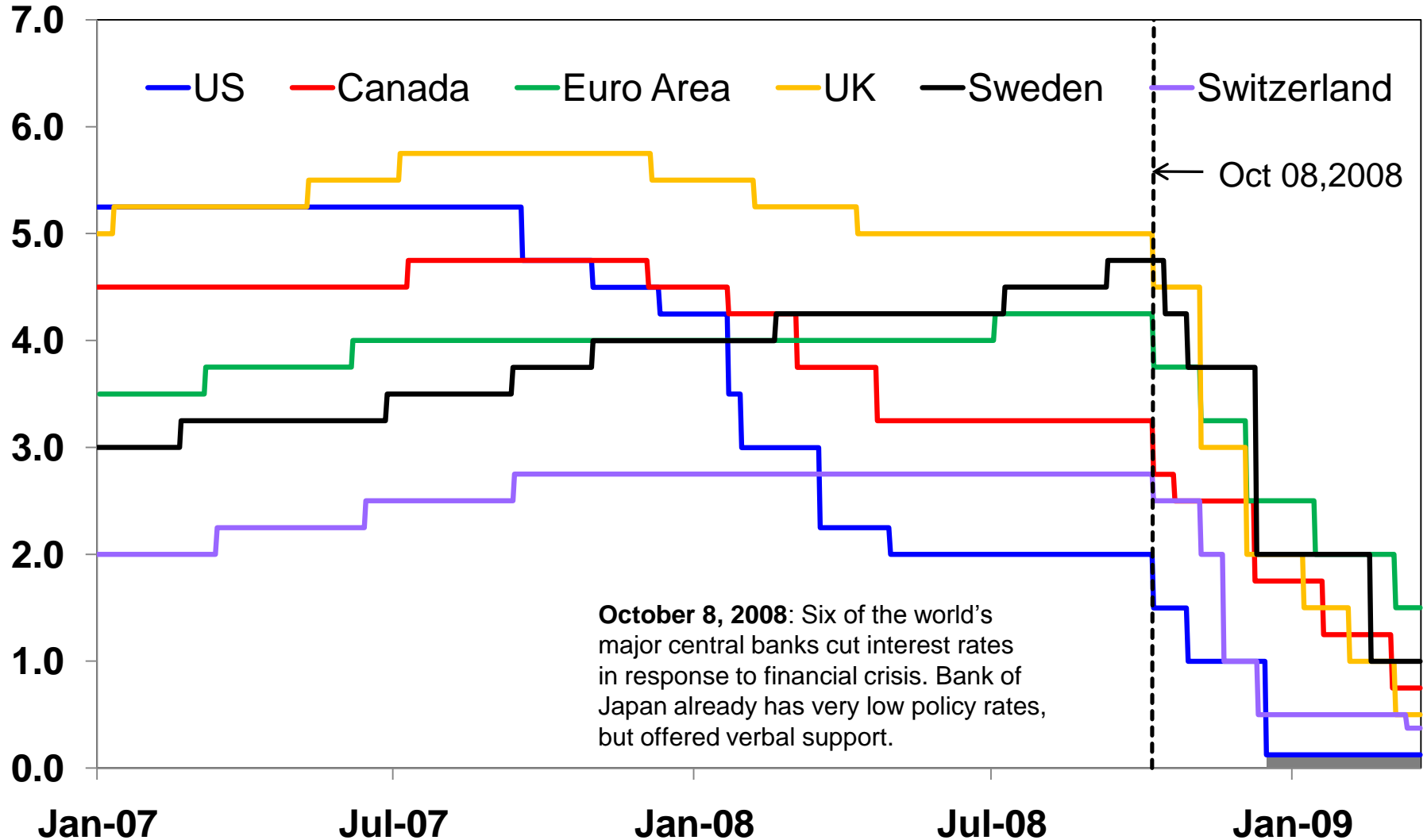


Coordinated Policy Actions

- Swap lines
 - First established December 12, 2007 with ECB & Swiss National Bank
 - Expanded over the course of last year to include central banks in Japan, UK, Canada, Australia, Denmark, Norway, Sweden, New Zealand, Brazil, Mexico, South Korea, & Singapore
 - Currently scheduled to run through October 30, 2009

Coordinated Policy Response

Percent



Conclusions

- “...the world is too interconnected for nations to go it alone in their economic, financial, and regulatory policies. International cooperation is thus essential if we are to address the crisis successfully and provide the basis for a healthy, sustained recovery.”
 - Ben Bernanke ,London School of Economics, January 13, 2009

