AcF 304 Financial Markets

Topic 4: Central Banks & Conduct of Monetary Policy

Part 4 – Summary & Next Week's Preview

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Lancaster University Management School

Nonconventional Monetary Policy Tools and Quantitative Easing

The Global Financial Crisis challenged the Fed's ability to stabilise the economy:

- Financial system seized
- Zero-lower-bound problem – could not take rates below zero (as in 2008 and in 2020/21)

…hence why the Fed wished to 'normalise' interest rates 2017-2020!

- The problems called for the use of nonconventional tools

Liquidity Provisions

- Discount windows expansion – discount rate lowered several times.
- Term auction facility – another loan facility, offering another $400 billion to institutions.
- New lending programs – included lending to IBs, and lending to promote purchase of asset-backed securities.

Inside the Fed

- **The 2008 Global Financial Crisis** tested the Fed's ability to act as a lender of last resort.
- The next 3 slides* detail some of the Fed's efforts during this period to provide liquidity to the banking system.

Non- Assessed

Fed Lending Facilities During the Global Financial Crisis (1 of 4)

Non-Assessed

Lending Facility	Date of Creation	Function
Term Auction Facility (TAF)	December 12, 2007	To make borrowing from the Fed more widely used; extends loans of fixed amounts to banks at interest rates that are determined by competitive auction rather than being set by the Fed, as with normal discount lending
Term Securities Lending Facility (TSLF)	March 11, 2008	To provide sufficient Treasury securities to act as collateral in credit markets; lends Treasury securities to primary dealers for terms longer than overnight against a broad range of collateral
Swap Lines	March 11, 2008	Lends dollars to foreign central banks in exchange for foreign currencies so that these central banks can in turn make dollar loans to their domestic banks

Fed Lending Facilities During the Global Financial Crisis (2 of 4)

Non-Assessed

Lending Facility	Date of Creation	Function
Loans to J.P. Morgan to buy Bear Stearns	March 14, 2008	Bought $30 billion of Bear Stearns assets through nonrecourse loans to J.P. Morgan to facilitate its purchase of Bear Stearns
Primary Dealer Credit Facility (PDCF)	March 16, 2008	Lends to primary dealers (including investment banks)* so that they can borrow on similar terms to banks using the traditional discount window facility
Loans to AIG	September 16, 2008	Loaned $85 billion to AIG

Fed Lending Facilities During the Global Financial Crisis (4 of 4)

Non-Assessed

Lending Facility	Date of Creation	Function
Commercial Paper Funding Facility (CPFF)	October 7, 2008	Finances purchase of commercial paper from issuers
Money Market Investor Funding Facility (MMIFF)	October 21, 2008	Lends to special-purpose vehicles so that they can buy a wider range of money market mutual fund assets
Term Asset-Backed Securities Loan Facility (TALF)	November 25, 2008	Lends to issuers of asset-backed securities against these securities as collateral to improve functioning of this market

Fed Lending Facilities During the Global 2020 Financial Crisis

(Additional to Fed Funds Cuts, Discount Rate Cuts, Forward Guidance, Massive Securities Purchases)
Between mid-March and early December, the Fed's holdings of securities grew from $3.9 trillion to $6.6 trillion)

Non-Assessed

Lending Facility	**2020**	**Function**
Primary Dealer Credit Facility	PDCF	Cheap loans to Primary Dealers
Money Market Mutual Fund Liquidity Facility	MMLF	Loans to banks against collateral they purchase from prime money market funds
Total Loss Absorbing Requirement	TLAR	Temporarily relaxing reserve requirements for banks

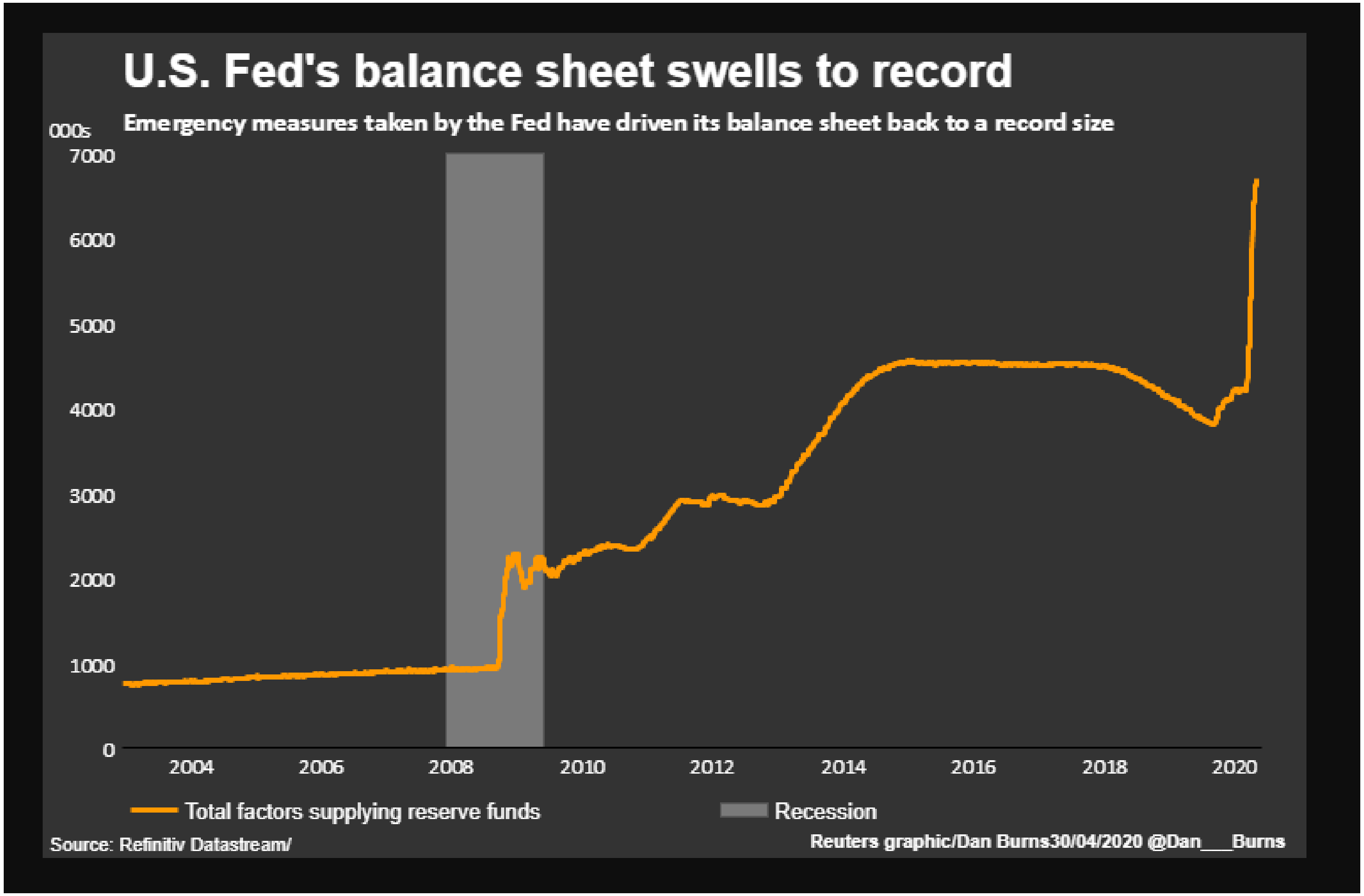
Fed Lending Facilities During the Global 2020 Financial Crisis

(Additional to Fed Funds Cuts, Discount Rate Cuts, Forward Guidance, Massive Securities Purchases - QE)
Between mid-March and early December, the Fed's holdings of securities grew from $3.9 trillion to $6.6 trillion)

Non-Assessed

Lending Facility	2020	Function
Primary Market Corporate Credit Facility	PDCF	Loans lend directly to corporations by buying new bond issuances and providing loans. (New to 2020)
Secondary Market Corporate Credit Facility	SMCCF	Purchasing existing corporate bonds as well as exchange-traded funds investing in investment-grade corporate bonds. (New to 2020)..this is QE!!
Commercial Paper Funding Facility	TLAR	Fed buys Commercial Paper essentially lending to Corporations

…and more.
1) Compare this to the Fed doing nothing in 1929!!
2) No wonder money has flowed into the US stock market!



https://www.investopedia.com/articles/economics/10/understanding-the-fed-balance-sheet.asp

Large-Scale Asset Purchases (Quantitative Easing)

- Nov 2008 – QE1 established, purchasing $1.25 trillion in MBSs.
- Nov 2010 – QE2, Fed purchases $600 billion in Treasuries, lower long-term rates.
- Sept 2012 – QE3, Fed commits to buying $40 billion in MBSs each month.
- (ECB had a Euro 2.5 Trillion QE programme December 2018 and modestly restarted QE again in Nov 2019.But ECB QE was later and less aggressive than Fed)

Quantitative Easing - Video

Explainer **FT Markets video**

Charts That Count: How central banks used QE to stop another financial crisis

https://www.ft.com/video/9eaa2561-45d3-4e58-b40d-38ca86929379

Quantitative Easing

- QE programs dramatically increases the Fed's balance sheet.

- Powerful force to stimulate the economy, but perhaps also lead to inflation?

Question?

How does the Federal Reserve control interest rates on Fed Funds?

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The Federal Reserve cannot directly control interest rates on Fed Funds. **1 mark** It can and does indirectly influence them by adjusting the level of reserves available to banks in the financial system. **1 mark** The Fed can increase the amount of money in the system by buying securities, **1 mark** thus lowering interest rates**. 1 mark** Alternatively, the Fed can remove reserves by selling securities, **1 mark** and then interest rates will increase. **1 mark**

Question?

The Federal Reserve will engage in an outright purchase if it wants to _________ reserves _________ in the banking system.

- A) increase; permanently
- B) increase; temporarily
- C) decrease; temporarily
- D) decrease; permanently
- Answer: A

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