MARKETBEAT

Blog Search:

WSJ.com's inside look at the markets

< Cutting Up Amex -- Previous | SEE ALL POSTS FROM THIS BLOG |
December 10, 2008, 12:39 pm

Five Questions: The Fed Proposes to Sell Debt

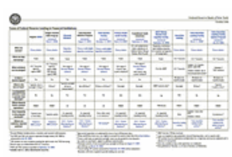
Posted by David Gaffen

One can criticize the Federal Reserve for a number of its actions in this 2007-2008 credit crisis, but it **has not lacked for creativity**. The most recent possibility that is being broached would be the sale of its own debt, in order to raise money so it can continue to support troubled credit markets, which are basically stuck.

Funding rates have declined over the last few months, but riskier credit markets remain essentially shut, and Treasury bill yields have recently plunged into negative territory due to year-end funding concerns. The idea of the Federal Reserve competing with the Treasury Department in the government-debt world seems strange, **but it could happen**. MarketBeat has a few questions about this, however.

- **Why is the Federal Reserve considering this**? The Fed is engaged in a massive effort to re-introduce liquidity into the various credit markets — to support these markets with the eventual hope of getting those markets to function normally. They've used tons of money through interventions in the commercial paper and short-term borrowing markets already, and that has worked, to a point, in lowering rates. But many markets remain essentially shut, and the original plan to address this — the Treasury's TARP facility — isn't being utilized. "They really need to get hands on the troubled assets," says Campbell Harvey, professor of finance at Duke University. The problem is that in order to keep financing these operations, the Fed believes it is necessary to do something other than what is has been doing: Increasing the level of excess reserves that commercial banks are holding at the Fed, because of the constraints it puts on banking balance sheets.

- **What's the problem with those balance sheets**? Why not keep doing what it's doing? The Fed has increased the level of excess reserves dramatically, something it can continue to do until the end of time. But it's not great for the nation's banks, says Lou Crandall, economist at Wrightson ICAP, because the banks receive a very low interest rate in exchange, and their balance sheets are being constrained. They're getting 0.5 percentage point right now (the expected federal-funds target as of next week), but in the open market, the federal-funds rate was lately trading at 0.06 percentage point — so the banks are essentially saying they'll hold this paper if they can buy it for almost nothing. "A lot of banks would prefer to have a tidier balance sheet and not have it bloated with assets that earn next to nothing," Mr. Crandall says. "Behaviorally, the Fed is surprised that this is the case. They underestimate the extent to which banks are still conservative and don't like blowing up their balance sheet at will."



A handy guide to the various Fed lending facilities (click here to go to New York Fed PDF document)

- **Ok, so what are the other options**? The first option is one that has been used — having the Treasury Department sell debt, with the money then deposited at the Federal Reserve. The Treasury has decided to scale back that effort, however. This leaves the Fed with the possibility of selling its own debt. That's an attractive possibility for this reason: Whereas the commercial banks are worried about their balance sheets, outside of the banking system, among regular investors, there's clearly massive demand for short-term debt, as Treasury bills have fallen into negative-yield territory. If the Fed were to issue debt that was considered on a par with the Treasury's debt, it would presumably attract tons of buyers.
- **So why not just go ahead with this plan**? That's the thing — this isn't legal. Not yet, anyway. The Federal Reserve Act doesn't explicitly permit the Fed to issue

Visit WSJ.com's Markets page

OTHER BLOGS FROM WSJ.COM

- Law Blog
- Political Perceptions
- Washington Wire
- Real Time Economics
- The Juggle
- Health Blog
- Environmental Capital
- Business Technology
- The Daily Fix
- The Wallet
- Middle Seat Terminal
- MarketBeat
- Deal Journal
- Developments
- The Numbers Guy
- The Wealth Report
- Baghdad Life
- Independent Street
- China Journal
- Shaping the New Agenda
- Olympics Opinion
- The Wallet

More

TODAY'S MARKETS 12:53 p.m. EST

STOCKS	LAST	CHANGE	%CHANGE
Dow Jones Industrials	8801.56	110.23	1.27
S&P 500	900.29	11.62	1.31
Nasdaq Composite	1569.80	22.46	1.45
Russell 2000	476.57	10.86	2.33
COMMODITIES		**LAST**	**CHANGE**
Gold, Feb		810.00	35.80
Crude Oil		45.39	3.32
TREASURYS		**YIELD**	**CHANGE**
10-Year Note		2.7012	-15/32
CURRENCIES		**LAST**	**PRIOR DAY**
Yen (per dollar)		92.9000	92.12
Euro (in dollars)		1.3024	1.2929

Source: Reuters and Dow Jones * At close
Note: Closing quotes are preliminary

MARKETS ON THE MOVE

Track indexes and hot stocks, with roll-over charting and headlines. Plus, comprehensive coverage of bonds, commodities and forex. Markets Data Center highlights:

- Most Actives
- Gainers
- Losers
- New Highs and Lows
- Money Flows
- Intraday Futures
- Currencies

notes beyond currency. The Fed could try some kind of end-around using a special-purpose vehicle, but it is more than likely to try to get something like this through Congress.

- **Will this happen**? With a new administration coming into office in a bit more than a month, it may not. The new Treasury Secretary, Tim Geithner, was the head of the New York branch of the Federal Reserve, and his involvement in these issues might result in the Treasury attempting to sell debt. The Treasury is getting close to a debt ceiling, but that has been expanded before, and might be politically easier than the Fed attempting to garner new authority to issue debt.

Permalink | Trackback URL: http://blogs.wsj.com/marketbeat/2008/12/10/five-questions-the-fed-proposes-to-sell-debt/trackback/
Save & Share: Yahoo! Buzz| Share on Facebook | Del.icio.us | Digg this | Email This | Print
Read more: Federal Reserve

Post a Comment

Name :

Comment:

Submit

MOST POPULAR POSTS VIEWED EMAILED

1. Obama ZuneGate, Day Two
2. Blagojevich, Elected as Reformer, Is Indicted
3. Highlights of the Blagojevich Corruption Charges
4. MarketBeat
5. Shell's Routs: On Diesel, Algae, and OPEC
6. Goldman Sachs Layoffs: Lather. Rinse. No Repeat
7. Mean Street: Why Merrill Lynch's John Thain Deserves a Bonus
8. Emirates' Glamorous Crew - WSJ.com
9. Verizon Issues Fixes for BlackBerry Storm
10. Three-Month Bill Yield Goes Negative

ABOUT THIS BLOG

MarketBeat, led by Wall Street Journal Online writer David Gaffen, looks under the hood of Wall Street each day, finding market-moving news and analyzing interesting trends and numbers. The blog is updated several times daily with contributions from reporters at The Wall Street Journal and the Online Journal and includes noteworthy commentary from the best blogs and research notes. Have a comment? Write to marketbeat@wsj.com.

BLOGS FROM BARRONS.COM

- Tech Trader Daily
- Stocks To Watch Today

More

Subscribe

RSS -- subscribe to updated headlines to read from anywhere on the Web. For more about RSS, click here.

MarketBeat Blog

Save & Share

Digg -- submit this item to be shared and voted on by the digg community. For more about digg, click here.
Del.icio.us -- mark an item as a favorite to access later or share with the del.icio.us community. For more about del.icio.us, click here.
Facebook -- share an item with users of Facebook, a collection of school, company and regional social networks. For more about Facebook, click here.

PAST POSTS

December 2008

M	T	W	T	F	S	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

« Nov

Top Markets Stories

Commodity Stocks Lead Rebound

Democrats Claim Deal on Auto Rescue Bill