

A low-angle, upward-looking photograph of the Federal Reserve Bank of New York building. The building's facade is made of light-colored stone with many windows. An American flag is flying from a pole on the left side of the building. In the background, other skyscrapers of Lower Manhattan are visible under a clear blue sky. A brown banner is overlaid on the right side of the image, and a blue banner is at the bottom.

FEDERAL RESERVE BANK *of* NEW YORK

Reserve Management and FX Operations

International Markets - Markets Group

September 30, 2015

Overview of Presentation

- Overview of International Markets (IM)
- Foreign Currency Policy Overview
- Foreign Exchange Activities
- Foreign Reserve Management
- Foreign Exchange Swaps

Overview of International Markets (IM)

Policy Overview: FRBNY's Mandate

- FRBNY has two unique responsibilities within the Federal Reserve
 - 1) Operating arm for the Federal Reserve System
 - 2) Fiscal agent for the U.S. Treasury Department
- Foreign currency-related operations are delegated to the International Markets Directorate in the Markets Group

Overview of IM Directorate

- Execute U.S. foreign exchange policy
- Manage U.S. foreign currency reserves
- Manage foreign exchange swap lines with other central banks (currently 5 central banks)
- Execute foreign exchange customer transactions
- Provide in-depth analysis of international financial market developments
- Support the Foreign Exchange Committee, an FX market industry group sponsored by FRBNY

Overview of IM Directorate

- The International Markets (IM) Directorate is comprised of several staffs:
 - *International Money & Capital Markets (IMCM)*
 - Analysis: Global fixed income and money market analysis, central bank policies
 - Operations: Central bank liquidity swap lines
 - *Global Foreign Exchange (GFX)*
 - Analysis: foreign exchange markets
 - Operations: FX intervention, FX customer trades
 - *Foreign Reserves Management (FRM)*
 - Operations: FX reserves management
 - Analysis: market structure, functioning and liquidity in investment markets
 - *FXC Secretariat* – Provides support to the FX Committee
- Staff must balance both operational and analytical responsibilities

Foreign Currency Policy Overview

Policy Overview: FX Policy Authorization

- Both the Federal Reserve and Treasury are authorized to hold foreign reserves for policy purposes. However, the Treasury is uniquely responsible for U.S. foreign exchange policy.
- Treasury
 - The Gold Reserve Act of 1934 authorized the Treasury to establish the ESF: “...*the Department of the Treasury has a stabilization fund ...Consistent with the obligations of the Government in the International Monetary Fund (IMF) on orderly exchange arrangements and an orderly system of exchange rates, the Secretary ..., with the approval of the President, may deal in gold, foreign exchange, and other instruments of credit and securities.*”
- Federal Reserve
 - Federal Reserve Act, Section 14(b)(1) permits the Reserve Banks “*To buy and sell, at home or abroad . . . obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof...*”
 - Authorization for Foreign Currency Operations, reaffirmed at every January FOMC meeting: “*The Federal Open Market Committee authorizes... for the System Open Market Account, to the extent necessary to carry out the Committee’s foreign currency directive... To purchase and sell... foreign currencies...*”
 - Foreign Currency Directive, reaffirmed at every January FOMC meeting: “*System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with IMF Article IV, Section 1.*”

Foreign Exchange Activities

Foreign Exchange: Operations

- **Analysis**

- Global monitoring of asset prices, market conditions/liquidity/structure, and financial stability issues; reporting mainly to the Federal Reserve Board of Governors and U.S. Treasury
- Advise on FX policy, technical considerations and operational strategy for intervention
- Understand intervention strategy and implementation techniques of foreign central banks

- **Trading**

- Daily FX Customer Transactions
- FX intervention on behalf of U.S. monetary authorities
- FX intervention on behalf of foreign central banks

- **Intervention preparedness**

- Daily FX transactions help our readiness to intervene
- Intervention training (*incl. principles and values of acting on behalf of U.S. government*)

Foreign Exchange: Intervention Objectives

Historically, the objective of intervention by international monetary authorities has largely been to address either:

1) Misalignment of a currency – (difficult to assess)

- Article IV of the IMF's articles of agreement requires that members shall avoid manipulating exchange rates to gain unfair competitive advantage over other members

2) Disorderly markets – (2 definitions)

- Most FX interventions by policymakers in developed economies have focused on countering disorderly market conditions
 - Markets where there is an absence of two-way risk – e.g. excess speculation, abrupt or aggressive pace of currency appreciation
 - Markets where there is an absence of market-making (e.g. when dealers stop quoting FX rates for customers).

Interpretation of current U.S. foreign exchange policy has focused on:

- Demonstrating respect for a market-determined floating FX rate
- “Coordination channel” and international cooperation
- Emphasizing the “signaling channel”

Foreign Exchange: History of U.S. Interventions

- Bretton Woods (pre-1973)
 - Intervention helped to maintain pegs
- Very active in late 1970s
 - Rising inflation, intervention to stem dollar depreciation
- Little activity in early 1980s
- Very active in late 1980s
 - 1985 Plaza Accord and 1987 Louvre Accord represented first coordinated efforts in a floating rate regime
- Active in early 1990s
 - 1995 G-7 Communiqué called for orderly reversal of dollar's decline
- Only three single-day interventions since August 1995:
 - June 1998 – dollar-yen intervention
 - September 2000 – euro-dollar intervention (G-7 support for the euro)
 - **March 2011 – dollar-yen intervention (Coordinated with the G-7)**

Foreign Reserve Management

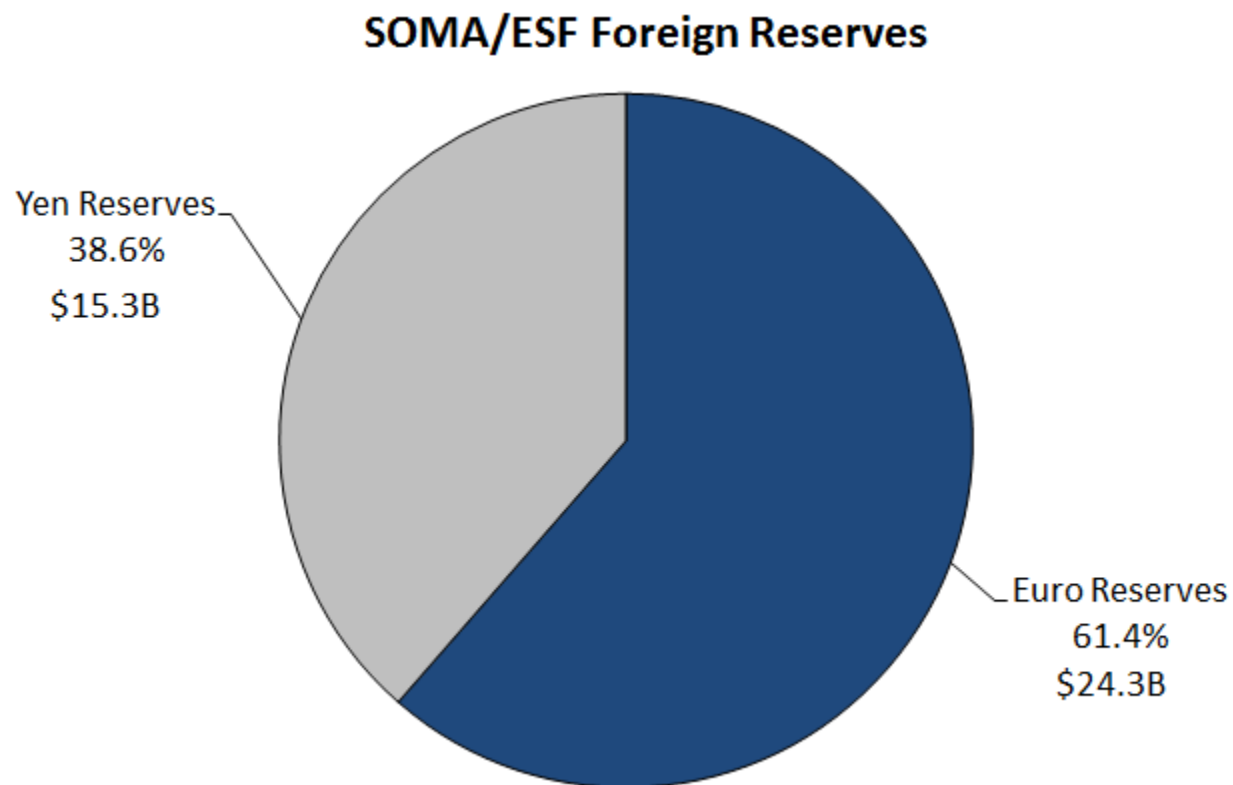
Foreign Reserve Management: Objectives

- FX reserves are a policy tool, intended for the sole purpose of financing foreign exchange intervention operations
- Portfolio goals
 - Liquidity
 - The portfolio assets must be able to be liquidated in a short period of time to fund an FX intervention. Portfolio is constructed to have high levels of both maturity and market liquidity
 - Safety
 - Reserves must be held in custody of institutions that have little to no credit risk, such as official institutions (risk tolerance is low)
 - Return
 - Efforts to improve portfolio returns are considered only after liquidity and safety objectives have been met
- Constraints
 - Timing and size of operations uncertain since funding needs for interventions unknown
 - Limited discretion as reserve managers must avoid trades and investments that result in perceived conflicts of interest given access to domestic monetary policy information
- Management style
 - Passive; most investments are buy-and-hold
 - Portfolio is not managed to a benchmark, but rather allocated according to pre-existing investment guidelines

Foreign Reserve Management: Overall Composition

- Approximately \$40 billion of euro- and yen-denominated assets held between FRS (SOMA) and Treasury (ESF)
- Invest reserves in a variety of instruments that yield market-related rates of return and have a high degree of liquidity and credit quality
 - Outright holdings: German, French and Japanese government securities
 - Reverse Repurchase agreements (Euro portfolio): Sovereign debt backed by the following governments: Belgium, France, Germany, Italy, the Netherlands, and Spain
 - Deposits: BIS and other official institutions

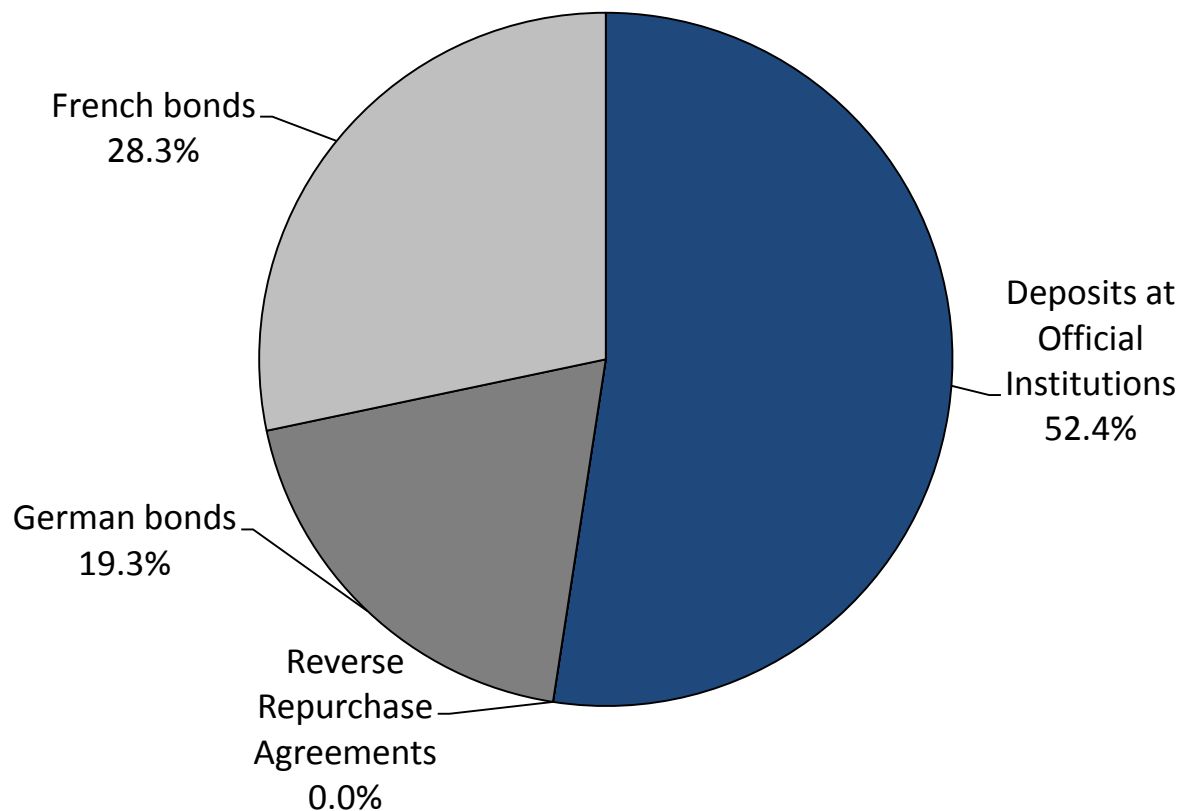
Foreign Reserve Portfolio



Note: USD Values as of 06/30/2015

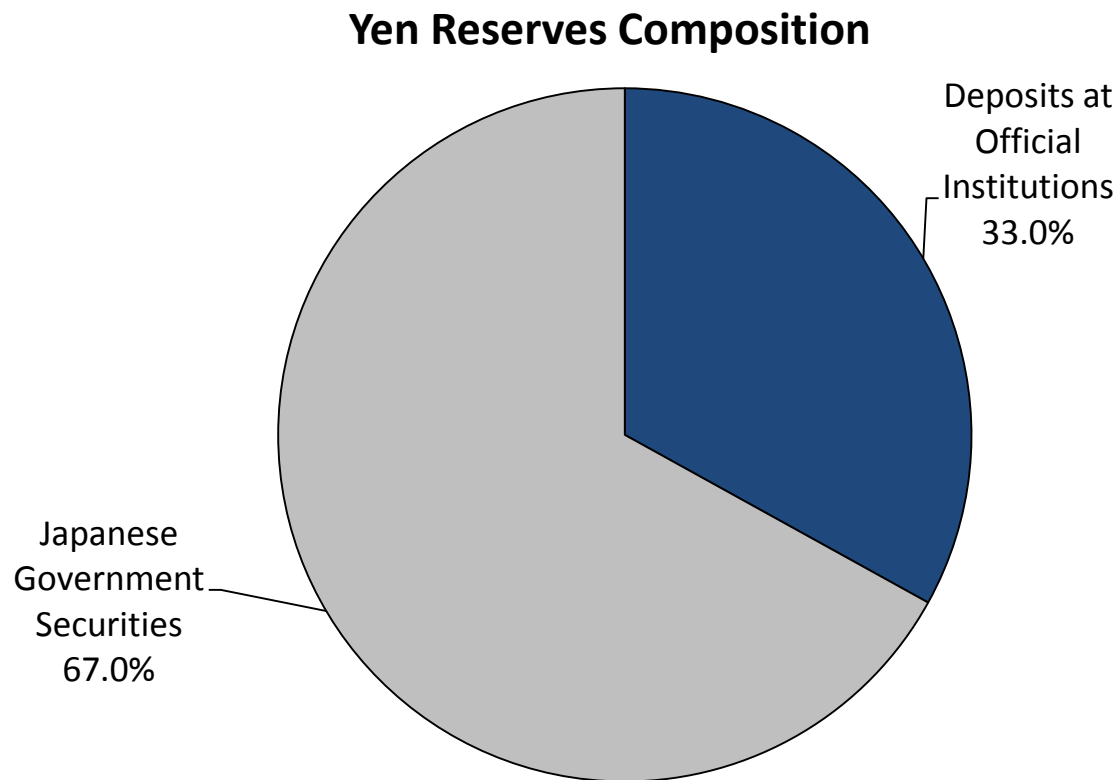
Foreign Reserve Management: Euro Portfolio – Q2 2015

Euro Reserves Composition



Note: USD Values as of 6/30/2015

Foreign Reserve Management: Yen Portfolio – Q2 2015



Note: USD Values as of 6/30/2015

Foreign Exchange Swaps

Foreign Exchange Swaps: Overview

- **Objective:** to improve funding conditions in U.S. financial markets and abroad
 - Authorized by the FOMC and the policy boards or executives of the respective foreign central banks
 - Dollar swap lines provide FCB's with the capacity to deliver U.S. dollar funding to institutions in their jurisdictions during times of market stress
 - Foreign currency swap lines allow the FRS to obtain foreign currency to provide to U.S. institutions in times of stress
- **Analysis**
 - Understand money market funding conditions and market dynamics
 - Inform decision-making process on the design and features of swap lines and individual requests
- **Execution**
 - Review of requests for swap draws (Federal Reserve has the right to approve or deny requests by foreign central banks to draw on their swap lines)
 - Circulate information about their impact on domestic bank reserves
 - As of mid-Sept, dollar swaps outstanding was \$145 mln (peak of \$586bn in Dec 2008).
 - Swap lines converted to standing arrangements in October 2013

More Information

More Information

- Foreign Reserves
 - Treasury ESF Report/ weekly figures on U.S. reserves
 - <http://www.treasury.gov/resource-center/data-chart-center/IR-Position/Pages/default.aspx>
- Foreign Exchange Intervention
 - Quarterly Report
 - http://www.newyorkfed.org/markets/quar_reports.html
- Foreign Exchange Swap Lines
 - Swap line background, including FAQs
 - http://www.federalreserve.gov/monetarypolicy/bst_liquidityswaps.htm
 - Weekly swap operations results
 - <http://www.newyorkfed.org/markets/fxswap/fxswap.cfm>
- Dodd-Frank Act - Transactional Data Release
 - Open Market Operations Data
 - http://www.newyorkfed.org/markets/OMO_transaction_data.html